2016
Annual Report

HCB Financial Corp.

To Our Shareholders

From the desk of Mark A. Kolanowski

$309,561,856

Total Assets

It is my pleasure to present to you the HCB Financial Corp. 2016 Annual Report. All aspects of our business performed well over the past year, providing continued improvement in many key areas of the income statement and balance sheet.

$1,783,509

Total Net Income

Net income for the year was $1,783,509 or $1.67 per common share, three percent more than our earnings of $1,725,176 ($1.62 per share) in 2015. Other financial highlights include total loans increasing by 7 percent during the year to $174,862,242. The majority of our loan growth came in our commercial portfolio which, in turn, has improved our interest margin. Total assets at year-end stood at $309,561,856 which represents another record high for our bank.

Aside from our financial achievements, we made tremendous gains this past year in enhancing our products and services. We strive to offer effortless banking; whether you prefer to bank in person, online or through your mobile device. Our updated website provides educational tutorials and links to download the applications you need to stay current with your finances at home and on the go. Great products and great service continues to be the winning combination as we position the bank to exceed customer expectations in the future.

2016 was a time for celebration as we marked our 130th year of community banking. Not many around us have the opportunity to reflect upon such a long and rich history, so we made every effort to commemorate, celebrate and simply enjoy every minute that we could. We celebrated with our community during an ice cream social this past summer, and again with employees, customers and shareholders during special events on October 26, 2016, exactly 130 years to the day of our bank charter. Staying true to our original mission of meeting the financial needs of the communities we serve while meeting and exceeding customer expectations in an ever changing world of banking technologies is reason to celebrate. In addition, we contributed in significant ways to the communities we serve with our investment of time and expertise.

The success of Hastings City Bank is due in no small way to our exceptional staff and we announce the following key promotions over the past year:

$174,862,242

Total Loans

Ashley E. Ulberg was promoted to Assistant Vice President, Retail Banking. She is responsible for business development, customer service, oversight of consumer lending and assisting in our branch transformation process. Ashley has been employed by Hastings City Bank in positions of increased responsibility for 15 years.

Dawn N. Braden was promoted to Retail Operations Manager and BSA Officer. Dawn joined Hastings City Bank in 2000 and has accepted additional responsibilities throughout the years. In addition to managing the deposit operations area she is now responsible for the management of electronic banking.

Peggy F. Day was promoted to Loan Operations Manager. Peggy joined Hastings City Bank in 2014, bringing over 25 years of banking experience to our team. She will manage all loan operation functions.

Our Annual Meeting will be held on Wednesday, April 19, 2017 at 1:00 p.m. in the Main Office of Hastings City Bank. Whether you are able to attend or not, please complete and return the enclosed proxy prior to the meeting. That will allow us to tally the votes before the meeting and proceed without undue delay. Our directors, officers and I look forward to seeing as many of you there as possible.

Yours truly,

Mark A. Kolanowski

Mark A. Kolanowski
President and Chief Executive Officer

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Stockholders
HCB Financial Corp.
Hastings, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of HCB Financial Corp., which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HCB Financial Corp. as of December 31, 2016 and 2015, 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.

Crowe Horwath LLP

Crowe Horwath LLP

Grand Rapids, Michigan
February 15, 2017

HCB Financial Corp.
Consolidated Balance Sheets
December 31, 2016 and 2015

	2016	2015
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 11,275,902	$ 7,273,138
	11,275,902	7,273,138
Interest-bearing time deposits in other financial institutions	30,862,000	33,292,000
Securities available for sale	72,512,827	77,756,686
Securities held to maturity (fair value of $1,069,830 in 2016 and $1,936,929 in 2015)	1,055,314	1,910,564
Restricted investment in Federal Home Loan Bank stock	1,580,800	1,580,800
Loans, net of allowance of $1,286,089 in 2016 and $1,445,394 in 2015	173,576,153	161,753,387
Premises and equipment, net	8,070,538	8,213,753
Other real estate owned, net	12,000	255,250
Bank owned life insurance	6,274,909	6,098,281
Accrued interest receivable and other assets	4,341,413	4,136,237
Total assets	$ 309,561,856	$ 302,270,096
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$ 51,343,756	$ 47,913,600
Interest-bearing	209,914,480	212,633,242
	261,258,236	260,546,842
Federal Home Loan Bank advances	18,663,000	12,570,593
Accrued interest payable and other liabilities	1,026,428	965,046
Total Liabilities	280,947,664	274,082,481
Stockholders' equity:		
Common stock, no par value - 1,500,000 shares authorized; issued and outstanding of 1,066,000 in 2016 and 2015	1,623,800	1,623,800
Capital surplus	2,601,641	2,601,641
Retained earnings	24,095,627	22,973,036
Accumulated other comprehensive income	293,124	989,138
Total stockholders' equity	28,614,192	28,187,615
Total liabilities and stockholders' equity	$ 309,561,856	$ 302,270,096

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Income
Years ended December 31, 2016 and 2015

	2016	2015
Interest income		
Loans, including fees	$ **7,204,502**	$ 6,675,310
Investment securities:		
Taxable	**1,055,670**	1,156,675
Tax-exempt	**567,121**	572,296
Federal funds sold and other	**511,993**	512,750
	9,339,286	8,917,031
Interest expense		
Deposits	**289,725**	304,529
Federal Home Loan Bank advances and other debt	**282,139**	299,445
	571,864	603,974
Net interest income	**8,767,422**	8,313,057
Provision for loan losses	**60,000**	-
Net interest income after provision for loan losses	**8,707,422**	8,313,057
Other income		
Service charges and fees	**1,527,734**	1,503,755
Trust income	**399,253**	447,264
Net gain (loss) on securities	**44,181**	6,523
Net gain on sale of loans	**311,961**	269,764
Earnings from bank owned life insurance	**210,351**	205,993
Other income	**285,229**	244,630
	2,778,709	2,677,929
Other expenses		
Salaries and employee benefits	**5,129,555**	4,773,081
Occupancy and equipment	**1,249,022**	1,290,329
Data processing	**1,437,043**	1,282,127
Professional fees	**434,979**	449,600
FDIC Insurance	**135,500**	156,000
Other operating expenses	**1,136,523**	1,104,673
	9,522,622	9,055,810
Income before federal income taxes	**1,963,509**	1,935,176
Federal income taxes	**180,000**	210,000
Net income	$ **1,783,509**	$ 1,725,176
Basic and Diluted earnings per share	$ **1.67**	$ 1.62

