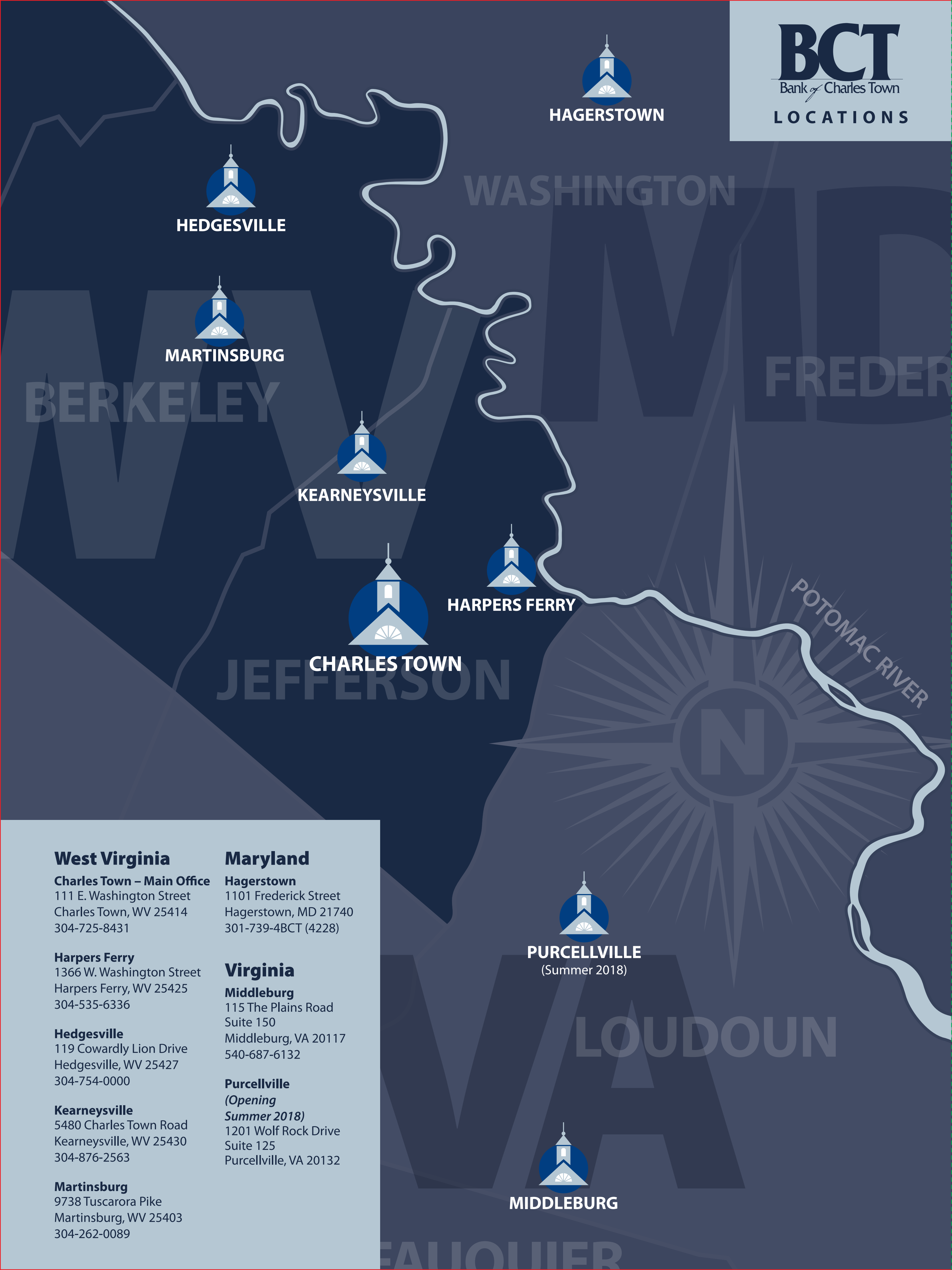
# POTOMAC BANCSHARES, INC.

# 2017 ANNUAL REPORT

A CELEBRATION OF OUR COMMUNITY

BCT
Bank of Charles Town

# BCT Bank of Charles Town LOCATIONS




## West Virginia

**Charles Town – Main Office**
111 E. Washington Street
Charles Town, WV 25414
304-725-8431

**Harpers Ferry**
1366 W. Washington Street
Harpers Ferry, WV 25425
304-535-6336

**Hedgesville**
119 Cowardly Lion Drive
Hedgesville, WV 25427
304-754-0000

**Kearneysville**
5480 Charles Town Road
Kearneysville, WV 25430
304-876-2563

**Martinsburg**
9738 Tuscarora Pike
Martinsburg, WV 25403
304-262-0089

## Maryland

**Hagerstown**
1101 Frederick Street
Hagerstown, MD 21740
301-739-4BCT (4228)

## Virginia

**Middleburg**
115 The Plains Road
Suite 150
Middleburg, VA 20117
540-687-6132

**Purcellville**
***(Opening Summer 2018)***
1201 Wolf Rock Drive
Suite 125
Purcellville, VA 20132

# DEAR FELLOW SHAREHOLDERS

**Alice P. Frazier**
President & CEO,
Potomac Bancshares, Inc. &
Bank of Charles Town

**Dr. Keith B. Berkeley**
Chairman of the Board,
Potomac Bancshares, Inc. &
Bank of Charles Town

On behalf of the employees and Board of Directors of the Bank of Charles Town (BCT) and its holding company, Potomac Bancshares, Inc., it is our pleasure to present to you our 2017 Annual Report. The positive financial results reflected in this report are a true testament of the quality and commitment of the BCT team, who rallied through this year.

With our bankers fully committed to providing a genuine experience to the customers and communities they serve, we realized 10.9% asset growth, pushing us to a new asset milestone of $425.4 million as of December 31, 2017. One measure of customer acceptance in a market is growth in deposits. We are pleased to report that our banking offices gained market share resulting in a $38.3 million increase in deposits to finish the year at $372.2 million.

Throughout the year our business clients shared lingering skepticism about the economy and were waiting to see what would happen with tax laws and regulation. Despite this, we were able to grow total loans by 4.2% to $343.2 million at year end. Asset quality continued to improve with non-performing assets to total assets of 0.42% at year end.

**Our roots began with 38 farmers and orchardists who saw the need for a bank with a stabilizing influence in the local community. Today we pride ourselves on being *The Community's Bank.***

Early growth in earning assets, a stable net interest margin and diversified fee income contributed to our 40.9% increase in core earnings. Net income, excluding one-time income events, totaled $3.1 million or $0.94 per share compared to earnings in 2016 of $2.2 million or $0.66 per share.

Helping our local families achieve home ownership is one of our most rewarding experiences as bankers. In 2017, we assisted 170 families to either purchase, construct or refinance their home through our residential lending division, resulting in $44.9 million in new loans. And finally, One Financial Center, our trust and investment management division, continued to build new relationships as assets under administration exceeded $160 million and associated fee income was $1.2 million for the year. Cumulatively all of these results led to a successful 2017.

In June, we were honored by the Jefferson County Chamber of Commerce as the Business of the Year for our many years of service to the community. As community bankers, we see the needs within the community up close. Proudly, our 108 employees worked on solving the issues by volunteering over 2,000 hours of community service to over 40 local nonprofits. You may find BCT's bankers packing weekend meals for children, collecting coats for those in need or organizing events to raise funds for a nonprofit. Education can help overcome the challenges that cause the needs served by the nonprofits. In recognition of our late President and CEO Robert F. Baronner, Jr.'s interest in education, the Board of Directors established a college scholarship program for four graduating high school students, providing each with $2,500 per year for four years. We don't do these things to be recognized, it is just who we are.

In the last half of the year, we went to work on our roadmap to future growth and profitability resulting in long-term shareholder value. Knowing that we already have the right core business lines, we honed in on strategies to invest in our future to deepen our market share in our existing markets, expand into new markets and increase the services we offer. We are fortunate to have branches not only in the fastest growing counties of West Virginia, but in Virginia, as well. By mid-summer we expect to open our second branch in Loudoun County, in Purcellville, Virginia. This is a market experiencing strong growth and considerable disruption.

We recognize that many folks are more inclined to bank digitally than visit a branch, so we plan to enhance the digital experience for our customers. However, we believe that a continued emphasis on an exceptional employee and customer experience will remain our key differentiator going forward. This will allow us to retain and attract the best community bankers who provide our customers the best banking experience.

We know that it is our bankers that drive our success.

Our culture is built upon the foundation of our core values of integrity, teamwork, growth, customer commitment and community focus; never wavering on each. In this annual report, our customers share how we execute upon our core values to create their BCT experience. We encourage you to share your own BCT experience and invite your family, friends and neighbors to join us as we grow. We are the community's bank!

The employees and your Board of Directors look forward to 2018 with enthusiasm and sincerely appreciate your continued support as customers and shareholders.

**TOTAL ASSETS UP 10.9%**

**$38.3 MILLION INCREASE IN DEPOSITS**

**NET INCOME $3.1 MILLION**

*President & CEO,*
*Potomac Bancshares, Inc. &*
*Bank of Charles Town*

*Chairman of the Board,*
*Potomac Bancshares, Inc. &*
*Bank of Charles Town*

**2017**

# BOARD OF DIRECTORS

*From left to right*

**Andrew C. Skinner**
Attorney/Owner, Skinner Law Firm

**J. Scott Boyd**
Pharmacist/President, Jefferson Pharmacy, Inc.
Pharmacist/President, JSB Enterprises, Inc. dba South Berkeley Pharmacy
Manager, Mountain Spring Properties, LLC

**Anthony P. Zelenka**
President & CEO, WVU Medicine Berkeley Medical Center and Jefferson Medical Center

**Alice P. Frazier**
President & CEO, Potomac Bancshares, Inc. & Bank of Charles Town

**Dr. Keith B. Berkeley**
Chairman of the Board, Potomac Bancshares, Inc. & Bank of Charles Town
Veterinarian/Owner, Valley Equine Associates

**Barbara H. Pichot**
Certified Public Accountant
Retired Partner, CoxHollida LLP

**Barbara L. Scott**
CEO, Summit Point Raceway Associates, Inc. /BSR Inc.

**Norman M. Casagrande**
Location Manager, BMC

**C. Larry Togans**
Retired Deputy Branch Chief of Human Resources
U. S. Geological Survey

**Margaret M. Cogswell**
CEO, Hospice of the Panhandle

## Hagerstown Advisory Board Members

**Todd A. Baer**
Chairman of the Advisory Board
Self Employed

**Kevin J. O'Leary**
Agent, Coldwell Banker Innovations

**Dr. Todd A. Harrison**
DPM, Foot & Ankle Specialists of the Mid-Atlantic

**Dr. Mitesh B. Kothari**
Capital Women's Care

**Ted Reeder III**
CPA, President, Tiger's Eye Benefits Consulting

**John H. Roney II**
Retired Commercial Banker

2017

# R & L LANDSCAPES
# KEARNEYSVILLE, WV

**"We're all about growth. BCT financed our vehicles, equipment, and even our expansion to a 5,000 square foot building. BCT values my time, and makes the whole process easy."**

***Charlie Lamp***
*Owner*

***Kim DeSarno***
*Consumer Banker*

***David Dalton***
*Commercial Banker*

"They've helped finance equipment, buildings, even our new ladder truck – when it comes to borrowing for Citizens Fire Company, it's always BCT."

*Ronald Fletcher*
*President*

## CITIZENS FIRE COMPANY
## CHARLES TOWN, WV

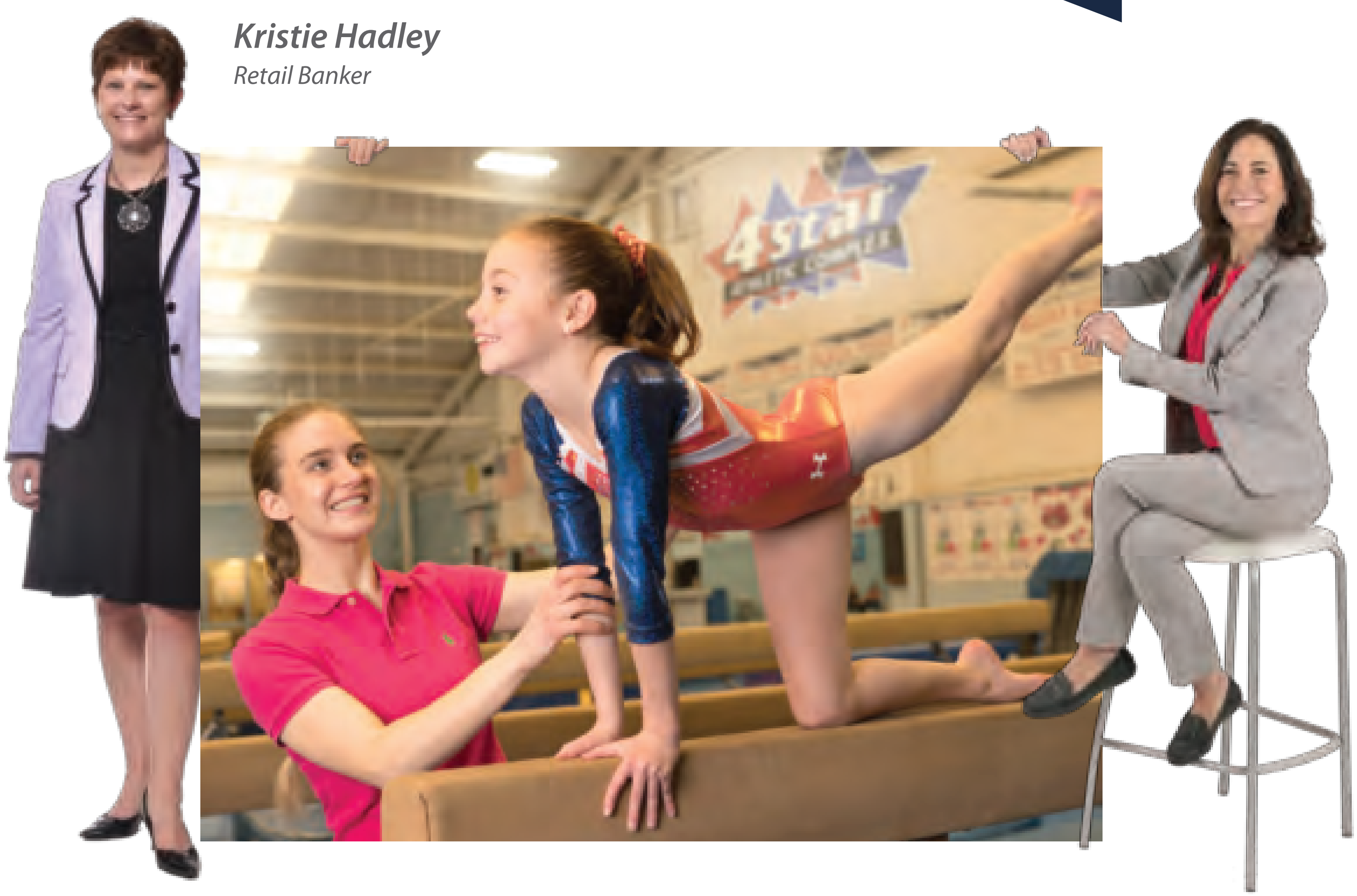
*Leslie Crabill*
*Wealth Advisor*

# 4 STAR ATHLETIC COMPLEX
## WILLIAMSPORT, MD

"They are who they say they are. They're very transparent, with more integrity than I've ever found from any other bank. I made a great decision switching to BCT.  I wish I had done it 28 years ago."

***Cleonica "Nica" Sutch***
*Owner*

***Kristie Hadley***
*Retail Banker*



“It’s a family affair. My dad started working with BCT in the 50’s. Even my wife and kids have accounts with them. Over the last two decades they’ve helped me double my business. They’re clearly our bank of choice.”

*Mark Roper*
*Owner*

MARK ROPER CONSTRUCTION
CHARLES TOWN, WV

MARK ROPER CONSTRUCTION

*Josh Householder*
*Commercial Banker*

## PANHANDLE BUILDERS & EXCAVATING
## MARTINSBURG, WV

"In order to achieve and exceed your goals in building, you need fast loan turnaround. With it's lightning fast decision making, BCT has clearly helped us reach and exceed our goals – time and again."

***Allen Henry***
*Co-Owner*

PANHANDLE BUILDERS & EXCAVATING
Residential
Commercial
Excavating

***Tammy Miller***
*Mortgage Banker*

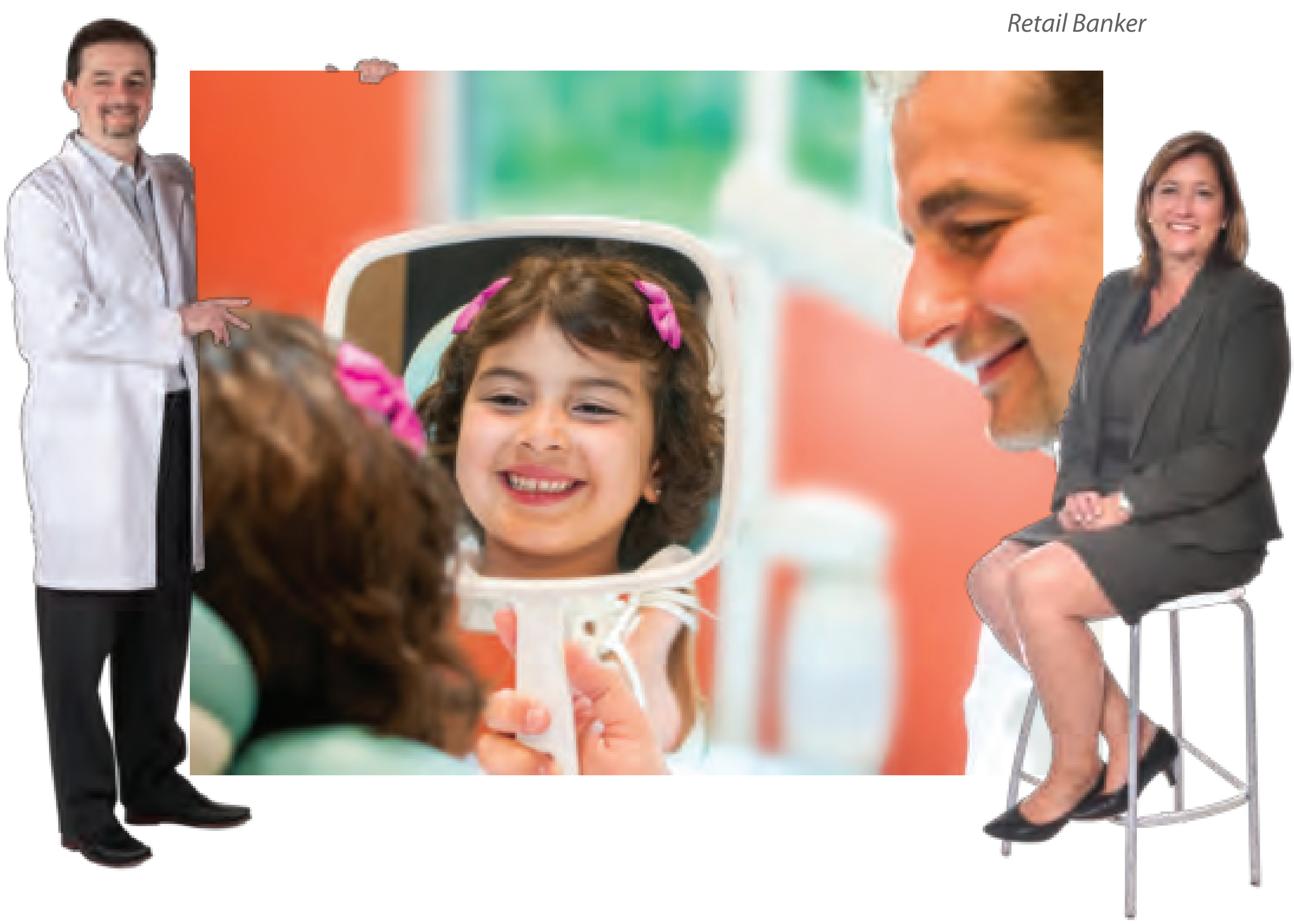
***Aaron Howell***
*Commercial Banker*

## ALSALEH DENTAL CENTER
## MARTINSBURG, WV

"BCT helped us purchase an existing dental practice and construct a new state-of-the-art dental facility. When it comes to a one-on-one tailored relationship, no one works harder."

