Peoples Ltd. and Subsidiaries

Financial Statements

December 31, 2018 and 2017

bakertilly

Table of Contents

December 31, 2018 and 2017

	Page
Independent Auditors' Report	1
Financial Statements	
Consolidated Balance Sheet	2
Consolidated Statement of Income	3
Consolidated Statement of Comprehensive Income	4
Consolidated Statement of Changes in Shareholders' Equity	5
Consolidated Statement of Cash Flows	6
Notes to Consolidated Financial Statements	7

bakertilly

Independent Auditors' Report

To the Board of Directors of
Peoples Ltd. and Subsidiaries

We have audited the accompanying consolidated financial statements of Peoples Ltd. and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Baker Tilly Virchow Krause, LLP

Wilkes-Barre, Pennsylvania
March 26, 2019

Baker Tilly Virchow Krause, LLP trading as Baker Tilly is a member of the global network of Baker Tilly International Ltd., the members of which are separate and independent legal entities. © 2018 Baker Tilly Virchow Krause, LLP

Peoples Ltd. and Subsidiaries

Consolidated Balance Sheet
December 31, 2018 and 2017
(In thousands, except share amounts)

	2018	2017
Assets		
Cash and due from banks	$ 29,534	$ 24,506
Available-for-sale securities	98,131	92,331
Loans, net	231,793	214,962
Cash surrender value, life insurance	2,435	6,322
Bank premises and equipment	4,887	5,195
Accrued interest receivable	929	921
Restricted equity securities	1,541	1,539
Deferred income taxes	845	578
Other assets	1,103	1,514
Total	$ 371,198	$ 347,868
Liabilities and Shareholders' Equity		
Liabilities		
Demand deposits:		
Noninterest-bearing	$ 67,097	$ 68,586
Interest-bearing	94,046	80,334
Total	161,143	148,920
Savings deposits	56,511	52,599
Time deposits	99,922	91,616
Total deposits	317,576	293,135
Borrowed funds	19,000	23,000
Accrued interest payable	126	97
Other liabilities	1,589	1,858
Total liabilities	338,291	318,090
Shareholders' Equity		
Common stock, $.50 par value, authorized 2,000,000 shares 2018 - 650,356 shares issued, 635,701 outstanding 2017 - 620,244 shares issued, 605,609 outstanding	325	310
Surplus	14,344	12,334
Retained earnings	20,612	19,043
Treasury stock, at cost	(512)	(511)
Accumulated other comprehensive loss	(1,862)	(1,398)
Total shareholders' equity	32,907	29,778
Total	$ 371,198	$ 347,868

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statement of Income
Years Ended December 31, 2018 and 2017
(In thousands, except per share amounts)

	2018	2017
Interest Income		
Interest and fees on loans	$ 11,500	$ 10,772
Interest and dividends on investments:		
Taxable interest and dividends	2,229	1,478
Nontaxable interest	486	499
Total interest income	14,215	12,749
Interest Expense		
Interest on deposits	1,843	1,232
Interest on borrowed funds	339	250
Total interest expense	2,182	1,482
Net Interest Income	12,033	11,267
Provision for Loan Losses	525	260
Net Interest Income After Provision for Loan Losses	11,508	11,007
Noninterest Income		
Service charges	1,210	1,225
Gain on sale of loans	652	688
Commissions	121	93
Increase in cash surrender value, life insurance	60	97
Gain on life insurance settlement	1,168	-
Gain (loss) on foreclosed assets	3	(85)
Other income	336	593
Total noninterest income	3,550	2,611
Noninterest Expenses		
Salaries and employee benefits	5,076	4,939
Occupancy and equipment	1,117	1,147
Data processing	586	523
Pennsylvania shares tax	280	236
Professional fees	256	213
FDIC insurance	183	173
Other expenses	1,939	1,732
Total noninterest expenses	9,437	8,963
Income Before Provision for Income Taxes	5,621	4,655
Provision for Income Taxes	780	1,628
Net Income	$ 4,841	$ 3,027
Earnings Per Share	$ 7.62	$ 4.76

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statement of Comprehensive Income
Years Ended December 31, 2018 and 2017
(In thousands)

	2018	2017
Net Income	$ 4,841	$ 3,027
Other Comprehensive Income (Loss)		
Unrealized gain (loss) on available-for-sale securities	(587)	24
Tax effect	123	(8)
Total other comprehensive income (loss)	(464)	16
Total Comprehensive Income	$ 4,377	$ 3,043

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statement of Changes in Shareholders' Equity
Years Ended December 31, 2018 and 2017
(In thousands, except share amounts)