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Comprehensive Income
Years ended December 31, 2016 and 2015

	2016	2015
Net income	$ 1,783,509	$ 1,725,176
Available-for-sale securities		
Unrealized holding gains (losses) arising during the year	(1,061,194)	(47,394)
Reclassification adjustment for net realized gains (losses) included in net income (A)	44,181	6,523
Defined Benefit Plans		
Net unrealized gain/(loss) on defined benefit plan	(37,555)	12,778
Reclassification adjustment for recognition of unrealized gains (B)	-	-
Other comprehensive loss before income tax benefit	(1,054,568)	(28,093)
Income tax related to other comprehensive loss (C)	358,554	9,552
Other comprehensive loss	(696,014)	(18,541)
Comprehensive Income	$ 1,087,495	$ 1,706,635

(A) - Included in net gain (loss) on securities

(B) - Included in salaries and employee benefits

(C) - Federal Income Tax expense in 2016 and 2015 includes $15,022 and $2,218 related to reclassification adjustments

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Stockholders' Equity
Years Ended December 31, 2016 and 2015

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Income	Total
Balance at January 1, 2015	$ 1,623,800	$ 2,601,641	$ 21,887,461	$ 1,007,679	$ 27,120,581
Net income	-	-	1,725,176	-	1,725,176
Other comprehensive income (loss)	-	-	-	(18,541)	(18,541)
Dividends declared - $.60 per share	-	-	(639,601)	-	(639,601)
Balance at December 31, 2015	1,623,800	2,601,641	22,973,036	989,138	28,187,615
Net income	**-**	**-**	**1,783,509**	**-**	**1,783,509**
Other comprehensive income (loss)	**-**	**-**	**-**	**(696,014)**	**(696,014)**
Dividends declared - $.62 per share	**-**	**-**	**(660,918)**	**-**	**(660,918)**
Balance at December 31, 2016	**$ 1,623,800**	**$ 2,601,641**	**$ 24,095,627**	**$ 293,124**	**$ 28,614,192**

See accompanying notes

HCB Financial Corp.
Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015

	2016	2015
Cash flows from operating activities		
Net income	$ 1,783,509	$ 1,725,176
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	60,000	-
Depreciation	488,594	527,091
Net amortization of securities	263,648	331,198
Earnings on bank owned life insurance, net	(176,628)	(173,942)
Loans originated for sale	(11,938,460)	(10,188,241)
Proceeds from sale of loans	12,250,421	10,458,005
Net gain on sales of other real estate	(24,801)	(11,128)
Net gain on sales of loans	(311,961)	(269,764)
Net gain on securities	(44,181)	(6,523)
Net change in:		
Accrued interest receivable and other assets	158,378	(419,873)
Accrued interest payable and other liabilities	2,510	(200,003)
Net cash from operating activities	2,511,029	1,771,996
Cash flows for investing activities		
Net change in interest-bearing deposits in other financial institutions	2,430,000	3,271,000
Activity in available-for-sale securities:		
Sales	4,760,430	2,023,900
Maturities, prepayments, calls	10,855,612	12,131,935
Purchases	(11,608,662)	(6,627,653)
Activity in held-to-maturity securities:		
Maturities, prepayments, calls	4,165,250	5,651,377
Purchases	(3,310,000)	(7,131,941)
Net (purchase)/redemption of Federal Home Loan Bank stock	-	1,400
Loan originations and payments, net	(11,957,009)	(9,562,138)
Purchases of premises and equipment, net	(345,379)	(376,091)
Proceeds from sales of other real estate owned	337,294	243,822
Net cash for investing activities	(4,672,464)	(374,389)
Cash flows from financing activities		
Net change in deposits	711,393	2,465,044
Proceeds from Federal Home Loan Bank advances	13,000,000	40,000,000
Repayments of Federal Home Loan Bank advances	(6,663,000)	(45,663,000)
Short-term borrowings, net	(244,593)	244,593
Cash dividends paid	(639,601)	(639,601)
Net cash from/(for) financing activities	6,164,199	(3,592,964)
Net change in cash and cash equivalents	4,002,764	(2,195,357)
Cash and cash equivalents at beginning of year	7,273,138	9,468,495
Cash and cash equivalents at end of year	$ 11,275,902	$ 7,273,138
Supplemental disclosures of cash flow information		
Cash paid for interest	$ 572,831	$ 608,280
Cash paid for income taxes	375,000	300,000
Supplemental non-cash disclosures		
Dividends declared and not paid	$ 213,200	$ 191,880
Transfer of loans to other real estate owned	74,243	83,000

See accompanying notes

HCB Financial Corp.
Notes to Consolidated Financial Statements
December 31, 2016 and 2015

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations: HCB Financial Corp. (the Company) is a bank holding company headquartered in Hastings, Michigan. The Company's wholly owned subsidiary, Hastings City Bank (the Bank) operates seven full-service banking offices in and around Barry County. The Bank offers a variety of deposit and lending services.

Principles of Consolidation: The consolidated financial statements include the accounts and operations of HCB Financial Corp. and its wholly owned subsidiaries, Hastings City Bank, Banin Corp., Citybanc Insurance Services, and HCB Real Estate Holdings LLC. All significant inter-company balances and transactions have been eliminated in consolidation.

Subsequent Events: The Company has evaluated subsequent events for recognition and disclosure through February 15, 2017, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions and federal funds sold. Net cash flows are reported for customer loan and deposit transactions and for interest bearing time deposits with other financial institutions.

Cash and Cash Equivalents: The Company maintains deposit accounts with other financial institutions which generally exceed federally insured limits or are uninsured.

Interest-Bearing Time Deposits in other Financial Institutions: Interest-bearing time deposits in other financial institutions consist of fully insured certificates of deposits with $6,649,000 maturing within 1 year, $22,972,000 maturing within 2-5 years and $1,241,000 maturing within 6-10 years.

