Banesco

ANNUAL REPORT


20
18

Banesco

# TABLE OF CONTENTS

# Banesco USA by The Numbers

# 13th Anniversary

5-Star Rating by Bauer Financial

**$1.28B**
In Total Assets

**$946.7MM**
Loan Portfolio

**$1.1B**
In Deposits

**$51.9MM**
2018 Annual Revenue

**$12.9MM**
2018 Annual Net Income

**18%**
2018 Increase in Net Interest Income

**10.58%**
Return on Equity

# Banesco USA Corp And Banesco Americas Corporation (The Group)

Banesco USA is part of Banesco Americas Corporation, a worldwide of financial institutions with presence in 16 countries. The largest bank by assets of the group, is the Spanish group Abanca.

Banesco Americas is organized in four fully independent holding companies that own domestic financial institutions.
It has more than US$62 billion in assets and more than 6 million clients.

**+ 11 thousand**
Employees

**+ 6 million**
Clients

**US$5,794**
million
Net Equity

# We Have 34 Years of History And Presence in 16 Countries. Our International Expansion Has Focused on Retail Banking And Trade Business.

**1985**
- We started with the creation of a brokerage house

**1992 1993**
- Banesco International Corp. (Puerto Rico) and Banesco International Bank (Panama) begin operations as banks off shores

**2006**
- BBU Bank (now Banesco USA) begins operations in South Florida

**2007**
- We establish our Holding in Spain
- Banesco Banesco Panama obtains the Commercial Bank license

**2010**
- Banesco International Corp. (Puerto Rico) merges with Banesco USA

**2011**
- Banesco Banco Multiple begins operations in the Dominican Republic

**2012 2013**
- Etcheverria - Banesco Panama opening representative office in Colombia
- Banesco Panama receives approval for the purchase of SFA Banco in Curaçao

**2014**
- Banesco Hispania acquires Nova Caixa Galicia and subsequently changes its commercial name to Abanca

**2015**
- Abanca opening representative office in Mexico City

**2017**
- Abanca opening representative office in Sao Paulo (Brazil)
- Abanca completes the acquisition of Popular Servicios Financieros

**2018**
- Abanca acquires Deutsche Bank PCC Portugal

American Expansion | European Expansion

1 — 3 — 3 — 4 — 4 — 5 — 8 — 12 — 12 — 14 — 16

\# No. of countries with presence

16 Countries:
Argentina, Brazil, Colombia, Curaçao, Dominican Republic, France, Germany, Mexico, Panama, Portugal, Puerto Rico, Spain, Switzerland, United Kingdom, USA, Venezuela

# Banesco International Leveraged on The Acquisition of Well Known Banking Franchises in Venezuela Since 1993...

| | | | | | | |
|---|---|---|---|---|---|---|
| Bancentro Group is acquired and the name changed to Banesco | Banesco acquires five) EAP (equivalent to american Savings and Loans) | The 5 EAP are merged and Caja Familia (Parallel Financial Institution) was born. | Banco Union (4th in Ranking) is acquired. Caja Familia EAP merged with La Primera EAP | Caja Familia EAP and Banco Union merged and Unibanca was created | The merger of Unibanca with Banesco Banco Universal was completed | Banesco attains the 1st place in the ranking by assets with solid financial reputation |
| 1991-1992 | 1993-1997 | 1998 | 2000 | 2001 | 2002 | 2007-2015 |
| 22 | 8 | 9 | 9 | 8 | 4 | 1 |

# ...And Simultaneously Started a Strategic International Expansion Focused on Retail Banking And Trade Business

**1992-1993**
Banesco International Corp. (Puerto Rico) and Banesco International Bank (Panama) begins operations as offshore banks

**2007**
Banesco Panama obtains the General Banking License

**2011**
Banesco Banco Multiple starts operations in the Dominican Republic

BBU Bank changes its name to Banesco USA

**2013**
-Banco Etcheverria obtains 63 offices of La Nova Caixa Galicia

- Banesco Hispania wins the bid to purchase Nova Caixa Galicia

**2015**
Abanca opens representative Office in Mexico City

**2018**
Abanca acquires Deutsche Bank PCC Portugal

**2006**
BBU Bank (now Banesco USA) begins operations in South Florida – USA as State Chartered FDIC regulated Bank

**2010**
Banesco International Corp. (Puerto Rico) is merged with BBU Bank

**2012**
- Banesco Panama opens a Representative Office in Colombia
- Banesco Panama receives authorization to buy SFA Bank in Curaçao
- Banesco obtains Banco Etchevarria

**2014**
- Banco Hispania takes control of Nova Caixa Galicia and changes its commercial name to Abanca

- Nova Caixa Galicia and Banco Etcheverria merge and Abanca Corp. Bancaria, S.A. is created

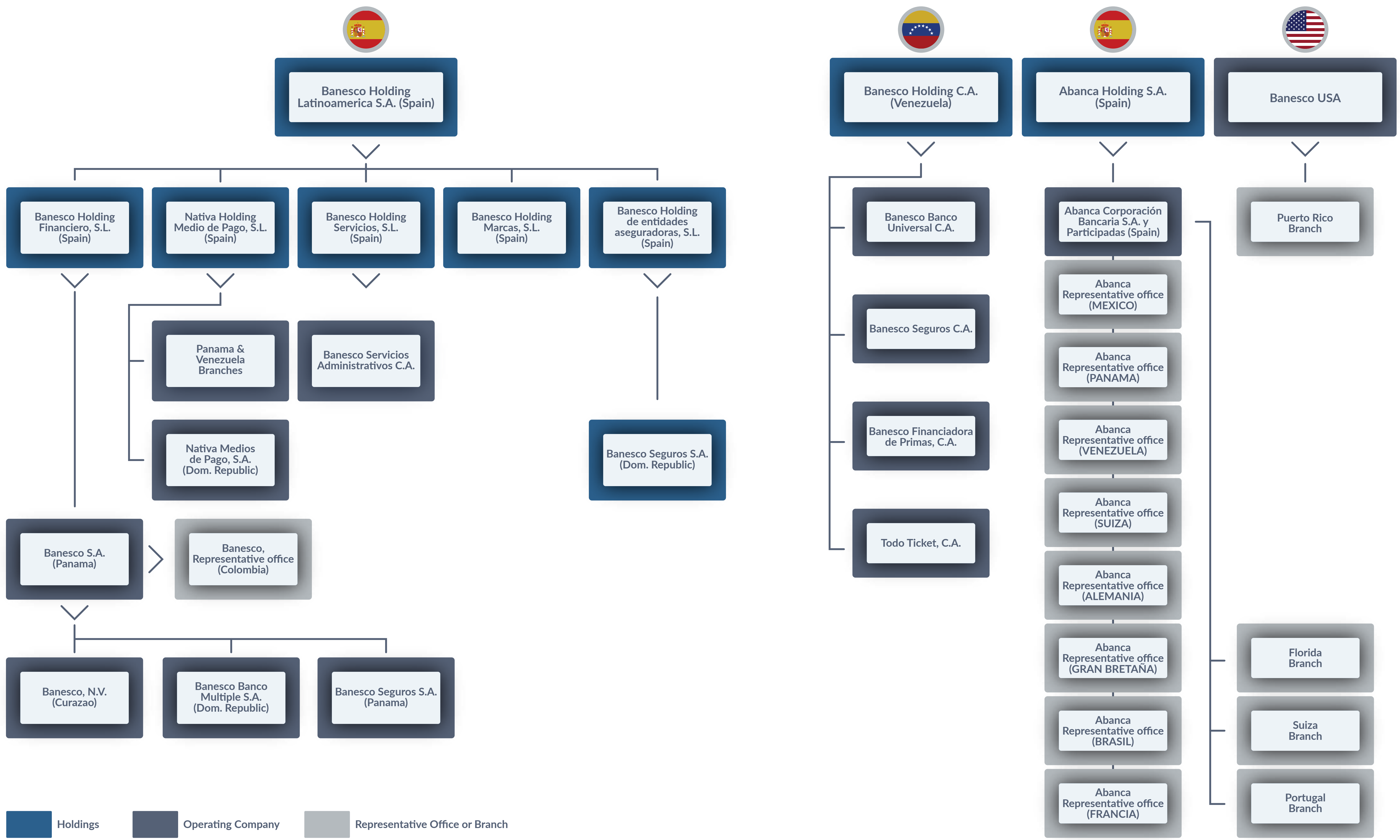
**2017**
Abanca opens representation office in Sao Paulo ( Brazil)

American Expansion | European Expansion

3 – 4 – 4 – 4 – 5 – 8 – 12 – 12 – 13 – 14 – 15

# No. of Countries with Presence

# Banesco International is Organized in Four Fully Independent Holding Companies That Owns Financial Institutions.




Banesco INTERNACIONAL
has more than $63 billion in assets and more than 7 million clients
Presence in 16 countries
US $6,057 million net equity
+7 million Clients
+12 thousand Employees
US $37,727 million Loan Portfolio
US $41,403 million in Deposits
1,077 Branches
US $63,078 million in Assets

# Corporate And Institutional Banking

Banesco USA's digital competency and use of technology to serve customers in innovative ways is uncommon among banks of its size. Not only are we technology-driven but we are also differentiated by our emphasis on local and personalized banking and today this is what Businesses demand in order to keep up with the market and succeed.

At Banesco USA we offer several business loans depending on the business specific reality and needs. As a community bank, growing and supporting our local businesses and the broader economy is part of our focus. That's why our decision-making process is local and takes place right here in our Coral Gables headquarters by people that understand local dynamics, know the neighborhoods and have the pulse of the area.

**Owner Occupied Loans**
For acquisition of fixed assets such as land and building, new construction or purchase and renovation.

**Commercial Lines of Credit**
For supplementing temporary working capital requirements or seasonal cash flow needs.

**Term Commercial Loans**
For the purchase of equipment with competitive interest rates and payment programs.

**Real Estate Investment Loans**
For the acquisition of real estate properties with the purpose of investment and income producing.

Banesco USA's Business Checking Accounts are designed for Businesses that have a significant amount of capital that require complex banking solutions and for those that are just starting out with basic checking needs. Our Business and Cash Management Services Include:

**BanescOnline:** Online Banking. View account balances and activity online, transfer funds, make payments, pay bills, create alerts and communicate with Banesco USA via secure messaging.

**BanescoMobile:** Mobile Banking.

**BanescoMobile Check Deposit:** Deposit checks to your account anytime, anywhere using your smartphone's camera.

**Banesco Visa® Check Card:** Easily and safely manage your Business Checking Account through your VISA@ Check Card. Prevent debit card fraud by monitoring your debit card usage from anywhere, 24/7 through email or text message.

*Merchant Services products and services are provided directly by First Data Merchant Services.

**Automatic Clearing House (ACH) Origination:** Securely send and/or receive electronic payments to make your operation more efficient. The transfer process is automated, convenient and predictable, giving you better control of your funds at less cost to your company.

**E-wires:** Transfer funds domestically and internationally through BanescOnline.

**Trusteer Rapport:** We offer this security software that detects malware risks.

**Remote Deposit Capture:** Through a small desk-top scanner you can deposit checks right from your office PC. Checks are cleared faster, funds are available faster and cash flow is improved.

**Digital Token:** A security feature enabled by an App that allows you to process online transactions quickly with an additional layer of security.

**Positive Pay:** A free service for business accounts that protects you from check fraud.

**Lock Box:** Comprehensive remittance processing to streamline receivables and reduce the potential of fraud and error. It also lets you receive client / consumer payments for faster cash flow of your business.

**Terminal & Point of Sale:** Accept virtually any payment type including Visa, Mastercard, Diners Club International, American Express, Discover Network, Pin-based or signature debit cards, gift cards and checks with our comprehensive suite of affordable terminals and peripherals.

**E-commerce:** Process online, phone or mail order payments through our state-of-the-art solutions that are convenient for your clients as well as secure and reliable for your business.

**Security and Compliance:** Our comprehensive security solutions protect your client's data during and after transactions. It helps defend your system against cyber-attacks in order to protect the success of your business.

"Most successful business owners and principals will agree that building a solid relationship with a business banker who understands your business is key. A good banker can help an owner throughout many years including different business cycles and stages of growth."

NELSON HIDALGO

# Banesco USA International Department

An international business, by definition, has either South Florida is home to many multinational companies. Therefore, we naturally have several individuals concerned with global banking services for transacting business.

For these international businesses, having a relationship with a bank that offers international banking services is essential. These services range from payment accounts to lending. An international bank will facilitate international business arrangements and transactions that may be unfeasible for domestic banks.

Banesco USA International Banking Services Banesco USA offers a wide range of international banking services including:

- **Experience:** Banesco USA's international roots create an institution attuned to the needs of diverse and increasingly international communities. This includes international personal banking services that are attractive to many business owners.

- **Presence:** Representative offices in 13 countries and territories via its affiliation with Banesco International and partner companies (Argentina, Colombia, Dominican Republic, France, Germany, Mexico, Panama, Portugal, Puerto Rico, Spain, Switzerland, United Kingdom, and Venezuela).

- **Business Checking Accounts:** With features like unlimited checks, no maintenance fees when maintaining the minimum daily balance required, online and mobile banking, electronic statements at no charge.

- **Business Savings Accounts:** With features to open savings accounts online, interest earned credited into your account at the end of the statement cycle, no maintenance fees when maintaining the minimum daily balance required, online and mobile banking, and electronic statements at no charge.

- **Money Market Accounts:** Immediate account access, interest earned credited into your account at the end of the statement cycle, no maintenance fees when maintaining the minimum daily balance required, online and mobile banking, electronic statements at no charge.

- **Certificates of Deposits:** Competitive rates and a wide variety of terms for international business customers, from 30 days to 5 years. You can choose your own payment schedule, either monthly, quarterly, semi-annually or at maturity. CDs are subject to early withdrawal penalties.

- **Partnership with Local Agency:** Where we refer our customers for investment needs.

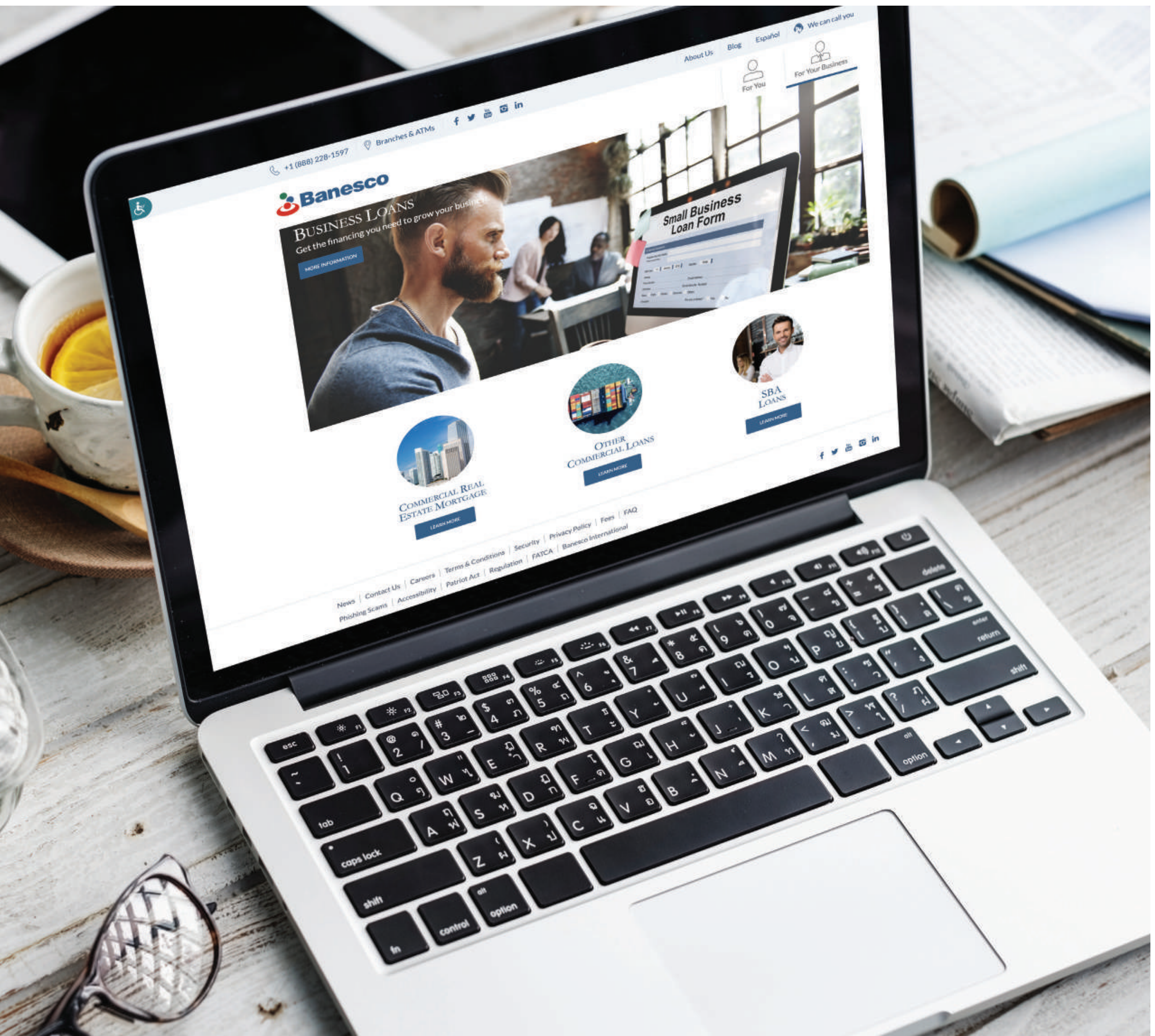
- **Foreign Correspondent Banking**

**LUIS GRAU**
**SENIOR VICE-PRESIDENT, HEAD OF INTERNATIONAL**

# Innovation at Banesco USA

Delivering excellence through innovation

Banesco USA's commitment to innovative banking is evident. Since 2016, Banesco USA has embraced an ambitious digital transformation initiative and roadmap of innovation. Its innovation roadmap featured the deployment of several advanced banking functionalities and frictionless technologies which included: The adoption of Net Promoter Score through fintech Satme- trix; An Online Account Opening Platform offered to nationwide customers and a revamped Client Care Center.