	Common Stock		Treasury Stock				Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Surplus	Retained Earnings	Loss	Total
Balance, January 1, 2017	591,569	$ 296	14,621	$ (510)	$ 10,486	$ 18,780	$ (1,184)	$ 27,868
Net income						3,027		3,027
Other comprehensive income							16	16
Reclassification due to adoption of ASU 2018-02						230	(230)	-
Purchase of treasury stock			14	(1)				(1)
Cash dividend ($1.94 per share)						(1,119)		(1,119)
5% stock dividend	28,675	14			1,848	(1,875)		(13)
Balance, December 31, 2017	620,244	310	14,635	(511)	12,334	19,043	(1,398)	29,778
Net income						4,841		4,841
Other comprehensive loss							(464)	(464)
Purchase of treasury stock			20	(1)				(1)
Cash dividend ($2.04 per share)						(1,236)		(1,236)
5% stock dividend	30,112	15			2,010	(2,036)		(11)
Balance, December 31, 2018	650,356	$ 325	14,655	$ (512)	$ 14,344	$ 20,612	$ (1,862)	$ 32,907

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statement of Cash Flows
Years Ended December 31, 2018 and 2017
(In thousands)

	2018	2017
Operating Activities		
Net income	$ 4,841	$ 3,027
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	525	260
Depreciation	436	449
Amortization and accretion, net	(65)	25
Gain on sale of loans	(652)	(688)
Loans originated for sale	(20,910)	(23,763)
Proceeds from sale of loans originated for sale	22,217	23,272
Writedown on foreclosed assets	45	95
Gain on sale of foreclosed assets	(3)	(10)
Gain on sale of equipment	(2)	(3)
Deferred income taxes	(144)	390
Change in cash surrender value, life insurance	(60)	(97)
Gain on life insurance settlement	(1,168)	-
Change in:		
Accrued interest receivable	(8)	(88)
Other assets	(3)	(326)
Accrued interest payable	29	34
Other liabilities	47	(125)
Net cash provided by operating activities	5,125	2,452
Investing Activities		
Proceeds from calls and maturities of available-for-sale securities	11,260	12,606
Purchase of available-for-sale securities	(17,582)	(14,154)
Proceeds from redemption of restricted equity securities	175	524
Purchase of restricted equity securities	(177)	(874)
Net increase in loans	(18,029)	(8,500)
Life insurance premiums paid	(128)	(16)
Proceeds from bank owned life insurance death benefit	4,927	-
Purchase of bank premises and equipment	(128)	(1,189)
Proceeds from sale of equipment	2	4
Proceeds from the sale of foreclosed assets	390	290
Net cash used in investing activities	(19,290)	(11,309)
Financing Activities		
Net increase in deposits	24,441	20,568
Proceeds from borrowed funds	6,000	18,000
Repayment of borrowed funds	(10,000)	(14,706)
Dividends paid	(1,247)	(1,132)
Purchase of treasury stock	(1)	(1)
Net cash provided by financing activities	19,193	22,729
Increase in Cash and Due from Banks	5,028	13,872
Cash and Due from Banks, Beginning of Year	24,506	10,634
Cash and Due from Banks, End of Year	$ 29,534	$ 24,506

See notes to consolidated financial statements

1. Nature of Operations and Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Peoples Ltd. and its wholly-owned subsidiaries, PS Bank (the "Bank") and DEPPLL Corp. (collectively, the "Company"). All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations

The Company provides a full range of basic financial services to individuals, small businesses and corporate customers through offices in Bradford, Lackawanna, Sullivan and Wyoming counties of Pennsylvania. The area is a rural and suburban market with an economic base made up of light manufacturing, retail and agricultural businesses. The Company's primary deposit products are demand deposits and interest bearing time and savings accounts. It offers a full array of loan products to meet the needs of retail and commercial customers.

The Bank is subject to regulation by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. Peoples Ltd. is subject to regulation by the Federal Reserve Bank of Philadelphia.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of investment securities.

In connection with the determination of the allowance for loan losses, management generally obtains independent appraisals for significant properties. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The Company's investment securities are comprised of a variety of financial instruments. The fair values of these securities are subject to various risks including changes in the interest rate environment and general economic conditions. Due to the increased level of these risks and their potential impact on the fair values of the securities, it is possible that the amounts reported in the accompanying consolidated financial statements could materially change in the near term.

Significant Group Concentrations of Credit Risk

The Company grants loans to customers primarily located in Bradford, Lackawanna, Sullivan and Wyoming counties of Pennsylvania. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic sector in which the Company operates. The Company does not have any significant concentrations from one industry or customer.

Investments

Debt and equity securities are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income (loss).

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale securities below their costs that are deemed to be credit-related are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Restricted Equity Securities

Restricted equity securities are carried at cost.

The Company, as a member of the Pittsburgh branch of the Federal Home Loan Bank system ("FHLB"), is required to maintain an investment in capital stock of the FHLB. The carrying value of this stock was $1,530,600 at December 31, 2018 and $1,529,000 at December 31, 2017. Based on redemption provisions of the FHLB, the stock has no quoted market value. The Company is also required to maintain an investment in the Atlantic Community Bankers Bank. The carrying value of this stock was $10,000 at December 31, 2018 and 2017.

Management considers whether these investments are impaired based on the ultimate recoverability of the cost basis rather than by recognizing temporary declines in value. Management believes no impairment has occurred related to these investments at December 31, 2018 and 2017.

Loans

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 outstanding unpaid principal balances adjusted for unearned income, the allowance for loan losses, and any unamortized deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield over the contractual life of the loan using the interest method.