***Dr. Hani AlSaleh***
*Owner*

***Karen Burkhart***
*Retail Banker*



# NEXTIDE ACADEMY
# PURCELLVILLE, VA

"We had a dream about changing education – inspiring learning in an interesting way. We needed a physical place where blended learning can happen. BCT listened to us and helped us realize our dream."

***Lakshman Babu***
*Owner*

NEXTiDE
ACADEMY

***Grant Wetmore***
*Commercial Banker*

“My vision was to bring back the art of male grooming. With BCT’s help, I’ve been able to expand my business and open a second barbershop.”

*Tammy Whitney*
*Owner*

## WILLIAMSPORT BARBER SHOP DOWNTOWN
## SMITHSBURG BARBER SHOP

WILLIAMSPORT BARBER SHOP DOWNTOWN

*Jonathan Agee*
*Commercial Banker*

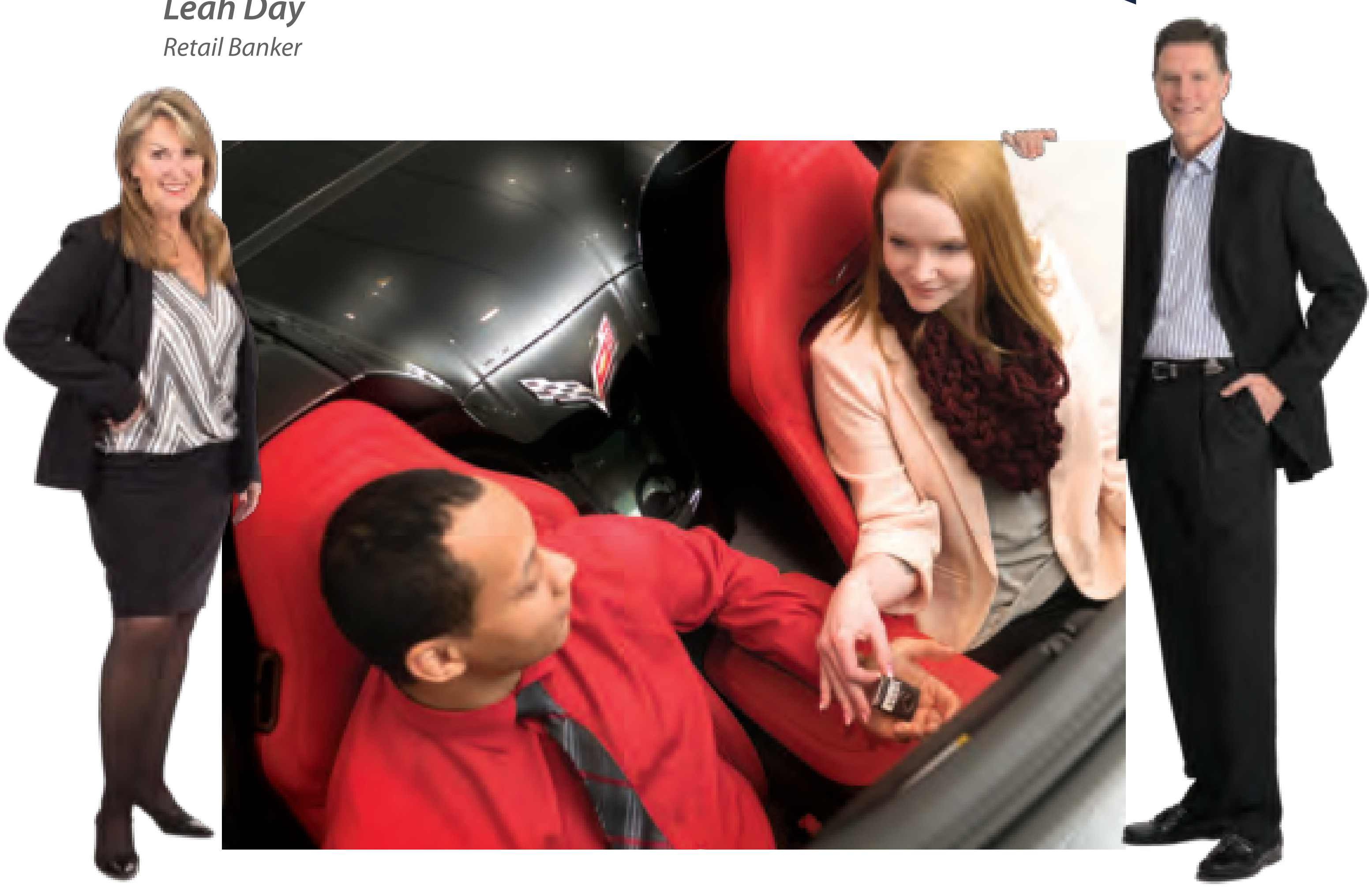
## ALLSTATE INSURANCE
## LEESBURG, VA
## WINCHESTER, VA

**"They were personable and very competitive. I learned to trust them. Between their level of service and their competitive position, switching to BCT was a no brainer."**

***Steve Douglass***
*Owner*

Allstate.

***Leah Day***
*Retail Banker*



# OUR COMMUNITY

**Our 108 employees volunteered over 2000 hours to 40 local non-profits in 2017, upholding our core value of Community Focus by giving back to the communities we serve.**


### United Way of the Eastern Panhandle

BCT earned the Bronze Award for top 2016-2017 Campaign, raising $53,795.76 through their Employee and Corporate Campaigns.

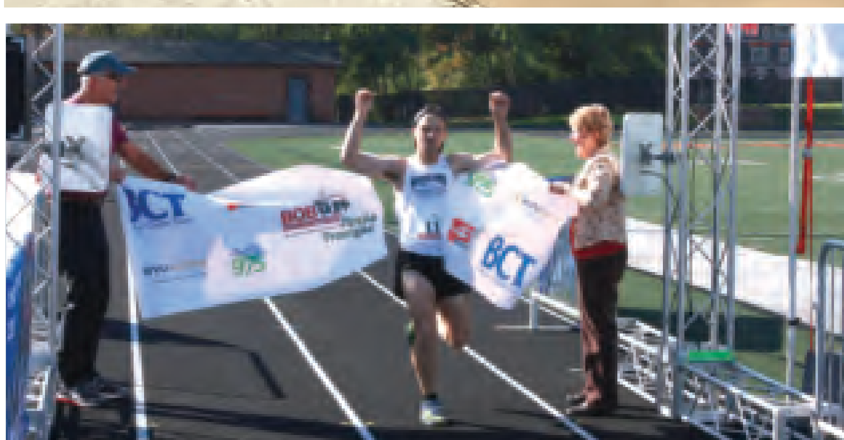
### United Way Day of Caring

BCT team members participated in the United Way Day of Caring, held at the Children First Child Development Center in Kearneysville, WV.

### Bob Baronner, Jr. 5K Apple Trample

BCT was the Presenting Sponsor of the 2017 Apple Trample, held during the Mountain State Apple Harvest Festival.

BOB BARONNER 5K
Mountain State Apple Harvest Festival
Apple Trample



# WITH MANY THANKS TO OUR EMPLOYEES

Jonathan M. Agee
Lucile K. Allen
Gayla L. Anderson
Mary A. Armstrong
Patricia D. Armstrong
Ashley M. Baccala
Tiffany D. Bartgis
John F. Beatty
Andrew P. Beckwith
Maryann Blehr
Jenny Blount
Jessica C. Bohrer
Mary L. Bowers
Jana M. Bressler
Ray A. Bromley
Scott E. Bronson
Barbara J. Brown
Hannah E. Burkhart
Karen R. Burkhart
Sarah E. Butler
Taylor M. Butts
Qytisha R. Canady
Diana J. Cangialosi
Lou Ann Cannon
Jennifer L. Canterbury
Benjamin S. Capriolo
Clara K. Carroll*
Larissa R. Carson
Beth A. Cash
Melissa D. Castle
Sherry D. Clem
Deanna D. Clingan
Dean J. Cognetti*
Leslie D. Crabill
Tiffany R. Dailey
David P. Dalton, Jr.
Stephanie D. Davis
Leah M. Day
Kimberly K. DeSarno
Brittney E. Delauter
Tammy S. Demick
Stacy L. Duranko
Amanda G. Egan
Albert Epps, Jr.
Jessica A. Eutin
Carolyn P. Fisher
Alice P. Frazier*
Shalena M. Gonzales
Michelle S. Griffith
Kristie R. Hadley
Tiffany D. Hall
Misty N. Harder
Patricia A. Hardy
Zari Hassanzadeh
Bonnie R. Hayden
Kevin D. Haymaker
Gabrielle A. Hill
Wanda L. Hill
Kimberly A. Himes
Shelly L. Holmes
Nicole S. Horn
Joshua E. Householder
Aaron J. Howell
Linda C. Jenkins
Magdalena C. Johnston
Ryan W. Kerns
Tim E. Lewis
Megan R. Manuel
Tonya McClure-Ibeeze
Kristal R. McKenrick
Brent A. Milbourne
Tammy L. Miller
Christina M. Mills-Morrison
Mariko T. Moore
Pamela K. Morrison
Urviben P. Patel
Julia A. Perry-Thorne
Brandt J. Petrie II
Renee L. Pifer
Joy A. Quezada
Susan S. Riston*
Breana Nichole Robbins
Vilma Y. Roberts
Kimberly L. Runion
Kellie M. Sansone
Amanda V. Scheuch
Karen L. Schleuss
Lauren N. Sekara
Steven B. Shaffer
Scott B. Slick
Elizabeth A. Smith
Angela D. Staubs
Selene M. Stevens
Alyssa M. Stewart
Matthew C. Stickel
Richard S. Stotler
Elizabeth R. Turnure
Tobey R. Twigg
Diandra D. Valderrama
Sarah E. Varner
Jenny L. Villar-Revello
Christopher T. Webb
R. Benjamin Weber
Julie I. Weister
Gregory G. Wetmore Jr.
Shannon D. Whitmore
Charles W. Wyndham, Jr.

* Officers of Potomac Bancshares, Inc.

# 2017 EMPLOYEE AWARDS

The **Unsung Hero Award** was presented to **Misty Harder**, VP/System/Procedure Administrator, for going above and beyond her current job duties to go the extra mile on behalf of BCT.

The **President's Award** was presented to both **Steven Shaffer**, AVP/Cash Management/Business Consultant, and **Clara Carroll**, AVP/Executive Administrative Assistant/Security Officer/Assistant Secretary, as the individuals who encompass the five core values of BCT – integrity, teamwork, growth, customer commitment and community focus.

The **Robert F. Baronner, Jr. Spirit Award** was presented to **Clara Carroll**, AVP/Executive Administrative Assistant/Security Officer/Assistant Secretary, as the individual that most people think of when they think of BCT.

The **Monster Service Award** was presented to **Betsy Smith**, Call Center/Deposit Operations Representative, for consistently executing BCT's nine principles of exceptional customer service.

**When asked "What do you like most about working at BCT?" – the reply always begins with "the family atmosphere, it is like a family." We value teamwork at BCT and enjoy working collaboratively to bring out the best in everyone. We celebrate our collective successes at an annual banquet but, most notably, four individuals were recognized by their peers for exceptional performance.**

*Steven Shaffer* *Betsy Smith*

*Misty Harder* *Clara Carroll*

# GENERAL INFORMATION

**QUARTERLY FINANCIAL REPORTS** are available online. To access a copy of these reports, visit:

**www.mybct.com**

**For further information contact:**
**Dean J. Cognetti**

Executive Vice President, Chief Financial Officer & Secretary/Treasurer, Potomac Bancshares, Inc.

111 East Washington Street, P.O. Box 906

Charles Town, WV 25414-0906

### Common Stock Trading Values & Dividends

Trading of Potomac Bancshares, Inc. common stock is not extensive and cannot be described as a public trading market. To gather information about Potomac in this market, use Potomac's symbol PTBS. Information about sales of Potomac's stock is available on the Internet through many of the stock information services using Potomac's symbol. Shares of Potomac common stock are occasionally bought and sold by private individuals, firms or corporations, and, in most instances, Potomac does not have knowledge of the purchase price or the terms of the purchase.

### Dividend Reinvestment & Direct Stock Purchase and Sale Plan

American Stock Transfer & Trust Company, LLC (the "Plan Administrator") has established an Investors Choice Dividend Reinvestment & Direct Stock Purchase and Sale Plan (the "Plan") for convenience of investors and shareholders in Potomac Bancshares, Inc. common stock. The Plan Administrator will administer the Plan, purchase and hold shares acquired for you under the Plan, keep records, send statements of account activity and perform other duties related to the Plan.

**To make an investment online,** logon to www.astfinancial.com, and select "Login."

**To invest by mail,** simply fill out an Enrollment Application, which can be obtained by calling the Plan Administrator toll free at 1-800-813-2847 or follow the instructions above for Investment Online.

**The following information reflects comparative per share data for the periods indicated for Potomac common stock for (a) trading values, and (b) dividends. The trading values are based on information available through the Internet. No attempt was made by Potomac to verify or determine the accuracy of the representations made to Potomac or gathered on the Internet.**

| | | HIGH | LOW | DIVIDENDS |
|---|---|---|---|---|
| 2017 | First Quarter | $11.20 | $9.35 | $0.065 |
| | Second Quarter | 11.20 | 10.25 | 0.065 |
| | Third Quarter | 12.95 | 10.78 | 0.070 |
| | Fourth Quarter | 14.35 | 12.57 | 0.070 |
| 2016 | First Quarter | $9.55 | $8.50 | $0.060 |
| | Second Quarter | 9.50 | 8.50 | 0.060 |
| | Third Quarter | 9.00 | 8.45 | 0.065 |
| | Fourth Quarter | 9.55 | 8.40 | 0.065 |

## STOCK TRANSFER AGENT

American Stock Transfer & Trust Company, LLC

Operations Center – 6201 15th Avenue, Brooklyn, NY 11219

718-921-8124 / 800-937-5449

www.astfinancial.com

## ANNUAL MEETING

The annual meeting of stockholders will be held at the Bavarian Inn

164 Shepherd Grade Road

Shepherdstown, WV 25443

Tuesday, April 24th, 2018

Beginning at 10:30 a.m.

# POTOMAC BANCSHARES, INC.

Charles Town, West Virginia

---

**NOTICE OF REGULAR ANNUAL MEETING OF SHAREHOLDERS**

**TO BE HELD APRIL 24, 2018**

---

To the Shareholders:

The Regular Annual Meeting of Shareholders of Potomac Bancshares, Inc. ("Potomac") will be held at the Bavarian Inn, Shepherdstown, West Virginia, at 10:30 a.m., on April 24, 2018, for the purposes of considering and voting upon proposals:

1. To elect a class of directors for a term of three years;
2. To ratify the appointment by the Board of Directors of Yount, Hyde & Barbour, P.C., as independent registered public accountants for the year 2018; and

To approve any other business that may properly be brought before the meeting or any adjournment thereof.

Only those shareholders of record at the close of business on February 26, 2018, shall be entitled to notice of the meeting and to vote at the meeting.

By Order of the Board of Directors

Alice P. Frazier
President and Chief Executive Officer

**PLEASE SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING IN PERSON. IF YOU DO ATTEND THE MEETING, YOU HAVE THE OPTION TO REVOKE YOUR PROXY BEFORE IT IS VOTED.**

**IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 24, 2018 - THE PROXY STATEMENT AND 2017 ANNUAL REPORT ARE AVAILABLE AT WWW.PROXYVOTE.COM.**

March 15, 2018

**POTOMAC BANCSHARES, INC.**
**111 EAST WASHINGTON STREET**
**P.O. BOX 906**
**CHARLES TOWN, WEST VIRGINIA 25414-0906**
**(304) 725-8431**

# PROXY STATEMENT
# ANNUAL MEETING OF SHAREHOLDERS – APRIL 24, 2018

Potomac Bancshares, Inc. is furnishing this statement in connection with its solicitation of proxies for use at the annual meeting of shareholders of Potomac Bancshares, Inc. to be held on April 24, 2018, at the time and for the purposes set forth in the accompanying notice of regular annual meeting of shareholders.

## Solicitation of Proxies

Potomac's management, at the direction of Potomac's Board of Directors, is making this proxy solicitation. These proxies enable shareholders to vote on all matters scheduled to come before the meeting. If the enclosed proxy is signed and returned, it will be voted as directed; or if not directed, the proxy will be voted "FOR" all of the various proposals to be submitted to the vote of shareholders described in the enclosed notice of regular annual meeting and this proxy statement. A shareholder executing the proxy may revoke it at any time before it is voted by:

- notifying Potomac in person,
- giving written notice to Potomac of the revocation of the proxy,
- submitting to Potomac a subsequently-dated proxy, or
- attending the meeting and withdrawing the proxy before it is voted at the meeting.