In 2018, the bank made commercial lending faster and easier in South Florida and Puerto Rico with the adoption of the #1 Commercial Loan Origination System in the USA, nCino. The nCino Bank Operating System employs automated workflow technology which controls and monitors the various steps in loan processing as well as electronic document management. This process eliminated the possibility of any potential delays associated with paper documents.

Also in 2018, the bank implemented a new Telephone Banking System, BanescoVoice which is easy to use, secure and available 24/7. With BanescoVoice customers can check account balances, activate debit cards, transfer funds and so much more.

Banesco USA customers will be able to apply for a loan online anywhere, even from their mobile devices. A real game - changer for community banks in South Florida.

At the end of the year, the bank launched a newly redesigned website with an accessibility feature which provides equal access to the site for people with disabilities.

The year's highlight was the partnership with Plug and Play a network startup accelerator program and corporate innovation platform. The deal enables Banesco USA to leverage the Plug and Play platform to explore partnerships with the aim of further innovating its consumer and commercial offerings as well as its customer experience. It allows Banesco USA to establish meaningful engagements with the best technology companies connected to the Plug and Play ecosystem, providing added fuel to Banesco USA's, growth and modernization strategies.


The bank's innovation strategy is scaling across all the organization. Internally, the bank also implemented the employee recognition program application, You Earned It which allows real-time recognition, collaboration and actionable insights that drive employee engagement and business results.
For 2019, Banesco USA is looking forward to a continuous path of innovation and technology investments that include:

A partnership with fintech, Q2ebanking to offer a new online & mobile banking platform that will maximize the integration of other bank systems in order to deliver the best user experience and functionality. The bank will support customers' business to the full extent through a single, unified customer interface resulting in a better digital customer journey.

The implementation of a new account opening on-boarding platform to deliver a better customer experience with faster service times.

The opening of a new business center in Aventura. This signature branch will welcome and engage customers in a newly-designed branch which combines digitization with human touch services to enable the customer to meet their daily banking needs as well as enjoy exploring the products and services to help them reach their financial goals. This new signature branch features a new generation Intelligent Teller Machines (ITM) to better connect with consumers within the branch. The new interior premium walk-up ATM features options including Interactive Teller for remote assisted service integration, as well as Interactive Banker for in-person assistance compatibility.

The pipeline also includes the adoption of process automatization using Robotic Process Automation (RPA); the merging form of business process automation technology based on the notion of software robots and artificial intelligence workers.
Banesco USA will continue to grow and transform, but its unwavering commitment of personal banking services will always remain.

***"Technology is the bloodstream of any institution in the USA and in the rest of the World. In South Florida, specifically, technology plays a critical role because it facilitates specific client requirements given the characteristics of this market. South Florida is the gateway to Latin America and the Caribbean; therefore technology, not only allows us to extend our presence beyond any physical frontiers but also, innovate more rapidly to keep with the demands of our customers."***

**Julio Valle**

# HUMAN RESOURCES

**Powered by our Employees**

Founded 13 years ago, the Bank's core model has always been centered around a team of responsive, dedicated, passionate and committed financial professionals that enables their customers to reach their personal and professional goals.

Everything we do is rooted in the following values:

RESPONSIBILITY:
- We respond to our obligations with accuracy and passion.
- We stand by our commitment.
- We use our time wisely.
- We give the best to everyone.

RELIABILITY:
- We tell the truth under any circumstance.
- We respond honestly.
- We acknowledge our mistakes.
- We ask for assistance when necessary.

QUALITY:
- We perform every task with the utmost care.
- We intend to be the best.
- We strive to exceed the expectations of our stakeholders.

INNOVATION:
- We are visionary. Offering new solutions.
- We seek ideas and technologies that promote change.

***"Banesco USA is an organization that embraces the personal and professional development of our team members. We aim to develop our talent by making a difference in the workplace and in our community."***

**Lettie Pino**

# Corporate Social Responsability
## Supporting Our Communities

Community involvement has always been part of Banesco USA's culture. It is part of our culture to give, not just monetarily but with our time, working handing in hand with the organizations we support such as Kapow, St. Jude Children's Hospital, and the Network For Teaching Entrepreneurship (NFTE).

In 2018, we announced an integrated company-wide corporate social responsibility strategy to address social, economic and environmental challenges over the next five years through products and services, culture and operations.

As part of this effort, we partnered with Fundación Comunitaria de Puerto Rico donating $20,000 that will go toward offering aid to Puerto Rico during its time of reconstruction and growth following the devastation of Hurricane Maria.

We also partnered with Junior Achievement, the world's largest non-profit organization, dedicated to giving students K-12 the knowledge and skills they need to own their economic success, plan their future and make smart academic and economic choices. Our employees provided relevant, hands-on experience in financial literacy, work readiness and entrepreneurship to these students.
Banesco USA also signed a commitment letter with Cristo Rey's Miami High School Corporate work-study program that will help students earn a private, college-preparatory education. The Cristo Rey model is an exciting and innovative way to address the educational needs of the underserved.

## Accomplishments

**240**
Volunteering Hours logged by Banesco USA Employees

**592**
People reached through financial education and other programs

**23**
Community Development Loans for apartment buildings and manufactured housing communities located in low or moderate income census tract.

## We support the following organizations:

Junior Achievement · Step Up for students · Fundación Comunitaria de Puerto Rico · Kapow · Cristo Rey Miami High School · St. Jude Children's Research Hospital · nfte!

# Condensed Consolidated Financial Statements

# BANESCO USA
## BALANCE SHEETS DECEMBER 31

| ASSETS | 2018 | 2017 |
|---|---|---|
| CASH AND CASH EQUIVALENTS: | | |
| Cash and due from banks | $ 5,964,365 | $ 6,736,099 |
| Interest bearing deposits in other financial institutions | 66,413,902 | 49,121,160 |
| TOTAL CASH AND CASH EQUIVALENTS | 72,378,267 | 55,857,259 |
| Investment securities available for sale | 214,477,485 | 169,036,780 |
| Investment securities held to maturity | 5,707,645 | 1,039,642 |
| Federal Home Loan Bank stock, at cost | 3,306,200 | 3,428,500 |
| Loans, net | 946,393,862 | 815,385,840 |
| Property and equipment, net | 2,278,811 | 2,095,030 |
| Accrued interest receivable | 3,825,984 | 2,932,431 |
| Deferred tax assets, net | 4,779,558 | 3,909,855 |
| Bank-owned life insurance | 20,994,377 | 20,305,083 |
| Prepaid expenses and other assets | 3,598,049 | 2,220,478 |
| TOTAL ASSETS | $ 1,277,740,238 | $ 1,076,210,898 |

| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
|---|---|---|
| DEPOSITS: | | |
| Noninterest bearing demand deposits | $ 391,901,070 | $ 358,846,508 |
| Interest bearing demand deposits | 120,700,050 | 107,989,198 |
| Money market and savings accounts | 199,538,090 | 209,359,022 |
| Time deposits | 385,169,492 | 240,282,661 |
| TOTAL DEPOSITS | 1,097,308,702 | 916,477,389 |
| Securities sold under agreements to repurchase | 412,330 | 646,790 |
| Federal Home Loan Bank advances | 55,000,000 | 60,000,000 |
| Accrued interest payable | 2,436,554 | 1,038,979 |
| Accrued expenses and other liabilities | 6,872,702 | 5,339,596 |
| TOTAL LIABILITIES | 1,162,030,288 | 983,502,754 |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, $5 par value; 16,000,000 and 6,000,000 shares authorized; 6,645,720 and 5,926,304 shares issued and outstanding in 2018 and 2017 | 33,228,600 | 29,631,520 |
| Additional paid-in capital | 59,152,209 | 50,842,927 |
| Retained earnings | 27,040,187 | 14,099,428 |
| Accumulated other comprehensive loss, net of taxes | (3,711,046) | (1,865,731) |
| TOTAL STOCKHOLDERS' EQUITY | 115,709,950 | 92,708,144 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 1,277,740,238 | $ 1,076,210,898 |

# Banesco USA

## Statements of Operations For The Years Ended December 31

| | 2018 | 2017 |
|---|---|---|
| INTEREST AND DIVIDEND INCOME: | | |
| Loan and fees on loans | $ 46,000,969 | $ 37,112,404 |
| Investment securities | 4,844,982 | 3,903,520 |
| Federal funds sold | 868,661 | 529,132 |
| Federal Home Loan Bank stock | 220,375 | 132,990 |
| TOTAL INTEREST AND DIVIDEND INCOME | 51,934,987 | 41,678,046 |
| INTEREST EXPENSES: | | |
| Deposits | 8,029,512 | 4,838,295 |
| Federal Home Loan Bank advances | 1,403,025 | 752,638 |
| Other borrowed funds | 16,283 | 9,451 |
| TOTAL INTEREST EXPENSES | 9,448,820 | 5,600,384 |
| NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES | 42,486,167 | 36,077,662 |
| (REVERSAL OF) PROVISION FOR LOAN LOSSES | (4,042,777) | 3,676,578 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 46,528,944 | 32,401,084 |
| NONINTEREST INCOME: | 5,369,852 | 4,815,356 |
| Service fees on loans and deposits | 689,294 | 305,083 |
| Banked-owned life insurance income | | |
| Gain on sales of investment securities, (includes $80,177 and $662,186 accumulated other comprehensive income reclassifications for unrealized net gains on available for sale securities, respectively) | 80,177 | 662,186 |
| Gain on resolution of acquired assets | 30,820 | 272,309 |
| Gain on sales of other real estate owned | - | 133,265 |
| Reversal of Provision for off-balance sheet | 215,834 | 247,976 |
| Commissions and other | 3,258,016 | 3,057,880 |
| TOTAL NONINTEREST INCOME | 9,643,993 | 9,494,055 |

# BANESCO USA
## STATEMENTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31

| | 2018 | 2017 |
|---|---|---|
| NONINTEREST EXPENSES: | | |
| Salaries and employee benefits | 24,901,666 | 21,446,985 |
| Occupancy | 2,959,106 | 2,861,328 |
| Professional fees | 2,461,204 | 2,571,213 |
| Electronic data processing | 2,367,950 | 1,663,296 |
| FDIC insurance | 741,912 | 791,356 |
| Depreciation and amortization | 912,445 | 985,611 |
| Advertising | 519,493 | 431,260 |
| Communication | 480,466 | 484,757 |
| Travel and entertainment | 333,829 | 204,269 |
| Insurance and license fees | 703,449 | 494,137 |
| Other | 1,650,926 | 1,179,559 |
| TOTAL NONINTEREST EXPENSES | 38,032,446 | 33,113,771 |
| INCOME BEFORE INCOME TAXES | 18,140,491 | 8,781,368 |
| PROVISION FOR INCOME TAXES, (includes approximately $20,000 and $249,000 of income tax expenses from reclassification items, respectively) | 5,199,732 | 5,232,069 |
| NET INCOME | $ 12,940,759 | 3,549,299 |

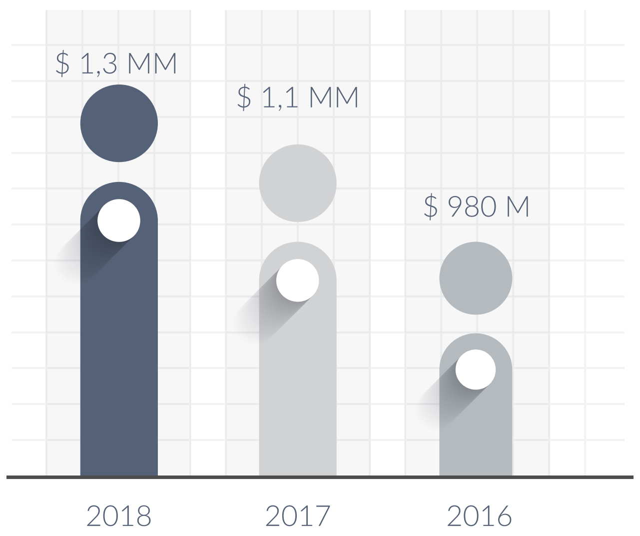
# BANESCO USA

## STATEMENTS OF COMPREHENSIVE INCOME FOR THE YEARS ENDED DECEMBER 31, 2018

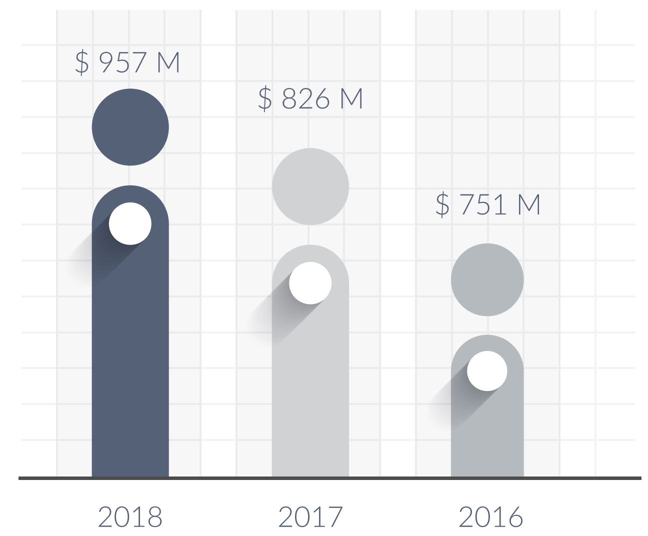
| 2018 | | |
|---|---|---|
| NET INCOME | | $ 12,940,759 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX | | |
| Unrealized gains (losses) on securities<br>Unrealized holding (losses) arising during period (net of income taxes of approximately $606,000) | $ (1,785,462) | |
| Less: reclassification adjustment for gains included in net income (net of income taxes of approximately $20,000) | (59,853) | (1,845,315) |
| COMPREHENSIVE INCOME | | $ 11,095,444 |