The loan receivable portfolio is segmented into commercial, residential, municipal and consumer loans. Commercial loans include commercial and industrial and commercial real estate loans. Residential loans include 1-4 family mortgage loans and home equity loans. Consumer loans consist of personal installment loans and municipal loans consist of loans to local municipalities and authorities. The segments of the Company's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. Common risk characteristics include loan type, collateral type and geographic location.

For all classes of loans receivable except certain residential loans, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. For residential loans that are well secured and in the process of collection, the accrual of interest is discontinued after one year of past due payments. When a loan is placed on nonaccrual status, unpaid interest is reversed against interest income. Interest received on nonaccrual loans, including impaired loans, is either applied to principal or recognized as interest income, depending on management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis (earlier in the event of bankruptcy) or if there is an amount deemed uncollectible.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components.

The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific allowance is established when the collateral value, observable market price, or discounted cash flows of the impaired loan is lower than the carrying value of that loan. A loan is considered impaired when, 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 records, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis. The Company does not separately evaluate individual residential and consumer loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted, when necessary, to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals, invoices or online pricing sources. Indications of value from these sources are generally discounted, as appropriate, based on the age of the financial information or the quality of the assets.

The general component covers pools of loans by loan class including loans not considered impaired, as well as smaller balance homogeneous loans, such as residential 1-4 family, home equity and consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates, adjusted for qualitative risk factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.

2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.

3. Nature and volume of the portfolio and terms of loans.

4. Experience, ability, and depth of lending management and staff.

5. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.

6. Existence and effect of any concentrations of credit and changes in the level of such concentrations.

7. Oversight, including the impact of banking laws and regulations as well as the overall regulatory environment.

8. External factors which may have either a direct or indirect impact on the quality of the loan portfolio.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for residential, municipal and consumer loans. Credit quality risk ratings include classifications of pass, special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are immediately charged to the allowance for loan losses. Loans not classified are rated pass. To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process encompassing both internal and external oversight. Generally, residential and consumer loans are included in the pass category unless on nonaccrual status at which time they are classified as substandard, or they are associated with a closely related criticized commercial credit. The Company's commercial loan officers are responsible for the timely and accurate risk rating of the commercial loans in their portfolio at origination and on an ongoing basis. The Company utilizes an external loan review consultant to conduct a loan review of its portfolio each year. The external consultant generally reviews all commercial loan relationships exceeding a specified threshold.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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

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

The Company made no significant changes to its accounting policies or methodologies for the allowance for loan losses in 2018 or 2017.

Revenue Recognition

The Company earns income from various sources, including loans, investment securities, bank-owned life insurance, deposit accounts, and sales of assets.

Interest income on loans is accrued on the unpaid principal balance and recorded daily. 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. Other loan fees, including late charges, are recognized as they occur.

Interest income on debt securities is recognized on the accrual basis. Purchase premiums and discounts are recognized using the interest method over the term of the securities. Dividends on equity securities are recorded when declared.

Service charges on deposits include maintenance and analysis fees, overdraft fees and automated teller machine (“ATM”) fees. Revenue is recognized when the Company’s performance obligation is completed which is generally monthly for account services or when a transaction has been completed. Payment for service charges on deposit accounts is received immediately or in the following month through a direct charge to customers’ accounts.

Commissions are received from third parties based on the sale of the third party’s investment and insurance products to the Company’s customers. The Company’s performance obligation is complete when the sale occurs.

Other income includes other fees and revenue which are generally transactional in nature and are recorded as they occur.

Gains or losses on sales of assets are generally recognized when the asset has been legally transferred to the buyer and the Company has no continuing involvement with the asset. The Company does not generally finance the sale.

Cash Surrender Value, Life Insurance

The Company is the owner and beneficiary of life insurance policies on certain employees and directors. The life insurance investment is carried at the cash surrender value of the underlying owned policies. The increase in the cash surrender value is recognized as a component of noninterest income. The policies can be liquidated, if necessary, with tax costs associated. However, the Company intends to hold these policies and, accordingly, the Company has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Bank Premises and Equipment

Bank premises (including leasehold improvements) and equipment are carried at cost, less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated lives of the assets for owned assets or the lesser of the lease term or the estimated lives of the assets for leasehold improvements.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses.

Foreclosed assets totaled $230,000 and $645,000 at December 31, 2018 and 2017, respectively, and are included in other assets. Foreclosed assets include $67,500 and $ 275,000 of residential real estate at December 31, 2018 and 2017, respectively. Residential real estate in process of foreclosure was $366,000 and $678,000 at December 31, 2018 and 2017, respectively.

Income Taxes

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities. Enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company recognizes interest and penalties on income taxes as a component of income tax expense.

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 - put presumptively beyond the 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.

Advertising Costs

Advertising costs are expensed as incurred and totaled $147,000 in 2018 and $165,000 in 2017.

Earnings Per Share

Earnings per share is based on the weighted average number of shares of common stock outstanding. 2017 earnings per share is adjusted for the effect of the 2018 stock dividend. The Company's basic and diluted earnings per share are the same since there are no dilutive shares of potential common stock outstanding.