Restricted Investments: The Bank is a member of the Federal Home Loan Bank (FHLB) System and is required to invest in capital stock of the FHLB of Indianapolis. The amount of the required investment is determined and adjusted periodically by the FHLB.

Securities: Debt securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Equity securities with readily determinable fair values are classified as available for sale. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

Interest income includes amortization of purchase premium or discount. Premiums and discounts are amortized on the level yield method. Gains and losses on sales are based on the amortized cost of the security sold. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement and 2) OTTI related to other factors, which is recognized in other comprehensive income. The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of unearned interest, deferred loan fees and costs, and an allowance for loan losses. The Bank's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets.

Interest income is reported on the interest method. Interest income on loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not received, for loans placed on nonaccrual, is reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loans held for sale are reported at the lower of cost or market, on an aggregate basis. Mortgage loans held for sale are generally sold with servicing rights retained; the carrying value of mortgage loans sold is reduced by the amount allocated to the servicing right. Gains and losses on sales of mortgage loans are based on the difference between the selling price and the carrying value of the related loan sold.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Commercial and commercial real estate loans are individually evaluated for impairment if outstanding loans to a borrower are, in aggregate, over $150,000 and the risk rating assigned to a loan is a non-pass rating. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported net at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Troubled debt restructurings are also considered impaired and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The general component of the Allowance for Loan Losses covers non-impaired loans and large groups of homogeneous loans and is based on historical loss experience, over the last three years, adjusted for current risk factors. The following portfolio segments have been identified and the risk factors listed below are considered in determining the allowance for loan loss:

Residential real estate loans are evaluated for impairment using various economic indicators. Environmental factors that may impact collateral value on residential real estate loans include data on average local home sales, national and local economic conditions, and local employment rates. These factors are used to calculate an adjustment for current economic conditions. Other residential real estate loans with additional risk factors are loans where the payment is more than 30 days past due.

Commercial loans are evaluated for impairment using the following risk classification codes assigned to commercial credits internally:

- Risk Ratings 1-5 are considered to be within an acceptable risk tolerance to the bank.
- Risk Rating 6 is considered special mention. Typically, these loans are inadequately protected by the current net worth or paying capacity of the obligor, even though the value of underlying collateral may be sufficient to protect against loss. These loans are included on the watch list.
- Risk Rating 7 is considered substandard. Typically, these loans have well-defined weaknesses, normal repayment is in jeopardy.
- Risk Rating 8 is considered impaired non-accrual. All the weaknesses of a 7 rating exist plus the loan is in non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.
- Risk Rating 9 is considered doubtful. All the weaknesses of an 8 rating exist, however, these weaknesses now make collection or liquidation in full, based on existing conditions, improbable.
- Risk Rating 10 is considered loss. The bank recognizes loss credits by recording the charge-off in a timely manner.

These risk codes are reviewed and adjusted as appropriate in several circumstances. A formal loan review process is conducted on loans above various dollar thresholds based on the type of collateral securing the credit. The loan reviewer will either affirm that the risk rating is appropriate or recommend a change. Risk codes are also adjusted upon loan renewals, additional requests, and upon receipt of knowledge that an event has caused a change in apparent risk of an individual credit. In addition, business loan charge-offs are evaluated annually to assess the likelihood of deteriorating to charge-off before the determination that an allocated reserve is required. That additional loss factor is applied to non-impaired loans with a 5 and 6 rating. Any loans that are not individually evaluated for impairment are assigned an additional risk factor if they become past due by 30 days or more.

Consumer loans are both secured and unsecured and an additional risk factor is applied to loans that are past due by 30 days or more.

Bank-Owned Life Insurance: The Company has purchased life insurance policies on certain key executives. Bank owned life insurance is recorded at the amount that can be realized under the insurance contracts at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts that are probable at settlement.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Servicing Rights: Servicing rights represent the fair value of retained servicing rights on loans sold. Servicing assets are expensed in proportion to, and over the period of, estimated net servicing revenues. Impairment is evaluated based on the fair value of the assets, using groupings of the underlying loans as to interest rates and then, secondarily, as to prepayment characteristics. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Any impairment is reported as a valuation allowance to the extent that fair value is less than the capitalized amount.

Servicing fee income, which is reported on the income statement as *other income,* is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income. Servicing fees total $123,000 and $115,000 for the years ended December 31, 2016 and 2015, respectively. Late fees and ancillary fees related to loan servicing are not material.

Premises and Equipment: Land is stated at cost. Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed principally using the straight-line method over the estimated lives of the related assets. Expenditures for normal repair and maintenance are charged to expenses as incurred.

Other Real Estate Owned: Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Long-Term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Post Retirement Benefit: The Bank sponsors a post retirement benefit plan that provides medical and life insurance benefits to eligible retirees, who retired prior to 2004, for life. At year-end 2016, the plan provided benefits to 12 participants. At year-end 2016 and 2015, the accrued benefit obligation recognized in the consolidated balance sheet and the unrecognized actuarial gain were $268,648 and $88,050 and $290,325 and $125,606, respectively. Additional disclosures related to the post retirement health care plan are not material to the financial statements.

Income Taxes: Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company recognizes interest and/or penalties related to income tax matters in income tax expense.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Earnings Per Share: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period, which were 1,066,000 for both 2016 and 2015. There were no potentially dilutive common stock equivalents for 2016 or 2015.

Off-Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

Comprehensive Income: Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale and changes in the funded status of the Company's post retirement benefit plans, which are also recognized as separate components of equity.

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.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the bank to the holding company or by the holding company to shareholders.

Reclassifications: Certain items in the prior year financial statements were reclassified to conform to the current presentation.