# Financial Highlights

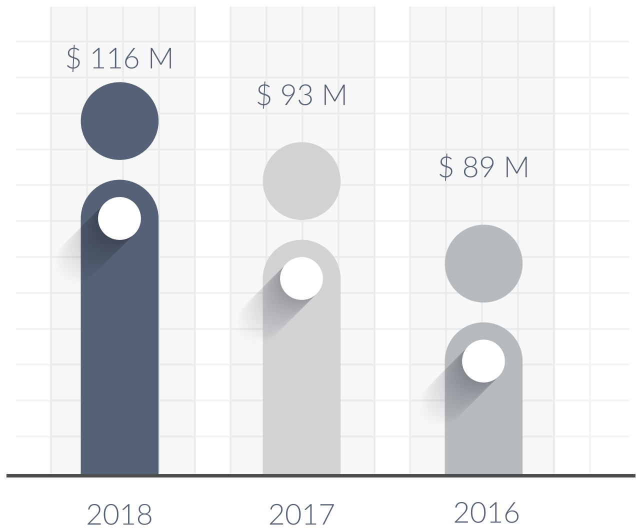
## Assets



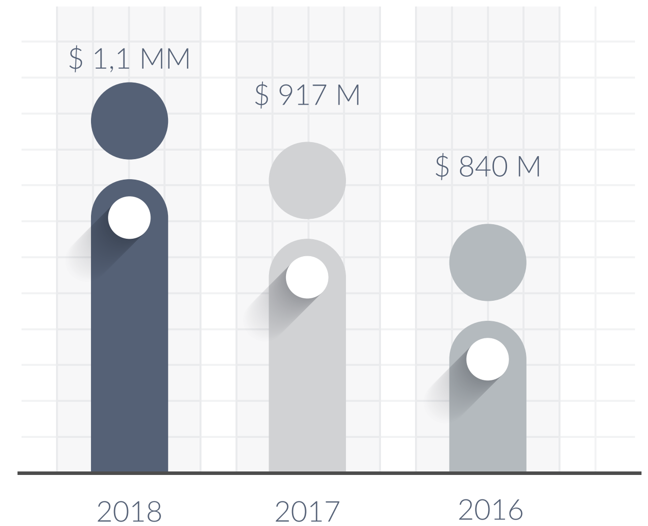

## Loans (Gross)



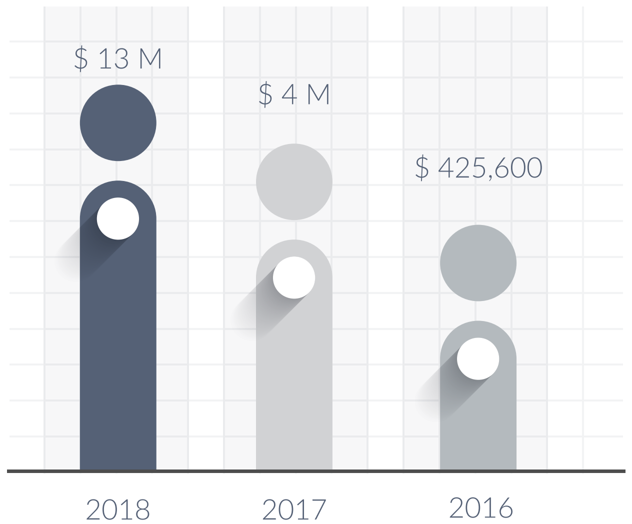

## Capital



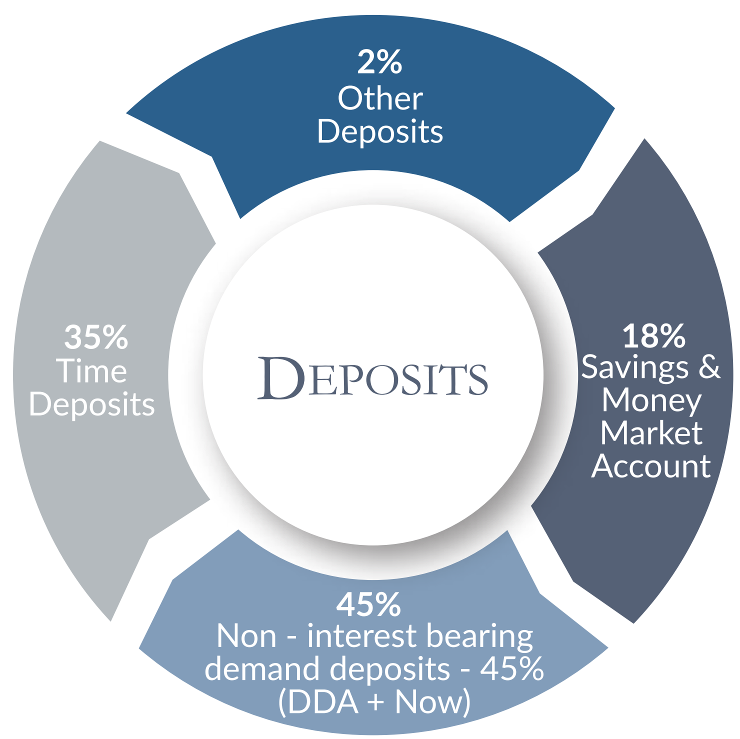

## Deposits

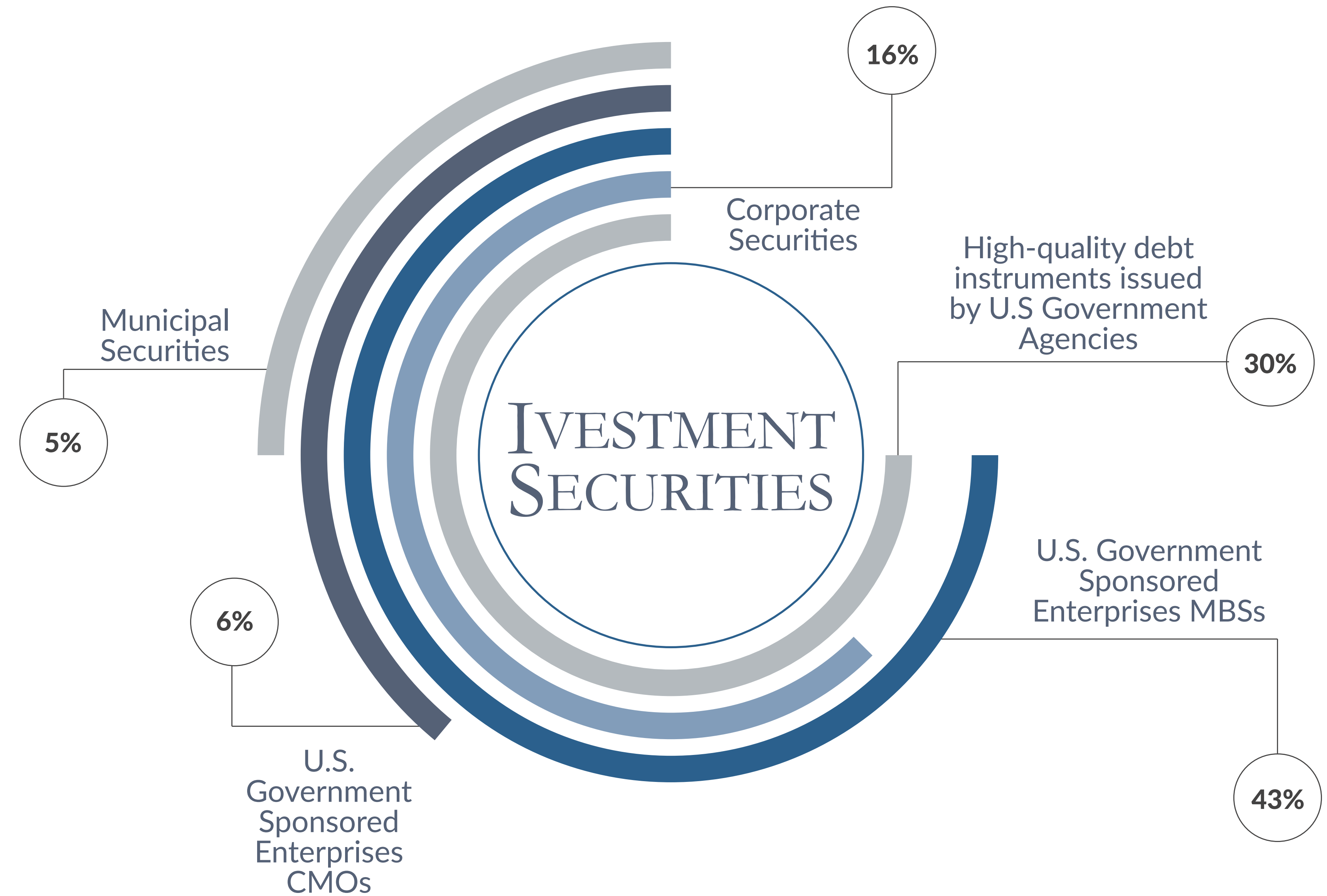



## Net Income



# Financial Highlights

# Executive Management

**JORGE SALAS**
President & CEO

**MERCEDES ESCOTET**
Executive Vice - President,
Chief Financial Officer

**ALBA PRÉSTAMO**
Executive Vice - President,
Chief Compliance Officer

**LETICIA PINO**
Executive Vice - President,
Operations & Administrative Officer

**MARITZA ABADÍA**
Executive Vice - President,
Puerto Rico Country Manager

**LUIS A. GRAU**
Senior Vice - President,
Head of international

**JOSÉ E. LÓPEZ**
Senior Vice - President,
Head of SMB, Lending & Branches

**MICHEL VOGEL**
Senior Vice - President,
Chief Credit Officer

**JULIO VALLE**
Executive Vice - President,
Chief Information Officer

**KENNETH SCHOENI**
Senior Vice - President,
Chief Risk Officer

**GUSTAVO RENGIFO**
Vice - President,
Head of Customer Experience

**RAFAEL NAVARRO**
Vice - President,
Strategic Planning Officer

**NELSON HIDALGO**
Executive Vice - President,
Head of Corporate Banking

# Board of Directors

**CARLOS PALOMARES**
Chairman of the Board

**JORGE SALAS**
President & CEO

**MIGUEL ÁNGEL MARCANO**
Vice - Chairman of the Board

**MARIO OLIVA**
Director

**JUAN CARLOS ESCOTET ALVIAREZ**
Director

**SENO BRIL**
Director

**FRANCISCO J. PAREDES**
Director

**PATRICIA HERNÁNDEZ**
Director

# BANESCO USA

FINANCIAL STATEMENTS

DECEMBER 31, 2018 AND 2017

MBAF

MORRISON BROWN ARGIZ & FARRA, LLC

CERTIFIED PUBLIC ACCOUNTANTS AND ADVISORS

## TABLE OF CONTENTS:

**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors and Stockholders
of Banesco USA

We have audited the accompanying financial statements of Banesco USA (the "Bank") (a Florida corporation), which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of operations, statements of comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements. We also have audited the Bank's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

**Management's Responsibility for the Financial Statements and Internal Control over Financial Reporting**

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. Management is also responsible for its assessment about the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting.

**Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements and an opinion on the Bank's internal control over financial reporting 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 of material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

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 Bank'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 Bank'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.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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

**Definition and Inherent Limitations of Internal Control**

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

**Opinion**

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Banesco USA as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also in our opinion, the Bank maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework issued by the COSO.

Morrison, Brown, Argiz & Farra

Miami, Florida
March 22, 2019

## Management's Report on Internal Control Over Financial Reporting

Banesco USA's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable financial statements in accordance with generally accepted accounting principles (GAAP) accepted in the United States of America. An entity's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction, of unauthorized acquisition, use, or disposition of the entity's assets that could have a material effect on the financial statements.

Management of Banesco USA is responsible for designing, implementing, and maintaining effective internal control over financial reporting. Management assessed the effectiveness of Banesco USA's internal control over financial reporting as of December 31, 2018, based on criteria established in the Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on that assessment, management concluded that, as of December 31, 2018, Banesco USA's internal control over financial reporting is effective, based on criteria established in the Internal Control—Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Internal control over financial reporting has inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of its inherent limitations, internal control over financial reporting may not prevent, or detect and correct, misstatements. Also, projections of any assessment of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Banesco USA

Miami, Florida
March 22, 2019

## BANESCO USA

BALANCE SHEETS
DECEMBER 31,

| ASSETS | 2018 | 2017 |
|---|---|---|
| CASH AND CASH EQUIVALENTS: | | |
| Cash and due from banks | $ 5,964,365 | $ 6,736,099 |
| Interest bearing deposits in other financial institutions | 66,413,902 | 49,121,160 |
| TOTAL CASH AND CASH EQUIVALENTS | 72,378,267 | 55,857,259 |
| Investment securities available for sale | 214,477,485 | 169,036,780 |
| Investment securities held to maturity | 5,707,645 | 1,039,642 |
| Federal Home Loan Bank stock, at cost | 3,306,200 | 3,428,500 |
| Loans, net | 946,393,862 | 815,385,840 |
| Property and equipment, net | 2,278,811 | 2,095,030 |
| Accrued interest receivable | 3,825,984 | 2,932,431 |
| Deferred tax assets, net | 4,779,558 | 3,909,855 |
| Bank-owned life insurance | 20,994,377 | 20,305,083 |
| Prepaid expenses and other assets | 3,598,049 | 2,220,478 |
| TOTAL ASSETS | **$ 1,277,740,238** | **$ 1,076,210,898** |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| DEPOSITS: | | |
| Noninterest bearing demand deposits | $ 391,901,070 | $ 358,846,508 |
| Interest bearing demand deposits | 120,700,050 | 107,989,198 |
| Money market and savings accounts | 199,538,090 | 209,359,022 |
| Time deposits | 385,169,492 | 240,282,661 |
| TOTAL DEPOSITS | 1,097,308,702 | 916,477,389 |
| Securities sold under agreements to repurchase | 412,330 | 646,790 |
| Federal Home Loan Bank advances | 55,000,000 | 60,000,000 |
| Accrued interest payable | 2,436,554 | 1,038,979 |
| Accrued expenses and other liabilities | 6,872,702 | 5,339,596 |
| TOTAL LIABILITIES | 1,162,030,288 | 983,502,754 |
| COMMITMENTS AND CONTINGENCIES (NOTES 13 AND 15) | | |
| STOCKHOLDERS' EQUITY: | | |
| Common stock, $5 par value; 16,000,000 and 6,000,000 shares authorized; 6,645,720 and 5,926,304 shares issued and outstanding in 2018 and 2017 | 33,228,600 | 29,631,520 |
| Additional paid-in capital | 59,152,209 | 50,842,927 |
| Retained earnings | 27,040,187 | 14,099,428 |
| Accumulated other comprehensive loss, net of taxes | (3,711,046) | (1,865,731) |
| TOTAL STOCKHOLDERS' EQUITY | 115,709,950 | 92,708,144 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | **$ 1,277,740,238** | **$ 1,076,210,898** |

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

## BANESCO USA

STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31,

| | 2018 | 2017 |
|---|---|---|
| INTEREST AND DIVIDEND INCOME: | | |
| Loan and fees on loans | $ 46,000,969 | $ 37,112,404 |
| Investment securities | 4,844,982 | 3,903,520 |
| Federal funds sold | 868,661 | 529,132 |
| Federal Home Loan Bank stock | 220,375 | 132,990 |
| TOTAL INTEREST AND DIVIDEND INCOME | 51,934,987 | 41,678,046 |
| INTEREST EXPENSES: | | |
| Deposits | 8,029,512 | 4,838,295 |
| Federal Home Loan Bank advances | 1,403,025 | 752,638 |
| Other borrowed funds | 16,283 | 9,451 |
| TOTAL INTEREST EXPENSES | 9,448,820 | 5,600,384 |
| NET INTEREST INCOME BEFORE PROVISION FOR LOAN LOSSES | 42,486,167 | 36,077,662 |
| (REVERSAL OF) PROVISION FOR LOAN LOSSES | (4,042,777) | 3,676,578 |
| NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES | 46,528,944 | 32,401,084 |
| NONINTEREST INCOME: | | |
| Service fees on loans and deposits | 5,369,852 | 4,815,356 |
| Banked-owned life insurance income | 689,294 | 305,083 |
| Gain on sales of investment securities, (includes $80,177 and $662,186 accumulated other comprehensive income reclassifications for unrealized net gains on available for sale securities, respectively) | 80,177 | 662,186 |
| Gain on resolution of acquired assets | 30,820 | 272,309 |
| Gain on sales of other real estate owned | - | 133,265 |
| Reversal of Provision for off-balance sheet | 215,834 | 247,976 |
| Commissions and other | 3,258,016 | 3,057,880 |
| TOTAL NONINTEREST INCOME | 9,643,993 | 9,494,055 |
| NONINTEREST EXPENSES: | | |
| Salaries and employee benefits | 24,901,666 | 21,446,985 |
| Occupancy | 2,959,106 | 2,861,328 |
| Professional fees | 2,461,204 | 2,571,213 |
| Electronic data processing | 2,367,950 | 1,663,296 |
| FDIC insurance | 741,912 | 791,356 |
| Depreciation and amortization | 912,445 | 985,611 |
| Advertising | 519,493 | 431,260 |
| Communication | 480,466 | 484,757 |
| Travel and entertainment | 333,829 | 204,269 |
| Insurance and license fees | 703,449 | 494,137 |
| Other | 1,650,926 | 1,179,559 |
| TOTAL NONINTEREST EXPENSES | 38,032,446 | 33,113,771 |
| INCOME BEFORE INCOME TAXES | 18,140,491 | 8,781,368 |
| PROVISION FOR INCOME TAXES, (includes approximately $20,000 and $249,000 of income tax expenses from reclassification items, respectively) | 5,199,732 | 5,232,069 |
| NET INCOME | **$ 12,940,759** | **$ 3,549,299** |