Treasury Stock

Treasury stock is recorded at cost. The subsequent disposition or sale of the treasury stock is recorded using the average cost method.

Statement of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks.

Interest paid totaled $2,153,000 in 2018 and $1,448,000 in 2017. The Company paid $1,050,000 of income tax payments in 2018 and $1,350,000 in 2017. Amounts transferred from loans to foreclosed assets were $18,000 in 2018 and $348,000 in 2017.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists solely of the net unrealized losses on available-for-sale securities, net of deferred income taxes. Accumulated other comprehensive loss consists of net unrealized losses of $2,357,000 less deferred income taxes of $495,000 at December 31, 2018 and $1,770,000 less deferred income taxes of $372,000 at December 31, 2017.

Reclassifications

Certain 2017 amounts have been reclassified to conform to the 2018 reporting format.

Subsequent Events

Subsequent events were evaluated for recognition or disclosure through March 26, 2019, the date the consolidated financial statements were available to be issued.

Recent Accounting Standards

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU No. 2014-09 establishes principles for recognizing revenue upon the transfer of promised goods or services to customers, in an amount that reflects the expected consideration received in exchange for those goods or services. ASU 2014-09 was effective for the Company in 2018. The Company adopted the guidance using the modified retrospective method. The adoption did not have a significant effect on the Company's consolidated financial statements as the recognition of interest income has been scoped out of the guidance and noninterest income recognition is similar to previous revenue recognition practices. The Company expanded its disclosures with respect to its noninterest income as a result of this guidance. See the "Revenue Recognition" section in Note 1.

In January 2016, the FASB issued ASU 2016-01, *Recognition and Measurement of Financial Assets and Liabilities*. This makes significant changes in U.S. GAAP related to certain aspects of recognition, measurement, presentation and disclosure of financial instruments. Among other changes, the ASU (1) eliminates the requirement to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (2) requires use of 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 (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (4) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The guidance was effective for the Company in 2018. The adoption did not have a significant effect on the Company's consolidated financial statements, but the Company has revised its fair value measurement of financial instruments to include an exit price notion.

In February 2016, the FASB issued ASU 2016-02 *Leases* which will require organizations that lease assets to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with lease terms of more than 12 months. Consistent with current U.S. GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease by the lessee will primarily depend on its classification as a finance or operating lease. However, unlike current U.S. GAAP, which requires only capital leases to be recognized on the balance sheet, the new ASU will require both types of leases to be recognized on the balance sheet. ASU 2016-02 will also require disclosures to help investors and other financial statement users better understand the amount, timing and uncertainty of cash flows arising from leases. The new disclosures will include both qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. ASU 2016-02 is effective for the Company in 2019. The Company is in the process of evaluating the potential impact of adopting this ASU.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. ASU No. 2016-13 requires financial assets measured at amortized cost to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. ASU No. 2016-13 is effective for the Company in 2021. The Company is in the process of evaluating the potential impact of adopting this ASU.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. ASU No. 2016-15 addresses eight cash flow issues with specific guidance on how certain cash receipts and cash payments should be presented on the statement of cash flows, including the presentation of proceeds from the settlement of bank owned life insurance policies. The guidance was effective for the Company in 2018. The Company has classified the proceeds it received in 2018 on the settlement of bank owned life insurance policies as an investing activity as required by the standard.

2. Investments

The amortized cost and fair value of available-for-sale securities at December 31 are summarized as follows (in thousands):

	December 31, 2018			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
U.S. government sponsored enterprises ("GSE")	$ 17,972	$ 1	$ 382	$ 17,591
State and municipal obligations	26,855	25	460	26,420
Mortgage-backed securities - GSE - residential	55,593	89	1,638	54,044
Total debt securities	100,420	115	2,480	98,055
Other securities	68	8	-	76
Total	$ 100,488	$ 123	$ 2,480	$ 98,131
U.S. government sponsored enterprises ("GSE")	$ 17,970	$ 1	$ 353	$ 17,618
State and municipal obligations	27,454	145	253	27,346
Mortgage-backed securities, GSE – residential	48,609	1	1,319	47,291
Total debt securities	94,033	147	1,925	92,255
Other securities	68	8	-	76
Total	$ 94,101	$ 155	$ 1,925	$ 92,331

Investments with a fair value of $41,436,000 at December 31, 2018 and $37,099,000 at December 31, 2017 are pledged as collateral to secure public deposits and for other purposes as required by law.

