ADVANCE AUTO PARTS INC
Form 4
January 12, 2016

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
SALADRIGAS CARLOS A

(Last) (First) (Middle)

ADVANCE AUTO PARTS, INC., 5008 AIRPORT RD

(Street)

ROANOKE, VA 24012

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
ADVANCE AUTO PARTS INC [AAP]

3. Date of Earliest Transaction (Month/Day/Year)
01/08/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	01/08/2016		A		8 (1)	A	$ 145.56	38,609	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
SALADRIGAS CARLOS A ADVANCE AUTO PARTS, INC. 5008 AIRPORT RD ROANOKE, VA 24012	X			

Signatures

/s/ Rachel E. Geiersbach, as Attorney-in-Fact for Carlos A. Saladrigas	01/12/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) These shares of issuer common stock were acquired pursuant to a dividend reinvestment feature of the Advance Auto Parts, Inc. Deferred Stock Unit Plan for Non-Employee Directors and Selected Executives.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. RAP COLSPAN="2" STYLE="font-weight: bold; text-align: center; border-bottom: Black 1pt solid">Unrealized
Loss Fair Value Unrealized
Losses Asset-backed securities issued by GSEs and U.S.
Agencies 33,218 961 42,074 1,891 75,292 2,852 Callable GSE Agency
Bonds 4,887 126 - - 4,887 126 Asset-backed securities issued by
Others - - 524 45 524 45 $38,105 $1,087 $42,598 $1,936 $80,703 $3,023

At June 30, 2018, the HTM investment portfolio had an estimated fair value of $98.0 million on an amortized cost of $100.8 million. Of these securities, $80.2 million were asset-backed securities or bonds issued by GSEs and U.S. Agencies and $524,000 were asset-backed securities issued by others.

HTM asset-backed securities issued by GSEs and GSE agency bonds are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. The securities with unrealized losses had an average life of 4.96 years and an average duration of 4.33 years. Management believes that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. HTM asset-backed securities issued by others with unrealized losses had an average life of 3.15 years and an average duration of 2.57 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2017 were as follows:

December 31, 2017	Less Than 12 Months		More Than 12 Months		Total	
(dollars in thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs and U.S. Agencies	$36,607	$ 254	$45,119	$ 1,130	$81,726	$ 1,384
Asset-backed securities issued by Others	-	-	599	52	599	52
	$36,607	$ 254	$45,718	$ 1,182	$82,325	$ 1,436

At December 31, 2017, the HTM investment portfolio had an estimated fair value of $98.0 million on an amortized cost of $99.2 million. Of these securities, $81.7 million were asset-backed securities issued by GSEs and U.S. Agencies and $599,000 were asset-backed securities issued by others.

23

HTM asset-backed securities issued by GSEs and GSE agency bonds are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. The securities with unrealized losses had an average life of 5.02 years and an average duration of 4.43 years. Management believes that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. HTM asset-backed securities issued by others with unrealized losses had an average life of 3.20 years and an average duration of 2.66 years.

Credit Quality of Asset-Backed Securities and Agency Bonds

The tables below present the Standard & Poor's ("S&P") or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and U.S. Agencies and others or bonds issued by GSEs or U.S. government agencies at June 30, 2018 and December 31, 2017 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed securities and GSE agency bonds with S&P AA+ ratings were treated as AAA based on regulatory guidance.

June 30, 2018		December 31, 2017	
Credit Rating	Amount	Credit Rating	Amount
(dollars in thousands)			
AAA	$179,296	AAA	$162,337
BB	569	BB	651
B+	-	B+	-
Total	$179,865	Total	$162,988

24

NOTE 11 – LOANS

Loans consist of the following:

	June 30, 2018				December 31, 2017	
(dollars in thousands)	PCI	All other loans**	Total	% of Gross Loans	Total	% of Gross Loans
Commercial real estate	$1,503	$826,941	$828,445	64.20 %	$727,314	63.25 %
Residential first mortgages	470	162,621	163,090	12.64 %	170,374	14.81 %
Residential rentals	1,274	126,195	127,469	9.88 %	110,228	9.58 %
Construction and land development	272	28,375	28,647	2.22 %	27,871	2.42 %
Home equity and second mortgages	319	36,707	37,026	2.87 %	21,351	1.86 %
Commercial loans	-	57,519	57,519	4.46 %	56,417	4.91 %
Consumer loans	-	801	801	0.06 %	573	0.05 %
Commercial equipment	-	47,418	47,418	3.67 %	35,916	3.12 %
Gross loans	3,838	1,286,577	1,290,415	100.00 %	1,150,044	100.00 %
Net deferred costs (fees)	-	1,122	1,122	0.09 %	1,086	0.09 %
Total loans, net of deferred costs	$3,838	$1,287,699	$1,291,537		$1,151,130	
Less: allowance for loan losses	-	(10,725)	(10,725)	-0.83 %	(10,515)	-0.91 %
Net loans	$3,838	$1,276,974	$1,280,812		$1,140,615	

**All other loans include acquired Non-PCI pools.

At June 30, 2018 and December 31, 2017, the Bank's allowance for loan losses totaled $10.7 million and $10.5 million, or 0.83% and 0.91%, respectively, of loan balances. Allowance for loan loss percentage levels decreased in first six months of 2018, primarily due to the addition of County First loans, after consummation of the legal merger on January 1, 2018, for which no allowance was provided for in accordance with purchase accounting standards. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

Net deferred loan fees and premiums of $1.1 million at June 30, 2018 included net deferred fees paid by customers of $2.9 million offset by net deferred premiums paid for the purchase of residential first mortgages and deferred costs of $4.0 million. Net deferred loan fees and premiums of $1.1 million at December 31, 2017 included net deferred fees paid by customers of $2.8 million offset by net deferred premiums paid for the purchase of residential first mortgages and deferred costs of $3.9 million.

Risk Characteristics of Portfolio Segments

Concentrations of Credit - Loans are primarily made within the Company’s operating footprint of Southern Maryland, Annapolis Maryland and the greater Fredericksburg area of Virginia. Real estate loans can be affected by the condition of the local real estate market. Commercial and industrial loans can be affected by the local economic conditions. The commercial loan portfolio has concentrations in business loans secured by real estate and real estate development loans. At June 30, 2018 and December 31, 2017, the Company had no loans outstanding with foreign entities.

The Company manages its credit products and exposure to credit losses (credit risk) by the following specific portfolio segments (classes), which are levels at which the Company develops and documents its allowance for loan loss methodology. These segments are:

Commercial Real Estate (“CRE”)

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were 7.0% and 6.2% of the CRE portfolio at June 30, 2018 and December 31, 2017, respectively. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

25

Loans secured by commercial real estate are larger and involve greater risks than one-to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy.

Residential First Mortgages

Residential first mortgage loans are generally long-term loans, amortized on a monthly basis, with principal and interest due each month. The contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank’s experience indicates that real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank’s residential portfolio has both fixed-rate and adjustable-rate residential first mortgages. During the six months ended June 30, 2018 and the year ended December 31, 2017, the Bank purchased residential first mortgages of $3.4 million and $25.5 million, respectively.

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank’s adjustable rate residential first mortgage portfolio was $55.0 million or 4.3% of total gross loans of $1.29 billion at June 30, 2018 compared to $56.9 million or 5.0% of total gross loans of $1.15 billion at December 31, 2017.

Residential Rentals

Residential rental mortgage loans are amortizing, with principal and interest due each month. The loans are secured by income-producing 1-4 family units and apartments. As of June 30, 2018, and December 31, 2017, $99.9 million and $85.0 million, respectively, were 1-4 family units and $27.6 million and $25.2 million, respectively, were apartment buildings or multi-family units. Loans secured by residential rental properties are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years. The primary security on a residential rental loan is the property and the leases that produce income. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank’s adjustable rate residential rental portfolio was $99.1 million or 7.7% of total gross loans of $1.29 billion at June 30, 2018 compared to $93.4 million or 8.1% of total gross loans of $1.15 billion at December 31, 2017.