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

STATEMENTS OF COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

| | | |
|---|---|---|
| **2018** | | |
| NET INCOME | | $ 12,940,759 |
| OTHER COMPREHENSIVE INCOME, NET OF TAX | | |
| Unrealized gains (losses) on securities | | |
| Unrealized holding (losses) arising during period (net of income taxes of approximately $606,000) | $ (1,785,462) | |
| Less: reclassification adjustment for gains included in net income (net of income taxes of approximately $20,000) | (59,853) | (1,845,315) |
| COMPREHENSIVE INCOME | | **$ 11,095,444** |
| **2017** | | |
| NET INCOME | | $ 3,549,299 |
| OTHER COMPREHENSIVE LOSS, NET OF TAX | | |
| Unrealized gains on securities | | |
| Unrealized holding gains arising during period (net of income taxes of approximately $726,000) | $ 1,203,461 | |
| Less: reclassification adjustment for gains included in net income (net of income taxes of approximately $249,000) | (413,006) | 790,455 |
| COMPREHENSIVE INCOME | | **$ 4,339,754** |

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

# BANESCO USA

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

| | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss), Net of Taxes | Total |
|---|---|---|---|---|---|---|
| | Shares | Par Value | | | | |
| BALANCES AT JANUARY 1, 2017 | 5,926,304 | $ 29,631,520 | $ 50,842,927 | $ 10,243,110 | $ (2,349,167) | $ 88,368,390 |
| Net income | - | - | - | 3,549,299 | - | 3,549,299 |
| Reclassification of income tax effect to retained earnings (see Note 10) | - | - | - | 307,019 | (307,019) | - |
| Other comprehensive income | - | - | - | - | 790,455 | 790,455 |
| BALANCES AT DECEMBER 31, 2017 | 5,926,304 | 29,631,520 | 50,842,927 | 14,099,428 | (1,865,731) | 92,708,144 |
| Capital Contribution | 719,416 | 3,597,080 | 8,309,282 | - | - | 11,906,362 |
| Net income | - | - | - | 12,940,759 | - | 12,940,759 |
| Other comprehensive loss | - | - | - | - | (1,845,315) | (1,845,315) |
| BALANCES AT DECEMBER 31, 2018 | **6,645,720** | **$ 33,228,600** | **$ 59,152,209** | **$ 27,040,187** | **$ (3,711,046)** | **$ 115,709,950** |

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

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

| | 2018 | 2017 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $ 12,940,759 | $ 3,549,299 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| (Reversal of) provision for loan losses | (4,042,777) | 3,676,579 |
| Gain on sales of foreclosed assets | - | (133,265) |
| Depreciation and amortization | 912,445 | 985,611 |
| Net amortization of discounts on investment securities available for sale | 2,237,060 | 2,094,042 |
| Net amortization of discounts on investment securities held to maturity | 15,746 | 8,901 |
| Gain on sales of investment securities avaiable for sale | (80,177) | (662,186) |
| Earnings on bank owned life insurance | (689,294) | (305,083) |
| Amortization of deferred loan fees | (179,860) | (249,489) |
| Amortization of intangible assets | - | 34,049 |
| Deferred income tax (benefit) provision | (242,896) | 4,535,038 |
| Changes in operating assets and liabilities: | | |
| Accrued interest receivable | (893,553) | (342,553) |
| Prepaid expenses and other assets | (1,377,571) | (407,000) |
| Accrued interest payable | 1,397,575 | 328,283 |
| Accrued expenses and other liabilities | 1,533,106 | (4,314,139) |
| NET CASH PROVIDED BY OPERATING ACTIVITIES | 11,530,563 | 8,798,087 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of investment securities available for sale | (85,715,565) | (92,451,106) |
| Purchase of investment securities held to maturity | (5,000,000) | - |
| Reduction (Purchase) of Federal Home Loan Bank stock | 122,300 | (880,100) |
| Maturities and principal repayments on investment securities available for sale | 31,575,856 | 21,798,862 |
| Principal repayments on investment securities held to maturity | 316,252 | 150,746 |
| Proceeds from sales of investment securities available for sale | 4,070,000 | 70,876,712 |
| Purchase of bank owned life insurance | - | (20,000,000) |
| Net increase in loans | (126,785,385) | (85,008,399) |
| Proceeds from sales of foreclosed assets | - | 2,908,965 |
| Net purchase of property and equipment | (1,096,228) | (704,330) |
| NET CASH USED IN INVESTING ACTIVITIES | (182,512,770) | (103,308,650) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net increase in deposits | 180,831,313 | 77,027,115 |
| Net decrease in securities sold under agreements to repurchase | (234,460) | (594,734) |
| Net decrease in Federal Home Loan Bank advances | (5,000,000) | 20,000,000 |
| Capital contribution | 11,906,362 | - |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 187,503,215 | 96,432,381 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 16,521,008 | 1,921,818 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 55,857,259 | 53,935,441 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | **$ 72,378,267** | **$ 55,857,259** |

| | | |
|---|---|---|
| SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION: | | |
| Interest paid on deposits and borrowed funds | **$ 8,051,245** | **$ 5,272,101** |
| Cash paid for income taxes | **$ 2,633,872** | **$ 1,398,457** |

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

## 1. GENERAL

Banesco USA (the “Bank”), a state-chartered bank, incorporated in the State of Florida. The Bank operates in South Florida and Puerto Rico, having 5 offices in operation at December 31, 2018 and December 31, 2017. The Bank is a member of the Federal Deposit Insurance Corporation (“FDIC”), is supervised and regulated by the Office of the Financial Regulation of the State of Florida and by the FDIC.

The Bank offers a variety of banking services to individual and corporate customers through its banking offices located in South Florida and Puerto Rico.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Accounting Policies**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The following is a summary of the significant accounting policies followed by the Bank.

The accounting policies and reporting practices of the Bank conform to the predominant practices in the banking industry and are based on U.S. GAAP.

**Use of Estimates**

The preparation of financial statements in conformity with 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 significantly 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, determination of fair values of acquired assets and assumed liabilities, loss estimates related to acquired loans and foreclosed assets, valuation of deferred tax assets and the fair value of financial instruments.

**Acquisitions**

The Bank accounts for all business combinations under the acquisition method of accounting in accordance with Accounting Standard Codification (“ASC”) Topic 805. Accordingly, the acquiring institution should recognize and measure the identifiable assets acquired, the liabilities assumed, and any non-controlling interests in the acquiree, if any.

The Bank purchased substantially all the assets and assumed substantially all the liabilities of Security Bank, N.A (SBNA) headquartered in Fort Lauderdale, Florida on May 4, 2012. The acquired assets and assumed liabilities of this transaction were measured at estimated fair value.

**Intangible Assets**

Intangible assets other than goodwill, which are determined to have finite lives, are amortized over the period benefited, generally five to fifteen years and are periodically reviewed for reasonableness. The recoverability of other intangibles is evaluated if events or circumstances indicate possible impairment. At December 31, 2018 and December 31, 2017, the Bank did not have any intangible assets.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Cash and Cash Equivalents

The Bank considers cash and cash equivalents with a maturity of three months or less from their original purchase date to be cash equivalents. Cash equivalents include cash and due from banks and interest bearing deposits in other financial institutions.

### Investment Securities

Investment securities consist of U.S. government agencies issued securities, U.S. government agencies sponsored, collateralized mortgage obligations, mortgage-backed securities, corporate bonds, and municipal securities. Certain debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held-to-maturity or trading, including equity securities with readily determinable fair values, 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). As of December 31, 2018 and 2017, the Bank’s investment securities were all classified as available for sale, except for one U.S. government sponsored mortgage backed security and one U.S. government agency security which were classified as held to maturity.

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 held-to-maturity and available for sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investments in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

### Federal Home Loan Bank Stock

Federal Home Loan Bank (“FHLB”) stock is a restricted asset, carried at cost, and evaluated for impairment. As of December 31, 2018 and 2017, FHLB stock amounted to $3,306,200 and $3,428,500, respectively.

### Loans

The Bank’s accounting methods for loans differ depending on whether the loans are originated or purchased, and for purchased loans, whether the loans were acquired as a result of a business combination or purchased individually or as a portfolio.

Legacy Loans and Leases:

Loans are reported at their principal outstanding balance net of deferred loan fees or costs, unearned income and the allowance for loan losses. Loan origination and commitment fees and the costs associated with the origination of loans are deferred and amortized using the straight-line method over the term of the related loan. Interest income is generally recognized when income is earned using the simple interest or effective yield method.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Loans (continued)**

Legacy Loans and Leases: (continued)

In many lending transactions, collateral is obtained to provide an additional measure of security. Generally, the cash flow and earnings power of the borrower represent the primary source of repayment and collateral is considered as an additional safeguard on an acceptable credit risk. The need for collateral is determined on a case by case basis after considering the current and prospective creditworthiness of the borrower, terms of the lending transaction and economic conditions.

The Bank classifies all loans and leases past due when the payment of principal and interest, based upon contractual terms, is not made as of its due date. Charge offs on commercial loans are recorded when available information confirms the loan is not fully collectible and the loss is reasonably quantifiable. Consumer loans are subject to mandatory charge off at a specified delinquency date consistent with regulatory guidelines.

Purchased Loans:

Loans acquired in a business combination are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date.

The Bank considers substantially all loans acquired via FDIC assisted transactions to meet the criteria of loans acquired with evidence of impairment, unless the loan type is specifically excluded from the scope of Accounting Standard Codification ("ASC") 310-30, Loans and Debt Securities Acquired with Deteriorated Credit Quality, such as loans with active revolver features or because management has minimal doubt of the collection of the loan. Loans acquired with evidence of impairment are classified as Purchased Credit Impaired ("PCI") loans.

The Bank makes an estimate of the loans' contractual principal and contractual interest payments as well as the total cash flows it expects to collect from the pools of loans, which includes undiscounted expected principal and interest. The excess of contractual amounts over the total cash flows expected to be collected from the loans is referred to as non-accretable difference, which is not accreted into income. The excess of the expected undiscounted cash flows over the fair value of the loans is referred to as accretable discount. Accretable discount is recognized as interest income on a level-yield basis over the life of the loans. Management has not included prepayment assumptions in its modeling of contractual or expected cash flows. The Bank continues to estimate cash flows expected to be collected over the life of the loans. Subsequent increases in total cash flows expected to be collected are recognized as an adjustment to the accretable yield with the amount of periodic accretion adjusted over the remaining life of the loans. Subsequent decreases in cash flows expected to be collected over the life of the loans are recognized as impairment in the current period through allowance for loan losses. Gain on resolution of acquired assets represents the net settlement amount between the proceeds received and the carrying amount of the loans.

Non-accrual Loans, Impaired Loans and Restructured Loans:

The Bank generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off, the loan has been restructured but is not meeting the terms of the restructure, or the loan reaches 90 days past due. All interest accrued but not collected for loans that are placed on non-accrual status or loans that are charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying to return to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Loans (continued)**

Non-accrual Loans, Impaired Loans and Restructured Loans: (continued)

The Bank has determined that the entire balance of a loan is contractually delinquent for all classes if the minimum payment is not received by the specified due date on the borrower's statement. Interest and fees continue to accrue on past due loans until the date the loan goes into non-accrual status, if applicable.

A loan is considered impaired when, based on current information and events, it is probable that the Bank 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 by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral less selling costs, if the loan is collateral dependent. If management determines that the value of the impaired loan is less than the recorded investment in the loan (outstanding principal balance, net of previous charge-offs, and net of deferred loan fees or cost), impairment is recognized through an allowance estimate or a charge-off to the allowance.

When the ultimate collectability of the total principal of an impaired loan is doubtful and the loan is on nonaccrual status, all payments are applied to principal, under the cost recovery method. When the ultimate collectability of the total principal of an impaired loan is not in doubt and the loan is on nonaccrual status, contractual interest is credited to interest income when received, under the cash basis method.

In situations where, due to a borrower's financial difficulties, management grants a concession for other than an insignificant period of time to the borrower that would not otherwise be granted, the loan is classified as a troubled debt restructuring ("TDR"). Management attempts to identify borrowers in financial difficulty early and work with them to modify terms before their loan reaches nonaccrual status. However, due to the complexity of modifying terms, many loans are modified after nonaccrual status has been established. The modified terms may include rate reductions, payment forbearance, principal forbearance, principal forgiveness and other actions intended to minimize the economic loss to the Bank and avoid foreclosure of the collateral. In cases where the borrowers are granted new terms that provide for a reduction of either interest or principal, management measures the impairment on the restructuring as detailed above for impaired loans.

In addition to the allowance for the pooled portfolios, management has developed a separate allowance for loans that are identified as impaired through a TDR and is included in the Bank's allowance for loan losses. These loans are excluded from pooled loss forecast and a separate reserve is provided under the accounting guidance for loan impairment. Residential loans whose terms have been modified in a TDR are also individually analyzed for estimated impairment.

Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Allowance for Loan Losses ("ALL")**

The allowance for loan losses reflects management's judgment of probable loan losses inherent in the portfolio at the balance sheet date. Management uses a disciplined process and methodology to establish the allowance for losses each quarter. To determine the total allowance for loan losses, the Bank estimates the reserves needed for each segment of the portfolio, including loans analyzed individually and loans analyzed on a pooled basis.

In determining the balance of the allowance account, loans are pooled by portfolio segment and management evaluates the allowance for loan losses on each segment and as a whole on a regular basis to maintain the allowance at an adequate level based on factors which, in management's judgment, deserve current recognition in estimating loan losses. Such factors include changes in prevailing economic conditions, historical experience, changes in the character and size of the loan portfolio and the overall credit worthiness of the borrowers.

The following is how management determines the balance of the general component for the allowance for loan losses account for each segment of the loans:

- Land and Land Development
- Real Estate Construction
- Commercial Real Estate Loans which includes Owner and Non-Owner Occupied and Multifamily loans
- Commercial and Industrial Loans which includes Working Capital Credit Lines, Asset Based Lending, Acceptances, Government Guaranteed and loans to Foreign Banks
- Residential Real Estate
- Consumer Loans

All loans are grouped by collateral type with similar risk characteristics and an average historical charge-off rate for the last twelve quarters is used. A loss factor is calculated and applied to the loan balance for each group.

Qualitative factors are applied to historical loss rate based on management's experience. Due to the static nature of the portfolio, the nine factors used are:

- Lending Policies and Procedures
- International, National, Regional, and Local Economic Conditions
- Nature or Volume of the Portfolio and Terms of Loans
- Experience, Ability, and Depth of Lending and Credit Management
- Levels and trends in delinquencies, non-accruals, and Risk Rating
- Quality of Loan Review System
- Value of Underlying Collateral
- Existences and Effect of Credit Concentrations
- Other External Consequences

The adjusted loss rates are applied to the outstanding balances of each loan grouping.

Changes in these factors could result in material adjustments to the allowance for loan losses and provision for loan losses. The losses the Bank may ultimately incur could differ materially from the amounts assumed in arriving at the allowance for loan losses.

The Bank provides for loan losses through a provision for loan losses charged to operations. When management believes that a loan balance is uncollectible, the loan balance is charged against the allowance for loan losses. Subsequent recoveries, if any, are credited to the allowance for loan losses.

In addition to the allowance for loan losses, the Bank also estimates probable losses related to unfunded lending commitments, such as letters of credit, financial guarantees and unfunded loan commitments. Unfunded lending commitments are subject to individual reviews and the Bank applies the same adjusted loss rates as those applied to similar loan pools in calculating the overall allowance for loan losses.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Allowance for Loan Losses ("ALL") (continued)**

These risk classifications, in conjunction with an analysis of historical loss experience, current economic conditions, performance trends within specific portfolio segments, and any other pertinent information, result in the estimation of the reserve for unfunded lending commitments. Provision for credit losses related to the loan portfolio and unfunded lending commitments are reported in the statements of operations. At December 31, 2018 and 2017, the allowance for unfunded lending commitments amounts to $962,545 and $1,178,379, respectively, and is included in other liabilities, on the accompanying balance sheets.