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

	Amortized Cost	**Fair Value**
Due in one year or less	$ 2,791	$ 2,781
Due after one year through five years	28,754	28,287
Due after five years through fifteen years	13,282	12,943
Subtotal	44,827	44,011
Mortgage-backed securities, GSE - residential	55,593	54,044
Total	$ 100,420	$ 98,055

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous loss position (in thousands):

	December 31, 2018					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government sponsored enterprises ("GSE")	$ 998	$ 2	$ 15,592	$ 380	$ 16,590	$ 382
State and municipal obligations	10,723	115	10,886	345	21,609	460
Mortgage-backed securities, GSE - residential	5,668	42	38,088	1,596	43,756	1,638
Total debt securities	$ 17,389	$ 159	$ 64,566	$ 2,321	$ 81,955	$ 2,480
	December 31, 2017					
U.S. government sponsored enterprises ("GSE")	$ 1,987	$ 13	$ 13,628	$ 340	$ 15,615	$ 353
State and municipal obligations	947	15	10,925	238	11,872	253
Mortgage-backed securities, GSE - residential	11,790	138	34,723	1,181	46,513	1,319
Total debt securities	$ 14,724	$ 166	$ 59,276	$ 1,759	$ 74,000	$ 1,925

The Company had 159 debt securities in unrealized loss positions at December 31, 2018. The unrealized losses are considered to result from changes in interest rates and not from downgrades in the creditworthiness of the issuers. In analyzing an issuer's financial condition, management considers whether the securities are general obligation or revenue bonds, whether they are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The Company does not intend to sell these securities nor is it more likely than not that it will be required to sell these securities prior to recovery. No declines are deemed to be other-than-temporary.

3. Loans and Allowance for Loan Losses

Loans at December 31 are summarized as follows (in thousands):

	2018	2017
Mortgage loans on real estate:		
Residential 1-4 family	$ 80,204	$ 79,643
Commercial real estate	82,927	76,275
Home equity	26,519	23,503
Total mortgage loans on real estate	189,650	179,421
Commercial and industrial	33,003	27,682
Municipal	9,786	7,363
Consumer	1,858	2,768
Total loans	234,297	217,234
Allowance for loan losses	(2,504)	(2,272)
Loans, net	$ 231,793	$ 214,962

The Company had $524 and $1,179 of residential mortgage loans held for sale at December 31, 2018 and 2017, respectively, which are included above. These loans are carried at the lower of cost or fair value.

Changes in the allowance for loan losses in 2018 are as follows (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance, January 1, 2018	$ 550	$ 1,011	$ 120	$ 289	$ 11	$ 28	$ 263	$ 2,272
Charge-offs	(24)	(214)	-	(4)	-	(104)	-	(346)
Recoveries	-	-	-	4	-	49	-	53
Provision	53	314	23	44	9	47	35	525
Ending balance, December 31, 2018	$ 579	$ 1,111	$ 143	$ 333	$ 20	$ 20	$ 298	$ 2,504
Ending balance individually evaluated for impairment	$ -	$ 136	$ -	$ -	$ -	$ -	$ -	$ 136
Ending balance collectively evaluated for impairment	$ 579	$ 975	$ 143	$ 333	$ 20	$ 20	$ 298	$ 2,368
Loans receivable at December 31, 2018:								
Total balance	$ 80,204	$ 82,927	$ 26,519	$ 33,003	$ 9,786	$ 1,858	$ -	$ 234,297
Ending balance individually evaluated for impairment	$ 497	$ 2,273	$ 160	$ -	$ -	$ -	$ -	$ 2,930
Ending balance collectively evaluated for impairment	$ 79,707	$ 80,654	$ 26,359	$ 33,003	$ 9,786	$ 1,858	$ -	$ 231,367

Changes in the allowance for loan losses in 2017 are as follows (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance, January 1, 2017	$ 467	$ 1,031	$ 139	$ 223	$ 11	$ 34	$ 234	$ 2,139
Charge-offs	(19)	(124)	-	-	-	(37)	-	(180)
Recoveries	6	32	-	-	-	15	-	53
Provision	96	72	(19)	66	-	16	29	260
Ending balance, December 31, 2017	$ 550	$ 1,011	$ 120	$ 289	$ 11	$ 28	$ 263	$ 2,272
Ending balance individually evaluated for impairment	$ 15	$ 249	$ -	$ -	$ -	$ -	$ -	$ 264
Ending balance collectively evaluated for impairment	$ 535	$ 762	$ 120	$ 289	$ 11	$ 28	$ 263	$ 2,008
Loans receivable at December 31, 2017:								
Total balance	$ 79,643	$ 76,275	$ 23,503	$ 27,682	$ 7,363	$ 2,768	$ -	$ 217,234
Ending balance individually evaluated for impairment	$ 97	$ 2,551	$ 161	$ -	$ -	$ -	$ -	$ 2,809
Ending balance collectively evaluated for impairment	$ 79,546	$ 73,724	$ 23,342	$ 27,682	$ 7,363	$ 2,768	$ -	$ 214,425

The following table summarizes information on impaired loans by loan portfolio class at December 31 (in thousands):