NOTE 2 - SECURITIES

The fair value of available-for-sale securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income were as follows:

Available-for-sale

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government and federal agency	**$ 11,311,515**	**$ 83,809**	**$ 997**	**$ 11,394,327**
State and municipal	**48,572,681**	**782,284**	**401,757**	**48,953,208**
Mortgage-backed, residential	**10,842,180**	**14,874**	**122,310**	**10,734,744**
Corporate	**1,248,879**	**3,945**	**-**	**1,252,824**
Asset-backed securities	**181,497**	**-**	**3,773**	**177,724**
Total	**$ 72,156,752**	**$ 884,912**	**$ 528,837**	**$ 72,512,827**
2015				
U.S. Government and federal agency	$ 16,543,168	$ 140,017	$ 12,751	$ 16,670,434
State and municipal	45,487,477	1,298,820	25,561	46,760,736
Mortgage-backed, residential	12,827,567	19,281	47,291	12,799,557
Corporate	1,251,338	5,735	927	1,256,146
Asset-backed securities	274,047	-	4,234	269,813
Total	$ 76,383,597	$ 1,463,853	$ 90,764	$ 77,756,686

The carrying amount, unrecognized gains and losses, and fair value of securities held-to-maturity were as follows:

Held-to-maturity

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
State and municipal	**$ 1,055,314**	**$ 14,516**	**$ -**	**$ 1,069,830**
2015				
State and municipal	$ 1,910,564	$ 26,365	$ -	$ 1,936,929

The fair value of debt securities and carrying amount, if different, at year-end 2016 by contractual maturity were as follows: Securities not due at a single maturity date, primarily consisting of mortgage-backed securities, are shown separately.

	Held-to-maturity		Available-for-sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	**$ 890,315**	**$ 890,474**	**$ 6,464,794**	**$ 6,481,108**
Due after one through five years	**164,999**	**179,356**	**33,425,960**	**33,711,870**
Due after five through ten years	**-**	**-**	**18,236,691**	**18,317,144**
Due after ten years	**-**	**-**	**3,005,630**	**3,090,237**
Mortgage and asset-backed	**-**	**-**	**11,023,677**	**10,912,468**
	$ 1,055,314	**$ 1,069,830**	**$ 72,156,752**	**$ 72,512,827**

NOTE 2 - SECURITIES (Continued)

Securities pledged at year-end 2016 and 2015 had a carrying amount of $8,172,000 and $15,394,000 respectively, and were pledged to secure public deposits and other purposes as required or permitted by law.

Securities with unrealized losses at year-end 2016 and 2015, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, are as follows:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
2016						
U.S. Govt. and federal agency	**$ 497,528**	**$ 997**	**$ -**	**$ -**	**$ 497,528**	**$ 997**
State and municipal	**15,875,534**	**401,757**	**-**	**-**	**15,875,534**	**401,757**
Mortgage-backed, residential	**9,981,146**	**122,310**	**-**	**-**	**9,981,146**	**122,310**
Asset-backed securities	**-**	**-**	**177,724**	**3,773**	**177,724**	**3,773**
	$ 26,354,208	**$ 525,064**	**$ 177,724**	**$ 3,773**	**$ 26,531,932**	**$ 528,837**
2015						
U.S. Govt. and federal agency	$ 5,233,049	$ 12,751	$ -	$ -	$ 5,233,049	$ 12,751
State and municipal	6,019,774	16,381	440,820	9,180	6,460,594	25,561
Mortgage-backed, residential	10,920,633	47,291	-	-	10,920,633	47,291
Corporate	504,257	927	-	-	504,257	927
Asset-backed securities	-	-	269,813	4,234	269,813	4,234
	$ 22,677,713	$ 77,350	$ 710,633	$ 13,414	$ 23,388,346	$ 90,764

Unrealized losses have not been recognized into income because the securities are of high credit quality, management does not intend to sell and it is not more likely than not that management would be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates. The fair value is expected to recover as the securities approach their maturity date and/or market rates decline.

Sales of available-for-sale securities were as follows:

	2016	2015
Proceeds	**$ 4,760,430**	$ 2,023,900
Gross gains	**11,491**	11,375
Gross losses	**-**	4,852

In 2016 the Company had additional net gains of $32,690 on the call of available-for-sale securities.

NOTE 3 - LOANS

Loans at year-end were as follows:

	2016	2015
Residential real estate:		
Residential mortgages	**$ 54,549,760**	$ 54,689,745
Home equity loans	**12,591,684**	10,973,393
Commercial:		
Real estate secured	**48,196,407**	42,197,787
Not real estate secured	**17,311,477**	16,209,203
Municipal	**32,546,951**	30,077,246
Consumer	**9,665,963**	9,051,407
Subtotal	**174,862,242**	163,198,781
Allowance for loan losses	**(1,286,089)**	(1,445,394)
	$ 173,576,153	$ 161,753,387

Mortgage loans serviced for others are not reported as assets. Such loans aggregated to $52,515,000 and $48,314,000 at year-end 2016 and 2015, respectively. Capitalized mortgage servicing rights were $390,000 and $357,000 at year-end 2016 and 2015, respectively.

Certain directors and executive officers of the Company, including their associates, were loan customers of the Bank during 2016 and 2015. The outstanding loan balances for these persons at December 31, 2016 and 2015 amounted to $2,150,000 and $1,685,000, respectively. During 2016, new loans to these persons amounted to $706,000 and payments amounted to $241,000, compared to new loans of $809,000 and payments of $587,000 during 2015.

Activity in the allowance for loan losses for 2016 and 2015, by portfolio segment, was as follows:

December 31, 2016	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:				
Beginning balance	**$ 470,389**	**$ 932,837**	**$ 42,168**	**$ 1,445,394**
Provision for loan losses	**(28,823)**	**40,249**	**48,574**	**60,000**
Loans charged-off	**-**	**(190,792)**	**(38,070)**	**(228,862)**
Recoveries	**329**	**2,012**	**7,216**	**9,557**
Ending balance:	**$ 441,895**	**$ 784,306**	**$ 59,888**	**$ 1,286,089**
December 31, 2015				
Allowance for loan losses:				
Beginning balance	$ 501,605	$ 1,089,113	$ 25,789	$ 1,616,507
Provision for loan losses	(31,216)	(18,589)	49,805	-
Loans charged-off	-	(164,343)	(41,396)	(205,739)
Recoveries	-	26,656	7,970	34,626
Ending balance:	$ 470,389	$ 932,837	$ 42,168	$ 1,445,394

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(Continued)

NOTE 3 - LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016 and 2015:

December 31, 2016	**Residential Real Estate**	**Commercial**	**Consumer**	**Total**
Allowance for loan losses:				
Individually evaluated for impairment	**$ 310,184**	**$ 364,816**	**$ 13,232**	**$ 688,232**
Collectively evaluated for impairment	**131,711**	**419,490**	**46,656**	**597,857**
Ending allowance balance attributable to loans:	**$ 441,895**	**$ 784,306**	**$ 59,888**	**$ 1,286,089**
Loan balances:				
Individually evaluated for impairment	**$ 1,319,720**	**$ 1,550,587**	**$ 44,263**	**$ 2,914,570**
Collectively evaluated for impairment	**65,821,724**	**96,504,248**	**9,621,700**	**171,947,672**
Total ending loan balances:	**$ 67,141,444**	**$ 98,054,835**	**$ 9,665,963**	**$ 174,862,242**
December 31, 2015				
Allowance for loan losses:				
Individually evaluated for impairment	$ 330,771	$ 633,083	$ 1,146	$ 965,000
Collectively evaluated for impairment	139,618	299,754	41,022	480,394
Ending allowance balance attributable to loans:	$ 470,389	$ 932,837	$ 42,168	$ 1,445,394
Loan balances:				
Individually evaluated for impairment	$ 1,474,347	$ 1,973,821	$ 42,344	$ 3,490,512
Collectively evaluated for impairment	64,188,791	86,510,415	9,009,063	159,708,269
Total ending loan balances:	$ 65,663,138	$ 88,484,236	$ 9,051,407	$ 163,198,781

The following table presents information related to impaired loans by class of loans as of and for the year ended December 31, 2016 and 2015:

December 31, 2016

	Unpaid Principal Balance	**Recorded Investment**	**Allowance for Loan Losses Allocated**	**Average Recorded Investment**	**Interest Income Recognized**	**Cash Basis Interest Recognized**
With no related allowance recorded:						
Residential real estate						
Residential mortgages	**$ 269,088**	**$ 269,088**	**$ -**	**$ 275,570**	**$ 14,624**	**$ 14,644**
Home equity loans	**8,644**	**8,644**	**-**	**10,066**	**478**	**483**
Commercial						
Real estate secured	**446,775**	**446,775**	**-**	**460,598**	**21,907**	**20,072**
Non-real estate secured	**26,741**	**26,741**	**-**	**39,629**	**403**	**428**
Consumer	**31,031**	**31,031**	**-**	**36,392**	**333**	**423**
Subtotal	**782,279**	**782,279**	**-**	**822,255**	**37,745**	**36,050**
With related allowance recorded:						
Residential real estate						
Residential mortgages	**1,041,988**	**1,041,988**	**310,184**	**1,053,449**	**47,952**	**48,040**
Home equity loans	**-**	**-**	**-**	**-**	**-**	**-**
Commercial						
Real estate secured	**1,077,071**	**1,077,071**	**364,816**	**1,094,656**	**32,621**	**32,465**
Non-real estate secured	**-**	**-**	**-**	**-**	**-**	**-**
Consumer	**13,232**	**13,232**	**13,232**	**13,341**	**58**	**52**
Subtotal	**2,132,291**	**2,132,291**	**688,232**	**2,161,446**	**80,631**	**80,557**
Total	**$ 2,914,570**	**$ 2,914,570**	**$ 688,232**	**$ 2,983,701**	**$ 118,376**	**$ 116,607**

NOTE 3 - LOANS (Continued)

December 31, 2015	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance recorded:						
Residential real estate						
Residential mortgages	$ 282,326	$ 282,326	$ -	$ 288,491	$ 15,317	$ 15,340
Home equity loans	11,136	11,136	-	12,176	548	553
Commercial						
Real estate secured	353,811	353,811	-	371,332	23,060	25,023
Non-real estate secured	-	-	-	-	-	-
Consumer	5,843	5,843	-	7,827	465	471
Subtotal	653,116	653,116	-	679,826	39,390	41,387
With related allowance recorded:						
Residential real estate						
Residential mortgages	1,180,885	1,180,885	330,771	1,193,081	53,809	53,774
Home equity loans	-	-	-	-	-	-
Commercial						
Real estate secured	1,568,242	1,568,242	611,272	1,637,097	57,017	52,798
Non-real estate secured	51,768	51,768	21,811	61,726	1,131	907
Consumer	36,501	36,501	1,146	38,965	195	195
Subtotal	2,837,396	2,837,396	965,000	2,930,869	112,152	107,674
Total	$ 3,490,512	$ 3,490,512	$ 965,000	$ 3,610,695	$ 151,542	$ 149,061

The recorded investment in loans excludes accrued interest receivable and loan origination fees, net due to immateriality. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following tables present the recorded investment in nonaccrual and loans past due over 90 days still on accrual by class of loans as of December 31, 2016 and December 31, 2015:

	2016		2015	
	Nonaccrual	Loans Past Due Over 90 Days Still Accruing	Nonaccrual	Loans Past Due Over 90 Days Still Accruing
Residential real estate				
Residential mortgages	**$ 46,711**	**$ -**	$ 55,387	$ 121,796
Home equity	**-**	**-**	-	29,243
Commercial				
Real estate secured	**397,283**	**-**	694,497	-
Non-real estate secured	**-**	**-**	-	-
Municipal loans	**-**	**-**	-	-
Consumer	**1,762**	**-**	12,805	3,084
	$ 445,756	**$ -**	$ 762,689	$ 154,123

NOTE 3 - LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2016 and 2015:

December 31, 2016	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due
Residential real estate				
Residential mortgages	$ -	$ 46,711	$ 46,711	$ 54,503,049
Home equity	-	-	-	12,591,684
Commercial				
Real estate secured	-	397,283	397,283	47,799,124
Non-real estate secured	-	-	-	17,311,477
Municipal loans	-	-	-	32,546,951
Consumer	6,837	1,762	8,599	9,657,364
	$ 6,837	$ 445,756	$ 452,593	$ 174,409,649

December 31, 2015	30 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due
Residential real estate				
Residential mortgages	$ 74,437	$ 177,183	$ 251,620	$ 54,438,125
Home equity	39,947	29,243	69,190	10,904,203
Commercial				
Real estate secured	3,819	694,497	698,316	41,499,471
Non-real estate secured	-	-	-	16,209,203
Municipal loans	-	-	-	30,077,246
Consumer	50,721	15,889	66,610	8,984,797
	$ 168,924	$ 916,812	$ 1,085,736	$ 162,113,045

Troubled Debt Restructurings:

The Company has allocated $543,000 and $620,000 of specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2016 and 2015. Of these reserves, $373,000 and $415,000 represent reserves on collateral dependent troubled debt restructures. The outstanding balance of such loans was $2,517,000 at year-end 2016. The Company committed to lending additional amounts of $12,000 and $53,000, as of December 31, 2016 and 2015 respectively, to customers with outstanding loans that are classified as troubled debt restructurings.