Also, various regulatory agencies, as an integral part of their examination process, periodically review the Bank's allowance for loan losses. Such agencies may require the Bank to recognize additions to the allowance for loan losses based on their judgments of information available to them at the time of their examination.

For PCI loans, a valuation allowance is established when it is probable that the Bank will be unable to collect all the cash flows expected at acquisition plus additional cash flows expected to be collected arising from changes in estimates after acquisition. A specific allowance is established when subsequent evaluations of expected cash flows from PCI loans reflect a decrease in those estimates. The Bank reassesses cash flows on its loan portfolio based on current circumstances and events. Occasionally, external factors non-controllable by the Bank could result in cash flows not performing in line with expectations. If a pool of loans has paid in excess of its carrying value and management considers that the information on the pool is such that it can no longer estimate an expectation of cash flows in a manner that is reliable, the Bank discontinues the accrual of income on that portfolio and recognizes income on a cash basis based on the payments of interest for the pool. A gain is recognized for the amount of excess cash collected on the pool when all loans in the pool have been disposed of.

The Bank uses assumptions and methodologies that are relevant to estimating the level of impairment and probable losses in the loan portfolio. To the extent that the data supporting such assumptions has limitations, management's judgment and experience play a key role in recording the allowance estimates. Additions to the allowance for loan losses are made by provisions charged to earnings. Furthermore, an improvement in the expected cash flows related to PCI loans would result in a reduction of the required specific allowance with a corresponding credit to the provision.

Risk grading:

The grading analysis estimates the capability of the borrower to repay the contractual obligation of the loan agreement as scheduled or at all. The Bank's internal credit risk grading system is based on experiences with similarly graded loans. Credit risk grades for classified loans are refreshed each quarter, and pass grades are done annually.

The Bank's internally assigned grades are as follows:

Pass – Loans indicate different levels of satisfactory financial condition and performance.
Special Mention – Loans are exhibiting potential weaknesses deserving management's close attention.
Substandard – Loans are exhibiting well-defined weaknesses that jeopardize repayment of the debt.
Doubtful – Loans where the possibility of loss is extremely high.
Loss – Loans are considered uncollectible.

**Interest Income**

Interest income is recognized as earned, based upon the principal amount outstanding, on an accrual basis.

**Property and Equipment, Net**

Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Property and Equipment, Net (continued)

amortized over the remaining term of the applicable leases or their useful lives, whichever is shorter. Estimated useful lives of these assets are as follows:

| | |
|---|---|
| Computer equipment and software | 3 to 5 years |
| Furniture and equipment | 3 to 7 years |
| Leasehold improvements | Shorter of life or term of lease |

Maintenance and repairs are charged to expense as incurred; improvements and betterments are capitalized. When items are retired or are otherwise disposed of, the related costs and accumulated depreciation and amortization are removed from the accounts and any resulting gains or losses are credited or charged to income.

### Foreclosed Assets

Assets acquired through or in lieu of loan foreclosure are held for sale and are initially recorded at fair value less estimated costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value less cost to sell. At December 31, 2018 and December 31, 2017, the Bank did not hold foreclosed assets.

### Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are classified as secured borrowings and are reflected at the amount of cash in connection with the transaction. The Bank may be required to provide additional collateral based on the fair value of the underlying securities (NOTE 8).

### Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. See Note 10 for the effect of the enactment of the 2017 Tax Cuts and Jobs Act.

The Bank recognizes positions taken or expected to be taken in a tax return in accordance with existing accounting guidance on income taxes which prescribes a recognition threshold and measurement process. Interest and penalties on tax liabilities, if any, would be recorded in interest expense and other noninterest expense, respectively

### Impairment of Long-Lived Assets

The Bank's long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet. The Bank did not recognize an impairment charge during the years ended December 31, 2018 and 2017.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Advertising Costs**

Advertising Costs are expensed as incurred. At December 31, 2018 and 2017, advertising costs amounted to $519,493 and $431,260, respectively.

**Interest Rate Risk**

The Bank's performance is dependent to a large extent on its net interest income, which is the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. The Bank, like most financial institutions, is affected by changes in general interest rate levels and by other economic factors beyond its control. Interest rate risk arises from mismatches between the dollar amount of repricing or maturing assets and liabilities (the interest rate sensitivity gap). More liabilities repricing or maturing than assets over a given time frame is considered liability-sensitive, or a negative gap. An asset-sensitive position will generally enhance earnings in a rising interest rate environment and will negatively impact earnings in a falling interest rate environment, while a liability-sensitive position will generally enhance earnings in a falling interest rate environment and negatively impact earnings in a rising interest rate environment. Fluctuations in interest rates are not predictable or controllable. The Bank has implemented asset and liability management strategies to mitigate the impact to net interest income resulting from changes in market interest rates.

**Concentration of Credit Risk**

Credit risk represents the maximum accounting loss that would be recognized at the reporting date if counterparties failed completely to perform as contracted and any collateral or security proved to be of no value. Concentrations of credit risk (whether on or off-balance sheet) arising from financial instruments exist in relation to certain groups of customers. A group concentration arises when a number of counterparties have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The Bank does not have a significant exposure to any individual customer or counterparty.

Most of the Bank's business activity is with customers located within its primary market area, which includes Miami-Dade, Broward, Palm Beach and Monroe Counties, Florida and the entire Commonwealth of Puerto Rico. The Bank's loan portfolio is concentrated largely in real estate and commercial loans in South Florida. Circumstances, which negatively impact the South Florida real estate industry or the South Florida economy, in general, could adversely impact the Bank's loan portfolio.

At various times during the year, the Bank has maintained deposits with other financial institutions in excess of amounts received. The exposure to the Bank from these transactions is solely dependent upon daily balances and the financial strength of the respective institution.

**Comprehensive Income**

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains (losses) on securities available for sale, and unrealized losses related to factors other than credit on debt securities.

In February 2018, the Financial Accounting Standards Board issued an accounting standard to allow a reclassification from accumulated other comprehensive income to retained earnings for certain tax effects resulting for the enactment of the Tax Act. The update is effective for annual periods beginning after December 15, 2018 and interim periods within those years. As permitted by the FASB, the Bank has elected to early adopt this accounting standard update and apply it to the financial statements for the period ended December 31, 2017. The effect of early implementation is further described in Note 10.

**Fair Value Measurement**

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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Subsequent Events**

The Bank has evaluated subsequent events through March 22, 2019 which is the date the financial statements were available to be issued.

**Recent Accounting Pronouncements**

Revenue From Contracts With Customers

In May 2014, the Financial Accounting Standard Board ("FASB") issued an accounting standard update ("ASU") on revenue recognition. This ASU outlines a single comprehensive model to use in accounting for revenue arising from contracts with customers. This standard supersedes existing revenue recognition requirements and eliminates most industry-specific guidance from GAAP. The core principle of the revenue recognition standard is to require an entity to recognize as revenue the amount that reflects the consideration to which it expects to be entitled in exchange for goods or services as it transfers control to its customers. This ASU is effective for the Bank on January 1, 2019. The ASU can be applied using a full retrospective method or a modified retrospective method of adoption. The Bank will adopt the new standard using the modified retrospective transition method, under which the cumulative effect of initially applying the new guidance is recognized as an adjustment to the opening balance of retained earnings on the first day of fiscal year 2019. The Bank is continuing the assessment of the impact of this ASU on its results of operations, financial position, cash flows and disclosures; the Bank's assessment will be finalized during the fiscal year 2019. The Bank continues to monitor additional changes, modifications, clarifications or interpretations undertaken by the FASB, which may impact the Bank's current conclusions.

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued an accounting standard update which seeks to enhance the recognition, measurement, presentation and disclosure requirements of financial instruments. The update is effective for fiscal years beginning after December 15, 2018 and for interim periods within fiscal years beginning after December 15, 2019 with early adoption permitted for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of this accounting standard update did not have a material impact on the Bank's financial statements.

Lease Accounting

In February 2016, the FASB issued an accounting standard update which amends existing lease guidance. The update requires lessees to recognize a right-of-use asset and related lease liability for many operating leases now currently off-balance sheet under current US Generally Accepted Accounting Principles ("GAAP"). The Bank is currently evaluating the effect the update will have on its financial statements but expects upon adoption that the update will have a material effect on the Bank's balance sheet due to the recognition of a right-of-use asset and related lease liability. The Bank does not anticipate the update having a material effect on the Bank's income statement or cash flows, though such an effect is possible. The update is effective using a modified retrospective approach for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020, with early application permitted. The Bank is currently evaluating the effect the update will have on its financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**Recent Accounting Pronouncements**

Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued an accounting standard update which will replace the current incurred loss impairment methodology in US GAAP with a methodology that reflects the expected credit losses. The update is intended to provide financial statement users with more decision-useful information about expected credit losses. This update is effective on a modified retrospective basis for financial statements issued for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. Early adoption is permitted for fiscal years beginning after December 15, 2018 including interim periods in those fiscal years. The Bank is currently evaluating the effect the update will have on its financial statements.

Clarifying the Definition of a Business

In January 2017, the FASB issued an accounting standards update to clarify the definition of a business to assist entities evaluating whether transactions should be accounted for as involving assets or of a business. As the update notes, the definition of a business affects many areas of accounting under US GAAP including acquisitions and disposals, goodwill, and consolidation. The update is effective prospectively for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019, with early application permitted in certain circumstances. The adoption of this accounting standard update did not have a material impact on the Bank's financial statements.

**Reclassification**

Certain amounts in the 2017 financial statements have been reclassified to conform to the 2018 presentation.

## 3. INVESTMENT SECURITIES

### Available for Sale

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities available for sale, by major security, as of December 31, 2018 and 2017 are as follows:

**AVAILABLE FOR SALE**

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| Securities available for sale: | | | | |
| U.S. government agencies issued securities | $ 66,425,338 | $ 164,760 | $ (969,860) | $ 65,620,238 |
| Collateralized mortgage obligations | 11,635,830 | 277,660 | (107,118) | 11,806,372 |
| Mortgage-backed securities | 95,386,687 | 11,963 | (3,241,376) | 92,157,274 |
| Municipals | 11,255,778 | 31,586 | (342,164) | 10,945,200 |
| Corporate bonds | 34,745,111 | 8,133 | (804,843) | 33,948,401 |
| | **$ 219,448,744** | **$ 494,102** | **$ (5,465,361)** | **$ 214,477,485** |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| Securities available for sale: | | | | |
| U.S. government agencies issued securities | $ 56,554,975 | $ 48,283 | $ (611,328) | $ 55,991,930 |
| Collateralized mortgage obligations | 2,682,154 | - | (110,257) | 2,571,897 |
| Mortgage-backed securities | 94,496,842 | - | (1,632,361) | 92,864,481 |
| Municipals | 10,414,959 | 44,627 | (205,141) | 10,254,445 |
| Corporate bonds | 7,386,988 | 4,295 | (37,256) | 7,354,027 |
| | **$ 171,535,918** | **$ 97,205** | **$ (2,596,343)** | **$ 169,036,780** |

Investment securities pledged to secure borrowings under securities sold under agreements to repurchase had a fair value of approximately $3,685,000 and $970,000 at December 31, 2018 and 2017, respectively.

Proceeds from the sales of investment securities available for sale for the years ended December 31, 2018 and 2017 amounted to $4,070,000 and $70,876,712, respectively. For the years ended December 31, 2018 and 2017, there were net gains of $80,177 and $662,186, respectively.

## 3. INVESTMENT SECURITIES (CONTINUED)

### Available for Sale (continued)

Expected maturities of securities available for sale will differ from contractual maturities because borrowers have the right to call or repay obligations with or without call or repayment penalties. The amortized cost and fair value of securities available for sale by contractual maturity are as follows, as of December 31:

| | 2018 Securities Available for Sale | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due after one year through five years | $ 26,632,126 | $ 26,069,916 |
| Due after five years through ten years | 46,452,766 | 45,833,798 |
| Due after ten years | 146,363,852 | 142,573,771 |
| | **$ 219,448,744** | **$ 214,477,485** |

Information pertaining to securities with gross unrealized holding losses, aggregated by investment category and length of time that individual securities have been in a continuous loss position at December 31 are as follows:

| | Less than Twelve Months | | Twelve Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Holding Losses | Fair Value | Gross Unrealized Holding Losses | Fair Value | Gross Unrealized Holding Losses |
| December 31, 2018 | | | | | | |
| U.S. government agencies issued securities | $ 17,495,392 | $ (113,159) | $ 36,773,068 | $ (856,701) | $ 54,268,460 | $ (969,860) |
| Collateralized mortgage obligations | - | - | 2,010,508 | (107,118) | 2,010,508 | (107,118) |
| Mortgage-backed securities | 9,320,389 | (70,331) | 78,220,844 | (3,171,045) | 87,541,233 | (3,241,376) |
| Municipals | - | - | 9,009,434 | (342,164) | 9,009,434 | (342,164) |
| Corporate bonds | 28,980,915 | (614,636) | 4,153,030 | (190,207) | 33,133,945 | (804,843) |
| | **$ 55,796,696** | **$ (798,126)** | **$ 130,166,884** | **$ (4,667,235)** | **$ 185,963,580** | **$ (5,465,361)** |

| | Less than Twelve Months | | Twelve Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Gross Unrealized Holding Losses | Fair Value | Gross Unrealized Holding Losses | Fair Value | Gross Unrealized Holding Losses |
| December 31, 2017 | | | | | | |
| U.S. government agencies issued securities | $ 29,209,695 | $ (220,739) | $ 21,497,341 | $ (390,589) | $ 50,707,036 | $ (611,328) |
| Collateralized mortgage obligations | - | - | 2,571,897 | (110,257) | 2,571,897 | (110,257) |
| Mortgage-backed securities | 35,711,124 | (334,609) | 57,153,357 | (1,297,752) | 92,864,481 | (1,632,361) |
| Municipals | 1,566,156 | (37,188) | 6,453,837 | (167,953) | 8,019,993 | (205,141) |
| Corporate bonds | 4,382,250 | (3,146) | 968,500 | (34,110) | 5,350,750 | (37,256) |
| | **$ 70,869,225** | **$ (595,682)** | **$ 88,644,932** | **$ (2,000,661)** | **$ 159,514,157** | **$ (2,596,343)** |

The Bank is proactive in determining what possible negative effects could impact their investment portfolio. The Bank performs assessments to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. Management considers many factors in their analysis including the (1) severity and duration of the impairment, (2) the specific credit rating of the security, (3) the intent and ability to hold these securities for a period of time until the value of the security recovers, (4) whether the current market is considered an inactive market where most sales are considered distressed sales or disorderly transactions, and most importantly (5) management estimates the portion of loss attributable to credit using a discounted cash flow model. The Bank estimates the expected cash flows of the underlying collateral using interest rate and prepayment risk models that incorporate management's best estimate of current key assumptions, such as default rates, loss severity and prepayment rates. Based on the expected cash flows derived from the model, the Bank expects to recover the remaining unrealized losses on the securities.

## 3. INVESTMENT SECURITIES (CONTINUED)

### Available for Sale (continued)

As of December 31, 2018, the Bank had $3,241,376 in unrealized losses relating to its mortgage-backed securities. Recent changes in interest rates and central bank activity in financial markets have caused changes in the value of mortgage backed securities to fluctuate unsteadily. The contractual cash flows of these securities are from U.S. government sponsored agencies. As of December 31, 2018, the Bank does not consider those investments to be other-than-temporarily impaired because the Bank does not intend to sell the securities before recovery of their amortized cost basis, which may be maturity, and it is more likely than not that the Bank will not be required to sell the securities.

At December 31, 2018, the Bank had unrealized losses on U.S. government agencies issued securities and collateralized mortgage obligations; totaling $1,076,978, respectively. The losses relate principally to interest rate changes, credit spread widening and reduced liquidity in applicable markets. However, without recovery in the near term such that liquidity returns to the applicable markets and spreads return to levels that reflect underlying credit characteristics, other-than-temporary impairments may occur in future periods. The contractual cash flows of these securities are guaranteed by an agency of the U.S. government. As of December 31, 2018, the Bank does not consider those investments to be other-than-temporarily impaired because the Bank does not intend to sell the securities before recovery of their amortized cost basis, which may be maturity, and it is more likely than not that the Bank will not be required to sell the securities.