Loans secured by residential rental properties involve greater risks than 1-4 family residential mortgage loans. Although, there are similar risk characteristics shared with commercial real estate loans, the balances for the loans secured by residential rental properties are generally smaller. Because payments on loans secured by residential rental properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the rental real estate market or the economy than similar owner-occupied properties.

Construction and Land Development

The Bank offers loans for the construction of one-to-four family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building.

A decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank’s risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project’s value might be insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk is heightened as the market value of residential property has not fully returned to pre-financial crisis levels and interest rates began to increase in 2017.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower’s payment history of both corporate and personal debt, the projected cash flows of the business, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower’s ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank.

Commercial loans are made on the basis of the borrower’s ability to make repayment from the cash flows of the borrower’s business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself.

Consumer Loans

Consumer loans consist of loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower’s continuing financial stability.

Commercial Equipment Loans

These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer’s equipment or secured by real property, accounts receivable, or other security as determined by the Bank. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk and typically are made on the basis of the borrower’s ability to make repayment from the cash flows of the borrower’s business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

Non-accrual and Aging Analysis of Current and Past Due Loans

Non-accrual loans as of June 30, 2018 and December 31, 2017 were as follows:

(dollars in thousands)	June 30, 2018 90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$9,219	9	$ 800	3	$ 10,019	12
Residential first mortgages	522	2	487	1	1,009	3
Residential rentals	84	1	697	3	781	4
Construction and land development	-	-	-	-	-	-
Home equity and second mortgages	36	1	118	1	154	2
Commercial loans	898	2	-	-	898	2
Consumer loans	-	-	1	1	1	1
Commercial equipment	1,588	5	42	1	1,630	6
	$12,347	20	$ 2,145	10	$ 14,492	30

27

(dollars in thousands)	December 31, 2017 90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$1,148	4	$ 839	3	$ 1,987	7
Residential first mortgages	478	3	507	1	985	4
Residential rentals	84	1	741	3	825	4
Construction and land development	-	-	-	-	-	-
Home equity and second mortgages	134	3	123	1	257	4
Commercial loans	172	2	-	-	172	2
Consumer loans	-	-	-	-	-	-
Commercial equipment	467	3	-	-	467	3
	$2,483	16	$ 2,210	8	$ 4,693	24

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) increased $9.8 million from $4.7 million or 0.41% of total loans at December 31, 2017 to $14.5 million or 1.12% of total loans at June 30, 2018. Non-accrual loans can be current but classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. In accordance with the Company’s policy, interest income is recognized on a cash basis or cost-recovery method, until qualifying for return to accrual status.

At June 30, 2018, non-accrual loans of $14.5 million included 30 loans, of which $11.7 million, or 80% represented 11 loans and two customer relationships. At December 31, 2017, non-accrual loans of $4.7 million included 24 loans, of which $3.3 million, or 71% represented 10 loans and five customer relationships. During the six months ended June 30, 2018, non-accrual loans increased $9.8 million primarily as a result of one well-secured classified relationship of $10.3 million that was placed on non-accrual during the second quarter of 2018, which resulted in the reversal of approximately $120,000 of interest income. During the year ended December 31, 2017 non-accrual loans decreased $3.0 million due to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Before the foreclosure, the loans in this relationship were troubled debt restructures (“TDRs”). Additionally, during the third quarter of 2017, non-accrual loans decreased $607,000 due to the foreclosure of a commercial office building.

Non-accrual loans included no TDRs at June 30, 2018 and one TDR totaling $769,000 at December 31, 2017. This loan was classified solely as non-accrual for the calculation of financial ratios. Loan delinquency (90 days or greater delinquent and 31-89 days delinquent) increased $1.2 million from $11.7 million, or 1.02% of loans, at December 31, 2017 to $12.9 million, or 1.00% of loans, at June 30, 2018.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $13.0 million and $3.8 million at June 30, 2018 and December 31, 2017, respectively. Interest due but not recognized on these balances at June 30, 2018 and December 31, 2017 was $252,000 and $85,000, respectively. Non-accrual loans with a specific allowance for impairment on which the recognition of interest has been discontinued amounted to $1.5 million and $876,000 at June 30, 2018 and December 31, 2017, respectively. Interest due but not recognized on these balances at June 30, 2018 and December 31, 2017 was $75,000 and $100,000, respectively.