Potomac will pay the expenses of this proxy solicitation. In addition to this solicitation by mail, officers and regular employees of Potomac and Bank of Charles Town may, to a limited extent, solicit proxies personally or by telephone or telegraph, although no person will be engaged specifically for that purpose.

## Eligibility of Stock for Voting Purposes

Under Potomac's bylaws, the Board of Directors has fixed February 26, 2018, as the record date for determining the shareholders entitled to notice of, and to vote at, the meeting or any adjournment thereof. Only shareholders of record at the close of business on that date are entitled to notice of and to vote at the annual meeting or any adjournment thereof. The presence, in person, or by properly executed proxy, of the holders of a majority of the outstanding shares of the company's common stock entitled to vote at the annual meeting is necessary to constitute a quorum at the annual meeting. Abstentions will be counted as shares present for purposes of determining the presence of a quorum. Any shares held in street name that are not voted ("broker non-votes") in the election of directors will not be included in determining the number of votes.

As of the record date for the annual meeting, 3,323,001 shares of the capital stock of Potomac were outstanding and entitled to vote. As of the record date, Potomac had a total of approximately 1,100 shareholders.

## PURPOSES OF MEETING

### 1. ELECTION OF DIRECTORS

**General**

Potomac's articles of incorporation currently provide for a classified Board of Directors. There are three classes with each being elected for a three-year term. There are presently 10 directors on the Board, four of whom are nominees for election at the 2018 annual meeting. Each director (Berkeley, Frazier, Scott, and Zelenka) is being elected for a term of three years.

Directors are elected by a plurality of the shares voted. As required by West Virginia law, each share is entitled to one vote per nominee, unless a shareholder requests cumulative voting for directors at least 48 hours before the meeting. If a shareholder properly requests cumulative voting for directors, then each shareholder will have the right to vote the number of shares owned by that shareholder for as many persons as there are directors to be elected, or to cumulate such shares and give one candidate as many votes as the number of directors multiplied by the number of shares owned shall equal, or to distribute them on the same principle among as many candidates as the shareholder sees fit. If any shares are voted cumulatively for the election of directors, the proxies, unless otherwise directed, shall have full discretion and authority to cumulate their votes and vote for less than all such nominees. For all other purposes, each share is entitled to one vote. Because director nominees must receive a plurality of the votes cast at the meeting, a vote withheld will not affect the outcome of the election.

The Board of Directors has a nominating committee tasked with identifying potential Board of Director members. The nominating committee makes nominations based upon its belief that candidates for director should have certain minimum qualifications, including:

- Directors should be of the highest ethical character.
- Directors should have excellent personal and professional reputations in the company's market area.
- Directors should be accomplished in their professions or careers.
- Directors should be able to read and understand financial statements and either have knowledge of, or the ability and willingness to learn, financial institution law.
- Directors should have relevant experience and expertise to evaluate financial data and provide direction and advice to the Chief Executive Officer and the ability to exercise sound business judgment.
- Directors must be willing and able to expend the time to attend meetings of the Board of Directors of the company and the bank and to serve on Board committees.
- The Board of Directors will consider whether a nominee is independent. In addition, directors should avoid the appearance of any conflict and should be independent of any particular constituency and be able to serve all shareholders of the company.

- Directors must be acceptable to the company's and the bank's regulatory agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation and the West Virginia Division of Financial Institutions and must not be under any legal disability which prevents them from serving on the Board of Directors or participating in the affairs of a financial institution.

- Directors must own or acquire sufficient capital stock to satisfy the requirements of federal law, state law and the bylaws of Potomac.

The nominating committee reserves the right to modify these minimum qualifications from time to time, except where the qualifications are required by the laws relating to financial institutions.

The process of identifying and evaluating nominees is as follows: In the case of incumbent directors whose terms are set to expire, the committee considers the directors' overall service to the company during their term, including such factors as the number of meetings attended, the level of participation, quality of performance and any transactions between such directors of the company and the bank. The Board also reviews the payment history of loans, if any, made to such directors of the bank to ensure that the directors are not chronically delinquent and in default. The committee considers whether any transactions between the directors and the bank have been criticized by any banking regulatory agency or the bank's external auditors and whether corrective action, if required, has been taken and was sufficient. The nominating committee also confirms that such directors remain eligible to serve on the Board of Directors of a financial institution under federal and state law. For new director candidates, the committee uses its network of contacts in the company's market area to compile a list of potential candidates. The committee then meets to discuss each candidate and whether he or she meets the criteria set forth above. The committee then discusses each candidate's qualifications and chooses a candidate by majority vote.

The committee will consider director candidates recommended by shareholders, provided that the recommendations are received at least 120 days before the next annual meeting of shareholders. In addition, the procedures set forth below are to be followed by shareholders submitting nominations. The committee does not intend to alter the manner in which it evaluates candidates, regardless of whether or not the candidate was recommended or nominated by a shareholder.

Potomac's bylaws provide that nominations for election to the Board of Directors, other than those made by or on behalf of Potomac's existing management, must be made by a shareholder in writing delivered or mailed to the President not less than 14 days nor more than 50 days prior to the meeting called for the election of directors; provided, however, that if less than 21 days' notice of the meeting is given to shareholders, the nominations must be mailed or delivered to the President not later than the close of business on the 7th day following the day on which the notice of meeting was mailed. The notice of nomination must contain the following information, to the extent known:

- name and address of nominee(s);

- principal occupation of nominee(s);

- total shares to be voted for each nominee;

- name and address of notifying shareholder;

- number of shares owned by notifying shareholder; and

- consent of such nominee(s) to being named in the proxy statement as a nominee and to serving as such a director, if elected.

Nominations not made in accordance with these requirements may be disregarded by the chairman of the meeting and in such case the votes cast for each such nominee will likewise be disregarded.

**Management Nominees to the Board of Potomac**

| **Nominees** | **Age** | **Served As Director of Potomac Since** | **Family Relationship With Other Nominees** | **Year in Which Term Expires** | **Principal Occupation or Employment Last Five Years** |
|---|---|---|---|---|---|
| Dr. Keith B. Berkeley | 59 | 2008 | None | 2018 | Veterinarian, President of Valley Equine Associates, Jefferson County, West Virginia. Chairman of The Board, Potomac Bancshares, Inc. and Bank of Charles Town. |
| Alice P. Frazier | 53 | 2017 | None | 2018 | Employed by Potomac Bancshares, Inc. and Bank of Charles Town as of July 5, 2017 as President and Chief Executive Officer. |
| Barbara L. Scott | 69 | 2012 | None | 2018 | CEO of Summit Point Raceway Associates, Inc. and BSR, Inc., 2009 to Present. Managing Member of Summit Point Automotive Research Center, LLC. |
| Anthony P. Zelenka | 64 | 2015 | None | 2018 | President and Chief Executive Officer of WVU Medicine – Berkeley Medical Center and Jefferson Medical Center. |

**The Board of Directors recommends that shareholders vote "For" all the nominees listed above.**

**Directors Continuing to Serve Unexpired Terms**

| Nominees | Age | Served As Director of Potomac Since | Family Relationship With Other Nominees | Year in Which Term Expires | Principal Occupation or Employment Last Five Years |
|---|---|---|---|---|---|
| J. Scott Boyd | 61 | 1999 | None | 2019 | Pharmacist, owner Jefferson Pharmacy, Inc., Jefferson County, West Virginia since 1982; Pharmacist, owner JSB Enterprises, Inc. dba South Berkeley Pharmacy, Berkeley County, West Virginia since 2006; Manager, Mountain Spring Properties, LLC. |
| Norman M. Casagrande | 58 | 2013 | None | 2020 | Location Manager, BMC East, LLC Member, Code Plus Components LLC, dba MAC Industries, LLC Berkeley County, West Virginia |
| Margaret M. Cogswell | 59 | 2003 | None | 2020 | Chief Executive Officer, Hospice of the Panhandle, Berkeley, Hampshire, Jefferson and Morgan Counties, West Virginia since 1987. |
| Barbara H. Pichot | 70 | 2004 | None | 2019 | Certified Public Accountant, retired partner CoxHollida LLP, a public accounting firm in Berkeley County, West Virginia, 1981 to 2006; past President, Hospice of the Panhandle; past Chair, Board of Governors, Shepherd University. |
| Andrew C. Skinner | 47 | 2017 | None | 2020 | Attorney/Owner, Skinner Law Firm. Jefferson County, West Virginia |
| C. Larry Togans | 71 | 2004 | None | 2019 | Retired Deputy Branch Chief of Human Resources, U. S. Geological Survey, employed 1973 to 2001. |

Alice P. Frazier has 26 years of banking experience. She was the Executive Vice President and Chief Operating Officer of Cardinal Financial Corporation prior to being hired as President and CEO of Potomac Bancshares and Bank of Charles Town. Before joining Cardinal, she was Senior Vice President and Area Executive for BB&T in the Loudoun County, VA market. Ms. Frazier began her banking career at Middleburg Financial Corporation in 1991 serving as Chief Financial Officer and later Chief Operating Officer. Prior to her banking career, she worked in public accounting with a national and a regional firm. Ms. Frazier is a graduate of Radford University and Stonier Graduate School of Banking. She is a past Chair of the Virginia Association of Community Banks. In March 2018, Ms. Frazier was elected as Bank Operations and Payments Committee Chairperson of the Independent Community Bankers of America (ICBA).

Dr. Keith B. Berkeley is the Chairman of the Board of Directors of Potomac and the Bank and has served on the Board of Directors since July 2008. He has been a veterinarian and business owner in the Eastern Panhandle of West Virginia for 20 plus years. Dr. Berkeley earned his Doctor of Veterinary Medicine from the Tuskegee Institute. Dr. Berkeley was elected to the Board for his business experience and his knowledge of Potomac's and Bank of Charles Town's market areas by virtue of his relationship with the community through his veterinary practice and as a successful businessman. In addition, Dr. Berkeley has attended the FDIC/West Virginia Community Bankers Directors College to further his own knowledge of the banking industry and his responsibilities as a Director.

J. Scott Boyd is a pharmacist and owner of one pharmacy in both Berkeley and Jefferson Counties. Mr. Boyd is a graduate of the West Virginia University School of Pharmacy. Mr. Boyd was chosen for his experience as a business owner and his knowledge of the market areas of Potomac and Bank of Charles Town in both Berkeley and Jefferson Counties. He has 30 plus years of business experience as well as his contacts with an array of persons from the communities the bank serves. Mr. Boyd has attended the FDIC/West Virginia Community Bankers Directors College.

Norman M. Casagrande is the location manager for BMC East, LLC. He is also a member in Code Plus Components LLC (dba MAC Industries, LLC) in Spring Mills, West Virginia which was formed in 1999. BMC East is a building materials supplier and manufacturer. Mr. Casagrande is originally from the Pittsburgh area and earned a Business/Economics degree from Washington and Jefferson College in Washington, PA. He previously owned a building materials company and was employed with 84 Lumber for eight years. Mr. Casagrande's manufacturing background and experience in the housing industry is an important asset for the board as much of the bank's portfolio is invested in residential real estate. Mr. Casagrande has attended the FDIC/West Virginia Community Bankers Directors College.

Margaret M. Cogswell is Chief Executive Officer of Hospice of the Panhandle. She has an Associate of Science degree in Nursing from Shepherd College. Ms. Cogswell brings a unique perspective of someone that has been involved in non-profit organizations most of her adult life and as a result, has a number of contacts within the company's and the bank's market area in Jefferson and Berkeley Counties, West Virginia. Her duties as CEO include management of a multi-million dollar budget. Ms. Cogswell is and has been involved with the non-profit community and her management experience is a valuable asset to the Board of Directors. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director.

Barbara H. Pichot is a Certified Public Accountant, and retired partner with CoxHollida LLP. Ms. Pichot has over 25 years of experience in public accounting and as the controller of a concrete manufacturing facility. She is a graduate of Shepherd College with a degree in accounting and was elected to the Board for her financial and accounting expertise. She currently serves as the company's Audit Committee financial expert. Ms. Pichot adds her knowledge of accounting and audit procedures and her business acumen to the board. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director.

Barbara L. Scott is CEO of Summit Point Raceway Associates Inc. (SPRA) and BSR Inc. These are the operating entities for the 785 acre Summit Point Motorsports Park located in Summit Point, West Virginia. SPRA hosts motorsport events to include amateur road racing for sports cars, motorcycles and karts. BSR Inc. provides specialty and anti-terrorist driver training programs for government agencies and the U.S. military. The facility has four European style road racing circuits and a 282 acre industrial park that houses a U.S. State Department training facility. Ms. Scott is a graduate of Southern Methodist University with a degree in Biology and English. Ms. Scott began her employment at Summit Point in 1987 and has extensive experience in all facets of the business. She contributes her business acumen gained in managing and operating a multi-faceted and highly successful company. Additionally, Ms. Scott has gained experience working and negotiating with governmental entities which are becoming more and more prevalent in the bank's local market area. Ms. Scott currently resides near Middleburg, Virginia and provides good perspective on the Northern Virginia banking market. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director.

Andrew C. Skinner is an attorney/owner at Skinner Law Firm in Charles Town, WV. Mr. Skinner has a bachelor's degree in economics from the College of William and Mary. Mr. Skinner served in the Army for four years. After coming off active duty, he obtained his law degree from the University of Texas School of Law. Mr. Skinner continues his military career by serving in the Army Reserves. He serves on the Board of the Jefferson County Chamber of Commerce. He also founded Leadership Jefferson, a program of the Jefferson County Chamber of Commerce. Mr. Skinner brings broad legal expertise to the board and has strong ties in the community.

C. Larry Togans is retired from the U. S. Geological Survey in Reston, VA where he served as the Deputy Branch Chief of Human Resources and Management Support. In his position, Mr. Togans served as special advisor to the Senior Executive Staff (SES) who manages more than 5000 geoscientists and technical support staff members. Mr. Togans received his Bachelor's degree from Shepherd College. Mr. Togans provides expertise in the human resources field and he has served as Board member in several positions including serving on the Shepherd University Foundation and Jefferson County Board of Education. Mr. Togans has taken the time to advance his knowledge of banking and directorship by attending the FDIC/West Virginia Community Bankers Directors College.

Anthony P. Zelenka was named President and Chief Executive Officer of WVU Medicine – Berkeley Medical Center and Jefferson Medical Center during 2015. Mr. Zelenka previously held the title of President and Chief Operating Officer from 2008 until 2015. A graduate of Marietta College in Ohio, he holds a certificate from the Executive Program in Healthcare Financial Management and a Master of Health Administration from The Ohio State University. Mr. Zelenka's business acumen and knowledge of an evolving healthcare industry is a real asset to the company.

**Ownership of Securities by Nominees, Directors and Officers**

All nominees, directors and principal officers have beneficial ownership of 87,283 shares as a group. These shares represent, in aggregate, 2.63% of the common stock of Potomac Bancshares, Inc. The information is furnished as of January 31, 2018, on which date 3,323,001 shares were outstanding.

**Compensation of Directors**

Directors of Potomac were not compensated for their services as directors during 2017, other than for committee meetings attended. Directors of the bank were compensated at the rate of $900 for each regular Board meeting attended in 2017. The Chairman of the Board was paid $500 per month in addition to director and committee fees. Directors were compensated $220 for each committee meeting attended in 2017. The audit committee member who is deemed the financial expert was compensated $330 for each audit committee meeting attended in 2017. The Chairperson of the Salary and Personnel Committee receives $330 per meeting attended. All directors receive 50 shares of Potomac Stock for each quarter of service as additional compensation. Directors who are operating officers of the bank are not compensated for committee meetings attended.

**Certain Transactions with Directors, Officers and Their Associates**

Potomac and the bank have had, and expect to have in the future, transactions in the ordinary course of business with directors, officers, principal shareholders and their associates. All these transactions remain on substantially the same terms, including interest rates, collateral and repayment terms on the extension of credit, as those prevailing at the same time for comparable transactions with unaffiliated persons, and in the opinion of management of Potomac and the bank, did not involve more than the normal risk of collectability or present other unfavorable features.

Potomac does not have a policy on related party transactions. As stated in the previous paragraph, transactions with directors are on the same terms and require the same documentation as those transactions with unaffiliated persons. These transactions are voted on by the Board of Directors with the particular director absent for the discussion and voting. The transactions and voting are recorded in the minutes. These transactions are designated so the information is accessible as needed for reporting purposes.

## 2. RATIFICATION OF SELECTION OF AUDITORS

The Audit Committee of the Board of Directors has selected the firm of Yount, Hyde & Barbour, P.C. to serve as independent auditors for Potomac for the calendar year 2018. If the shareholders do not ratify the appointment of Yount, Hyde & Barbour, P.C., the committee will consider the appointment of other auditors. Potomac is advised that no member of this accounting firm has any direct or indirect material interest in Potomac, or any of its subsidiaries.

A representative of Yount, Hyde & Barbour, P.C., will be present at the annual meeting to respond to appropriate questions and to make a statement if he or she so desires. The enclosed proxy will be voted "FOR" the ratification of the selection of Yount, Hyde & Barbour, P.C., unless otherwise directed. The affirmative vote of a majority of the shares of Potomac's common stock represented at the annual meeting of shareholders is required to ratify the appointment of Yount, Hyde & Barbour, P.C. Because a majority of the votes cast will be sufficient for the ratification of the appointment of Yount, Hyde & Barbour, P. C., neither broker non-votes nor abstentions will affect the outcome of the proposal. Any shares held in street name that are not voted ("broker non-votes") will not be included in determining the number of votes cast.

**The Audit Committee and the Board of Directors unanimously recommend that shareholders vote "For" such ratification.**

## OTHER MATTERS

If any of the nominees for election as directors should be unable to serve as a director by reason of death or other unexpected occurrence, a proxy will be voted for a substitute nominee or nominees designated by the Board of Potomac unless the Board of Directors adopts a resolution pursuant to the bylaws reducing the number of directors.

The Board of Directors is unaware of any other matters to be considered at the meeting but; if any other matters properly come before the meeting, persons named in the proxy will vote such proxy in accordance with their judgment on such matters.