The modifications of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan, an extension of the maturity date at a stated rate of interest lower than the market rate for new debt with similar risk, capitalization of interest due or a nominal principal advance to enhance collectability of the debt.

Modifications involving a reduction of the stated interest rate of the loan were for periods ranging from 12 months to 30 years. Modifications involving an extension of the maturity date were for periods ranging from 12 months to 30 years.

During 2016, 1 commercial real estate loan was modified. The pre-modification outstanding recorded investment on this modified loan was $41,900 and the post-modification outstanding recorded investment was $13,500. This troubled debt restructuring increased the allowance for loan losses by $13,500 and resulted in a charge-off of $9,000 during the year ending December 31, 2016.

There were no troubled debt restructures during the year ended December 31, 2015.

There were no troubled debt restructurings in payment default within twelve months following the modification during the year ending December 31, 2016 and December 31, 2015. A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

NOTE 3 - LOANS (Continued)

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes credit relationships with an outstanding balance greater than $150,000 and non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed annually, at renewals, and when new information on a credit is learned. The Company uses the following definitions for risk ratings:

Special Mention: Loans classified as special mention are included on the watch list, have identifiable weaknesses and are reviewed quarterly for impairment. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Not rated loans that are past due 30-89 days are also included in this category.

Substandard: Loans classified as substandard are considered very high risk, included on watch list, have well-defined weaknesses, normal repayment is in jeopardy and they are reviewed quarterly for impairment. Not rated loans that are more than 89 days past due are included in this category.

Impaired Non-Accrual: Loans classified as impaired non-accrual are very high risk and are in non-accrual status. These loans have significant weaknesses making full collection of interest unlikely.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as impaired non-accrual, plus significant weaknesses making full collection through payment or liquidation questionable and improbable. The bank had no doubtful loans in 2016 and 2015.

Loans not meeting the criteria above, that are analyzed individually as part of the above described process, are considered to be pass rated loans. Municipal loans are primarily short-moderate term loans to municipalities related to maintenance or improvement projects that are funded by approved special tax assessments. The Company reviews updated financial information on long-term issues periodically. Groups of homogeneous loans and municipal loans are not rated and are listed as pass.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

December 31, 2016	**Pass**	**Special Mention**	**Substandard**	**Impaired Non-Accrual**	**Total**
Residential real estate					
Residential mortgages	**$ 53,191,973**	**$ 1,311,076**	**$ -**	**$ 46,711**	**$ 54,549,760**
Home equity	**12,583,040**	**8,644**	**-**	**-**	**12,591,684**
Commercial					
Real estate secured	**45,343,606**	**1,950,648**	**504,870**	**397,283**	**48,196,407**
Non-real estate secured	**17,284,736**	**26,741**	**-**	**-**	**17,311,477**
Municipal loans	**32,546,951**	**-**	**-**	**-**	**32,546,951**
Consumer	**9,613,102**	**51,099**	**-**	**1,762**	**9,665,963**
Total	**$ 170,563,408**	**$ 3,348,208**	**$ 504,870**	**$ 445,756**	**$ 174,862,242**

December 31, 2015	**Pass**	**Special Mention**	**Substandard**	**Impaired Non-Accrual**	**Total**
Residential real estate					
Residential mortgages	$ 52,974,914	$ 1,537,648	$ 121,796	$ 55,387	$ 54,689,745
Home equity	10,893,067	51,083	29,243	-	10,973,393
Commercial					
Real estate secured	39,278,675	1,651,416	573,199	694,497	42,197,787
Non-real estate secured	16,070,314	57,528	81,361	-	16,209,203
Municipal loans	30,077,246	-	-	-	30,077,246
Consumer	8,942,453	93,065	3,084	12,805	9,051,407
Total	$ 158,236,669	$ 3,390,740	$ 808,683	$ 762,689	$ 163,198,781

NOTE 4 - PREMISES AND EQUIPMENT

Premises and equipment are summarized as follows:

	2016	2015
Land	$ 1,785,136	$ 1,835,288
Buildings	9,265,933	9,199,602
Furniture and equipment	5,625,464	5,358,076
	16,676,533	16,392,966
Less: Accumulated depreciation	(8,605,995)	(8,179,213)
	$ 8,070,538	$ 8,213,753

NOTE 5 - DEPOSITS

Time deposits of $250,000 or more were $1,823,000 and $1,783,000 at year-end 2016 and 2015, respectively. Scheduled maturities of all time deposits for the next five years and thereafter are as follows:

2017	$ 17,296,804
2018	3,453,319
2019	1,956,944
2020	1,080,505
2021	326,946
Thereafter	104,119

The Company held deposits of approximately $2,911,000 and $2,092,000 for related parties at December 31, 2016 and 2015, respectively.

NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES

Advances from the Federal Home Loan Bank were $18,663,000 and $12,326,000 at year-end 2016 and 2015, respectively. The weighted average fixed interest rate of outstanding advances was 1.54% and 1.97% at year-end 2016 and 2015, respectively.

Advances are payable at maturity date or with penalty for prepayment. The advances were collateralized by $47,330,000 and $48,693,000 of first mortgage loans under a blanket lien arrangement at year-end 2016 and 2015, respectively.