28

The Company considers a loan to be past due or delinquent when the terms of the contractual obligation are not met by the borrower. PCI loans are included as a single category in the table below as management believes, regardless of their age, there is a lower likelihood of aggregate loss related to these loan pools. Additionally, PCI loans are discounted to allow for the accretion of income on a level yield basis over the life of the loan based on expected cash flows. Regardless of payment status, the associated discount on these loan pools results in income recognition.

Past due and PCI loans as of June 30, 2018 and December 31, 2017 were as follows:

	June 30, 2018						
(dollars in thousands)	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	PCI Loans	Current	Total Loan Receivables
Commercial real estate	$74	$85	$ 9,219	$9,378	$ 1,503	$817,564	$828,445
Residential first mortgages	-	71	522	593	470	162,027	163,090
Residential rentals	14	-	84	98	1,274	126,097	127,469
Construction and land dev.	-	-	-	-	272	28,375	28,647
Home equity and second mtg.	202	30	36	268	319	36,439	37,026
Commercial loans	-	-	898	898	-	56,621	57,519
Consumer loans	-	-	-	-	-	801	801
Commercial equipment	58	48	1,588	1,694	-	45,724	47,418
Total	$348	$234	$ 12,347	$12,929	$ 3,838	$1,273,648	$1,290,415

	December 31, 2017						
(dollars in thousands)	31-60 Days	61-89 Days	90 or Greater Days	Total Past Due	PCI Loans	Current	Total Loan Receivables
Commercial real estate	$-	$6,711	$ 1,148	$7,859	$ -	$719,455	$727,314
Residential first mortgages	-	68	478	546	-	169,828	170,374
Residential rentals	-	207	84	291	-	109,937	110,228
Construction and land dev.	-	-	-	-	-	27,871	27,871
Home equity and second mtg.	19	18	134	171	-	21,180	21,351
Commercial loans	892	299	172	1,363	-	55,054	56,417
Consumer loans	-	1	-	1	-	572	573
Commercial equipment	1,012	-	467	1,479	-	34,437	35,916
Total	$1,923	$7,304	$ 2,483	$11,710	$ -	$1,138,334	$1,150,044

29

Impaired Loans and Troubled Debt Restructures ("TDRs")

Impaired loans, including TDRs, at June 30, 2018 and 2017 and at December 31, 2017 were as follows:

	June 30, 2018								
(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Quarter Average Recorded Investment	Quarter Interest Income Recognized	YTD Average Recorded Investment	YTD Interest Income Recognized
Commercial real estate	$26,804	$ 24,923	$ 1,569	$26,492	$ 182	$26,609	$ 214	$26,695	$ 469
Residential first mortgages	2,473	2,434	-	2,434	-	2,480	26	2,490	53
Residential rentals	1,430	1,396	-	1,396	-	1,440	18	1,450	35
Construction and land dev.	729	-	729	729	210	729	10	729	20
Home equity and second mtg.	303	213	86	299	7	304	3	306	7
Commercial loans	2,792	1,892	900	2,792	458	2,793	32	2,793	52
Consumer loans	2	1	1	2	1	2	-	2	-
Commercial equipment	1,645	1,021	622	1,643	508	1,661	13	1,692	29
Total	$36,178	$ 31,880	$ 3,907	$35,787	$ 1,366	$36,018	$ 316	$36,157	$ 665

	December 31, 2017						
(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	YTD Average Recorded Investment	YTD Interest Income Recognized
Commercial real estate	$33,180	$ 30,921	$ 2,008	$ 32,929	$ 370	$ 33,575	$ 1,379
Residential first mortgages	2,455	1,978	459	2,437	2	2,479	91
Residential rentals	2,389	1,981	395	2,376	18	2,432	111
Construction and land dev.	729	-	729	729	163	729	26
Home equity and second mtg.	317	317	-	317	-	318	12
Commercial loans	3,010	2,783	168	2,951	168	3,048	137
Commercial equipment	1,538	1,048	467	1,515	303	1,578	73
Total	$43,618	$ 39,028	$ 4,226	$ 43,254	$ 1,024	$ 44,159	$ 1,829