At December 31, 2018, the Bank had an unrealized loss on corporate bonds totaling $804,843. As of December 31, 2018, the Bank does not consider the corporate bonds to be other-than-temporarily impaired because the decline in market value is mainly attributable to changes in interest rates and not credit quality, the Bank does not intend to sell the securities before recovery of their amortized cost basis, which may be maturity, and it is more likely than not that the Bank will not be required to sell the securities.

At December 31, 2018, the Bank had an unrealized loss on municipal bonds totaling $342,164. As of December 31, 2018, the Bank does not consider the municipal bonds to be other-than-temporarily impaired because the decline in market value is attributable to changes in interest rates and not credit quality, the Bank does not intend to sell the securities before recovery of their amortized cost basis, which may be maturity, and it is more likely than not that the Bank will not be required to sell the securities.

### Held to Maturity

The amortized cost, gross unrealized holding gains, gross unrealized holding losses, and fair value of investment securities held to maturity, by major security, as of December 31, 2018 and 2017 are as follows:

| | December 31, 2018 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| U.S. government agencies issued securities | $ 5,000,000 | $ 8,700 | $ - | $ 5,008,700 |
| U.S. government sponsored mortgage-backed securities | 707,645 | - | (30,483) | 677,162 |
| | **$ 5,707,645** | **$ 8,700** | **$ (30,483)** | **$ 5,685,862** |

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Holding Gains | Gross Unrealized Holding Losses | Fair Value |
| U.S. government sponsored mortgage-backed securities | **$ 1,039,642** | **$ -** | **$ (17,160)** | **$ 1,022,482** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The following is a summary of loans outstanding as of December 31:

(1) Purchase Non-Credit Impaired Loans ("PNCI), shown at carrying value;
(2) Purchased Credit Impaired Loans ("PCI"), shown at carrying.

| | 2018 | | | | | 2017 |
|---|---|---|---|---|---|---|
| | Legacy Loans | PNCI (1) | Total Loans | PCI (2) | Grand Total | |
| Land and land development | $ 3,069,039 | $ - | $ 3,069,039 | $ - | $ 3,069,039 | $ 3,675,965 |
| Real estate construction | 77,617,668 | - | 77,617,668 | - | 77,617,668 | 72,847,144 |
| Residential real estate | 108,581,384 | 585,212 | 109,166,596 | 2,494,726 | 111,661,322 | 112,244,025 |
| Commercial real estate | 599,487,033 | 215,143 | 599,702,176 | 3,062,902 | 602,765,078 | 461,798,152 |
| Commercial and Industrial | 161,764,519 | - | 161,764,519 | - | 161,764,519 | 175,306,501 |
| Consumer | 545,324 | - | 545,324 | - | 545,324 | 340,872 |
| | 951,064,967 | 800,355 | 951,865,322 | 5,557,628 | 957,422,950 | 826,212,659 |
| Less: | | | | | | |
| Allowance for loan and lease losses | (10,572,392) | - | (10,572,392) | (15,324) | (10,587,716) | (9,687,120) |
| Deferred loan fees/unamortized discount | (441,372) | - | (441,372) | - | (441,372) | (1,139,699) |
| **Net Loans** | **$ 940,051,203** | **$ 800,355** | **$ 940,851,558** | **$ 5,542,304** | **$ 946,393,862** | **$ 815,385,840** |

A reconciliation of the recorded investment in loans, is as follows:

| | 2018 | 2017 |
|---|---|---|
| Gross loans | $ 957,422,950 | $ 826,212,659 |
| Plus: Accured interest receivable | 2,642,750 | 2,116,108 |
| Less: Unearned income | 441,371 | 1,139,699 |
| Recorded investments in loans | **$ 959,624,329** | **$ 827,189,068** |

The Bank has pledged approximately $222,024,000 and $227,108,000 of mortgage loans as collateral for advances from the Federal Home Loan Bank of Atlanta as of December 31, 2018 and 2017, respectively.

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented the loans in the portfolio by product type. Loans are segmented into the following pools: land and land development, real estate construction, residential real estate, commercial real estate, commercial and industrial and consumer.

The total allowance reflects management's estimate of loan losses inherent in the loan portfolio at the balance sheet date. The Bank considers the allowance for loan losses of $10,587,716 and $9,687,120 adequate to cover the loan losses inherent in the loan portfolio at December 31, 2018 and 2017, respectively.

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following tables summarize the Bank's loans acquired during 2012, the outstanding balance and related carrying amount as of December 31, 2018 and 2017.

| | December 31, 2018 | | | | | |
|---|---|---|---|---|---|---|
| | PCI | | PNCI | | Total Portfolio | |
| | Outstanding Balance | Carrying Amount | Outstanding Balance | Carrying Amount | Outstanding Balance | Carrying Amount |
| **Real Estate** | | | | | | |
| 1-4 single family residential | $ 4,007,203 | $ 2,494,726 | $ 641,801 | $ 585,212 | $ 4,649,004 | $ 3,079,938 |
| Commercial real estate | 3,743,803 | 3,062,902 | 215,143 | 215,143 | 3,958,946 | 3,278,045 |
| **Total real estate** | $ 7,751,006 | $ 5,557,628 | $ 856,944 | $ 800,355 | $ 8,607,950 | $ 6,357,983 |

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| | PCI | | PNCI | | Total Portfolio | |
| | Outstanding Balance | Carrying Amount | Outstanding Balance | Carrying Amount | Outstanding Balance | Carrying Amount |
| **Real Estate** | | | | | | |
| 1-4 single family residential | $ 4,639,267 | $ 2,868,000 | $ 701,897 | $ 637,401 | $ 5,341,164 | $ 3,505,401 |
| Commercial real estate | 4,262,346 | 3,457,516 | 222,605 | 222,605 | 4,484,951 | 3,680,121 |
| **Total real estate** | $ 8,901,613 | $ 6,325,516 | $ 924,502 | $ 860,006 | $ 9,826,115 | $ 7,185,522 |

The following table summarizes the Bank's amount of accretable yield discount at the beginning and end of the period, reconciled for additions, accretion, disposals of loans, and reclassifications to or from "non-accretable difference" as of December 31, 2018:

| | PCI | PNCI | Total |
|---|---|---|---|
| Balance at December 31, 2017 | $ 5,472,374 | $ 64,496 | $ 5,536,870 |
| Accretable discount arising from acquisition of PCI loans | - | - | - |
| Accretion during the period | (760,336) | (7,863) | (768,199) |
| Reclassification from non-accretable difference | 324,835 | - | 324,835 |
| Loan resolution | (372,679) | (44) | (372,723) |
| Balance as of December 31, 2018 | **$ 4,664,194** | **$ 56,589** | **$ 4,720,783** |

The following table summarizes the allowance for loan losses associated with PCI loans as of as of December 31:

| | 2018 | 2017 |
|---|---|---|
| Beginning Balance | $ 21,173 | $ 11,146 |
| (Reversal of) Provision for loan losses | (5,849) | 10,027 |
| Ending Balance at December 31, | **$ 15,324** | **$ 21,173** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Changes in the allowance for loan losses and the outstanding balances in Legacy and PNCI loans are follows for:

**For the Year Ended December 31, 2018**

| | Land and Land Development | Real Estate Construction | Residential Real Estate | Commercial Real Estate | Commercial and Industrial | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses:** | | | | | | | | |
| Balance at beginning of year | $ 31,363 | $ 994,104 | $ 188,994 | $ 6,028,502 | $ 2,278,147 | $ 88 | $ 144,749 | $ 9,665,947 |
| (Reversal of) provision for loan losses | (9,431) | (134,364) | (414,632) | 1,801,983 | (5,140,937) | 5,202 | (144,749) | (4,036,928) |
| Recoveries | - | 52,911 | 287,307 | - | 5,000,000 | - | - | 5,340,218 |
| Chargeoffs | - | - | - | - | (391,555) | (5,290) | - | (396,845) |
| Ending Balance | **$ 21,932** | **$ 912,651** | **$ 61,669** | **$ 7,830,485** | **$ 1,745,655** | **$ -** | **$ -** | **$ 10,572,392** |
| Ending balance: individually evaluated for impairment | $ - | $ - | $ 49,404 | $ 90,982 | $ - | $ - | $ - | $ 140,386 |
| Ending balance: collectively evaluated for impairment | $ 21,932 | $ 912,651 | $ 12,265 | $ 7,739,503 | $ 1,745,655 | $ - | $ - | $ 10,432,006 |
| **Loans:** | | | | | | | | |
| Ending balance | **$ 3,069,039** | **$ 77,617,668** | **$109,166,596** | **$ 599,702,176** | **$ 161,764,519** | **$ 545,324** | **$ -** | **$ 951,865,322** |
| Ending balance: individually evaluated for impairment | $ - | $ - | $ 5,468,277 | $ 2,547,252 | $ 566,217 | $ - | $ - | $ 8,581,746 |
| Ending balance: collectively evaluated for impairment | $ 3,069,039 | $ 77,617,668 | $103,698,319 | $ 597,154,924 | $ 161,198,302 | $ 545,324 | $ - | $ 943,283,576 |

**For the Year Ended December 31, 2017**

| | Land and Land Development | Real Estate Construction | Residential Real Estate | Commercial Real Estate | Commercial and Industrial | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|---|
| **Allowance for Loan Losses:** | | | | | | | | |
| Balance at beginning of year | $ 39,540 | $ 745,600 | $ 64,690 | $ 3,997,942 | $ 11,779,750 | $ 318 | $ - | $ 16,627,840 |
| Provision for(reversal of) loan losses | (8,177) | 248,504 | 124,304 | 2,030,560 | 1,117,407 | 9,204 | 144,749 | 3,666,551 |
| Recoveries | - | - | - | - | 14,750 | - | - | 14,750 |
| Chargeoffs | - | - | - | - | (10,633,760) | (9,434) | - | (10,643,194) |
| Ending Balance | **$ 31,363** | **$ 994,104** | **$ 188,994** | **$ 6,028,502** | **$ 2,278,147** | **$ 88** | **$ 144,749** | **$ 9,665,947** |
| Ending balance: individually evaluated for impairment | $ 1,395 | $ - | $ 51,165 | $ 102,329 | $ - | $ - | $ - | $ 154,889 |
| Ending balance: collectively evaluated for impairment | $ 29,968 | $ 994,104 | $ 137,829 | $ 5,926,173 | $ 2,278,147 | $ 88 | $ 144,749 | $ 9,511,058 |
| **Loans:** | | | | | | | | |
| Ending balance | **$ 3,675,965** | **$ 72,847,144** | **$109,376,025** | **$ 458,340,636** | **$ 175,306,501** | **$ 340,872** | **$ -** | **$ 819,887,143** |
| Ending balance: individually evaluated for impairment | $ 70,033 | $ 178,296 | $ 2,061,352 | $ 4,870,561 | $ 1,455,959 | $ - | $ - | $ 8,636,201 |
| Ending balance: collectively evaluated for impairment | $ 3,605,932 | $ 72,668,848 | $107,314,673 | $ 453,470,075 | $ 173,850,542 | $ 340,872 | $ - | $ 811,250,942 |

The loan recovery in 2018 of $5,000,000 was mainly related to one commercial and industrial loan which was charged-off in 2017 due to an isolated incident and not due to weaknesses of a particular industry or due to economic conditions.

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

During the year ended December 31, 2018, there was a reversal of provision for loan losses of $4,042,777 and is comprised of $4,036,928 for legacy and PNCI loans and $5,849 for PCI loans. During the year ended December 31, 2017, the provision for loan losses amounted to $3,676,578 and is comprised of $3,666,551 for legacy and PNCI loans and a reversal of $10,027 for PCI loans.

Legacy and PNCI loan credit exposures by internally assigned grades are as follows:

| **December 31, 2018**<br>Land and land development and real estate construction | **Pass** | **Special Mention** | **Substandard** | **Total** |
|---|---|---|---|---|
| Land and land development | $ 3,069,039 | $ - | $ - | $ 3,069,039 |
| Real estate construction | 77,617,668 | - | - | 77,617,668 |
| Residential real estate | | | | |
| 1-4 family first lien | 100,499,156 | 134,081 | 5,330,219 | 105,963,456 |
| 1-4 family second lien | 3,203,140 | - | - | 3,203,140 |
| Commercial real estate | | | | |
| Commercial real estate term | 475,248,526 | 3,188,337 | 1,017,792 | 479,454,655 |
| Owner occupied commercial real estate | 111,750,509 | 7,482,682 | 1,014,330 | 120,247,521 |
| Commercial and industrial | 158,870,315 | 2,327,987 | 566,217 | 161,764,519 |
| Consumer | 545,324 | - | - | 545,324 |
| Total loans | **$ 930,803,677** | **$ 13,133,087** | **$ 7,928,558** | **$ 951,865,322** |

| **December 31, 2017**<br>Land and land development and real estate construction | **Pass** | **Special Mention** | **Substandard** | **Total** |
|---|---|---|---|---|
| Land and land development | $ 3,605,932 | $ 70,033 | $ - | $ 3,675,965 |
| Real estate construction | 72,668,848 | - | 178,296 | 72,847,144 |
| Residential real estate | | | | |
| 1-4 family first lien | 102,172,395 | 1,205,242 | 3,699,325 | 107,076,962 |
| 1-4 family second lien | 2,299,063 | - | - | 2,299,063 |
| Commercial real estate | | | | |
| Commercial real estate term | 329,801,934 | 3,080,831 | 1,050,397 | 333,933,162 |
| Owner occupied commercial real estate | 117,461,369 | 5,434,470 | 1,511,635 | 124,407,474 |
| Commercial and industrial | 172,946,837 | 903,705 | 1,455,959 | 175,306,501 |
| Consumer | 340,872 | - | - | 340,872 |
| Total loans | **$ 801,297,250** | **$ 10,694,281** | **$ 7,895,612** | **$ 819,887,143** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Performing and nonperforming Legacy and PNCI loans based on payment activity are as follows:

**December 31, 2018**

| Land and land development and real estate construction | Performing | Non Performing | Total |
|---|---|---|---|
| Land and land development | $ 3,069,039 | $ - | $ 3,069,039 |
| Real estate construction | 77,617,668 | - | 77,617,668 |
| Residential real estate | | | |
| 1-4 family first lien | 104,240,303 | 1,723,153 | 105,963,456 |
| 1-4 family second lien | 3,203,140 | - | 3,203,140 |
| Commercial real estate | | | |
| Commercial real estate term | 479,454,655 | - | 479,454,655 |
| Owner occupied commercial real estate | 120,247,521 | - | 120,247,521 |
| Commercial and industrial | 161,736,284 | 28,235 | 161,764,519 |
| Other Loans | | | |
| Consumer | 545,324 | - | 545,324 |
| **Total loans** | **$ 950,113,934** | **$ 1,751,388** | **$ 951,865,322** |

**December 31, 2017**

| Land and land development and real estate construction | Performing | Non Performing | Total |
|---|---|---|---|
| Land and land development | $ 3,675,965 | $ - | $ 3,675,965 |
| Real estate construction | 72,668,848 | 178,296 | 72,847,144 |
| Residential real estate | | | |
| 1-4 family first lien | 105,220,981 | 1,855,981 | 107,076,962 |
| 1-4 family second lien | 2,299,063 | - | 2,299,063 |
| Commercial real estate | | | |
| Commercial real estate term | 333,933,162 | - | 333,933,162 |
| Owner occupied commercial real estate | 124,407,474 | - | 124,407,474 |
| Commercial and industrial | 175,261,649 | 44,852 | 175,306,501 |
| Other Loans | | | |
| Consumer | 340,872 | - | 340,872 |
| **Total loans** | **$ 817,808,014** | **$ 2,079,129** | **$ 819,887,143** |

Nonperforming loans also include certain loans that have been modified in TDRs where economic concessions have been granted to borrowers who have experienced financial difficulties.

Payment activity is reviewed by management on a monthly basis to determine how loans are performing. Loans are considered to be nonperforming when the loan is greater than 90 days delinquent. Certain TDR's that are greater than 90 days past due are considered performing, based on their adherence with their modified terms.

Nonperforming loans, non-accrual loans and 90 days or more past due loans represent 0.18% and 0.25% of total loans as of December 31, 2018 and 2017.