Scheduled maturities and required payments over the next five years and thereafter:

2017	$ 7,663,000
2018	2,000,000
2019	2,000,000
Thereafter	7,000,000

$7,000,000 of advances are “Putable” advances which provide the Federal Home Loan Bank (“FHLB”) the option to convert the entire advance to an Adjustable Rate Advance at certain dates. The advances are fixed rate advances until that time. If the FHLB exercises its option, the Corporation may pay off the advance without penalty.

The Company's Federal Home Loan Bank Overdraft Line of Credit had a balance of $0 as of December 31, 2016. The same line had a balance of $245,000 as of December 31, 2015.

NOTE 7 - RETIREMENT PLAN

The Bank sponsors a 401(k) savings plan that allows eligible employees to contribute a percentage of their annual compensation. The Bank matches a portion of the participant's contribution, up to plan-specified maximums. The Bank contributed $60,000 and $57,000 to the plan during 2016 and 2015, respectively. The Bank may also elect to make a profit-sharing contribution to the Plan.

Additionally, retirement benefits are provided to substantially all employees under a discretionary profit-sharing and employee stock ownership plan (ESOP). The Bank recognized expense of $190,000 and $190,000 during 2016 and 2015, respectively, related to the profit-sharing plan, which includes contributions to the ESOP of $120,000 and $120,000 in 2016 and 2015, respectively.

NOTE 8 - FEDERAL INCOME TAXES

The provision for income taxes is summarized as follows:

	Year ended December 31	
	2016	**2015**
Current	**$ 334,000**	$ 360,000
Deferred	**(154,000)**	(150,000)
	$ 180,000	$ 210,000

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Bank's deferred tax assets and liabilities are as follows:

	December 31	
	2016	**2015**
Deferred income tax assets:		
Allowance for loan losses in excess of deductible amounts	**$ 300,000**	$ 287,000
Post retirement benefits	**91,000**	99,000
AMT credit carry forward	**2,160,000**	2,002,000
Accrued liabilities	**103,000**	90,000
Other	**34,000**	75,000
	2,688,000	2,553,000
Deferred income tax liabilities:		
Prepaid expenses	**(45,000)**	(47,000)
Book-tax basis differences on property and equipment	**(154,000)**	(183,000)
Unrealized gains on securities	**(121,000)**	(467,000)
Mortgage servicing rights	**(133,000)**	(121,000)
Other	**(54,000)**	(67,000)
	(507,000)	(885,000)
Net deferred income tax assets	**$ 2,181,000**	$ 1,668,000

At December 31, 2016 and December 31, 2015 there were no unrecognized tax benefits recorded. The Bank does not expect the amount of unrecognized tax benefits to significantly change within the next twelve months. There were no interest or penalties recorded during 2016 or 2015. The company is subject to U.S. federal income tax and is no longer subject to examination by taxing authorities for years before 2013. The deferred tax assets include $2,160,000 of AMT credit carryforward. The AMT credits do not expire.

A reconciliation of the difference between federal income taxes and the amount computed by applying the statutory rate are as follows:

	Year ended December 31	
	2016	**2015**
Taxes at statutory rate	**$ 668,000**	$ 658,000
Effect of tax-exempt interest	**(450,000)**	(417,000)
Effect of BOLI income	**(60,000)**	(59,000)
Other	**22,000**	28,000
	$ 180,000	$ 210,000

NOTE 9 - LOAN COMMITMENTS AND STANDBY LETTERS OF CREDIT

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

At December 31, 2016 and 2015, the Banks customers had commitments to fund loans and available unused lines of credit of $18,125,000 and $17,015,000, respectively. Commitments under outstanding standby letters of credit amounted to $1,405,000 and $688,000 at December 31, 2016 and 2015, respectively.

NOTE 10 – REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The net unrealized gain or loss on available-for-sale securities is not included in computing regulatory capital. The table below presents capital adequacy information assuming full phase-in of these new requirements, which includes the full 2.50% capital conservation buffer which will be required as of January 1, 2019. The current capital conservation buffer requirement at December 31, 2016 is 0.625%. Management believes, as of December 31, 2016 and December 31 2015, the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2016 and 2015, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

Actual and required capital amounts (000's omitted) and ratios at year-end are presented below:

	Actual		Required For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Regulations	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
2016						
Total capital to risk-weighted assets:	**$ 27,645**	**16.79%**	**$ 17,293**	**10.50%**	**$ 16,470**	**10.00%**
Tier 1 (Core) Capital to risk-weighted assets:	**26,359**	**16.00**	**13,999**	**8.50**	**13,176**	**8.00**
Common Tier 1 to risk-weighted assets (CET1)	**26,359**	**16.00**	**11,529**	**7.00**	**10,705**	**6.50**
Tier 1 (Core) Capital to average assets:	**26,359**	**8.57**	**20,001**	**4.00**	**15,386**	**5.00**
2015						
Total capital to risk-weighted assets:	$ 26,780	17.39%	$ 16,170	10.50%	$ 15,400	10.00%
Tier 1 (Core) Capital to risk-weighted assets:	25,335	16.45	13,090	8.50	12,320	8.00
Common Tier 1 to risk-weighted assets (CET1)	25,335	16.45	10,780	7.00	10,010	6.50
Tier 1 (Core) Capital to average assets:	25,335	8.42	19,557	4.00	15,044	5.00

NOTE 11 - FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as 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.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: The fair value for securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2). For securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators (Level 3). Discounted cash flows are calculated using spread to swap and Treasury curves that are updated to incorporate loss severities, volatility, credit spread and optionality. During times when trading is more liquid, broker quotes are used (if available) to validate the model. Rating agency and industry research reports as well as defaults and deferrals on individual securities are reviewed and incorporated into the calculations. The Company had no securities designated as Level 3 securities at year-end 2016 and 2015.

Impaired Loans: The fair value of collateral dependent impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate valuations. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Other Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate valuations which are updated no less frequently than annually. These valuations may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Valuations for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties), certified residential appraisers, state licensed appraisers or licensed realtors (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, an adminstrator level or higher reviews the assumptions and approaches utilized in the valuation as well as the overall resulting fair value in comparison with independent data sources such as recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent valuation to determine what additional adjustment should be made to the valuation to arrive at fair value. The most recent analysis performed indicated that a discount of 20% should be applied.