30

(dollars in thousands)	June 30, 2017 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Quarter Average Recorded Investment	Quarter Interest Income Recognized	YTD Average Recorded Investment	YTD Interest Income Recognized
Commercial real estate	$20,277	$ 13,079	$ 6,987	$ 20,066	$ 693	$ 20,186	$ 198	$ 20,274	$ 417
Residential first mortgages	2,294	1,823	468	2,291	11	2,299	21	2,311	49
Residential rentals	2,758	2,286	400	2,686	23	2,693	27	2,731	56
Construction and land dev.	981	252	729	981	163	980	4	980	7
Home equity and second mtg.	109	109	-	109	-	110	1	111	2
Commercial loans	3,063	2,804	169	2,973	169	2,974	23	2,986	46
Commercial equipment	638	108	491	599	417	617	6	625	11
Total	$30,120	$ 20,461	$ 9,244	$ 29,705	$ 1,476	$ 29,859	$ 280	$ 30,018	$ 588

31

TDRs, included in the impaired loan schedules above, as of June 30, 2018 and December 31, 2017 were as follows:

(dollars in thousands)	June 30, 2018 Dollars	June 30, 2018 Number of Loans	December 31, 2017 Dollars	December 31, 2017 Number of Loans
Commercial real estate	$ 8,396	8	$ 9,273	9
Residential first mortgages	517	2	527	2
Residential rentals	218	1	221	1
Construction and land development	729	2	729	2
Commercial loans	4	1	4	1
Commercial equipment	-	-	36	1
Total TDRs	$ 9,864	14	$ 10,790	16
Less: TDRs included in non-accrual loans	-	-	(769)	(1)
Total accrual TDR loans	$ 9,864	14	$ 10,021	15

TDRs decreased $926,000 due to principal paydowns and payoffs for the six months ended June 30, 2018. There were no TDRs added during the six months ended June 30, 2018. The Company had specific reserves of $393,000 on three TDRs totaling $2.3 million at June 30, 2018. The Company had specific reserves of $413,000 on seven TDRs totaling $3.0 million at December 31, 2017. During the year ended December 31, 2017, TDR disposals, which included payoffs and refinancing decreased by seven loans totaling $3.9 million, of which $3.0 million related to the foreclosure of the stalled residential development project. TDR loan principal curtailment was $385,000 for the year ended December 31, 2017. There were no TDRs added during the year ended December 31, 2017.

32

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the three and six months ended June 30, 2018 and 2017, respectively. An allocation of the allowance to one category of loans does not prevent the Company from using that allowance to absorb losses in a different category.

	June 30, 2018				
(dollars in thousands)	Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Three Months Ended					
Commercial real estate	$6,664	$ -	$ 4	$ (105)	$6,563
Residential first mortgages	937	(76)	-	(124)	737
Residential rentals	459	-	-	10	469
Construction and land development	482	-	-	16	498
Home equity and second mortgages	118	-	5	(19)	104
Commercial loans	1,045	(88)	-	246	1,203
Consumer loans	7	-	-	-	7
Commercial equipment	759	-	9	376	1,144
	$10,471	$ (164)	$ 18	$ 400	$10,725
Purchase Credit Impaired**	$-	$ -	$ -	$ -	$-
Six Months Ended					
Commercial real estate	$6,451	$ (236)	$ 6	$ 342	$6,563
Residential first mortgages	1,144	(113)	-	(294)	737
Residential rentals	512	-	-	(43)	469
Construction and land development	462	-	-	36	498
Home equity and second mortgages	162	(7)	14	(65)	104
Commercial loans	1,013	(88)	-	278	1,203
Consumer loans	7	(1)	-	1	7
Commercial equipment	764	(299)	34	645	1,144
	$10,515	$ (744)	$ 54	$ 900	$10,725
Purchase Credit Impaired**	$-	$ -	$ -	$ -	$-

** There is no allowance for loan loss on the PCI portfolios. A more detailed rollforward schedule will be presented if an allowance is required.