## SHAREHOLDER COMMUNICATIONS WITH THE BOARD

Any shareholder desiring to contact the Board of Directors or any individual director serving on the Board may do so by written communication mailed to: Board of Directors, Attention: (name of director(s), as applicable), c/o Corporate Secretary Dean Cognetti, Potomac Bancshares, Inc., P.O. Box 906, Charles Town, West Virginia 25414. Any proper communication so received will be processed by the Corporate Secretary as agent for the Board. Unless, in the judgment of the Corporate Secretary, the matter is not intended or appropriate for the Board (and subject to any applicable regulatory requirements), the Corporate Secretary will prepare a summary of the communication for prompt delivery to each member of the Board or, as appropriate, to the member(s) of the Board named in the communication. Any director may request the Corporate Secretary to produce for his or her review the original of the shareholder communication.

**MEETING LOCATION, TIME AND DATE**

The Regular Annual Meeting of Shareholders will be held at the Bavarian Inn, Shepherdstown, WV at 10:30 a.m. on April 24, 2018.

Alice P. Frazier
President and Chief Executive Officer

Charles Town, West Virginia
March 15, 2018

(This page intentionally left blank.)

YHB CPAs & Consultants

**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors and Stockholders
Potomac Bancshares, Inc. and Subsidiary
Charles Town, West Virginia

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of Potomac Bancshares, Inc. and its Subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

**Management's Responsibility for the Financial Statements**

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

**Auditor's Responsibility**

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

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

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

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Potomac 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.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 15, 2018

**POTOMAC BANCSHARES, INC. AND SUBSIDIARY**
**CONSOLIDATED BALANCE SHEETS**
**December 31, 2017 and 2016**
**($ in thousands, except per share data)**

| | 2017 | 2016 |
|---|---|---|
| ASSETS | | |
| Cash and due from banks | $ 1 981 | $ 1 886 |
| Interest-bearing deposits in other financial institutions | 31 089 | 9 591 |
| Securities available for sale, at fair value | 31 316 | 23 411 |
| Loans, net of allowance for loan losses of $3,590 in 2017 and $3,202 in 2016 | 343 178 | 329 397 |
| Premises and equipment, net | 7 155 | 7 062 |
| Other real estate owned, net of valuation allowance of $142 in 2017 and $132 in 2016 | 220 | 656 |
| Accrued interest receivable | 963 | 832 |
| Bank owned life insurance | 7 279 | 7 993 |
| Federal Home Loan Bank of Pittsburgh stock | 854 | 594 |
| Other assets | 1 459 | 2 284 |
| Total Assets | $425 494 | $383 706 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Deposits | | |
| Noninterest-bearing | $ 54 684 | $ 54 928 |
| Interest-bearing | 317 475 | 278 943 |
| Total Deposits | 372 159 | 333 871 |
| Securities sold under agreements to repurchase | 3 825 | 6 112 |
| Federal Home Loan Bank advances | 11 538 | 7 545 |
| Accrued interest payable | 219 | 182 |
| Other liabilities | 1 934 | 2 813 |
| Total Liabilities | $389 675 | $350 523 |
| STOCKHOLDERS' EQUITY | | |
| Common stock, $1 per share par value; 10,000,000 shares authorized; 3,671,691 issued and outstanding | $ 3 672 | $ 3 672 |
| Surplus | 3 944 | 3 944 |
| Undivided profits | 34 425 | 31 043 |
| Accumulated other comprehensive loss, net | (2 728) | (2 259) |
| | $ 39 313 | $ 36 400 |
| Less cost of shares acquired for the treasury, 348,690 shares in 2017 and 326,690 in 2016 | (3 494) | (3 217) |
| Total Stockholders' Equity | $ 35 819 | $ 33 183 |
| Total Liabilities and Stockholders' Equity | $425 494 | $383 706 |

See Notes to Consolidated Financial Statements.

**POTOMAC BANCSHARES, INC. AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF INCOME**
**Years Ended December 31, 2017 and 2016**
**($ in thousands, except per share data)**

| | 2017 | 2016 |
|---|---|---|
| Interest and Dividend Income: | | |
| Interest and fees on loans | $15 429 | $13 786 |
| Interest on securities available for sale – taxable | 280 | 289 |
| Interest on securities available for sale – nontaxable | 56 | 84 |
| Other interest and dividends | 340 | 175 |
| Total Interest and Dividend Income | 16 105 | 14 334 |
| Interest expense: | | |
| Interest on deposits | 1 890 | 1 619 |
| Interest on securities sold under agreement to repurchase and federal funds purchased | 35 | 28 |
| Interest on Federal Home Loan Bank advances | 190 | 116 |
| Total Interest Expense | 2 115 | 1 763 |
| Net Interest Income | 13 990 | 12 571 |
| Provision for Loan Losses | 180 | 928 |
| Net Interest Income after Provision for Loan Losses | 13 810 | 11 643 |
| Noninterest Income: | | |
| Trust and financial services | 1 153 | 1 173 |
| Service charges on deposit accounts | 1 121 | 1 159 |
| Secondary market fee income | 307 | 363 |
| Visa/MC Fees | 1 192 | 1 066 |
| Earnings on bank owned life insurance | 896 | 203 |
| Gain on sales of securities available for sale | 302 | 121 |
| Other operating income | 323 | 303 |
| Total Noninterest Income | 5 294 | 4 388 |
| Noninterest Expense: | | |
| Salaries and employee benefits | 6 881 | 6 455 |
| Net occupancy expense of premises | 681 | 693 |
| Furniture and equipment expenses | 1 174 | 1 205 |
| Loss (gain) on sales of other real estate owned | 4 | (2) |
| Accounting, audit and compliance | 171 | 189 |
| Advertising | 163 | 186 |
| Computer services and online banking | 631 | 551 |
| FDIC assessment | 227 | 213 |
| Other professional fees | 300 | 172 |
| Trust investing outsource | 199 | 185 |
| Director & committee fees | 186 | 168 |
| Legal fees | 132 | 100 |
| Printing, stationery and supplies | 161 | 166 |
| Communications | 187 | 193 |
| Foreclosed property expense | 41 | 120 |
| Write down of other real estate owned | 55 | 163 |
| ATM and check card expenses | 745 | 665 |
| Other operating expenses | 1 247 | 1 223 |
| Total Noninterest Expenses | 13 185 | 12 645 |
| Income before Income Tax Expense | 5 919 | 3 386 |
| Income Tax Expense | 2 108 | 1 168 |
| Net Income | $ 3 811 | $ 2 218 |
| Earnings Per Common Share, Basic and Diluted | $ 1.14 | $ 0.66 |

See Notes to Consolidated Financial Statements.

**POTOMAC BANCSHARES, INC. AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**Years Ended December 31, 2017 and 2016**
**($ in thousands)**

| | 2017 | 2016 |
|---|---|---|
| Net Income | $3 811 | $2 218 |
| Other comprehensive income (loss): | | |
| Unrealized holding (loss) gain on securities, | | |
| net of tax of $34 and $72, respectively | (55) | 118 |
| Reclassification adjustment for gains included in net income, | | |
| net of tax of $115 and $46, respectively | (187) | (75) |
| Net pension and other postretirement gain (loss) arising during the period | | |
| net of tax of $40 and $151, respectively | 66 | (245) |
| Amortization of net actuarial loss included in net periodic benefit cost | | |
| net of tax of $111 and $105, respectively | 180 | 170 |
| Other comprehensive income (loss), net of tax | 4 | (32) |
| Comprehensive income | $3 815 | $2 186 |

See Notes to Consolidated Financial Statements.

**POTOMAC BANCSHARES, INC. AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**
**Years Ended December 31, 2017 and 2016**
**($ in thousands, except per share data)**

| | Common Stock | Surplus | Undivided Profits | Treasury Stock | Accumulated Other Comprehensive Loss, net | Total |
|---|---|---|---|---|---|---|
| Balances, December 31, 2015 | $3 672 | $3 944 | $29 661 | $(3 217) | $(2 227) | $31 833 |
| Net Income | - - | - - | 2 218 | - - | - - | 2 218 |
| Other comprehensive loss | - - | - - | - - | - - | (32) | (32) |
| Cash dividends ($.25 per share) | - - | - - | (836) | - - | - - | (836) |
| Balances, December 31, 2016 | $3 672 | $3 944 | $31 043 | $(3 217) | $(2 259) | $33 183 |
| Net Income | - - | - - | 3 811 | - - | - - | 3 811 |
| Reclassification of stranded tax effects from change in tax rate | - - | - - | 473 | - - | (473) | - - |
| Other comprehensive income | - - | - - | - - | - - | 4 | 4 |
| Purchase of treasury shares | - - | - - | - - | (277) | - - | (277) |
| Cash dividends ($.27 per share) | - - | - - | (902) | - - | - - | (902) |
| Balances, December 31, 2017 | $3 672 | $3 944 | $34 425 | $(3 494) | $(2 728) | $35 819 |

See Notes to Consolidated Financial Statements.

**POTOMAC BANCSHARES, INC. AND SUBSIDIARY**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**Years Ended December 31, 2017 and 2016**
**($ in thousands)**

| | 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 3 811 | $ 2 218 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 180 | 928 |
| Depreciation | 445 | 441 |
| (Gain) on sales and disposals of premises and equipment | - - | (24) |
| Deferred tax expense (benefit) | 419 | (7) |
| Deferred tax asset adjustment for enacted change in tax rate | 314 | - - |
| Premium amortization on securities, net | 24 | 81 |
| Write down of other real estate owned | 55 | 163 |
| Loss (Gain) on sales of other real estate owned | 4 | (2) |
| Gain on sale of securities available for sale, net | (302) | (121) |
| Decrease in loans held for sale | - - | 294 |
| Earnings on bank owned life insurance | (896) | (203) |
| Changes in assets and liabilities: | | |
| Increase in accrued interest receivable | (131) | (37) |
| Increase in other assets | (152) | (305) |
| Increase in accrued interest payable | 37 | 4 |
| (Decrease) increase in other liabilities | (240) | 157 |
| Net cash provided by operating activities | $ 3 568 | $ 3 587 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from maturity of certificates of deposits in other financial institutions | $ 250 | $ 500 |
| Purchase of certificates of deposits from other financial institutions | (3 750) | - - |
| Proceeds from sale of securities available for sale | 1 136 | 9 153 |
| Proceeds from maturities and principal repayments of securities available for sale | 4 186 | 5 192 |
| Proceeds from call of securities available for sale | 20 | 3 720 |
| Purchases of securities available for sale | (13 360) | (6 998) |
| Net increase in loans | (14 173) | (53 133) |
| Proceeds from sale of premises and equipment | - - | 53 |
| Purchases of premises and equipment | (538) | (407) |
| (Purchase) redemption of FHLB stock, net | (260) | 26 |
| Proceeds from sale of other real estate owned | 589 | 873 |
| Proceeds from bank owned life insurance | 1 610 | - - |
| Net cash used in investing activities | $(24 290) | $(41 021) |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Net (decrease) increase in noninterest-bearing deposits | $ (244) | $ 2 272 |
| Net increase in interest-bearing deposits | 38 532 | 28 064 |
| Net (repayment) proceeds of securities sold under agreements to repurchase | (2 287) | 973 |
| Net proceeds (repayment) of Federal Home Loan Bank advances | 3 993 | (992) |
| Purchase of treasury shares | (277) | - - |
| Cash dividends | (902) | (836) |
| Net cash provided by financing activities | $ 38 815 | $ 29 481 |
| Increase (decrease) in cash and cash equivalents | $ 18 093 | $ (7 953) |
| CASH AND CASH EQUIVALENTS | | |
| Beginning | 9 727 | 17 680 |
| Ending | $ 27 820 | $ 9 727 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION | | |
| Cash payments for: | | |
| Interest | $ 2 078 | $ 1 759 |
| Income taxes | $ 1 127 | $ 1 392 |
| SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | |
| Unrealized (loss) gain on securities available for sale | $ (391) | $ 69 |
| Change in benefit obligations and plan assets for pension and other postretirement benefits | $ 397 | $ (121) |
| Loans transferred to other real estate owned | $ 246 | $ 371 |
| Loans originated on sale of other real estate owned | $ 34 | $ - - |

See Notes to Consolidated Financial Statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies

Potomac Bancshares, Inc., and Subsidiary (collectively the company), through Bank of Charles Town, (the bank) a wholly owned subsidiary of Potomac Bancshares, Inc., grants commercial, financial, agricultural, residential and consumer loans to customers, primarily in Jefferson, Berkeley and Morgan Counties of West Virginia; Clarke, Frederick and Loudoun Counties of Virginia and Washington and Frederick Counties of Maryland. The loan portfolio, while having a higher concentration of real estate loans, is diversified among a large number of borrowers and loans generally are collateralized by assets of the customers. The loans are expected to be repaid from cash flows from business operations, customers' recurring income, or proceeds from the sale of selected assets of the borrowers.

Bank of Charles Town is a West Virginia state-chartered bank that formed and opened for business in 1871. The Federal Deposit Insurance Corporation insures the bank's deposits. The main office is in Charles Town, West Virginia at 111 East Washington Street, with additional branch offices in:

- Harpers Ferry, West Virginia,
- Kearneysville, West Virginia,
- Martinsburg, West Virginia,
- Hedgesville, West Virginia,
- Hagerstown, Maryland and
- Middleburg, Virginia

The company also offers deposit products to the same primary market area as loans. These products include noninterest-bearing and interest-bearing checking accounts, savings accounts and certificates of deposit in various terms. The company also offers through One Financial Center; financial planning, trust and investment management products.

The accounting and reporting policies of the company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The following is a summary of the more significant policies.

Principles of Consolidation

The consolidated financial statements of Potomac Bancshares, Inc. and its wholly-owned subsidiary, Bank of Charles Town, include the accounts of both companies. All material intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, evaluation for other-than-temporary impairment of investment securities, the valuation of other real estate owned, and the post retirement benefit obligations.

Interest-Bearing Deposits in Financial Institutions

Interest-bearing deposits in financial institutions are primarily overnight deposits held at the Federal Reserve and to a lesser extent certificates of deposits with other financial institutions. These funds are carried at cost.

Securities

Investments in debt and equity securities with readily determinable fair values are classified as either held to maturity, available for sale, or trading, based on management's intent. Currently all debt securities of the company are classified as available for sale. All equity securities, except investment in Federal Home Loan

Securities (Continued)

Bank (FHLB) are classified as available for sale. FHLB stock is classified as restricted and carried at cost. Available for sale securities are carried at estimated fair value with the corresponding unrealized gains and losses excluded from earnings and reported in other comprehensive income. Gains or losses are recognized in earnings on the trade date using the amortized cost of the specific security sold. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the company intends to sell the security or (2) it is more-likely-than-not that the company will be required to sell the security before recovery of its amortized cost basis. If, however, the company does not intend to sell the security and it is not more-likely-than-not that it will be required to sell the security before recovery, the company must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is credit loss, the loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

For equity securities, impairment is considered to be other-than-temporary based on the company's ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in net income.

Management regularly reviews each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, the best estimate of the present value of cash flows expected to be collected from debt securities, its intention with regard to holding the security to maturity and the likelihood that the company would be required to sell the security before recovery.

Loans

The company grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is comprised of loans secured by real estate. The ability of the company's debtors to honor their contracts is dependent upon customers' recurring income or income derived from collateral securing the loan, real estate and general economic conditions of the company's market area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off, generally, are reported at their recorded investment, which is the outstanding unpaid principal balance adjusted for the allowance for loan losses and any deferred fees or costs on the originated loan. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans are placed on nonaccrual status when bank management determines that it is no longer prudent for a loan to continue to accrue interest. Generally, it is the policy of this bank to stop accruing interest when principal or interest is greater than 90 days past due based upon the loan's contractual terms, unless the loan is well secured and in the process of collection. Furthermore, should the bank become aware of events which have occurred or are expected to occur which causes doubt as to the full collectability of principal or interest in the future, even though the loan is currently less than 90 days past due, the loan should be considered for nonaccrual status.

In order to justify the continuation of the accrual of interest on a loan which is greater than 90 days past due, the loan must be well secured and in the process of collection. In order to determine whether the loan is well secured, an appraisal of the collateral may be obtained establishing a value at least equal to principal and accrued interest for all loans greater than $250,000. For all loans greater than 90 days past due which fall below this threshold, the bank may complete its own appraisal or valuation of the collateral as long

Loans (Continued)

as its methodology is documented and consistently applied. For a loan to be considered in the process of collection, there must be corrective action contemplated by the borrower, such as payment of all past due amounts, or the bank must be ready to pursue the liquidation of the underlying collateral, generally within a reasonable period of time.

All interest accrued but not collected for all classes of loans that are placed on nonaccrual or charged-off is reversed against interest income. If the ultimate repayment of principal, in whole or in part, is not expected, any payment received on a loan on which the accrual of interest has been suspended is applied to reduce principal to the extent necessary to restore the expectation of ultimate collectability. At such time as full collection of the remaining recorded balance is expected, interest payments are recorded as interest income on a cash basis until such time the loan can be restored to accrual status in accordance with regulatory guidelines. Loans of all classes are returned to accrual status when all payments contractually due are brought current and future payments are reasonably assured.

For all classes of loans, approval of the President or Chief Lending Officer is required for all loans greater than 90 days past due which are not placed on nonaccrual status and for restoration of nonaccrual loans to accrual status.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the probable losses inherent in our loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectability of a loan balance is no longer present. Subsequent recoveries, if any, are credited to the allowance.

The allowance is based on two basic principles of accounting: (1) losses be accrued when they are probable of occurring and are capable of estimation and (2) losses be accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan losses is evaluated on a regular basis, monthly by management, and is based upon management's ongoing review of the collectability of the loans in light of historical experience, the economic environment, concentration and growth trends, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. Management monitors the loan portfolio on a continual basis with procedures that allow for problem loans and potential problem loans to be highlighted and watched. Written reports are prepared on a monthly basis for all commercial loans graded below a certain level for management review and are reported to the Board of Directors on a quarterly basis.

Based on experience, these loan policies and the bank's grading and review system, management believes the loan loss allowance is adequate. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

During these evaluations, particular risk characteristics associated with a segment of the loan portfolio are also considered. These characteristics are detailed below:

- Loans secured by farmland, commercial real estate, and commercial loans not secured by real estate carry risks associated with the successful operation of a business or farm and the repayment of these loans may depend on the profitability and cash flows of the business or farm. Additional risk relates to the value of collateral other than real estate where depreciation occurs, and the appraisal is less precise.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

- Real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be the loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.
- Consumer and all other loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral, such as automobiles, which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. These loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.
- Residential real estate loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

The primary tool used in managing and controlling problem loans is a watch list report. The report is a listing of all commercial loans that are considered problem loans. The report is controlled by Credit Administration. Consumer and residential mortgage loans deemed significant may be included at management's discretion. It is a primary responsibility of the loan officer to manage the credit risk within their loan portfolio. As such, they should be proactive rather than reactive when considering adding a loan to the watch list report. Occurrence of any of the following criteria is a basis for adding a loan to the watch list report.