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following tables includes an aging analysis of the outstanding balances of past due Legacy and PNCI loans as of December 31, 2018 and 2017. Certain loans over 90 days or more past due with interest and principal are still accruing.

**As of December 31, 2018**

| Age Analysis of Past Due Loans by Loan Class | 30-90 Days Past Due | Over 90 Days | Total Past Due | Current | Total Loans | Loans > 90 days and Accruing |
|---|---|---|---|---|---|---|
| Land and land development and real estate construction | | | | | | |
| Land and land development | $ - | $ - | $ - | $ 3,069,039 | $ 3,069,039 | $ - |
| Real estate construction | - | - | - | 77,617,668 | 77,617,668 | - |
| Residential real estate | | | | | | |
| 1-4 family first lien | - | 1,310,197 | 1,310,197 | 104,653,259 | 105,963,456 | - |
| 1-4 family second lien | - | - | - | 3,203,140 | 3,203,140 | - |
| Commercial real estate | | | | | | |
| Commercial real estate term | - | - | - | 479,454,655 | 479,454,655 | - |
| Owner occupied commercial real estate | 1,517,420 | - | 1,517,420 | 118,730,101 | 120,247,521 | - |
| Commercial and industrial | 91,909 | - | 91,909 | 161,672,610 | 161,764,519 | - |
| Other Loans | | | | | | |
| Consumer | - | - | - | 545,324 | 545,324 | - |
| **Total loans** | **$ 1,609,329** | **$ 1,310,197** | **$ 2,919,526** | **$ 948,945,796** | **$ 951,865,322** | **$ -** |

**As of December 31, 2017**

| Age Analysis of Past Due Loans by Loan Class | 30-90 Days Past Due | Over 90 Days | Total Past Due | Current | Total Loans | Loans > 90 days and Accruing |
|---|---|---|---|---|---|---|
| Land and land development and real estate construction | | | | | | |
| Land and land development | $ - | $ - | $ - | $ 3,675,965 | $ 3,675,965 | $ - |
| Real estate construction | - | - | - | 72,847,144 | 72,847,144 | - |
| Residential real estate | | | | | | |
| 1-4 family first lien | - | 1,310,197 | 1,310,197 | 105,766,765 | 107,076,962 | - |
| 1-4 family second lien | - | - | - | 2,299,063 | 2,299,063 | - |
| Commercial real estate | | | | | | |
| Commercial real estate term | - | - | - | 333,933,162 | 333,933,162 | - |
| Owner occupied commercial real estate | - | - | - | 124,407,474 | 124,407,474 | - |
| Commercial and industrial | - | - | - | 175,306,501 | 175,306,501 | - |
| Other Loans | | | | | | |
| Consumer | - | - | - | 340,872 | 340,872 | - |
| **Total loans** | **$ -** | **$ 1,310,197** | **$ 1,310,197** | **$ 818,576,946** | **$ 819,887,143** | **$ -** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

The following table includes the recorded investment and unpaid principal balances for impaired Legacy loans with the associated allowance amount, if applicable. Management determined the specific valuation allowance based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the remaining source of repayment for the loan is the operation or liquidation of the collateral. In those cases, the current fair value of the collateral, less selling costs was used to determine the specific valuation allowance recorded.

Also presented are the average recorded investments in the impaired loans and the related amount of interest recognized during the time within the period that the impaired loans were impaired. The average balances are calculated based on the month-end balances of the financing receivables of the period reported.

**December 31, 2018**

| Impaired Loans by Class | Recorded Investment | Unpaid Principal Balance | Valuation Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **With No Specific Allowance Recorded:** | | | | | |
| Real estate construction | $ - | $ - | $ - | $ 99,054 | $ 13,216 |
| 1-4 family first lien | 5,342,554 | 5,334,195 | - | 2,665,669 | 220,878 |
| Commercial real estate term | 821,714 | 1,014,330 | - | 68,476 | 55,288 |
| Owner occupied commercial real estate | - | - | - | 406,725 | 70,905 |
| Commercial and industrial | 561,845 | 566,217 | - | 530,105 | 42,448 |
| **Total** | **$ 6,726,113** | **$ 6,914,742** | **$ -** | **$ 3,770,029** | **$ 402,735** |
| **With an allowance recorded:** | | | | | |
| Land and land development | $ - | $ - | $ - | $ 34,710 | $ 2,062 |
| 1-4 family first lien | 134,497 | 134,081 | 49,404 | 135,626 | 5,419 |
| Commercial real estate term | 1,538,404 | 1,532,921 | 90,982 | 1,772,016 | 84,367 |
| Commercial and industrial | - | - | - | 163,237 | 10,203 |
| **Total** | **$ 1,672,901** | **$ 1,667,002** | **$ 140,386** | **$ 2,105,589** | **$ 102,051** |
| **Impaired Loans by Class Total** | | | | | |
| Land and land development | $ - | $ - | $ - | $ 34,710 | $ 2,062 |
| Real estate construction | - | - | - | 99,054 | 13,216 |
| 1-4 family first lien | 5,477,051 | 5,468,277 | 49,404 | 2,801,295 | 226,297 |
| Commercial real estate | 2,360,118 | 2,547,252 | 90,982 | 2,247,217 | 210,560 |
| Commercial and industrial | 561,845 | 566,217 | - | 693,342 | 52,651 |
| **Total loans** | **$ 8,399,014** | **$ 8,581,746** | **$ 140,386** | **$ 5,875,618** | **$ 504,786** |

**December 31, 2017**

| Impaired Loans by Class | Recorded Investment | Unpaid Principal Balance | Valuation Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| **With No Specific Allowance Recorded:** | | | | | |
| Real estate construction | 178,296 | 178,296 | - | 190,584 | - |
| 1-4 family first lien | 1,924,731 | 1,924,734 | - | 1,965,492 | 24,665 |
| Commercial real estate term | 180,885 | 180,584 | - | 183,476 | 11,188 |
| Owner occupied commercial real estate | 1,518,174 | 1,511,635 | - | 1,543,863 | 72,492 |
| Commercial and industrial | 1,452,736 | 1,455,959 | - | 3,771,906 | 70,564 |
| **Total** | **$ 5,254,822** | **$ 5,251,208** | **$ -** | **$ 7,655,321** | **$ 178,909** |
| **With an allowance recorded:** | | | | | |
| Land and land development | $ 70,313 | $ 70,033 | $ 1,395.00 | $ 71,308 | $ 2,975.00 |
| 1-4 family first lien | 137,058 | 136,618 | 51,165 | 338,166 | 5,054 |
| Commercial real estate term | 2,268,335 | 2,260,973 | 94,511 | 2,360,776 | 101,306 |
| Owner occupied commercial real estate | 919,280 | 917,369 | 7,818 | 935,621 | 59,348 |
| Commercial and industrial | - | - | - | 5,038,152 | - |
| **Total** | **$ 3,394,986** | **$ 3,384,993** | **$ 154,889** | **$ 8,744,023** | **$ 168,683** |
| **Impaired Loans by Class Total** | | | | | |
| Land and land development | $ 70,313 | $ 70,033 | $ 1,395 | $ 71,308 | $ 2,975 |
| Real estate construction | 178,296 | 178,296 | - | 190,584 | - |
| 1-4 family first lien | 2,061,789 | 2,061,352 | 51,165 | 2,303,658 | 29,719 |
| Commercial real estate | 4,886,674 | 4,870,561 | 102,329 | 5,023,736 | 244,334 |
| Commercial and industrial | 1,452,736 | 1,455,959 | - | 8,810,058 | 70,564 |
| **Total loans** | **$ 8,649,808** | **$ 8,636,201** | **$ 154,889** | **$ 16,399,344** | **$ 347,592** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

Legacy and PNCI loans on non-accrual status by loan segment are as follows:

| | December 31, 2018 | December 31, 2017 |
|---|---|---|
| Land and land development and real estate construction | | |
| Real estate construction | $ - | $ 178,296 |
| Residential real estate | | |
| 1-4 family first lien | 1,723,153 | 1,855,981 |
| Commercial and industrial | 28,235 | 44,852 |
| **Total loans** | **$ 1,751,388** | **$ 2,079,129** |

The following tables present troubled debt restructurings as of December 31, 2018 and 2017:

| **2018** | Accrual Status | Non-Accrual Status | Total Troubled Debt Restructured |
|---|---|---|---|
| Residential real estate | | | |
| 1-4 family first lien | $ 134,081 | $ - | $ 134,081 |
| Commercial real estate | | | |
| Commercial real estate term | 1,358,844 | - | 1,358,844 |
| Owner occupied commercial real estate | 446,073 | - | 446,073 |
| **Total** | **$ 1,938,998** | **$ -** | **$ 1,938,998** |

| **2017** | Accrual Status | Non-Accrual Status | Total Troubled Debt Restructured |
|---|---|---|---|
| Land and land development and real estate construction | | | |
| Land and land development | $ 70,033 | $ - | $ 70,033 |
| Residential real estate | | | |
| 1-4 family first lien | 136,618 | 98,371 | 234,989 |
| Commercial real estate | | | |
| Commercial real estate term | 2,260,973 | - | 2,260,973 |
| Owner occupied commercial real estate | 917,369 | - | 917,369 |
| Commercial and industrial | | | |
| **Total** | **$ 3,384,993** | **$ 98,371** | **$ 3,483,364** |

## 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (CONTINUED)

As of December 31, 2017 there were no newly restructured Legacy and PNCI loans that occurred during the year. The following table presents newly restructured Legacy and PNCI loans that occurred during the year ended December 31, 2018.

| 2018 | Number of Modifications | Recorded Investment Prior to Modification | Recorded Investment After Modification |
|---|---|---|---|
| Commercial and Industrial | **1** | **$ 454,323** | **$ 454,323** |

As of December 31, 2018 and 2017, there were no troubled debt restructuring loans in which a concession was made and the loan re-defaulted during the same year.

As of December 31, 2018 and 2017, there were no commitments to lend additional funds to borrowers with an impaired loan.

## 5. PROPERTY AND EQUIPMENT, NET

Property and equipment, net, is summarized as follows at December 31:

| | 2018 | 2017 |
|---|---|---|
| Leasehold improvements | $ 4,241,841 | $ 4,245,993 |
| Furniture and equipment | 3,072,685 | 2,983,043 |
| Computer equipment and software | 2,951,799 | 2,447,445 |
| Work in progress | 544,470 | 121,208 |
| Art work | 12,911 | 12,911 |
| | 10,823,706 | 9,810,600 |
| Less: | | |
| Accumulated depreciation and amortization | 8,544,895 | 7,715,570 |
| Property and equipment, net | **$ 2,278,811** | **$ 2,095,030** |

Depreciation and amortization of property and equipment amounted to $912,445 and $985,611 for the years ended December 31, 2018 and 2017, respectively.

## 6. FORECLOSED ASSETS, NET

The Bank did not have foreclosed assets at December 31, 2018 and 2017.

Foreclosed assets are presented net of an allowance for losses. An analysis of the allowance for losses on foreclosed assets is as follows at December 31:

| | 2018 | 2017 |
|---|---|---|
| Balance at beginning of year | $ - | $ 234,991 |
| Provision for losses | - | - |
| Gain on sales of foreclosed assets | - | (133,265) |
| Charge offs | - | (101,726) |
| **Balance at end of year** | **$ -** | **$ -** |

Expenses applicable to foreclosed assets include the following at December 31:

| | 2018 | 2017 |
|---|---|---|
| Provision for losses | $ - | $ - |
| Gain on sales of foreclosed assets | - | (133,265) |
| Operating (recoveries) expenses | (11,551) | 69,718 |
| **Balance at end of year** | **$ (11,551)** | **$ (63,547)** |

## 7. DEPOSITS

At December 31, 2018, the scheduled maturities of time deposits are as follows:

| | |
|---|---|
| 2019 | $ 287,593,169 |
| 2020 | 68,033,768 |
| 2021 | 9,912,662 |
| 2022 | 19,470,000 |
| 2023 | 159,893 |
| | **$ 385,169,492** |

At December 31, 2018 and 2017, overdrafts amounting to $457,232 and $209,579, respectively, were reclassified from demand deposits to loans on the balance sheets.

## 8. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The following sets forth information concerning securities sold under agreements to repurchase as of December 31:

| | 2018 | 2017 |
|---|---|---|
| Securities sold under agreements to repurchase | $ 412,330 | $ 646,790 |
| Fair value of securities pledged for repurchase agreements | $ 3,684,825 | $ 969,714 |
| Maximum amount outstanding at any month-end during the year | $ 5,860,325 | $ 2,169,503 |
| Average amount outstanding during the year | $ 1,031,702 | $ 1,380,945 |
| Weighted-average interest rate for the year | 1.57% | 0.66% |

All securities sold under agreements to repurchase matured within 30 days of December 31, 2018 and 2017.

## 9. FEDERAL HOME LOAN BANK ADVANCES

At December 31, 2017 and 2016, the Bank had Federal Home Loan Bank ("FHLB") advances as follows:

| Year of Maturity | Interest Rate | 2018 | 2017 |
|---|---|---|---|
| 2018 | 1.41% | $ - | $ 35,000,000 |
| 2018 | 1.42% | - | 20,000,000 |
| 2018 | 3.64% | - | 5,000,000 |
| 2019 | 2.49% | 10,000,000 | - |
| 2019 | 2.51% | 10,000,000 | - |
| 2019 | 2.54% | 35,000,000 | - |
| | | **$ 55,000,000** | **$ 60,000,000** |

The FHLB advances agreement requires the Bank to maintain certain loans as collateral for these advances (NOTE 4). At December 31, 2018 and 2017, the Bank was in compliance with this requirement of the FHLB membership agreement. At December 31, 2018 and 2017, FHLB stock held by the Bank amounted to $3,306,200 and $3,428,500, respectively.

The Bank has a line of credit with FHLB of Atlanta that allows drawing up to 20% of total assets. As of December 31, 2018 and 2017, the unused portion of the line amounted to approximately $256,641,000 and $197,967,000, respectively. Additionally, the Bank maintains unused lines of credits with other financial institutions for approximately $35,000,000.

## 10. INCOME TAXES

The provision for (benefit from) income taxes is as follows as of December 31:

| | 2018 | 2017 |
|---|---|---|
| Current (Benefit) Expense: | | |
| Federal | $ 3,113,992 | $ 212,295 |
| State | 991,997 | (29,543) |
| Foreign | 1,336,639 | 514,279 |
| | 5,442,628 | 697,031 |
| Deferred Expense (Benefit): | | |
| Federal | $ (206,660) | $ 4,339,858 |
| State | (36,236) | 195,180 |
| | (242,896) | 4,535,038 |
| **Total** | **$ 5,199,732** | **$ 5,232,069** |

The actual income tax expense for 2018 and 2017 differs from the statutory tax expense for the year (computed by applying the U.S. federal corporate tax rate of 21% and 34%, respectively, to income before provision for (benefit from) income taxes) as follows:

| | 2018 | Effective Tax Rate |
|---|---|---|
| Federal taxes at statutory rate | $ 3,809,503 | 21.0% |
| State income taxes, net of federal tax benefit | 761,004 | 4.2% |
| Bank-owned life insurance | (144,752) | (0.8%) |
| Foreign income taxes | 591,860 | 3.3% |
| Other, net | 182,117 | 1.0% |
| Total | **$ 5,199,732** | **28.7%** |

| | 2017 | Effective Tax Rate |
|---|---|---|
| Federal taxes at statutory rate | $ 2,985,665 | 34.0% |
| State income taxes, net of federal tax benefit | 307,806 | 3.5% |
| Bank-owned life insurance | (106,779) | 1.2% |
| Tax exempt income | (88,345) | (1.0%) |
| Impact of the Tax Cuts & Jobs Act | 1,895,149 | 21.6% |
| Foreign income taxes | 431,408 | 4.9% |
| Other, net | (192,835) | (2.2%) |
| Total | **$ 5,232,069** | **59.6%** |

On December 22, 2017, the President signed into law the Tax Act. The Tax Act includes a permanent reduction in the corporate income tax rate from 35% to 21%. The rate reduction took effect on January 1, 2018. As a result, the Bank has remeasured its December 31, 2017 deferred tax assets and liabilities at the 21% tax rate. The effect on the change in rates on the Bank's deferred tax asset was a decrease of $1,895,149 which the Bank has recognized in the income tax expense caption in the accompanying statement of operations for the period ending December 31, 2017. In addition, the Bank reclassified $307,019 from accumulated other comprehensive income to retained earnings so that the tax effects of items within accumulated other comprehensive income reflect the appropriate tax.