33

(dollars in thousands)	June 30, 2017 Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Three Months Ended					
Commercial real estate	$5,179	$ -	$ 4	$ 902	$6,085
Residential first mortgages	1,428	-	-	(128)	1,300
Residential rentals	354	(42)	-	23	335
Construction and land development	891	(25)	-	(146)	720
Home equity and second mortgages	76	(1)	-	37	112
Commercial loans	789	-	-	25	814
Consumer loans	5	-	-	-	5
Commercial equipment	1,387	-	13	(337)	1,063
	$10,109	$ (68)	$ 17	$ 376	$10,434
Six Months Ended					
Commercial real estate	$5,212	$ -	$ 9	$ 864	$6,085
Residential first mortgages	1,406	-	-	(106)	1,300
Residential rentals	362	(42)	-	15	335
Construction and land development	941	(25)	-	(196)	720
Home equity and second mortgages	138	(1)	-	(25)	112
Commercial loans	794	-	1	19	814
Consumer loans	3	(2)	-	4	5
Commercial equipment	1,004	(146)	24	181	1,063
	$9,860	$ (216)	$ 34	$ 756	$10,434

The following tables detail loan receivable and allowance balances disaggregated on the basis of the Company's impairment methodology at June 30, 2018 and 2017 and December 31, 2017.

	June 30, 2018				December 31, 2017			June 30, 2017	
(dollars in thousands)	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Purchase Credit Impaired	Total	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Total	Ending balance: individually evaluated for impairment	Ending balance: collectivel evaluated for impairmen
Loan Receivables:									
Commercial real estate	$26,492	$800,450	$1,503	$828,445	$32,929	$694,385	$727,314	$20,066	$693,723
Residential first mortgages	2,434	160,186	470	163,090	2,437	167,937	170,374	2,291	179,095
Residential rentals	1,396	124,799	1,274	127,469	2,376	107,852	110,228	2,686	100,675
Construction and land development	729	27,646	272	28,647	729	27,142	27,871	981	31,622
Home equity and second mortgages	299	36,408	319	37,026	317	21,034	21,351	109	20,738
Commercial loans	2,792	54,727	-	57,519	2,951	53,466	56,417	2,973	52,050
Consumer loans	2	799	-	801	-	573	573	-	412
Commercial equipment	1,643	45,775	-	47,418	1,515	34,401	35,916	599	33,990
	$35,787	$1,250,790	$3,838	$1,290,415	$43,254	$1,106,790	$1,150,044	$29,705	$1,112,30
Allowance for loan losses:									
Commercial real estate	$182	$6,381	$-	$6,563	$370	$6,081	$6,451	$693	$5,392
Residential first mortgages	-	737	-	737	2	1,142	1,144	11	1,289
Residential rentals	-	469	-	469	18	494	512	23	312
Construction and land development	210	288	-	498	163	299	462	163	557
Home equity and second mortgages	7	97	-	104	-	162	162	-	112
Commercial loans	458	745	-	1,203	168	845	1,013	169	645
Consumer loans	1	6	-	7	-	7	7	-	5
Commercial equipment	508	636	-	1,144	303	461	764	417	646
	$1,366	$9,359	$-	$10,725	$1,024	$9,491	$10,515	$1,476	$8,958

During the fourth quarter of 2016, the Company expanded its factor scoring categories from three levels to five levels to capture additional movements in qualitative factors used to calculate the general allowance of each portfolio segment. No additional qualitative factors were added to the Company's methodology as part of this change. There were no material changes to the existing allowance for loan losses by portfolio segment or in the aggregate as a result of the change.