- Loans classified as special mention, substandard, doubtful or loss by bank examiners, external auditors, loan officer or the bank's credit administration department personnel based upon financial trends of the business.
- Loans on nonaccrual status.
- Loans more than 60 days delinquent.
- Loans renewed or extended more than three times with little or no principal curtailment.
- Loans judgmentally selected by executive management due to unexpected changes or events which could have a potentially adverse effect on the borrower's ability to repay.

When a loan is added to the watch list report, the watch committee will estimate the need for a specific loss to be calculated in the bank's loan loss allowance.

The allowance consists of specific and general components. The specific component may relate to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for environmental factors such as economic, concentration and growth trends. The bank uses a thirty-six month rolling average for the historical loss factor in the loan portfolio.

Characteristics of the bank's risk classification grades are as follows:

- Pass – Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. Borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. Acceptable personal guarantors support the loan as needed.
- Special Mention – Are assets that have potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or in the institution's credit position at some future date.

Allowance for Loan Losses (Continued)

- Substandard – The bank is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.
- Doubtful – Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.
- Loss – Loans classified in this category are considered uncollectable and of such little value that their continuation as bankable assets is not warranted. This classification does not mean that the loan has absolutely no recovery or salvage value but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future. Any time a credit is placed in this category, it will be in non-accrual status.

A loan is generally considered impaired when, in the judgment of management, based on current information and events, it is probable that the company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral dependent. If an impaired loan is on nonaccrual status, any payments received will generally be applied first to principal. If an impaired loan is not on nonaccrual status, generally any payments received will be applied to principal and interest using usual procedures.

Large groups of smaller balance homogeneous loans (consumer and residential mortgage loans) are collectively evaluated for impairment. Accordingly, the company does not necessarily separately identify individual consumer and residential loans for impairment disclosures unless these loans are related to a borrower with commercial or other real estate loans that are classified or are the subject of a troubled debt restructuring.

In connection with the evaluation of the collectability of all classes of loans which are greater than 90 days past due as to principal or interest for nonaccrual status, any amounts not deemed well secured or otherwise collectible shall be recommended for charge-off at that time. Additionally, charge-off consideration shall be given to loans evaluated in connection with the bank's loan review policy and procedures and loans identified for repossession or foreclosure or meet the criteria for classification as an in-substance foreclosure. In any event, it shall be the policy of the bank to charge-off amounts deemed uncollectable in the periods when identified. All charge-off amounts are approved by the Chief Lending Officer, President, or Credit Administrator subject to Board ratification.

## Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

### Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. All home equity, lot, real estate, and commercial loans that are processed for a renewal, modification or refinance are reviewed to determine if it qualifies as a TDR. All loans that are not dependent on the sale of collateral or operation of collateral for repayment, the impairment will be based on a discounted future cash flow method. All loans with similar characteristics, such as mortgage and retail, will be measured as one homogenous group. If the repayment of the loan is solely based on the sale of collateral, the impairment will be based on the discounted value of the collateral. If repayment is based on operation of the collateral, the impairment will be based on fair value without discount. At times when a loan has previously been modified in a troubled debt restructuring, the company and the borrower may subsequently enter into another restructuring agreement. The facts and circumstances of each subsequent restructuring of a TDR are then evaluated to determine the appropriate accounting. Under certain circumstances we may no longer account for the subsequently restructured loan as a TDR if at the time of the subsequent restructuring the borrower is not experiencing financial difficulties, and under the terms of the subsequent restructuring agreement, no concession has been granted by us to the borrower. To meet these conditions for removing the TDR designation, the subsequent restructuring agreement must specify market terms, including a contractual interest rate not less than a market interest rate for new debt with similar credit risk characteristics and other terms no less favorable to the company than those it would offer for such new debt. If at the time of the subsequent restructuring the loan meets the conditions discussed above, the loan is no longer disclosed as a TDR or individually evaluated for impairment.

### Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or market value determined in the aggregate. There were no loans held for sale as of December 31, 2017 and December 31, 2016.

### Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method. Estimated useful lives range from five to forty years for premises and improvements and three to seven years for furniture and equipment.

Maintenance and repairs of property and equipment are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

### Other Real Estate Owned

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are recorded at the fair value net of estimated selling costs at the date of foreclosure, establishing a new cost basis. The value of real estate collateral is determined based on an internal evaluation, appraisal outside of the company, or a comparative market analysis. Revenue and expenses from operations and changes in the valuation allowance are included in foreclosed property expense and write down of other real estate owned, respectively.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Other Real Estate Owned (Continued)

At December 31, 2017 and December 31, 2016, the balance of other real estate owned includes $54 thousand and $337 thousand of foreclosed residential real estate properties, respectively, recorded as a result of obtaining physical possession of the property. As of December 31, 2017 and December 31, 2016, there were no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process.

Bank-Owned Life Insurance

The company owns insurance on the lives of a certain group of key employees. The cash surrender value of these policies is included as an asset on the consolidated balance sheets, and any increase in cash surrender value is recorded as noninterest income on the consolidated statements of income. In the event of the death of an insured individual under these policies, the company would receive a death benefit which would be recorded as other noninterest income.

Employee Benefit Plans

Summaries of company employee benefit plans are given below:

- The noncontributory, defined benefit pension plan covering employees meeting certain age and service requirements was frozen at October 31, 2009, the end of the plan year. No additional participants may enter the plan, and there will be no further increase in benefits due to increases in salaries and years of service.
- A postretirement life insurance plan covers certain current retirees who met certain requirements. This plan is not available for future retirees.
- A health care plan covers certain retirees who met certain eligibility requirements. This plan is not available for future retirees.
- A contributory health care plan is available to current full time employees.
- A 401(k)-retirement savings plan is available to all employees meeting certain age and service requirements. The employer match for this plan was increased with the freezing of the defined benefit plan as described above. Under this plan, the employer may make a discretionary matching contribution each plan year and may also make other discretionary contributions to the plan.

Earnings Per Common Share

Basic earnings per common share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance.

Income Taxes

Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary difference between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Income Taxes (Continued)

measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. There were no unrecognized tax benefits recorded as of December 31, 2017 and 2016. Interest and penalties, if any, associated with unrecognized tax benefits are classified as additional income taxes in the consolidated statements of income.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits in financial institutions, securities purchased under agreements to resell and federal funds sold. Generally, securities purchased under agreements to resell and federal funds sold are purchased and sold for one-day periods. Certificates of deposits in other financial institutions of $5.25 million and $1.75 million as of December 31, 2017 and December 31, 2016, respectively, are not included in cash and cash equivalents. These balances typically have maturities greater than 90 days.

One Financial Center

Securities and other property held by One Financial Center in a fiduciary or agency capacity are not assets of the company and are not included in the accompanying consolidated financial statements.

Advertising

The company follows the policy of charging the costs of advertising to expense as incurred. These amounts were $163 thousand and $186 thousand in 2017 and 2016, respectively.

Treasury Stock

Common shares repurchased are recorded as treasury stock at cost.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and changes in pension and postretirement benefit obligations, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income, and are presented in the consolidated statements of comprehensive income.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Stock-Based Compensation Plan

The 2003 Stock Incentive Plan was approved by stockholders on May 13, 2003. Under the plan, the option price cannot be less than the fair market value of the stock on the date granted. An option's maximum term was ten years from the date of grant. Options granted to employees were subject to a five-year vesting period. Options granted to non-employee directors vested on the grant date. This plan expired on February 11, 2013, and therefore no additional options can be granted under the plan. The final date to exercise options on this plan was January 9, 2017.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

### Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the company—presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

### Reclassifications

Certain reclassifications have been made to the prior period amounts to conform to the current year. None were of a material nature.

### Recent Accounting Pronouncements

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The company does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The company is currently assessing the impact that ASU 2016-02 will have on its consolidated) financial statements. The company is currently assessing the impact of existing leases. The company is gathering information on additional contracts/agreements that might fall under the requirements of ASU 2016-02.

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The company has attended trainings, consulted with industry experts, and started gathering information to implement.

During August 2016, the FASB issued ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments", to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a Business". The amendments in this ASU clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. Under the current implementation guidance in Topic 805, there are three elements of a business—inputs, processes, and outputs. While an integrated set of assets and activities (collectively referred to as a "set") that is a business usually has outputs, outputs are not required to be present. In addition, all the inputs and processes that a seller uses in operating a set are not required if market participants can acquire the set and continue to produce outputs. The amendments in this ASU provide a screen to determine when a set is not a business. If the screen is not met, the amendments (1) require that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The ASU provides a framework to assist entities in evaluating whether both an input and a substantive process are present. The amendments in this ASU are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. The amendments in this ASU should be applied prospectively on or after the effective date. No disclosures are required at transition. The company does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU 2017-07, "Compensation — Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." The amendments in this ASU require an employer that offers defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715 to report the service

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

cost component of net periodic benefit cost in the same line item(s) as other compensation costs arising from services rendered during the period. The other components of net periodic benefit cost are required to be presented in the income statement separately from the service cost component. If the other components of net periodic benefit cost are not presented on a separate line or lines, the line item(s) used in the income statement must be disclosed. In addition, only the service cost component will be eligible for capitalization as part of an asset, when applicable. The amendments are effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods. Early adoption is permitted. The company does not expect the adoption of ASU 2017-07 to have a material impact on its consolidated financial statements.

During March 2017, the FASB issued ASU 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

During February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The company has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending December 31, 2017. The amount of this reclassification in 2017 was $473 thousand.

Note 2. Securities

There were no securities held to maturity as of December 31, 2017 and 2016.

The amortized cost and fair value of securities available for sale (in thousands) as of December 31, 2017 and 2016 are as follows:

| | 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
| Obligations of U.S. Government sponsored agencies | $28 917 | $ - - | $(227) | $28 690 |
| State and municipal obligations | 2 508 | 13 | (13) | 2 508 |
| Equity securities | 115 | 3 | - - | 118 |
| | $31 540 | $ 16 | $(240) | $31 316 |

| | 2016 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized (Losses) | Fair Value |
| Obligations of U.S. Government sponsored agencies | $20 165 | $ 10 | $(122) | $20 053 |
| State and municipal obligations | 2 129 | 10 | (6) | 2 133 |
| Equity securities | 950 | 275 | - - | 1 225 |
| | $23 244 | $295 | $(128) | $23 411 |

The amortized cost and fair value of the securities available for sale as of December 31, 2017 (in thousands), by contractual maturity, are shown below. The equity securities have no stated maturities.

| | Amortized Cost | Fair Value |
|---|---|---|
| Due in one year or less | $ 7 043 | $ 7 035 |
| Due after one year through five years | 22 823 | 22 623 |
| Due after five years through ten years | 1 157 | 1 150 |
| Due after ten years | 402 | 390 |
| Equity securities | 115 | 118 |
| | $31 540 | $31 316 |

Proceeds of sales of securities during 2017 were $1.1 million. Gross gains of $302 thousand were realized on those sales. The tax expense applicable to these gains amounted to $115 thousand. Proceeds of the sales of securities during 2016 were $9.2 million. Gross gains of $121 thousand were realized on those sales. The tax expense applicable to these realized gains amounted to $46 thousand.

The primary purpose of the investment portfolio is to generate income and meet liquidity needs of the company through readily saleable financial instruments. The portfolio is made up primarily of fixed rate bonds, whose prices move inversely with rates. At the end of any accounting period, the investment portfolio has unrealized gains and losses. The company monitors the portfolio, which is subject to liquidity needs, market rate changes and credit risk changes, to see if adjustments are needed. The primary concern in a loss situation is the credit quality of the business behind the instrument. The primary cause of impairments is the decline in the prices of the bonds as rates have risen. There are twenty-four debt security accounts in the consolidated portfolio that had a loss at December 31, 2017. There were fifteen debt security accounts in the consolidated portfolio that had a loss at December 31, 2016. The primary cause of the temporary impairments in the company's investments in debt securities was fluctuations in interest rates. Because the company intends to hold these investments in debt securities to maturity and it is more likely than not that the company will not be required to sell these investments before a recovery of the unrealized loss, the company does not consider these investments to be other-than-temporarily impaired at December 31, 2017 and 2016 and no impairment has been recognized.

There were no equity securities in the company's portfolio with a loss at December 31, 2017 and December 31, 2016.

US Government sponsored agencies include the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation debt securities with a fair value of $10.9 million and $9.0 million as of December 31, 2017 and December 31, 2016, respectively.

The following table summarizes the fair value and gross unrealized losses for securities aggregated by investment category and length of time that individual securities have been in a continuous gross unrealized loss position as of December 31, 2017 and 2016 (in thousands).

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | More than 12 months | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Obligations of U.S. Government sponsored agencies | $22 838 | $ (149) | $5 852 | $(78) | $28 690 | $ (227) |
| State and municipal obligations | 534 | (13) | - - | - - | 534 | (13) |
| | $23 372 | $ (162) | $5 852 | $(78) | $29 224 | $ (240) |

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 months | | More than 12 months | | Total | |
| | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses |
| Obligations of U.S. Government sponsored agencies | $13 292 | $ (119) | $ 755 | $ (3) | $14 047 | $ (122) |
| State and municipal obligations | 871 | (6) | - - | - - | 871 | (6) |
| | $14 163 | $ (125) | $ 755 | $ (3) | $14 918 | $ (128) |

The company's investment in Federal Home Loan Bank (FHLB) stock totaled $854 thousand at December 31, 2017. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLB or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The company does not consider this investment to be other-than-temporarily impaired at December 31, 2017 and no impairment has been recognized. FHLB stock is shown as a separate line item on the consolidated balance sheet and is not a part of the available for sale securities portfolio.

Securities with a carrying value of $5.4 million and $16.0 million at December 31, 2017 and 2016, respectively were pledged to secure public funds, securities sold under agreement to repurchase, other borrowings, and for other purposes as required or permitted by law.

Note 3. Loans and Related Party Transactions

The loan portfolio, stated at face amount is composed of the following:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Commercial – non real estate | | |
| Commercial and industrial | $ 14 461 | $ 14 883 |
| Commercial real estate | | |
| Owner occupied | 44 317 | 42 852 |
| Non-owner occupied | 62 093 | 61 520 |
| Construction | | |
| Residential | 8 608 | 7 417 |
| Commercial | 13 800 | 18 050 |
| Real Estate | | |
| Farmland | 3 603 | 4 213 |
| Residential | | |
| Revolving open end | 10 700 | 9 668 |
| 1 to 4 family – first liens | 154 416 | 143 068 |
| 1 to 4 family – junior liens | 4 837 | 5 207 |
| 5 or more family | 10 939 | 11 514 |
| Consumer loans | 8 508 | 8 573 |
| All other loans | 10 486 | 5 634 |
| Total loans (1) | $346 768 | $332 599 |
| Less: allowance for loan losses | 3 590 | 3 202 |
| | $343 178 | $329 397 |

(1) Includes net deferred loan fees of $181 thousand and $306 thousand, respectively.

Loans to directors and executive officers of the company or to their associates at December 31, 2017 and 2016 totaled $4.8 million and $5.4 million, respectively. In management's opinion, such loans were made on substantially the same terms as those prevailing for comparable transactions with similar risks. During 2017, total principal additions were $0.5 million and total principal payments were $1.1 million.

The FHLB of Pittsburgh has a blanket lien on all the company's loans except those loans specifically pledged to the Federal Reserve and removed from the FHLB lien. Currently, the FHLB lien is securing advances to the company in the amount of $11.5 million and letters of credit issued on behalf of customers of the company in the amount of $24.5 million.

Note 4. Allowance for Loan Losses

Allowance for Loan Losses – By Segment
December 31, 2017
(in thousands)

| | Farmland | Commercial | Commercial Real Estate | Construction | Consumer | Residential | All Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | | | |
| Beginning balance | $ 33 | $ 58 | $ 1 361 | $ 238 | $ 113 | $ 1 363 | $ 36 | $ - - | $ 3 202 |
| Charge-offs | - - | (271) | (41) | (14) | (124) | (117) | - - | - - | (567) |
| Recoveries | - - | - - | 431 | 233 | 68 | 43 | - - | - - | 775 |
| Provision (Recovery) | (8) | 1 045 | (841) | (265) | 58 | 10 | 32 | 149 | 180 |
| Ending balance | $ 25 | $ 832 | $ 910 | $ 192 | $ 115 | $ 1 299 | $ 68 | $149 | $ 3 590 |
| Individually evaluated for impairment | $ - - | $ 668 | $ 208 | $ 2 | $ 14 | $ 38 | $ - - | $ - - | $ 930 |
| Collectively evaluated for impairment | 25 | 164 | 702 | 190 | 101 | 1 261 | 68 | 149 | 2 660 |
| | $ 25 | $ 832 | $ 910 | $ 192 | $ 115 | $ 1 299 | $ 68 | $149 | $ 3 590 |
| Loans: | | | | | | | | | |
| Ending balance | $3 603 | $14 461 | $106 410 | $22 408 | $8 508 | $180 892 | $10 486 | $ - - | $346 768 |
| Ending balance: | | | | | | | | | |
| Individually evaluated for impairment | $ - - | $ 1 057 | $ 3 494 | $ 120 | $ 19 | $ 2 918 | $ - - | $ - - | $ 7 608 |
| Collectively evaluated for impairment | 3 603 | 13 404 | 102 916 | 22 288 | 8 489 | 177 974 | 10 486 | - - | 339 160 |
| Total | $3 603 | $14 461 | $106 410 | $22 408 | $8 508 | $180 892 | $10 486 | $ - - | $346 768 |

Allowance for Loan Losses – By Segment
December 31, 2016
(in thousands)

| | Farmland | Commercial | Commercial Real Estate | Construction | Consumer | Residential | All Other | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses: | | | | | | | | | |
| Beginning balance | $ 18 | $ 36 | $ 1 097 | $ 173 | $ 118 | $ 1 080 | $ 24 | $ 2 | $ 2 548 |
| Charge-offs | - - | - - | (34) | (26) | (122) | (256) | - - | - - | (438) |
| Recoveries | - - | 34 | 35 | 8 | 80 | 7 | - - | - - | 164 |
| Provision (Recovery) | 15 | (12) | 263 | 83 | 37 | 532 | 12 | (2) | 928 |
| Ending balance | $ 33 | $ 58 | $ 1 361 | $ 238 | $ 113 | $ 1 363 | $ 36 | $ - - | $ 3 202 |
| Individually evaluated for impairment | $ - - | $ - - | $ 118 | $ 2 | $ 16 | $ 45 | $ - - | $ - - | $ 181 |
| Collectively evaluated for impairment | 33 | 58 | 1 243 | 236 | 97 | 1 318 | 36 | - - | 3 021 |
| | $ 33 | $ 58 | $ 1 361 | $ 238 | $ 113 | $ 1 363 | $ 36 | $ - - | $ 3 202 |
| Loans: | | | | | | | | | |
| Ending balance | $4 213 | $14 883 | $104 372 | $25 467 | $8 573 | $169 457 | $5 634 | $ - - | $332 599 |
| Ending balance: | | | | | | | | | |
| Individually evaluated for impairment | $ - - | $ - - | $ 3 065 | $ 501 | $ 24 | $ 3 720 | $ - - | $ - - | $ 7 310 |
| Collectively evaluated for impairment | 4 213 | 14 883 | 101 307 | 24 966 | 8 549 | 165 737 | 5 634 | - - | 325 289 |
| Total | $4 213 | $14 883 | $104 372 | $25 467 | $8 573 | $169 457 | $5 634 | $ - - | $332 599 |

Note 4. Allowance for Loan Losses (Continued)

Credit Quality Information – By Class
December 31, 2017
(in thousands)

| Internal Risk Rating Grades | Pass | Special Mention | Sub-Standard | Doubtful | Loss |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $ 13 016 | $ 388 | $1 057 | $ - - | $ - - |
| Commercial real estate | | | | | |
| Owner occupied | 43 681 | - - | 636 | - - | - - |
| Non-owner occupied | 59 309 | 1 105 | 1 679 | - - | - - |
| Construction | | | | | |
| Residential | 8 608 | - - | - - | - - | - - |
| Commercial | 13 443 | 239 | 118 | - - | - - |
| Real estate | | | | | |
| Farmland | 3 603 | - - | - - | - - | - - |
| Consumer | N/A | N/A | N/A | N/A | N/A |
| Residential | | | | | |
| Revolving open end | N/A | - - | 714 | N/A | N/A |
| 1-4 family – first liens | N/A | - - | 974 | N/A | N/A |
| 1-4 family – junior liens | N/A | - - | 25 | N/A | N/A |
| 5 or more family | N/A | 446 | 105 | N/A | N/A |
| Totals | $141 660 | $2 178 | $5 308 | $ - - | $ - - |

As a matter of practice, we do not necessarily risk rate consumer or residential mortgage loans. Generally, these loans listed in the risk rating table above are associated with commercial loans that have been risk rated as per our policy. When a loan is designated as a loss, the loss portion is charged off, and if applicable, the remaining balance classified as substandard. Loans identified in the table below as nonperforming are in nonaccrual status.