NOTE 11 - FAIR VALUE (Continued)

Assets and liabilities measured at fair value on a recurring basis are summarized below:

Fair Value Measurements at December 31 using:

2016	Carrying Value	Level 1	Level 2	Level 3
U.S. Government and federal agency	**$ 11,394,327**	**$ 5,748,594**	**$ 5,645,733**	**$ -**
State and municipal	**48,953,208**	**-**	**48,953,208**	**-**
Mortgage-backed, residential	**10,734,744**	**-**	**10,734,744**	**-**
Corporate	**1,252,824**	**-**	**1,252,824**	**-**
Asset-backed securities	**177,724**	**-**	**177,724**	**-**
Available-for-sale securities	**$ 72,512,827**	**$ 5,748,594**	**$ 66,764,233**	**$ -**

2015	Carrying Value	Level 1	Level 2	Level 3
U.S. Government and federal agency	$ 16,670,434	$ 9,486,446	$ 7,183,988	$ -
State and municipal	46,760,736	-	46,760,736	-
Mortgage-backed, residential	12,799,557	-	12,799,557	-
Corporate	1,256,146	-	1,256,146	-
Asset-backed securities	269,813	-	269,813	-
Available-for-sale securities	$ 77,756,686	$ 9,486,446	$ 68,270,240	$ -

Assets measured at fair value on a non-recurring basis are summarized below:

December 31, 2016	Level 1	Level 2	Level 3
Impaired Loans			
Residential mortgages	**$**	**$**	**$ 302,172**
Commercial			
Real estate secured	**-**	**-**	**127,660**
Non-real estate secured	**-**	**-**	**15,707**
Total impaired loans	**-**	**-**	**445,539**
Other Real Estate Owned			
Commercial real estate	**-**	**-**	**12,000**
Total impaired loans / other real estate owned	**$ -**	**$ -**	**$ 457,539**

NOTE 11 - FAIR VALUE (Continued)

December 31, 2015	**Level 1**	**Level 2**	**Level 3**
Impaired Loans			
Residential real estate			
Residential mortgages	$	$	$ 300,887
Commercial			
Real estate secured	-	-	108,672
Non-real estate secured	-	-	69,955
Total impaired loans	-	-	479,514
Other Real Estate Owned			
Commercial real estate	-	-	255,250
Total impaired loans / other real estate owned	$ -	$ -	$ 734,764

As discussed previously, the fair values of impaired loans carried at fair value are determined by third party appraisals. Management makes adjustments to these appraised values based on the age of the appraisal. The following tables present quantitative information about level 3 fair value measurements for the larger or more complex classes of financial instruments measured at fair value on a non-recurring basis:

December 31, 2016	**Fair Value**	**Valuation Technique**	**Unobservable Input(s)**	**Range (Weighted average)**
Impaired loans - commercial real estate	**$ 127,660**	Sales comparison approach	Management discount for property type and recent volatility	10% - 20% (17%)

December 31, 2015	**Fair Value**	**Valuation Technique**	**Unobservable Input(s)**	**Range (Weighted average)**
Impaired loans - commercial real estate	$ 108,672	Sales comparison approach	Management discount for property type and recent volatility	10% - 20% (17%)

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, a level 3 value, had a carrying amount of $819,000 prior to a valuation allowance of $373,000 at December 31, 2016, resulting in a reduction of allocation for loan losses of $22,000 for the year ending December 31, 2016. At December 31, 2015, impaired loans had a carrying amount of $895,000, prior to a valuation allowance of $415,000, resulting in a reduction of allocation for loan losses of $50,000 for the year ending December 31, 2015.

Other real estate owned, with a valuation reserve, measured at the lower of carrying or fair value less costs to sell, a level 3 value, had a net carrying amount of $12,000, which is made up of the outstanding balance of $12,000, net of a valuation allowance of $0 at December 31, 2016, resulting in a write-down of $0 for the year ending December 31, 2016. As of December 31, 2015, the net carrying amount was $255,250, which is made up of outstanding balance of $355,000, net of a valuation allowance of $99,750, resulting in a write-down of $35,750 for the year ending December 31, 2015.

NOTE 11 - FAIR VALUE (Continued)

The methods and assumptions, not previously presented, used to estimate fair value are described as follows:

Carrying amount is the estimated fair value for cash and cash equivalents, interest-bearing deposits, short-term borrowings, accrued interest receivable and payable, and variable rate loans or deposits that reprice frequently and fully. The methods for determining the fair values for securities were described previously. For fixed rate loans or interest-bearing deposits and for variable rate loans or deposits with infrequent repricing or repricing limits, fair value is based on discounted cash flows using current market rates applied to the estimated life and credit risk. Fair value of debt is based on current rates for similar financing. It was not practicable to determine the fair value of FHLB stock due to restrictions placed on its transferability. The fair value of off-balance sheet items is not considered material.

The carrying amounts and the estimated fair values of financial instruments are summarized as follows:

	2016		2015	
	Carrying Amount	**Estimated Fair Value**	**Carrying Amount**	**Estimated Fair Value**
Assets:				
Cash and cash equivalents	**$ 11,275,902**	**$ 11,276,000**	$ 7,273,138	$ 7,273,000
Interest-bearing deposits	**30,862,000**	**30,256,000**	33,292,000	32,603,000
Securities - held-to-maturity	**1,055,314**	**1,070,000**	1,910,564	1,937,000
Securities - available-for-sale	**72,512,827**	**72,513,000**	77,756,686	77,757,000
Federal Home Loan Bank stock	**1,580,800**	**NA**	1,580,800	NA
Loans, net	**173,576,153**	**173,430,000**	161,753,387	161,660,000
Accrued interest receivable	**1,163,280**	**1,163,000**	1,093,313	1,093,000
Liabilities:				
Deposits	**$ 261,258,236**	**$ 261,161,000**	$ 260,546,842	$ 261,417,000
Federal Home Loan Bank advances	**18,663,000**	**18,526,000**	12,326,000	12,663,000
Short-term borrowings	**-**	**-**	244,593	245,000
Accrued interest payable	**37,330**	**37,000**	38,298	38,000

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