35

Credit Quality Indicators

Credit quality indicators as of June 30, 2018 and December 31, 2017 were as follows:

Credit Risk Profile by Internally Assigned Grade

(dollars in thousands)	Commercial Real Estate 6/30/2018	12/31/2017	Construction and Land Dev. 6/30/2018	12/31/2017	Residential Rentals 6/30/2018	12/31/2017
Unrated	$ 75,916	$ 75,581	$ 2,175	$ 1,775	$ 30,827	$ 28,428
Pass	725,402	619,604	25,471	25,367	95,246	80,279
Special mention	582	-	272	-	-	-
Substandard	26,545	32,129	729	729	1,396	1,521
Doubtful	-	-	-	-	-	-
Loss	-	-	-	-	-	-
Total	$ 828,445	$ 727,314	$ 28,647	$ 27,871	$ 127,469	$ 110,228

(dollars in thousands)	Commercial Loans 6/30/2018	12/31/2017	Commercial Equipment 6/30/2018	12/31/2017	Total Commercial Portfolios 6/30/2018	12/31/2017
Unrated	$ 14,441	$ 14,356	$ 12,273	$ 10,856	$ 135,632	$ 130,996
Pass	40,296	39,118	33,544	23,581	919,959	787,949
Special mention	-	-	-	-	854	-
Substandard	2,782	2,943	1,498	1,479	32,950	38,801
Doubtful	-	-	103	-	103	-
Loss	-	-	-	-	-	-
Total	$ 57,519	$ 56,417	$ 47,418	$ 35,916	$ 1,089,498	$ 957,746

(dollars in thousands)	Non-Commercial Portfolios ** 6/30/2018	12/31/2017	Total All Portfolios 6/30/2018	12/31/2017
Unrated	$ 148,482	$ 152,616	$ 284,114	$ 283,612
Pass	50,826	38,081	970,785	826,030
Special mention	-	96	854	96
Substandard	1,609	1,505	34,559	40,306
Doubtful	-	-	103	-
Loss	-	-	-	-
Total	$ 200,917	$ 192,298	$ 1,290,415	$ 1,150,044

** Non-commercial portfolios are generally evaluated based on payment activity but may be risk graded if part if a larger commercial relationship or are credit impaired (e.g., non-accrual loans, TDRs).

36

Credit Risk Profile Based on Payment Activity

dollars in (thousands)	Residential First Mortgages 6/30/2018	12/31/2017	Home Equity and Second Mtg. 6/30/2018	12/31/2017	Consumer Loans 6/30/2018	12/31/2017
Performing	$ 162,569	$ 169,896	$ 36,990	$ 21,217	$ 801	$ 573
Nonperforming	521	478	36	134	-	-
Total	$ 163,090	$ 170,374	$ 37,026	$ 21,351	$ 801	$ 573

A risk grading scale is used to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Loans are graded at inception, annually thereafter when financial statements are received and at other times when there is an indication that a credit may have weakened or improved. Only commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are subject to being risk rated.

Home equity and second mortgages and consumer loans are evaluated for creditworthiness in underwriting and are monitored based on borrower payment history. Residential first mortgages are evaluated for creditworthiness during credit due diligence before being purchased. Residential first mortgages, home equity and second mortgages and consumer loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned (“OAEM”) or higher risk rating due to a delinquent payment history.

Management regularly reviews credit quality indicators as part of its individual loan reviews and on a monthly and quarterly basis. The overall quality of the Bank’s loan portfolio is assessed using the Bank’s risk grading scale, the level and trends of net charge-offs, nonperforming loans and delinquencies, the performance of troubled debt restructured loans and the general economic conditions in the Company’s geographical market. This review process is assisted by frequent internal reporting of loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Credit quality indicators and allowance factors are adjusted based on management’s judgment during the monthly and quarterly review process. Loans subject to risk ratings are graded on a scale of one to ten. The Company considers loans classified substandard, doubtful and loss as classified assets for regulatory and financial reporting.

Ratings 1 thru 6 - Pass

Ratings 1 thru 6 have asset risks ranging from excellent low risk to adequate. The specific rating assigned considers customer history of earnings, cash flows, liquidity, leverage, capitalization, consistency of debt service coverage, the nature and extent of customer relationship and other relevant specific business factors such as the stability of the industry or market area, changes to management, litigation or unexpected events that could have an impact on risks.

Rating 7 - OAEM (Other Assets Especially Mentioned) – Special Mention

These credits, while protected by the financial strength of the borrowers, guarantors or collateral, have reduced quality due to economic conditions, less than adequate earnings performance or other factors which require the lending officer to direct more than normal attention to the credit. Financing alternatives may be limited and/or command higher risk interest rates. OAEM loans are the first adversely classified assets on our watch list. These relationships will be reviewed at least quarterly.