	December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential 1-4 family	$ 497	$ 584	$ -	$ 586	$ 7
Commercial real estate	1,773	1,792	-	1,900	108
Home equity	160	160	-	164	10
With an allowance recorded:					
Residential 1-4 family	-	-	-	-	-
Commercial real estate	500	720	136	549	-
Home equity	-	-	-	-	-
Total:					
Residential 1-4 family	497	584	-	586	7
Commercial real estate	2,273	2,512	136	2,449	108
Home equity	160	160	-	164	10
	December 31, 2017				
With no related allowance recorded:					
Residential 1-4 family	$ -	$ -	$ -	$ -	$ -
Commercial real estate	1,819	1,819	-	1,883	109
Home equity	161	161	-	167	11
With an allowance recorded:					
Residential 1-4 family	97	97	15	99	6
Commercial real estate	732	863	249	868	44
Home equity	-	-	-	-	-
Total:					
Residential 1-4 family	97	97	15	99	6
Commercial real estate	2,551	2,682	249	2,751	153
Home equity	161	161	-	167	11

The following table presents information on nonaccrual loans by loan portfolio class at December 31 (in thousands):

	2018	2017
Residential 1-4 family	$ 558	$ 79
Commercial real estate	681	732
Home equity	31	52
Total	$ 1,270	$ 863

The following table presents information on the loan portfolio classes by the Company's internal risk ratings system at December 31, 2018 (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Total
Pass	$ 79,579	$ 80,744	$ 26,342	$ 32,967	$ 9,786	$ 1,858	$ 231,276
Special mention	-	-	-	-	-	-	-
Substandard	625	2,183	177	36	-	-	3,021
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	$ 80,204	$ 82.927	$ 26,519	$ 33,003	$ 9,786	$ 1,858	$ 234,297

The following table presents information on the loan portfolio classes by the Company's internal risk ratings system at December 31, 2017 (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Total
Pass	$ 79,493	$ 73,676	$ 23,323	$ 27,645	$ 7,363	$ 2,768	$ 214,268
Special mention	-	-	-	-	-	-	-
Substandard	150	2,599	180	37	-	-	2,966
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	$ 79,643	$ 76,275	$ 23,503	$ 27,682	$ 7,363	$ 2,768	$ 217,234

The following table presents information on the loan portfolio classes by past due status at December 31, 2018 (in thousands):

	30-59 Days Past Due	60-89 Day Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment ≥ 90 Days and Accruing
Residential 1-4 family	$ 600	$ -	$ 659	$ 1,259	$ 78,945	$ 80,204	$ 101
Commercial real estate	-	-	680	680	82,247	82,927	-
Home equity	184	55	32	271	26,248	26,519	1
Commercial and industrial	-	21	-	21	32,982	33,003	-
Municipal	-	-	-	-	9,786	9,786	-
Consumer	8	-	-	8	1,850	1,858	-
Total	$ 792	$ 76	$ 1,371	$ 2,239	$ 233,058	$ 234,297	$ 102

The following table presents information on the loan portfolio classes by past due status at December 31, 2017 (in thousands):

	30-59 Days Past Due	60-89 Day Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment ≥ 90 Days and Accruing
Residential 1-4 family	$ 611	$ 377	$ 916	$ 1,904	$ 77,739	$ 79,643	$ 857
Commercial real estate	53	-	794	847	75,428	76,275	62
Home equity	84	62	94	240	23,263	23,503	42
Commercial and industrial	-	16	-	16	27,666	27,682	-
Municipal	-	-	-	-	7,363	7,363	-
Consumer	-	1	5	6	2,762	2,768	5
Total	$ 748	$ 456	$ 1,809	$ 3,013	$ 214,221	$ 217,234	$ 966

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring ("TDR"). The Company may modify loans through rate reductions, extensions of maturity, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are generally considered impaired loans for purposes of calculating the Company's allowance for loan losses.

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

There were no TDRs made in 2018 and 2017. No TDRs defaulted in 2018 or 2017.

There are no commitments to lend additional funds to borrowers whose loans were modified.

4. Bank Premises and Equipment

Bank premises and equipment at December 31 is summarized as follows (in thousands):

	2018	2017
Land	$ 1,360	$ 1,360
Bank premises	5,910	5,893
Equipment, furniture and fixtures	5,408	5,312
Total	12,678	12,565
Less accumulated depreciation	7,791	7,370
Net	$ 4,887	$ 0

5. Deposits

The aggregate amount of certificates of deposit with a minimum denomination of $250,000 was $23,644,000 and $18,888,000 at December 31, 2018 and 2017, respectively.

At December 31, 2018, the scheduled maturities of time deposits are as follows (in thousands):

Years ending December 31:	
2019	$ 63,343
2020	21,947
2021	7,142
2022	5,045
2023	2,444
Total	$ 99,992

6. Borrowed Funds

The Company has a maximum borrowing capacity with the FHLB of $123,396,000, including a $58,000,000 line of credit. The Company had no borrowings under the line at December 31, 2018 and 2017. The Company has used $375,000 in 2018 and 2017 of its borrowing capacity to issue irrevocable letters of credit to collateralize public deposits. Advances from the FHLB are secured by qualifying assets of the Company, which include FHLB stock, certain U.S. government sponsored enterprise securities, and first mortgage loans.

The Company has a $2,500,000 unsecured federal funds borrowing agreement with Atlantic Community Bankers Bank. There were no borrowings at December 31, 2018 and 2017.