Credit Quality Information – By Class
December 31, 2017
(in thousands)

| Non Risk Rated Loans | Performing | Nonperforming |
|---|---|---|
| Consumer | $ 8 496 | $ 12 |
| Residential | | |
| Revolving open end | 9 984 | 2 |
| 1-4 family – first liens | 153 063 | 379 |
| 1-4 Family – junior liens | 4 802 | 10 |
| 5 or more family | 10 388 | - - |
| All other | 10 486 | - - |
| Totals | $197 219 | $403 |

Note 4. Allowance for Loan Losses (Continued)

Credit Quality Information – By Class
December 31, 2016
(in thousands)

| Internal Risk Rating Grades | Pass | Special Mention | Sub-Standard | Doubtful | Loss |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $ 14 797 | $ 86 | $ - - | $ - - | $ - - |
| Commercial real estate | | | | | |
| Owner occupied | 40 764 | 748 | 1 340 | - - | - - |
| Non-owner occupied | 60 012 | 1 120 | 388 | - - | - - |
| Construction | | | | | |
| Residential | 7 417 | - - | - - | - - | - - |
| Commercial | 17 562 | - - | 488 | - - | - - |
| Real estate | | | | | |
| Farmland | 4 213 | - - | - - | - - | - - |
| Consumer | N/A | N/A | N/A | N/A | N/A |
| Residential | | | | | |
| Revolving open end | N/A | - - | 666 | N/A | N/A |
| 1-4 family – first liens | N/A | 204 | 1 159 | N/A | N/A |
| 1-4 family – junior liens | N/A | - - | 30 | N/A | N/A |
| 5 or more family | N/A | - - | 110 | N/A | N/A |
| Totals | $144 765 | $2 158 | $4 181 | $ - - | $ - - |

Credit Quality Information – By Class
December 31, 2016
(in thousands)

| Non Risk Rated Loans | Performing | Nonperforming |
|---|---|---|
| Consumer | $ 8 558 | $ 15 |
| Residential | | |
| Revolving open end | 8 997 | 5 |
| 1-4 family – first liens | 141 341 | 364 |
| 1-4 Family – junior liens | 5 160 | 17 |
| 5 or more family | 11 404 | - - |
| All other | 5 634 | - - |
| Totals | $181 094 | $401 |

Impaired Loans – By Class
December 31, 2017
(in thousands)

With no related allowance:

| | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $ 29 | $ 14 | $- - | $ 28 | $ 1 |
| Commercial real estate | | | | | |
| Owner occupied | - - | - - | - - | - - | - - |
| Non-owner occupied | 1 909 | 1 900 | - - | 1973 | 84 |
| Construction | | | | | |
| Residential | - - | - - | - - | - - | - - |
| Commercial | - - | - - | - - | - - | - - |
| Real estate | | | | | |
| Farmland | - - | - - | - - | - - | - - |
| Residential | | | | | |
| Revolving open end | - - | - - | - - | - - | - - |
| 1 to 4 family – first liens | 610 | 608 | - - | 633 | 46 |
| 1 to 4 family – junior liens | - - | - - | - - | - - | - - |
| 5 or more family | - - | - - | - - | - - | - - |
| Consumer | - - | - - | - - | - - | - - |
| All other | - - | - - | - - | - - | - - |
| | $2 548 | $2 522 | $- - | $2 634 | $131 |

Impaired Loans – By Class
December 31, 2017
(in thousands)

With an allowance recorded:

| | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $1 064 | $1 043 | $668 | $1 092 | $ 73 |
| Commercial real estate | | | | | |
| Owner occupied | 709 | 643 | 62 | 665 | 25 |
| Non-owner occupied | 957 | 951 | 146 | 920 | 43 |
| Construction | | | | | |
| Residential | - - | - - | - - | - - | - - |
| Commercial | 121 | 120 | 2 | 130 | 10 |
| Real estate | | | | | |
| Farmland | - - | - - | - - | - - | - - |
| Residential | | | | | |
| Revolving open end | - - | - - | - - | - - | - - |
| 1 to 4 family – first liens | 1 938 | 1 907 | 31 | 1 940 | 85 |
| 1 to 4 family – junior liens | 312 | 298 | 5 | 326 | 22 |
| 5 or more family | 105 | 105 | 2 | 107 | 8 |
| Consumer | 19 | 19 | 14 | 22 | 1 |
| All other | - - | - - | - - | - - | - - |
| | $5 225 | $5 086 | $930 | $5 202 | $267 |

| Totals: | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Commercial – non real estate | $1 093 | $1 057 | $668 | $1 120 | $ 74 |
| Commercial real estate | 3 575 | 3 494 | 208 | 3 558 | 152 |
| Construction | 121 | 120 | 2 | 130 | 10 |
| Real estate – farmland | - - | - - | - - | - - | - - |
| Residential | 2 965 | 2 918 | 38 | 3 006 | 161 |
| Consumer | 19 | 19 | 14 | 22 | 1 |
| All other | - - | - - | - - | - - | - - |
| | $7 773 | $7 608 | $930 | $7 836 | $398 |

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2016
(in thousands)

With no related allowance:

| | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $ - - | $ - - | $- - | $ - - | $ - - |
| Commercial real estate | | | | | |
| Owner occupied | 1 089 | 1 036 | - - | 1 176 | 47 |
| Non-owner occupied | 2 337 | 1 027 | - - | 1 099 | 37 |
| Construction | | | | | |
| Residential | - - | - - | - - | - - | - - |
| Commercial | 1 457 | 362 | - - | 524 | - - |
| Real estate | | | | | |
| Farmland | - - | - - | - - | - - | - - |
| Residential | | | | | |
| Revolving open end | - - | - - | - - | - - | - - |
| 1 to 4 family – first liens | 1 050 | 768 | - - | 807 | 56 |
| 1 to 4 family – junior liens | - - | - - | - - | - - | - - |
| 5 or more family | - - | - - | - - | - - | - - |
| Consumer | - - | - - | - - | - - | - - |
| All other | - - | - - | - - | - - | - - |
| | $5 933 | $3 193 | $- - | $3 606 | $140 |

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2016
(in thousands)

With an allowance recorded:

| | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Commercial – non real estate | | | | | |
| Commercial and industrial | $ - - | $ - - | $ - - | $ - - | $ - - |
| Commercial real estate | | | | | |
| Owner occupied | 340 | 320 | 109 | 330 | 8 |
| Non-owner occupied | 684 | 682 | 9 | 696 | 33 |
| Construction | | | | | |
| Residential | - - | - - | - - | - - | - - |
| Commercial | 140 | 139 | 2 | 147 | 11 |
| Real estate | | | | | |
| Farmland | - - | - - | - - | - - | - - |
| Residential | | | | | |
| Revolving open end | - - | - - | - - | - - | - - |
| 1 to 4 family – first liens | 2 481 | 2 455 | 36 | 2 409 | 103 |
| 1 to 4 family – junior liens | 403 | 387 | 7 | 419 | 28 |
| 5 or more family | 110 | 110 | 2 | 113 | 9 |
| Consumer | 24 | 24 | 16 | 22 | 1 |
| All other | - - | - - | - - | - - | - - |
| | $ 4 182 | $4 117 | $181 | $4 136 | $193 |

| | Unpaid Principal | Recorded Investment | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| Totals: | | | | | |
| Commercial – non real estate | $ - - | $ - - | $ - - | $ - - | $ - - |
| Commercial real estate | 4 450 | 3 065 | 118 | 3 301 | 125 |
| Construction | 1 597 | 501 | 2 | 671 | 11 |
| Real estate – farmland | - - | - - | - - | - - | - - |
| Residential | 4 044 | 3 720 | 45 | 3 748 | 196 |
| Consumer | 24 | 24 | 16 | 22 | 1 |
| All other | - - | - - | - - | - - | - - |
| | $10 115 | $7 310 | $181 | $7 742 | $333 |

No additional funds are committed to be advanced on impaired loans, as of December 31, 2017 and 2016.

Note 4. Allowance for Loan Losses (Continued)

Modifications
(in thousands except number of contracts)

For the Year Ended
December 31, 2017

| **Troubled Debt Restructurings** | Number Of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Commercial – non real estate | | | |
| Commercial and industrial | 2 | $ 71 | $ 71 |
| Commercial real estate | | | |
| Owner occupied | 1 | 325 | 325 |
| Non owner occupied | - - | - - | - - |
| Construction | | | |
| Residential | - - | - - | - - |
| Commercial | - - | - - | - - |
| Real Estate | | | |
| Farmland | - - | - - | - - |
| Residential | | | |
| Revolving open end 1 to 4 family | - - | - - | - - |
| 1 to 4 family – first liens | - - | - - | - - |
| 1 to 4 family – junior liens | - - | - - | - - |
| 5 or more family | - - | - - | - - |
| Consumer | - - | - - | - - |
| All Other | - - | - - | - - |
| Totals | 3 | $396 | $396 |

| **Troubled Debt Restructurings That Subsequently Defaulted** | Number of Contracts | Recorded Investment |
|---|---|---|
| Commercial – non real estate | | |
| Commercial and industrial | 1 | $ 7 |
| Commercial real estate | | |
| Owner occupied | - - | - - |
| Non owner occupied | - - | - - |
| Construction | | |
| Residential | - - | - - |
| Commercial | - - | - - |
| Real Estate | | |
| Farmland | - - | - - |
| Residential | | |
| Revolving open end 1 to 4 family | - - | - - |
| 1 to 4 family – first liens | - - | - - |
| 1 to 4 family – junior liens | - - | - - |
| 5 or more family | - - | - - |
| Consumer | - - | - - |
| All Other | - - | - - |
| Totals | 1 | $ 7 |

Loans having been greater than 30 days past due at any time subsequent to the restructuring date in the current year are considered as having defaulted.

Note 4. Allowance for Loan Losses (Continued)

Modifications
(in thousands except number of contracts)

For the Year Ended
December 31, 2016

| Troubled Debt Restructurings | Number Of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
|---|---|---|---|
| Commercial – non real estate | | | |
| Commercial and industrial | - - | $ - - | $ - - |
| Commercial real estate | | | |
| Owner occupied | - - | - - | - - |
| Non owner occupied | - - | - - | - - |
| Construction | | | |
| Residential | - - | - - | - - |
| Commercial | - - | - - | - - |
| Real Estate | | | |
| Farmland | - - | - - | - - |
| Residential | | | |
| Revolving open end 1 to 4 family | - - | - - | - - |
| 1 to 4 family – first liens | 2 | 105 | 111 |
| 1 to 4 family – junior liens | - - | - - | - - |
| 5 or more family | - - | - - | - - |
| Consumer | - - | - - | - - |
| All Other | - - | - - | - - |
| Totals | 2 | $105 | $111 |

| Troubled Debt Restructurings That Subsequently Defaulted | Number of Contracts | Recorded Investment |
|---|---|---|
| Commercial – non real estate | | |
| Commercial and industrial | - - | $- - |
| Commercial real estate | | |
| Owner occupied | - - | - - |
| Non owner occupied | 1 | 80 |
| Construction | | |
| Residential | - - | - - |
| Commercial | - - | - - |
| Real Estate | | |
| Farmland | - - | - - |
| Residential | | |
| Revolving open end 1 to 4 family | - - | - - |
| 1 to 4 family – first liens | - - | - - |
| 1 to 4 family – junior liens | - - | - - |
| 5 or more family | - - | - - |
| Consumer | - - | - - |
| All Other | - - | - - |
| Totals | 1 | $80 |

As of December 31, 2017 and 2016 there were $4.9 million and $6.1 million of troubled debt restructurings, respectively.

Note 4. Allowance for Loan Losses (Continued)

Nonaccrual and Past Due Loans – By Class
December 31, 2017
(in thousands)

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | 90 Days Past Due Still Accruing | Non-Accrual |
|---|---|---|---|---|---|---|---|---|
| Commercial – non real estate | | | | | | | | |
| Commercial and industrial | $ 11 | $ - - | $ 14 | $ 25 | $ 14 436 | $ 14 461 | $ - - | $ 986 |
| Commercial real estate | | | | | | | | |
| Owner occupied | - - | - - | - - | - - | 44 317 | 44 317 | - - | 188 |
| Non owner occupied | 368 | 99 | - - | 467 | 61 626 | 62 093 | - - | - - |
| Construction | | | | | | | | |
| Residential | - - | - - | - - | - - | 8 608 | 8 608 | - - | - - |
| Commercial | 11 | 41 | - - | 52 | 13 748 | 13 800 | - - | - - |
| Real estate | | | | | | | | |
| Farmland | - - | - - | - - | - - | 3 603 | 3 603 | - - | - - |
| Residential | | | | | | | | |
| Revolving open end | - - | - - | - - | - - | 10 700 | 10 700 | - - | 2 |
| 1 to 4 family – first liens | 1 033 | 191 | 48 | 1 272 | 153 144 | 154 416 | - - | 379 |
| 1 to 4 family – junior liens | 138 | 35 | - - | 173 | 4 664 | 4 837 | - - | 10 |
| 5 or more family | - - | - - | - - | - - | 10 939 | 10 939 | - - | - - |
| Consumer | 20 | - - | 3 | 23 | 8 485 | 8 508 | - - | 12 |
| All other | - - | - - | - - | - - | 10 486 | 10 486 | - - | - - |
| Totals | $1 581 | $ 366 | $ 65 | $2 012 | $344 756 | $346 768 | $ - - | $1 577 |
| Percentage to Total Loans | 0.46% | 0.10% | 0.02% | 0.58% | 99.42% | | 0.00% | 0.45% |

Included in the 30 or more days past due loans are certain non-accrual loans in the amount of $65 thousand. The remaining non-accrual loans of $1.512 million are in current status.

Note 4. Allowance for Loan Losses (Continued)

Nonaccrual and Past Due Loans – By Class
December 31, 2016
(in thousands)

| | 30-59 Days Past Due | 60-89 Days Past Due | 90 Days or More Past Due | Total Past Due | Current | Total Loans | 90 Days Past Due Still Accruing | Non-Accrual |
|---|---|---|---|---|---|---|---|---|
| Commercial – non real estate | | | | | | | | |
| Commercial and industrial | $ - - | $ - - | $ - - | $ - - | $ 14 883 | $ 14 883 | $ - - | $ - - |
| Commercial real estate | | | | | | | | |
| Owner occupied | 967 | - - | 168 | 1 135 | 41 717 | 42 852 | - - | 373 |
| Non owner occupied | - - | - - | 57 | 57 | 61 463 | 61 520 | - - | 57 |
| Construction | | | | | | | | |
| Residential | - - | - - | - - | - - | 7 417 | 7 417 | - - | - - |
| Commercial | 160 | - - | - - | 160 | 17 890 | 18 050 | - - | 372 |
| Real estate | | | | | | | | |
| Farmland | - - | - - | - - | - - | 4 213 | 4 213 | - - | - - |
| Residential | | | | | | | | |
| Revolving open end | - - | - - | - - | - - | 9 668 | 9 668 | - - | 5 |
| 1 to 4 family – first liens | 562 | 48 | 269 | 879 | 142 189 | 143 068 | - - | 391 |
| 1 to 4 family – junior liens | 116 | 17 | - - | 133 | 5 074 | 5 207 | - - | 17 |
| 5 or more family | - - | - - | - - | - - | 11 514 | 11 514 | - - | - - |
| Consumer | 15 | 24 | 6 | 45 | 8 528 | 8 573 | - - | 15 |
| All other | - - | - - | - - | - - | 5 634 | 5 634 | - - | - - |
| Totals | $1 820 | $ 89 | $ 500 | $2 409 | $330 190 | $332 599 | $ - - | $1 230 |
| Percentage to Total Loans | 0.55% | 0.02% | 0.15% | 0.72% | 99.28% | | 0.00% | 0.37% |

Included in the 30 or more days past due loans are certain non-accrual loans in the amount of $574 thousand. The remaining non-accrual loans of $656 thousand are in current status.