## 10. INCOME TAXES (CONTINUED)

The Bank's deferred tax assets and deferred tax liabilities are as follows as of December 31:

| | 2018 | 2017 |
|---|---|---|
| Deferred tax assets: | | |
| Net unrealized loss on securities available-for-sale | $ 1,260,214 | $ 633,407 |
| Allowance for loan losses | 2,689,843 | 2,461,587 |
| Accruals | 271,258 | 216,253 |
| Loan fees | 331,343 | 282,526 |
| Organizational and start-up costs | 18,995 | 28,494 |
| Non-accrual interest | 45,128 | 39,360 |
| Core deposit intangibles | 23,888 | 26,727 |
| Provision for off balance sheet risk | 243,957 | 298,660 |
| Deferred tax assets | 4,884,626 | 3,987,014 |
| Deferred tax liabilities: | | |
| Depreciable property | 105,068 | 77,159 |
| Deferred tax liability | 105,068 | 77,159 |
| **Net deferred tax asset** | **$ 4,779,558** | **$ 3,909,855** |

In assessing the realizability of deferred tax assets, management considered whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment.

The U.S. Federal jurisdiction, Florida, and Puerto Rico are the major tax jurisdictions where the Bank files income tax returns. The Bank is generally no longer subject to U.S. Federal, State, or foreign examinations by tax authorities for years before 2015.

For the year ended December 31, 2018 and 2017, the Bank did not have any unrecognized tax benefits as a result of tax positions taken during a prior period or during the current period. No interest or penalties have been recorded as a result of tax uncertainties.

## 11. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Bank grants loans to and accepts deposits from its executive officers, principal shareholders, directors, and its affiliates. At December 31, these amounts are summarized as follows:

| | 2018 | |
|---|---|---|
| | Range of Interest Rate | Balance |
| Loans | 5.00% | $ 491,367 |
| Deposits | 0.00% to 2.35% | 59,105,217 |
| Securities sold under agreements to repurchase | 2.00% | 21,228 |

| | 2017 | |
|---|---|---|
| | Range of Interest Rate | Balance |
| Loans | 5.00% | $ 502,943 |
| Deposits | 0.00% to 1.15% | 37,270,514 |
| Securities sold under agreements to repurchase | 1.10% | 261,216 |

As of December 31, 2018 and 2017, interest income and interest expense for the years ended December 31, 2018 and 2017 amounted to $25,228 and $250,832 and $31,664 and $38,277, respectively. For the years ended December 31, 2018 and 2017 loan servicing fees from affiliates amounted to $1,021,500 and $1,024,500, respectively.

## 12. EMPLOYEE BENEFIT PLAN

The Bank has adopted a retirement savings plan (the "Retirement Plan") (a 401k plan) covering substantially all eligible employees effective January 1, 2005. The Retirement Plan includes a provision that the Bank may contribute to the accounts of eligible employees for whom a salary deferral is made. Employees may contribute up to 90% of their compensation subject to certain limits based on federal tax laws. The Bank contributed $536,239 and $446,222 towards the Retirement Plan in 2018 and 2017, respectively.

## 13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

The Bank is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, unused lines of credit and standby letters of credit.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit, unused lines of credit, standby letters of credit are represented by the contractual amount of those instruments. The Bank uses the same credit policies in making these commitments as it does for on-balance-sheet instruments.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are usually collateralized and usually do not contain a specified maturity date and ultimately may not be drawn upon to the total extent to which the Bank is committed.

## 13. FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK (CONTINUED)

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 some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank's standby letters of credit are secured by cash collateral at December 31, 2018 and 2017 in the amount of $56,179,916 and $36,977,474, respectively. A summary of the amounts of the Bank's financial instruments, with off-balance sheet risk, is as follows at December 31:

| | 2018 | 2017 |
|---|---|---|
| | Contract Amount | Contract Amount |
| Unused lines of credit | $ 123,634,047 | $ 117,999,285 |
| Commitment to extend credit | 15,253,761 | 2,240,000 |
| Standby letters of credit | 56,735,102 | 38,888,018 |

## 14. REGULATORY MATTERS

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

Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), the Bank became subject to new capital requirements adopted by the FDIC. These new requirements create a new required ratio for common equity tier 1 capital, increase the tier 1 capital ratios, change the risk weight of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios and change what qualifies as capital for purposes of meeting these various capital requirements. Beginning in 2016, failure to maintain the required capital conservation buffer will limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses.

Under the new capital regulations, the minimum capital ratios are: (1) common equity tier 1 capital ratio of 4.5% of risk-weighted assets, (2) a tier 1 capital ratio of 6.0% of risk-weighted assets, (3) a total capital ratio of 8.0% of risk-weighted assets, and (4) a tier 1 capital to average assets ratio of 4.0%. Common equity tier 1 capital generally consists of common stock and retained earnings, subject to applicable regulatory adjustments and deductions.

The Bank has elected to permanently opt-out of the inclusion of accumulated other comprehensive income in our capital calculations, as permitted by the regulations. This opt-out will reduce the impact of market volatility on our regulatory capital levels.

## 14. REGULATORY MATTERS (CONTINUED)

The Bank is required to maintain a capital conservation buffer consisting of additional common equity tier 1 capital greater than 2.5% to risk-weighted assets above the required minimum levels. This capital conservation buffer requirement began to be phased in in January 2016 at 0.625% of risk-weighted assets and increasing each year until fully implemented in January 2019.

The FDIC's prompt corrective action standards also changed effective January 1, 2015. Under the new standards, in order to be considered well-capitalized, the Bank must have a common equity tier 1 capital ratio of 6.5% (new), a tier 1 ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged) and a leverage ratio of 5.0% (unchanged). The Bank meets all these new requirements, including the full capital conservation buffer.

As of December 31, 2018, the Bank was well-capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since December 31, 2018 that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios as of December 31, 2018 and 2017 are presented in the following table:

| | Actual | | Minimum Capital Requirements | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2018 | | | | | | |
| Total risk-based capital (to risk-weighted assets) | $ 130,971,347 | 13.4% | $ 78,214,226 | 8.0% | $ 97,767,782 | 10.0% |
| Tier 1 capital (to risk-weighted assets) | $ 119,421,086 | 12.2% | $ 58,660,669 | 6.0% | $ 78,214,226 | 8.0% |
| Common equity tier 1 capital (to risk-weighted assets) | $ 119,421,086 | 12.2% | $ 43,995,502 | 4.5% | $ 63,549,059 | 6.5% |
| Tier 1 capital (to average total assets) | $ 119,421,086 | 9.4% | $ 50,766,156 | 4.0% | $ 63,457,696 | 5.0% |

| | Actual | | Minimum Capital Requirements | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| As of December 31, 2017 | | | | | | |
| Total risk-based capital (to risk-weighted assets) | $ 105,056,473 | 12.5% | $ 67,057,013 | 8.0% | $ 83,821,267 | 10.0% |
| Tier 1 capital (to risk-weighted assets) | $ 94,574,026 | 11.3% | $ 50,292,760 | 6.0% | $ 67,057,013 | 8.0% |
| Common equity tier 1 capital (to risk-weighted assets) | $ 94,574,026 | 11.3% | $ 37,719,570 | 4.5% | $ 54,483,823 | 6.5% |
| Tier 1 capital (to average total assets) | $ 94,574,026 | 8.9% | $ 42,341,587 | 4.0% | $ 52,926,984 | 5.0% |

## 15. COMMITMENTS AND CONTINGENCIES

### Operating Leases

The Bank is obligated under noncancellable operating leases for office space and for the rental of office equipment expiring on various date through 2029. Minimum rent payments under operating leases are recognized on a straight-line basis over the term of the lease. These leases contain escalation clauses providing for increased rent expense based on either a fixed rate or an increase in the average consumer price index. Rental expense for office space and for office equipment was $2,527,986 and $2,499,026 for the years ended December 31, 2018 and 2017, respectively, and is included in occupancy expense in the accompanying statements of operations.

At December 31, 2018, future minimum rental commitments under these noncancellable leases were approximately as follows:

| Year ending December 31, | |
|---|---|
| 2019 | $ 1,593,537 |
| 2020 | 1,420,678 |
| 2021 | 1,235,354 |
| 2022 | 459,102 |
| 2023 | 286,184 |
| Thereafter | 1,602,870 |
| | **$ 6,597,725** |

### Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there are such matters that will have a material effect on the financial statements.

## 16. FAIR VALUE MEASUREMENTS

### Determination of Fair Value

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the fair value measurements accounting guidance, 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 Bank'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.

The recent 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 Bank groups its financial assets and financial liabilities generally measured

## 16. FAIR VALUE MEASUREMENTS (CONTINUED)

**Fair Value Hierarchy (continued)**

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. There have been no changes in the methodologies used at December 31, 2018 and 2017.

**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 to estimate the fair value of each significant class of financial instruments for which it is practicable to estimate fair value:

Cash and Cash Equivalents - For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Investment Securities Available for Sale - When instruments are traded in secondary markets and quoted market prices do not exist for such securities, management generally relies on prices obtained from independent vendors or third party broker-dealers. Management reviews pricing methodologies provided by the vendors and third party broker-dealers in order to determine if observable market information is being utilized. Securities measured with pricing provided by independent vendors or third party broker-dealers are classified within Level 2 of the hierarchy and often involve using quoted market prices for similar securities, pricing models or discounted cash flow analyses utilizing inputs observable in the market where available. The specific investment holdings which are included in the Level 2 classification are U.S government issued securities; U.S. government agencies collateralized mortgage obligations, mortgage-backed securities, corporate bonds and municipal securities.

FHLB Stock - The carrying value of the FHLB stock approximates fair value based on the redemption provisions of the FHLB.

Loans - For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values are based on carrying values. Fair values for certain fixed-rate mortgage (e.g. one-to-four family residential), commercial real estate and commercial loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Bank Owned Life Insurance - The fair value of the Bank owned life insurance policies approximates the carrying values which are based on the policies cash surrender value.

Accrued Interest Receivable and Payable - Carrying amounts of accrued interest receivable and payable approximates its fair value due to the short-term nature of these financial instruments.

Deposits - Fair value of demand deposits, money market and saving accounts is the amount payable on demand (carrying amount) at December 31, 2018 and 2017. The fair value of fixed-maturity time deposits are estimated using discounted cash flow analysis, using the rates currently offered for deposits of similar remaining maturities.

## 16. FAIR VALUE MEASUREMENTS (CONTINUED)

**Fair Value Hierarchy (continued)**

Borrowed Funds - Borrowings under repurchase agreements and other short-term borrowings maturing within ninety days approximate their fair values. Fair values of other long-term borrowings are estimated using discounted cash flow analysis based on the Bank's current incremental borrowing rates for similar types of borrowing arrangements.

Unused Lines of Credit, Commitments to Extend Credit, and Standby Letters of Credit - The fair value of off-balance-sheet, credit-related financial instruments are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties.

**Items Measured at Fair Value on a Recurring Basis**

The following table represents the Bank's financial instruments measured at fair value on a recurring basis for each of the fair value hierarchy levels:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2018 | | | | |
| U.S. government agencies issued securities | $ - | $ 65,620,238 | $ - | $ 65,620,238 |
| Collateralized mortgage obligations | - | 11,806,371 | - | 11,806,371 |
| Mortgage-backed securities | - | 92,157,274 | - | 92,157,274 |
| Corporate bond | - | 10,945,200 | - | 10,945,200 |
| Municipal securities | - | 33,948,402 | - | 33,948,402 |
| | **$ -** | **$ 214,477,485** | **$ -** | **$ 214,477,485** |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| U.S. government agencies issued securities | $ - | $ 55,991,930 | $ - | $ 55,991,930 |
| Collateralized mortgage obligations | - | 2,571,897 | - | 2,571,897 |
| Mortgage-backed securities | - | 92,864,481 | - | 92,864,481 |
| Corporate bond | - | 10,254,445 | - | 10,254,445 |
| Municipal securities | - | 7,354,027 | - | 7,354,027 |
| | **$ -** | **$ 169,036,780** | **$ -** | **$ 169,036,780** |

There were no financial liabilities measured at fair value on a recurring basis at December 31, 2018 and 2017.

**Items Measured at Fair Value on a Nonrecurring Basis**

*Impaired Loans*

Certain assets that are considered impaired are not measured at fair value on an ongoing basis but are subject to fair value measurements. These instruments are measured at fair value on a nonrecurring basis and include certain loans that have been deemed to necessitate an impairment analysis.

When a loan is deemed impaired, the Bank's management measures impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical method, impairment may be measured based on the fair value of the loan or on the fair value of the underlying collateral if the loan is collateral dependent. As of December 31, 2018 and 2017, loans deemed to be impaired based on fair value measurement totaled $1,672,901 and $3,528,694, respectively, with the portion deemed to be impaired included in the allowance for loan losses.

Collateral dependent loans and loans based on the present value of expected future cash flows discounted at the loan's effective interest rate are classified in Level 3 of the fair value hierarchy as the valuation technique requires inputs that are both significant and unobservable.

## 16. FAIR VALUE MEASUREMENTS (CONTINUED)

### Items Measured at Fair Value on a Nonrecurring Basis (continued)

The following table represents the Bank's financial instruments measured at fair value on a nonrecurring basis for each of the fair value hierarchy levels:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2018 | | | | |
| Impaired loans | $ - | $ - | $ 1,672,901 | $ 1,672,901 |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| December 31, 2017 | | | | |
| Impaired loans | $ - | $ - | $ 3,528,694 | $ 3,528,694 |

There were no financial liabilities measured at fair value on a nonrecurring basis at December 31, 2018 and 2017.

The carrying amounts and estimated fair values of the Bank's financial instruments were as follows at December 31, 2018:

| | 2018 | |
|---|---|---|
| | Carrying Amount | Fair Value |
| Financial assets: | | |
| Cash and cash equivalents | $ 72,378,267 | $ 72,113,368 |
| Investment securities available for sale | 214,477,485 | 214,477,485 |
| Investment securities held to maturity | 5,707,645 | 5,685,862 |
| Federal Home Loan Bank stock | 3,306,200 | 3,306,200 |
| Loans, net | 946,393,862 | 994,892,808 |
| Bank-owned life insurance | 20,994,377 | 20,994,377 |
| Accrued interest receivable | 3,825,984 | 3,825,984 |
| Financial liabilities: | | |
| Demand, money market and saving accounts | $ 712,139,210 | $ 712,139,210 |
| Time deposits | 385,169,492 | 383,462,225 |
| Securities sold under agreements to repurchase | 412,330 | 412,330 |
| Federal Home Loan Bank advance | 55,000,000 | 55,000,000 |
| Accrued interest payable | 2,436,554 | 2,436,554 |

## 16. FAIR VALUE MEASUREMENTS (CONTINUED)

### Items Measured at Fair Value on a Nonrecurring Basis (continued)

The carrying amounts and estimated fair values of the Bank's financial instruments were as follows at December 31, 2017:

| | 2017 | |
|---|---|---|
| | Carrying Amount | Fair Value |
| Financial assets: | | |
| Cash and cash equivalents | $ 55,857,259 | $ 55,798,114 |
| Investment securities available for sale | 169,036,780 | 169,036,780 |
| Investment securities held to maturity | 1,039,642 | 1,022,482 |
| Federal Home Loan Bank stock | 3,428,500 | 3,428,500 |
| Loans, net | 815,385,840 | 825,383,185 |
| Bank-owned life insurance | 20,305,083 | 20,305,083 |
| Accrued interest receivable | 2,932,431 | 2,932,431 |
| Financial liabilities: | | |
| Demand, money market and saving accounts | $ 676,194,728 | $ 676,194,728 |
| Time deposits | 240,282,661 | 239,460,286 |
| Securities sold under agreements to repurchase | 646,790 | 646,790 |
| Federal Home Loan Bank advance | 60,000,000 | 60,055,301 |
| Accrued interest payable | 1,038,979 | 1,038,979 |

## 17. BANK OWNED LIFE INSURANCE

Bank owned life insurance ("BOLI") is carried at the amount that could be realized under the contract at the balance sheet date, which is typically the cash surrender value. Changes in cash surrender value are recorded in non-interest income. The Bank maintains BOLI policies with two insurance carriers with a combined cash surrender value of $20,994,377 and $20,305,083 at December 31, 2018 and December 31, 2017 covering certain present and former executives and officers. The Bank is the beneficiary of these policies.