Borrowed funds from FHLB consisted of the following at December 31 (in thousands):

	2018	2017
Fixed rate advances:		
Due in 2018	$ -	$ 10,000
Due in 2019	16,000	13,000
Due in 2020	3,000	-
Total	$ 19,000	$ 23,000

The weighted average interest rate was 1.89% in 2018 and 1.40% in 2017.

7. Income Taxes

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

	2018	2017
Current	$ 924	$ 1,230
Deferred	(144)	398
Total	$ 780	$ 1,628

A reconciliation between the effective income tax expense and the amount computed using the federal statutory rate of 21% in 2018 and 34% in 2017 is as follows:

	2018	2017
Federal income tax expense at statutory rate	$ 1,181	$ 1,580
Effect of:		
Tax-exempt income	(416)	(287)
Federal tax rate change	-	358
Other items	15	(23)
Total	$ 780	$ 1,628

The following temporary differences gave rise to the net deferred tax asset at December 31 (in thousands):

	2018	2017
Deferred tax assets:		
Allowance for loan losses	$ 356	$ 246
Deferred compensation	48	53
Other	14	10
Unrealized losses on available-for-sale securities	495	372
Total deferred tax assets	913	681
Deferred tax liabilities,		
Depreciation	(68)	(103)
Total	$ 845	$ 578

A valuation allowance has not been established as the Company believes that the deferred tax assets are more likely than not realizable.

The Company had no unrecognized tax benefits at December 31, 2018 and 2017. There were no interest and penalties recognized in 2018 and 2017.

8. Retirement Plan

The Company sponsors a defined contribution retirement plan. Retirement plan expense was $264,000 in 2018 and $201,000 in 2017.

9. Financial Instruments with Off-Balance-Sheet Risk

Overview

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. Unless noted otherwise, the Company does not require collateral or other security to support financial instruments with off-balance-sheet credit risk.

Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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 creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Company upon extension of credit, is based on management's credit evaluation.

Unfunded commitments under commercial lines-of-credit and revolving credit lines are commitments for possible future extensions of credit to existing customers. These commitments may or may not be collateralized and usually contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. 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.

Collateral Requirements

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate. The Company has not incurred any losses on its commitments in either 2018 or 2017.

Financial instruments whose contract amount represents credit risk were as follows (in thousands):

	2018	2017
Commitments to extend credit	$ 39,616	$ 31,698
Standby letters of credit	3,245	2,882

10. Leases

The Company leases certain of its offices under the terms of lease agreements classified as operating leases. These agreements expire at varying dates. Rent expense was $246,000 in 2018 and $266,000 in 2017.

Minimum future payments as of December 31, 2018 under noncancelable operating leases are as follows (in thousands):

Years ending December 31:	
2019	$ 140,000
2020	128,000
2021	128,000
2022	128,000
2023	128,000
Thereafter	364,000
Total	$ 1,015,000

11. Related Party Transactions

The Company has granted loans to principal officers, directors, significant shareholders (greater than 10%) and their affiliates. The following table summarizes the activity in these loans (in thousands):

	2018	2017
Balance, beginning	$ 1,325	$ 772
New loans	4,890	983
Repayment	(2,068)	(430)
Balance, ending	$ 4,147	$ 1,325

Related party deposits were $3,570,000 at December 31, 2018 and $2,161,000 at December 31, 2017.

12. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by state and federal banking agencies. The final rules implementing BASEL Committee on Banking Supervisor's Capital Guidance for U.S. banks (BASEL III rules) became effective for the Company 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. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the bank to maintain minimum amounts and ratios (set forth in the following table) of total, common equity Tier 1 and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2018, that the Bank meets all capital adequacy requirements to which they are subject.

The Federal Reserve Bank has established capital guidelines for bank holding companies. These guidelines allow small bank holding companies, as defined, an exemption from regulatory capital requirements. Peoples Ltd. meets the eligibility criteria and is exempt from regulatory capital requirements. The Bank’s capital ratios are shown below:

	December 31, 2018					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 37,172	14.5 %	$ ≥20,521	≥8.0 %	$ ≥25,652	≥10.0 %
Common equity Tier 1 (CET1) capital (to risk-weighted assets)	34,668	13.5	≥11,543	≥4.5	≥16,674	≥ 6.5
Tier 1 capital (to risk-weighted assets)	34,668	13.5	≥15,391	≥6.0	≥20,521	≥ 8.0
Tier 1 capital (to average assets)	34,668	9.3	≥14,978	≥4.0	≥18,723	≥ 5.0

	December 31, 2017					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 33,334	14.7 %	$ ≥18,154	≥8.0 %	$ ≥22,692	≥10.0 %
Common equity Tier 1 (CET1) capital (to risk-weighted assets)	31,062	13.7	≥10,211	≥4.5	≥14,750	≥ 6.5
Tier 1 capital (to risk-weighted assets)	31,062	13.7	≥13,615	≥6.0	≥18,154	≥ 8.0
Tier 1 capital (to average assets)	31,062	9.1	≥13,634	≥4.0	≥17,042	≥ 5.0

Federal and state banking regulations place certain restrictions on dividends paid by the Bank to Peoples Ltd. The amount of total dividends is generally limited to the retained earnings of the Bank. However, dividend payments would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements as discussed above.