The past due policy of the bank is to report all classes of loans past due in the following categories:

- 30 to 59 days past due (principal or interest)
- 60 to 89 days past due (principal or interest)
- 90 days or more past due (principal or interest)
- Nonaccrual status.

Note 4. Allowance for Loan Losses (Continued)

The following table summarizes non-performing assets at December 31, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| | (in thousands) | |
| Nonperforming assets | | |
| Nonaccrual loans (1) | $1 577 | $1 230 |
| Other Real Estate Owned | 220 | 656 |
| Total nonperforming assets | $1 797 | $1 886 |
| Performing troubled debt restructures (2) | $4 855 | $5 478 |
| Loans past due 90 days accruing interest | $ - - | $ - - |

(1) Currently there are two restructurings in non-performing assets with a balance of $75 thousand at December 31, 2017. There were four restructurings in non-performing assets with a balance of $618 thousand at December 31, 2016.

(2) Within this amount are three restructurings with a balance totaling $506 thousand, 30 or more days past due at December 31, 2017. There was one restructuring with a balance of $195 thousand at December 31, 2016, 30 or more days past due.

The interest income that would have been earned if the loans classified as nonaccrual had performed in accordance with the original terms was approximately $195 thousand and $208 thousand in 2017 and 2016, respectively.

Note 5. Premises and Equipment, Net

Premises and equipment consists of the following:

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| | (in thousands) | |
| Premises and improvements | $ 9 443 | $ 9 291 |
| Furniture and equipment | 4 361 | 4 323 |
| | $13 804 | $13 614 |
| Less accumulated depreciation | 6 649 | 6 552 |
| | $ 7 155 | $ 7 062 |

Depreciation included in noninterest expense for 2017 and 2016 was $445 thousand and $441 thousand, respectively. At December 31, 2017 and 2016 rent expense was $150 thousand.

Note 6. Deposits

The aggregate amount of time deposits with a balance of $250,000 or more was $18.2 million and $15.7 million at December 31, 2017 and 2016, respectively.

At December 31, 2017, the scheduled maturities of all time deposits (in thousands) are as follows:

| | |
|---|---|
| 2018 | $ 30 979 |
| 2019 | 31 590 |
| 2020 | 22 274 |
| 2021 | 11 890 |
| 2022 | 8 938 |
| | $ 105 671 |

Note 6. Deposits (Continued)

Brokered deposits totaled $37.6 million and $14.9 million at December 31, 2017 and 2016, respectively. Certificates of deposits included in these totals are $16.0 million and $7.9 million at December 31, 2017 and 2016, respectively.

Deposits of the company's directors, executive officers and associates totaled $2.2 million at December 31, 2017 and totaled $2.2 million at December 31, 2016.

Note 7. Borrowings

Short-term borrowings consist of securities sold under agreements to repurchase and federal funds purchased, which totaled $3.8 million and $6.1 million as of December 31, 2017 and 2016, respectively.

The table below presents selected information on these short-term borrowings (in thousands):

| | December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Balance outstanding at year end | $3 825 | $6 112 |
| Maximum balance at any month-end during the year | $7 300 | $6 356 |
| Average balance for the year | $5 554 | $4 447 |
| Weighted average rate for the year | 0.64% | 0.64% |
| Weighted average rate at year end | 0.65% | 0.63% |

Total FHLB advances at December 31, 2017 and 2016 were $11.5 million and $7.5 million, respectively. At December 31, 2017 the company had two non-amortizing $5 million Federal Home Loan Bank advances. One of the advances has an interest rate of 1.39% and a maturity date of May 30, 2018, while the other has an interest rate of 2.22% and a maturity date of March 28, 2022. The company also has an amortizing Federal Home Loan Bank advance with an interest rate of 1.43% and a balance of $1.5 million and $2.5 million at December 31, 2017 and 2016, respectively. This advance has a maturity date of June 26, 2019. This advance amortizes to the maturity date with future scheduled yearly principal payments of $1.0 million and $516 thousand, respectively.

Noncore funding capabilities, including borrowing, provide additional liquidity. The subsidiary bank maintains a federal funds line with one financial institution and is a member of the Federal Home Loan Bank of Pittsburgh. The subsidiary bank also has a credit line with the Federal Reserve discount window. At December 31, 2017, the subsidiary bank had total credit available through these institutions of approximately $130.9 million.

Securities sold under agreement to repurchase to the company's directors, executive officers and associates totaled $1.8 million at December 31, 2017 and totaled $3.6 million at December 31, 2016.

Note 8. Employee Benefit Plans

The company's defined benefit pension plan, covering full-time employees over 21 years of age upon completion of one year of service, was frozen as of October 31, 2009, the end of the plan year. Benefits will be based on average compensation for the five consecutive full calendar years of service which produces the highest average as of October 31, 2009. No additional participants may enter the plan, and there will be no further increases in benefits due to increases in salaries and years of service.

The company sponsors an unfunded postretirement life insurance plan covering certain retirees with 25 years of service who are over the age of 60 and an unfunded health care plan for certain retirees that met certain eligibility requirements. These plans are not available to future retirees.

The company sponsors a 401(k)-retirement savings plan available to all employees meeting certain age and service requirements. Employees become eligible to participate in the plan upon reaching age 21 and completing one year of service. Employees can make a salary deferral election authorizing the company to withhold up to the amount allowed by law each calendar year. The company may make a discretionary matching contribution each plan year. The company may also make other discretionary contributions to the plan. The company made 401(k) matching contributions of $311 thousand and $315 thousand in 2017 and 2016, respectively.

Note 8. Employee Benefit Plans (Continued)

The company has entered into contracts with two retirees where the company has agreed to pay the beneficiaries of one participant $50,000 and the beneficiary of one participant $25,000 at the death of the participants. This postretirement benefit has been accrued as of December 31, 2017. While these liabilities are unfunded, life insurance has been obtained by the company to help offset these payments.

Obligations and funded status:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | (in thousands) | |
| Change in benefit obligation: | | | | |
| Benefit obligation, beginning | $ 9 471 | $ 9 526 | $ 354 | $ 364 |
| Interest cost | 394 | 420 | 13 | 14 |
| Actuarial loss (gain) | 530 | 53 | (55) | 2 |
| Benefits paid | (554) | (528) | (23) | (26) |
| Benefit obligation, ending | $ 9 841 | $ 9 471 | $ 289 | $ 354 |
| Change in plan assets: | | | | |
| Fair value of plan assets, beginning | $ 7 988 | $ 8 338 | $ - - | $ - - |
| Actual return on plan assets | 1 085 | 178 | - - | - - |
| Employer contributions | 1 200 | - - | 23 | 26 |
| Benefits paid | (554) | (528) | (23) | (26) |
| Fair value of plan assets, ending | $ 9 719 | $ 7 988 | $ - - | $ - - |
| Funded status at end of year | $ (122) | $ (1 483) | $ (289) | $ (354) |
| Accounts recognized on consolidated balance sheet as: | | | | |
| Accrued benefit liabilities | $ (122) | $ (1 483) | $ (289) | $ (354) |
| Amounts recognized in accumulated other comprehensive loss consists of: | | | | |
| Net actuarial loss (gain) | $ 3 425 | $ 3 766 | $ (12) | $ 44 |
| Deferred tax (asset) liability | (856) | (1 431) | 3 | (16) |
| | $ 2,569 | $ 2 335 | $ (9) | $ 28 |

The accumulated benefit obligation for the defined benefit pension plan was $9.8 million and $9.5 million at December 31, 2017 and 2016, respectively.

Note 8. Employee Benefit Plans (Continued)

Components of net periodic benefit cost and other amounts recognized in accumulated other comprehensive loss:

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| | (in thousands) | | (in thousands) | |
| Components of net periodic benefit cost: | | | | |
| Interest cost | $ 393 | $ 420 | $ 13 | $ 14 |
| Expected return on plan assets | (503) | (519) | - - | - - |
| Amortization of actuarial loss | 290 | 274 | 1 | 1 |
| Net periodic benefit cost | $ 180 | $ 175 | $ 14 | $ 15 |
| Other changes in plan assets and benefit obligations recognized as other comprehensive income (loss): | | | | |
| Net actuarial (gain) loss | $ (51) | $ 394 | $(55) | $ 2 |
| Deferred tax | 130 | (46) | 21 | - - |
| Amortization of actuarial loss | (290) | (274) | (1) | (1) |
| Total recognized as other comprehensive (income) loss | $(211) | $ 74 | $(35) | $ 1 |
| Total recognized in comprehensive income | $ (31) | $ 249 | $(21) | $ 16 |

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year approximates $243 thousand.

Assumptions

| | Pension Benefits | | Other Postretirement Benefits | |
|---|---|---|---|---|
| | 2017 | 2016 | 2017 | 2016 |
| Weighted-average assumptions used to determine net periodic benefit cost: | | | | |
| Discount rate | 4.27% | 4.53% | 4.00% | 4.00% |
| Expected return on plan assets | 6.05% | 6.42% | - - | - - |
| Weighted-average assumptions used to determine benefit obligations: | | | | |
| Discount rate | 3.70% | 4.27% | 3.55% | 4.00% |
| Expected return on plan assets | 6.34% | 6.05% | - - | - - |

Note 8. Employee Benefit Plans (Continued)

Long-Term Rate of Return

The plan sponsor selects the expected long-term rate-of-return-on-assets assumption in consultation with their actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rates of return (net of inflation), for the major asset classes held or anticipated to be held by the trust, and for the trust itself. Undue weight is not given to recent experience that may not continue over the measurement period, with higher significance placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

The fair value (in thousands) of the company's pension assets as of December 31, 2017 and 2016, respectively, are as follows:

| | | Fair Value Measurement at December 31, 2017 | | |
|---|---|---|---|---|
| Asset Category | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash & cash equivalents | $ 296 | $ 296 | $ - - | $- - |
| Equity securities | | | | |
| U.S. companies | 4 334 | 4 334 | - - | - - |
| International companies | 1 021 | 1 021 | - - | - - |
| U. S. Treasury securities | 1 131 | - - | 1 131 | - - |
| U. S. Government Agencies | 614 | - - | 614 | - - |
| U. S. Corporate bonds | 2 102 | - - | 2 102 | - - |
| International Corporate bonds | 221 | - - | 221 | - - |
| Total | $9 719 | $5 651 | $4 068 | $- - |

| | | Fair Value Measurement at December 31, 2016 | | |
|---|---|---|---|---|
| Asset Category | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Cash & cash equivalents | $ 93 | $ 93 | $ - - | $- - |
| Equity securities | | | | |
| U.S. companies | 3 799 | 3 799 | - - | - - |
| International companies | 722 | 722 | - - | - - |
| U. S. Treasury securities | 588 | - - | 588 | - - |
| U. S. Government Agencies | 701 | - - | 701 | - - |
| U. S. Corporate bonds | 1 755 | - - | 1 755 | - - |
| International Corporate bonds | 330 | - - | 330 | - - |
| Total | $7 988 | $4 614 | $3 374 | $- - |

Note 8. Employee Benefit Plans (Continued)

Asset Allocation

The pension plan's asset allocations at December 31, 2017 and 2016 by asset category are as follows:

| | Plan Assets at December 31 | |
|---|---|---|
| | 2017 | 2016 |
| Asset Category | | |
| Equities | 55% | 57% |
| Fixed income/cash | 45% | 43% |
| Total | 100% | 100% |

The trust fund is diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 50% equities, 50% fixed income and cash, with range of 40% to 60%. The trust fund allocation is reviewed on a monthly basis and rebalanced to within the acceptable ranges as needed. The investment manager selects investment fund managers with demonstrated experience and expertise and funds with demonstrated historical performance for the implementation of the plan's investment strategy. The investment manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the trustee to administer the investments of the trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the trust.

There is no company common stock included in the equity securities of the pension plan at December 31, 2017 and 2016.

Cash Flow

The company currently expects to make contributions of $150 thousand to its pension plan in 2018 and $26 thousand to its postretirement plan in 2018.

The following benefit payments (in thousands) are expected to be paid:

| | Pension Benefits | Other Postretirement Benefits |
|---|---|---|
| 2018 | $ 574 | $ 26 |
| 2019 | 569 | 26 |
| 2020 | 576 | 26 |
| 2021 | 576 | 25 |
| 2022 | 576 | 25 |
| Thereafter | 2 877 | 110 |

For measurement purposes, a 7.00% and 7.80% annual rate of increase in per capita health care costs of covered benefits was assumed for the retiree health care plan for 2017 and 2016.

Note 8. Employee Benefit Plans (Continued)

Cash Flow (Continued)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

| | 1% Increase | 1% Decrease |
|---|---|---|
| | (in thousands) | |
| Effect on the health care component of the accumulated postretirement benefit obligation | $15 | $(13) |
| Effect on total of service and interest cost components of net periodic other postretirement health care benefit cost | 1 | (0) |

Note 9. Weighted Average Number of Shares Outstanding and Earnings Per Common Share

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential diluted common stock had no effect on earnings per share available to stockholders.

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Average Shares (in thousands) | Per Share Amount | Average Shares (in thousands) | Per Share Amount |
| Basic earnings per common share | 3 339 | $ 1.14 | 3 345 | $.66 |
| Effect of dilutive securities: | | | | |
| Stock options | - - | | - - | |
| Diluted earnings per common share | 3 339 | $ 1.14 | 3 345 | $.66 |

Stock options for 542 and 35,104 average shares of common stock were not considered in computing diluted earnings per common share for 2017 and 2016, respectively, because they were anti-dilutive.

Note 10. Stock-Based Compensation

During 2003, the company adopted an incentive stock plan which allowed key employees and directors to increase their personal financial interest in the company. This plan permitted the issuance of incentive stock options and non-qualified stock options. The plan expired on February 11, 2013 and, therefore, no additional options can be granted under the plan. All remaining options outstanding at the end of the prior year expired during 2017 and there are no options outstanding at December 31, 2017.

Note 10. Stock-Based Compensation (Continued)

A summary of option activity under the plan as of December 31, 2017, and changes during the year then ended is presented below:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life in Years | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at beginning of year | 22 014 | $15.60 | | |
| Exercised | - - | - - | | |
| Forfeited | - - | - - | | |
| Expired | (22 014) | 15.60 | | |
| Outstanding at end of year | - - | $ - - | 0.0 | $- - |
| Exercisable at end of year | - - | $ - - | 0.0 | $- - |

Note 11. Income Taxes

The company files income tax returns in the U. S. Federal jurisdiction and the states of West Virginia and Maryland. With few exceptions, the company is no longer subject to U. S. Federal, state and local income tax examinations by tax authorities for years prior to 2014.

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Net deferred tax assets (in thousands) consist of the following components as of December 31, 2017 and 2016:

| | 2017 | 2016 |
|---|---|---|
| Deferred tax assets: | | |
| Reserve for loan losses | $278 | $ 352 |
| Accrued pension expense | 52 | 595 |
| Accrued postretirement benefits | 83 | 163 |
| Nonaccrual interest | 184 | 264 |
| Stock option expense | - - | 35 |
| Net loan origination fees | 44 | 112 |
| Net operating loss carry forward | - - | 3 |
| OREO valuation allowance | 34 | 49 |
| OREO built in gain | 31 | 34 |
| Securities available for sale | 56 | - - |
| | $762 | $1 607 |
| Deferred tax liabilities: | | |
| Depreciation | $160 | $ 206 |
| Gain on intangible | 4 | 7 |
| Securities available for sale | - - | 63 |
| | $164 | $ 276 |
| Net deferred tax assets | $598 | $1 331 |

Note 11. Income Taxes (Continued)

The provision for income taxes charged to operations for the years ended December 31, 2017 and 2016 consists of the following (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Current tax expense | $1 375 | $1 175 |
| Deferred tax expense (benefit) | 419 | (7) |
| Deferred tax asset adjustment for enacted change in tax rate | 314 | - - |
| | $2 108 | $1 168 |

Income tax expense for 2017 includes a downward adjustment of net deferred tax assets in the amount of $314 thousand, recorded as a result of H.R.1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced the corporate federal tax rate from 34% to 21% effective January 1, 2018.

The income tax provision differs from the amount of income tax determined by applying the federal income tax rate to pretax income for the years ended December 31, 2017 and 2016 due to the following (in thousands):

| | 2017 | 2016 |
|---|---|---|
| Computed "expected" tax expense | $2 012 | $1 151 |
| Increase (decrease) in income taxes resulting from: | | |
| Tax impact from enacted change in rate | 314 | - - |
| Tax exempt income | (395) | (122) |
| State income tax expense, net of federal benefit | 127 | 91 |
| Other | 50 | 48 |
| | $2 108 | $1 168 |

The realization of deferred income tax assets is assessed, and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. Management considers all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed. Management's assessment is primarily dependent on historical taxable income and projections of future taxable income, which are directly related to the company's core earnings capacity and its prospects to generate core earnings in the future. Projections of core earnings and taxable income are inherently subject to uncertainty and estimates that may change given the uncertain economic outlook, banking industry conditions and other factors. Based upon an analysis of available evidence, management has determined that it is "more likely than not" that the company's deferred income tax assets as of December 31, 2017 will be fully realized and therefore no valuation allowance to the company's deferred income tax assets was recorded. However, the company can give no assurance that in the future its deferred income tax assets will not be impaired because such determination is based on projections of future earnings and the possible effect of certain transactions, which are subject to uncertainty and based on estimates that may change due to changing economic conditions and other factors. Due to the uncertainty of estimates and projections, it is possible that the company will be required to record adjustments to the valuation allowance in future reporting periods.

Note 12. Commitments and Contingent Liabilities

In the normal course of business, there are outstanding various commitments and contingent liabilities which are not reflected in the accompanying financial statements. The company does not anticipate losses as a result of these transactions. See Note 15 with respect to financial instruments with off-balance-sheet risk.

The company must maintain a reserve against its deposits in accordance with Regulation D of the Federal Reserve Act. For the final bi-weekly reporting periods which included December 31, 2017 and 2016, this requirement was met by the amount of vault cash.

In the normal course of business, the company may be involved in various legal proceedings. Based on the information presently available, management believes that the ultimate outcome in such proceedings, in the aggregate, will not have a material adverse effect on the business or the financial condition or results of operations of the company.

The table below presents the contractual obligations of the company as of December 31, 2017 not disclosed in other notes (in thousands):

| | Lease Obligations For Real Estate | Lease Obligations For Equipment |
|---|---|---|
| 2018 | $ 158 | $ 75 |
| 2019 | 212 | 37 |
| 2020 | 209 | - - |
| 2021 | 196 | - - |
| 2022 | 163 | - - |
| Thereafter | 716 | - - |
| | $1 654 | $112 |

Note 13. Retained Earnings

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the bank to the company. The approval of the State Banking Commissioner is required if the total of all dividends declared in any calendar year exceeds the bank’s net profits for that year combined with its retained net profits for the preceding two calendar years.