13. Fair Value Disclosures

Fair value is defined as an exit price representing the amount that would be received to sell an asset or settle a liability in an orderly transaction between market participants. A three-level hierarchy exists for fair value measurements based upon the inputs to the valuation of an asset or liability.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities;

Level 2 - Valuation is determined from quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 - Valuation is derived from model-based and other techniques in which at least one significant input is unobservable and which may be based on the Company's own estimates about the assumptions that a market participant would use to value the asset or liability.

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
U.S. government sponsored enterprises	$ 17,591	$ -	$ 17,591	$ -
State and municipal obligations	26,420	-	26,420	-
Mortgage-backed securities - GSE - residential	54,044	-	54,044	-
Total debt securities	98,055	-	98,055	-
Other securities	76	76	-	-
Total	$ 98,131	$ 76	$ 98,055	$ -

	December 31, 2017			
	Total	Level 1	Level 2	Level 3
U.S. government sponsored enterprises	$ 17,618	$ -	$ 17,618	$ -
State and municipal obligations	27,346	-	27,346	-
Mortgage-backed securities - GSE - residential	47,291	-	47,291	-
Total debt securities	92,255	-	92,255	-
Other securities	76	76	-	-
Total	$ 92,331	$ 76	$ 92,255	$ -

The classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Other securities are measured at fair value using quoted market prices in an active market for identical assets and are classified as Level 1 in the hierarchy. All debt securities are measured at fair value using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices and are classified as Level 2 in the hierarchy.

The following table presents the Company's financial instruments subject to fair value adjustments on a nonrecurring basis by level within the fair value hierarchy (in thousands):

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Impaired loans, net	$ 364	$ -	$ -	$ 364
Foreclosed assets	115	-	-	115
	December 31, 2017			
Impaired loans, net	$ 565	$ -	$ -	$ 565
Foreclosed assets	340	-	-	340

Impaired loans that are collateral dependent are written down to fair value through partial charge-offs or the establishment of specific reserves. Such collateral is primarily real estate whose value is based on appraisals performed by certified appraisers. These values are generally adjusted based on management's knowledge of changes in market conditions or other factors and include estimated liquidation expenses which are generally 10% of the collateral value. Management's assumptions of the collateral value include consideration of location and occupancy as well as condition of the property or asset. At December 31, 2018 and 2017, management adjustments to the collateral value for these factors ranged from 10% to 100%. Since the adjustments may be significant, are based on management's estimates and are generally unobservable, they have been classified as Level 3.

Assets taken in foreclosure of defaulted loans are measured at the lower of cost or fair value less costs to sell of 10%. The fair value of the real property is generally determined using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace, and the related nonrecurring fair value measurement adjustments have generally been classified as Level 3.

In addition to the disclosures of financial instruments recorded at fair value, U.S. GAAP requires the disclosure of the estimated fair value of all the Company's financial instruments. The majority of the Company's assets and liabilities are considered financial instruments. However, many of these instruments lack an available market. In addition, the Company's general practice and intent is to hold its financial instruments to maturity. The Company has considered the fair value measurement criteria as required under the accounting standard relating to fair value measurement as noted above. Fair value estimates have been determined based on the methodologies management considers most appropriate for each financial instrument.

The following are the carrying amounts and estimated fair values of the Company's financial instruments as of December 31 (in thousands):

	2018				
	Carrying Amount	**Estimated Fair Value**	**Level 1**	**Level 2**	**Level 3**
Financial assets:					
Cash and due from banks	$ 29,534	$ 29,534	$ 29,534	$ -	$ -
Available-for-sale securities	98,131	92,131	76	98,055	
Loans, net	231,793	232,004	-	-	232,004
Accrued interest receivable	929	929	-	929	-
Restricted equity securities	1,541	1,541	-	1,541	-
Financial liabilities:					
Deposits	317,576	316,839	-	316,839	-
Borrowed funds	19,000	18,921	-	18,921	-
Accrued interest payable	126	126	-	126	-
	2017				
Financial assets:					
Cash and due from banks	$ 24,506	$ 24,506	$ 24,506	$ -	$ -
Available-for-sale securities	92,331	92,331	76	92,255	-
Loans, net	214,962	220,548	-	-	220,548
Accrued interest receivable	921	921	-	921	-
Restricted equity securities	1,539	1,539	-	1,539	-
Financial liabilities:					
Deposits	293,135	292,592	-	292,592	-
Borrowed funds	23,000	22,758	-	22,758	-
Accrued interest payable	97	97	-	97	-

14. Gain on Life Insurance Settlement

As discussed in Note 1 to the consolidated financial statements, the Company is the owner and beneficiary of life insurance policies on certain employees and directors. During 2018, three of the insured individuals passed away. The Company received $4,927,000 in the settlement of the related policies. A gain on life insurance settlement of $1,168,000, representing the excess of the proceeds received over the carrying value, as well as the reversal of certain related liabilities, was recognized.