At January 1, 2018 the bank had available $4.6 million for the payment of dividends.

In addition, dividends paid by the bank to the company would be prohibited if the effect thereof would cause the bank’s capital to be reduced below applicable minimum capital requirements.

Note 14. Accumulated Other Comprehensive Income (Loss)

The balances in accumulated other comprehensive (loss) are shown in the following table (in thousands):

| | Net Unrealized Gains (Losses) on Securities | Adjustments Related to Pension and Other Post Retirement Benefits | Accumulated Other Comprehensive Loss, net |
|---|---|---|---|
| Balance at December 31, 2015 | $ 62 | $(2 289) | $(2 227) |
| Net unrealized holding gains (losses) on securities, net of tax of $26 | 43 | - - | 43 |
| Change in benefit obligation and plan assets for pension and other postretirement benefits, net of tax of $46 | - - | (75) | (75) |
| Balance at December 31, 2016 | 105 | (2 364) | (2 259) |
| Net unrealized holding gains (losses) on securities, net of tax of $149 | (242) | - - | (242) |
| Change in benefit obligation and plan assets for pension and other postretirement benefits, net of tax of $151 | - - | 246 | 246 |
| Stranded tax effects from change in tax law | (31) | (442) | (473) |
| Balance at December 31, 2017 | $ (168) | $(2 560) | $(2 728) |

The following table presents information on amounts reclassified out of accumulated other comprehensive loss, by category during the years ended December 31, 2017 and 2016 (in thousands):

| | 2017 | 2016 | Affected Line Item on the Consolidated Statements of Income |
|---|---|---|---|
| Available for sale securities | | | |
| Realized gains on securities available for sale, net | $ 302 | $ 121 | Gains on sales of securities available for sale |
| Tax effect | 115 | 46 | Income tax expense |
| Net of tax | 187 | 75 | Net of tax |
| Pension and other postretirement benefits | | | |
| Amortization of net actuarial loss (1) | $(291) | $(275) | Salaries and employee benefits |
| Tax effect | (111) | (105) | Income tax expense |
| Net of tax | $(180) | $(170) | Net of tax |
| Total reclassifications for the period | $ 7 | $ (95) | Net of tax |

(1) This accumulated other comprehensive loss component is included in the computation of net pension benefit cost (see Note 8 Employee Benefit Plans for additional details).

Note 15. 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. Those financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, 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 borrowers for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the contract or notional amount of the company's exposure to off-balance-sheet risk as of December 31, 2017 and 2016 (in thousands) is as follows:

| | 2017 | 2016 |
|---|---|---|
| Financial instruments whose | | |
| amounts represent credit risk: | | |
| Commitments to extend credit | $40 408 | $48 413 |
| Standby letters of credit | 549 | 823 |

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The company evaluates each customer's credit-worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the company upon extension of credit, is based on management's credit evaluation of the borrower. Collateral held varies but typically is cash or real estate.

Unfunded commitments under commercial lines of credit are commitments for possible future extensions of credit to existing customers. The majority of the lines of credit are collateralized and usually contains a specified maturity date.

Standby letters of credit are conditional commitments issued by the company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The company generally holds collateral supporting those commitments if deemed necessary.

Note 16. Fair Value Measurements

Determination of Fair Value

The company uses fair value measurements to record fair value adjustments for certain assets and to determine fair value disclosures. In accordance with the Fair Value Measurements and Disclosures topic of FASB ASC, the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

Note 16. Fair Value Measurements (Continued)

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the company groups its financial assets and financial liabilities generally measured 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 fair value.

Level 1—Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2—Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3—Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by the company in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amounts of cash and cash equivalents approximate fair values.

Certificates of Deposits with Other Financial Institutions

Fair value for certificates of deposits with other financial institutions was estimated using discounted cash flow analysis.

Securities

Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2). Certain of the equity securities with inactive markets utilize level 3 which may include judgment or estimation.

Loans

Fair values for loans were estimated using discounted cash flow analyses. Valuation methods for impaired loans are described below.

Loans Held for Sale

The fair value of loans held for sale is based on outstanding commitments from investors.

FHLB Stock

The carrying amounts of FHLB stock approximate fair value based on redemption provisions of the FHLB.

Bank Owned Life Insurance (BOLI)

The carrying amounts of BOLI approximate fair value.

Deposit Liabilities

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using discounted cash flow analysis.

Short-Term Borrowings

The carrying amounts of borrowings under repurchase agreements and federal funds purchased approximate fair value.

FHLB Advances

The fair values of the company's FHLB advances are estimated using discounted cash flow analysis based on the company's incremental borrowing rates for similar types of borrowing arrangements.

Accrued Interest

The carrying amounts of accrued interest approximate fair value.

Off-Balance Sheet Financial Instruments

At December 31, 2017 and 2016, the fair value of loan commitments and standby-letters of credit was immaterial. Therefore, they have not been included in the following table.

Note 16. Fair Value Measurements (Continued)

The carrying amounts and estimated fair values of the company's financial instruments are as follows (in thousands):

| | | Fair Value Measurements at December 31, 2017 Using | | | |
|---|---|---|---|---|---|
| | Carrying Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance |
| **Assets** | | | | | |
| Cash and cash equivalents | $ 27 820 | $27 820 | $ - - | $ - - | $ 27 820 |
| Certificates of deposits in other financial institutions | 5 250 | - - | 5 217 | - - | 5 217 |
| Securities available for sale | 31 316 | - - | 31 216 | 100 | 31 316 |
| Loans, net | 343 178 | - - | - - | 339 864 | 339 864 |
| FHLB Stock | 854 | - - | 854 | - - | 854 |
| BOLI | 7 279 | - - | 7 279 | - - | 7 279 |
| Accrued interest receivable | 963 | - - | 963 | - - | 963 |
| **Liabilities** | | | | | |
| Deposits | $372 159 | $ - - | $371 261 | $ - - | $371 261 |
| Securities sold under agreement to repurchase | 3 825 | - - | 3 825 | - - | 3 825 |
| FHLB advances | 11 538 | - - | 11 411 | - - | 11 411 |
| Accrued interest payable | 219 | - - | 219 | - - | 219 |

| | | Fair Value Measurements at December 31, 2016 Using | | | |
|---|---|---|---|---|---|
| | Carrying Value | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance |
| **Assets** | | | | | |
| Cash and cash equivalents | $ 9 727 | $ 9 727 | $ - - | $ - - | $ 9 727 |
| Certificates of deposits in other financial institutions | 1 750 | - - | 1 759 | - - | 1 759 |
| Securities available for sale | 23 411 | - - | 23 311 | 100 | 23 411 |
| Loans, net | 329 397 | - - | - - | 327 872 | 327 872 |
| FHLB Stock | 594 | - - | 594 | - - | 594 |
| BOLI | 7 993 | - - | 7 993 | - - | 7 993 |
| Accrued interest receivable | 832 | - - | 832 | - - | 832 |
| **Liabilities** | | | | | |
| Deposits | $333 871 | $ - - | $333 921 | $ - - | $333 921 |
| Securities sold under agreement to repurchase | 6 112 | - - | 6 112 | - - | 6 112 |
| FHLB advances | 7 545 | - - | 7 508 | - - | 7 508 |
| Accrued interest payable | 182 | - - | 182 | - - | 182 |

Note 16. Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis

The following table presents the balances (in thousands) of financial assets measured at fair value on a recurring basis as of December 31, 2017 and 2016:

| Description | Balance as of December 31 2017 | Fair Value Measurements at December 31, 2017 Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Available for sale debt securities | | | | |
| U.S. Government sponsored agency securities | $28 690 | $- - | $28 690 | $ - - |
| State and municipal securities | 2 508 | - - | 2 508 | - - |
| Total available for sale debt securities | 31 198 | - - | 31 198 | - - |
| Available for sale equity securities | | | | |
| Financial services industry | 118 | - - | 18 | 100 |
| Total available for sale securities | $31 316 | $- - | $31 216 | $100 |

| Description | Balance as of December 31 2016 | Fair Value Measurements at December 31, 2016 Using: Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Available for sale debt securities | | | | |
| U.S. Government sponsored agency securities | $20 053 | $- - | $20 053 | $ - - |
| State and municipal securities | 2 133 | - - | 2 133 | - - |
| Total available for sale debt securities | 22 186 | - - | 22 186 | - - |
| Available for sale equity securities | | | | |
| Financial services industry | 1 225 | - - | 1 125 | 100 |
| Total available for sale securities | $23 411 | $- - | $23 311 | $100 |

Assets Measured at Fair Value on a Recurring Basis Using Significant Unobservable Inputs (Level 3)

| Asset | Quantitative information about Level 3 Fair Value Measurement for December 31, 2017: Fair Value (000s) | Valuation Technique(s) | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| Available for sale equity securities | | | | |
| Financial services industry | $100 | Approximate book value | Lack of marketability | 0% |

Note 16. Fair Value Measurements (Continued)

| Asset | Fair Value (000s) | Valuation Technique(s) | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| | Quantitative information about Level 3 Fair Value Measurement for December 31, 2016 | | | |
| Available for sale equity securities | | | | |
| Financial services industry | $100 | Approximate book value | Lack of marketability | 0% |

| | Fair Value Measurements Using Significant Unobservable Inputs (Level 3) ($ in thousands) Available for Sale Equity Securities |
|---|---|
| Beginning Balance January 1, 2017 | $ 100 |
| Transfers into Level 3 | - - |
| Transfers out of Level 3 | - - |
| Ending Balance December 31, 2017 | $ 100 |

Assets Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis in accordance with generally accepted accounting principles.

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

Impaired Loans: ASC 820 applies to loans measured for impairment at an observable market price (if available), present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by a licensed appraiser outside of the company using observable market data. In certain instances an internal independent collateral valuation may be performed to determine value. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statements of income. The carrying values of all impaired loans are considered to be Level 3.

Note 16. Fair Value Measurements (Continued)

Other Real Estate Owned: Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of ASC 820.

Real estate acquired through foreclosure is transferred to other real estate owned (OREO). The measurement of loss associated with OREO is based on the fair value of the collateral less anticipated selling costs compared to the unpaid loan balance. The value of real estate collateral is determined based on an internal evaluation, appraisal outside of the company, or comparative market analysis. Any fair value adjustments are recorded in the period incurred and expensed against current earnings. The carrying values of all OREO are considered to be Level 3.

The following table summarizes the company's assets that were measured at fair value (in thousands) on a nonrecurring basis as of December 31, 2017 and 2016.

| | | Carrying Value at December 31, 2017 | | |
|---|---|---|---|---|
| Description | Balance as of December 31, 2017 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Input (Level 2) | Significant Unobservable Input (Level 3) |
| Assets | | | | |
| Impaired Loans with a valuation allowance | $4 156 | $ - - | $- - | $4 156 |
| OREO | 220 | - - | - - | 220 |

| | | Carrying Value at December 31, 2016 | | |
|---|---|---|---|---|
| Description | Balance as of December 31, 2016 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Input (Level 2) | Significant Unobservable Input (Level 3) |
| Assets | | | | |
| Impaired Loans with a valuation allowance | $3 936 | $ - - | $- - | $3 936 |
| OREO | 656 | - - | - - | 656 |

| | Quantitative information about Level 3 Fair Value Measurement for December 31, 2017 | | | |
|---|---|---|---|---|
| | Fair Value (000s) | Valuation Technique(s) | Unobservable Input | Range (Weighted Average) |
| Asset | | | | |
| Impaired loans with a valuation allowance | $4 156 | Appraisal and income or market valuation | Market discount | 0% - 100% (18.3%) |
| OREO | $ 220 | Appraisal and income or market valuation | Market discount | 0% - 100% (39.2%) |

| | Quantitative information about Level 3 Fair Value Measurement for December 31, 2016 | | | |
|---|---|---|---|---|
| | Fair Value (000s) | Valuation Technique(s) | Unobservable Input | Range (Weighted Average) |
| Asset | | | | |
| Impaired loans with a valuation allowance | $3 936 | Appraisal and income or market valuation | Market discount | 0% - 100% (4.4%) |
| OREO | $ 656 | Appraisal and income or market valuation | Market discount | 0% - 100% (16.8%) |

Note 17. Regulatory Matters

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As part of the new requirements, the Common Equity Tier 1 Capital (CET1) ratio is calculated and utilized in the assessment of capital for banking institutions. Under Basel III capital guidelines, Bank of Charles Town is required to maintain minimum total capital, CET1 capital, Tier 1 capital, and Tier 1 capital leverage ratios of 8.0%, 4.5%, 6.0%, and 4.0%, respectively. Failure to meet minimum capital requirements can initiate certain mandatory, possibly additional discretionary, actions by regulators. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The bank had a capital conservation buffer of 5.18% as of December 31, 2017.

The implementation of a capital conservation buffer began on January 1, 2016 and is phased in over a four-year period until it reaches 2.5% on January 1, 2019. When fully phased in, the minimum total capital, CET1 capital, and Tier 1 capital will be 10.5%, 7.0%, and 8.5%, respectively. There is no capital conservation buffer for the Tier 1 Leverage ratio.

The bank's actual capital amounts and ratios are presented in the table.

| | Actual | | Minimum Required – Basel III Phase-In Schedule | | Required To Be Considered Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (in thousands) | | | |
| As of December 31, 2017: | | | | | | |
| Total capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $41 698 | 13.18% | $29 259 | 9.25% | $31 631 | 10.0% |
| CET 1 capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $38 108 | 12.05% | $18 188 | 5.75% | $20 560 | 6.5% |
| Tier 1 capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $38 108 | 12.05% | $22 933 | 7.25% | $25 305 | 8.0% |
| Tier 1 Leverage (to average assets): | | | | | | |
| Bank of Charles Town | $38 108 | 8.79% | $17 339 | 4.00% | $21 675 | 5.0% |

| | Actual | | Minimum Required – Basel III Phase-In Schedule | | Required To Be Considered Well Capitalized | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | (in thousands) | | | |
| As of December 31, 2016: | | | | | | |
| Total capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $37 610 | 12.14% | $26 721 | 8.625% | $30 981 | 10.0% |
| CET 1 capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $34 408 | 11.11% | $15 878 | 5.125% | $20 138 | 6.5% |
| Tier 1 capital (to risk-weighted assets): | | | | | | |
| Bank of Charles Town | $34 408 | 11.11% | $20 525 | 6.625% | $24 785 | 8.0% |
| Tier 1 Leverage (to average assets): | | | | | | |
| Bank of Charles Town | $34 408 | 8.98% | $15 318 | 4.00% | $19 148 | 5.0% |

Note 18. Parent Company Only Financial Statements

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Balance Sheets
December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| ASSETS | | |
| Cash | $ 389 | $ 13 |
| Investment in subsidiary | 35 378 | 31 982 |
| Equity securities available for sale, at fair value | 118 | 1 225 |
| Other assets | 1 | - - |
| Total Assets | $35 886 | $33 220 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| LIABILITIES | | |
| Other liabilities | $ 67 | $ 37 |
| Total Liabilities | $ 67 | $ 37 |
| STOCKHOLDERS' EQUITY | | |
| Common stock | $ 3 672 | $ 3 672 |
| Surplus | 3 944 | 3 944 |
| Undivided profits | 34 425 | 31 043 |
| Accumulated other comprehensive loss, net | (2 728) | (2 259) |
| | $39 313 | $36 400 |
| Less cost of shares acquired for the treasury | (3 494) | (3 217) |
| Total Stockholders' Equity | $35 819 | $33 183 |
| Total Liabilities and Stockholders' Equity | $35 886 | $33 220 |

Note 18. Parent Company Only Financial Statements (Continued)

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Statements of Income
Years Ended December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| Income | | |
| Dividends from subsidiary | $ 499 | $ 901 |
| Gain on sales of securities available for sale | 302 | - - |
| Other income | - - | 1 |
| Total Income | $ 801 | $ 902 |
| | | |
| Expenses | | |
| Public relations & new business development | $ 4 | $ 6 |
| Transfer agent expense | 29 | 27 |
| Director and committee fees | 21 | 10 |
| Legal fees | 4 | - - |
| Other professional fees | 24 | 21 |
| Postage | 6 | 6 |
| Proxy solicitation | 10 | 9 |
| Printing, stationery and supplies | 15 | 13 |
| Other taxes | 1 | 1 |
| Total Expenses | $ 114 | $ 93 |
| | | |
| Income before Income Tax Expense (Benefit) and Equity in Undistributed Income of Subsidiary | $ 687 | $ 809 |
| | | |
| Income Tax Expense (Benefit) | 99 | (31) |
| | | |
| Income before Equity in Undistributed Income of Subsidiary | $ 588 | $ 840 |
| | | |
| Equity in Undistributed Income of Subsidiary | 3 223 | 1 378 |
| Net Income | $3 811 | $2 218 |

Note 18. Parent Company Only Financial Statements (Continued)

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Statements of Cash Flows
Years Ended December 31, 2017 and 2016
(in thousands)

| | 2017 | 2016 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | $ 3 811 | $ 2 218 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Equity in undistributed income of Subsidiary | (3 223) | (1 378) |
| Deferred tax expense | 35 | - - |
| Gain on sale of securities available for sale | (302) | - - |
| Increase in other assets | (1) | - - |
| Increase (decrease) in other liabilities | 99 | (1) |
| Net cash provided by operating activities | $ 419 | $ 839 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Proceeds from sale of securities available for sale | $ 1 136 | $ - - |
| Net cash provided by investing activities | $ 1 136 | $ - - |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Purchase of treasury shares | $ (277) | $ - - |
| Cash dividends | (902) | (836) |
| Net cash used in financing activities | $(1 179) | $ (836) |
| Increase in cash and cash Equivalents | $ 376 | $ 3 |
| CASH AND CASH EQUIVALENTS | | |
| Beginning | $ 13 | $ 10 |
| Ending | $ 389 | $ 13 |

Note 19. Subsequent Events

In preparing these financial statements, the company has evaluated events and transactions for potential recognition or disclosure through March 15, 2018, the date the financial statements were available to be issued. In the opinion of management, all subsequent events requiring recognition or disclosure have been included in the consolidated annual statements.

(This page intentionally left blank.)

SERVICE
OPEN
Authentic
GENUINE
Honest
COMMUNITY
Responsive
TEAMWORK
TRUSTED
Relationship
LOCAL
WELCOME
Flexible



EQUAL HOUSING LENDER
Member FDIC