Rating 8 - Substandard

Substandard assets are assets that are inadequately protected by the sound worth or paying capacity of the borrower or of the collateral pledged. These assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. The loans may have a delinquent history or combination of weak collateral, weak guarantor strength or operating losses. When a loan is assigned to this category the Bank may estimate a specific reserve in the loan loss allowance analysis. These assets listed may include assets with histories of repossessions or some that are non-performing bankruptcies. These relationships will be reviewed at least quarterly.

37

Rating 9 - Doubtful

Doubtful assets have many of the same characteristics of Substandard with the exception that the Bank has determined that loss is not only possible but is probable and the risk is close to certain that loss will occur. When a loan is assigned to this category the Bank will identify the probable loss and the loan will receive a specific reserve in the loan loss allowance analysis. These relationships will be reviewed at least quarterly.

Rating 10 – Loss

Once an asset is identified as a definite loss to the Bank, it will receive the classification of “loss.” There may be some future potential recovery; however, it is more practical to write off the loan at the time of classification. Losses will be taken in the period in which they are determined to be uncollectable.

Purchased Credit-Impaired Loans and Acquired Loans

PCI loans had an unpaid principal balance of $4.5 million and a carrying value of $3.8 million at June 30, 2018. PCI loans represented 0.24% of total assets at June 30, 2018. Determining the fair value of the PCI loans at the time of acquisition required the Company to estimate cash flows expected to result from those loans and to discount those cash flows at appropriate rates of interest and taking into account prepayment assumptions. For such loans, the excess of cash flows expected at acquisition over the estimated fair value is recognized as interest income over the remaining lives of the loans and is called accretable yield. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition reflects the impact of estimated credit losses and is called the nonaccretable difference. In accordance with GAAP, there was no carryover of previously established allowance for loan losses from acquisition. In conjunction with the acquisition of County First, the PCI loan portfolio was accounted for at the fair values as follows:

(dollars in thousands)	January 1, 2018	
Contractual principal and interest at acquisition	$ 6,126	
Nonaccretable difference	(1,093	)
Expected cash flows at acquisition	5,033	
Accretable yield	(517	)
Basis in PCI loans at acquisition - estimated fair value	$ 4,517	

A summary of changes in the accretable yield for PCI loans for the three and six months ended June 30, 2018 follows:

	Three Months Ended	Six Months Ended
(dollars in thousands)	June 30, 2018	June 30, 2018
Accretable yield, beginning of period	$ 459	$ -

Additions		-		517
Accretion		(58)		(116)
Reclassification from (to) nonaccretable difference		-		-
Other changes, net		-		-
Accretable yield, end of period	$	401	$	401

38

In terms of accounting designations, compared to December 31, 2017, (i) non-acquired loans, which include certain renewed and/or restructured acquired performing loans that are re-designated as non-acquired, increased $21.4 million, or 1.9%, to $1,174.4 million at June 30, 2018; (ii) acquired performing loans were $115.2 million at June 30, 2018; and (iii) purchase credit impaired (“PCI”) loans were $3.8 million at June 30, 2018. At June 30, 2018, performing acquired loans, which totaled $115.2 million, included a $2.2 million net acquisition accounting fair market value adjustment, representing a 1.84% “mark;” and PCI loans which totaled $3.8 million, included a $671,000 adjustment, representing a 14.89% “mark.” During the three and six months ended June 30, 2018 there was $152,000 and $473,000, respectively, of accretion interest.

The following is a summary of acquired and non-acquired loans as of June 30, 2018 and December 31, 2017:

BY ACQUIRED AND NON-ACQUIRED	June 30, 2018	%	December 31, 2017	%
Acquired loans - performing	$ 115,157	8.92 %	$ -	0.00 %
Acquired loans - purchase credit impaired ("PCI")	3,838	0.30 %	-	0.00 %
Total acquired loans	118,995	9.22 %	-	0.00 %
Non-acquired loans**	1,171,420	90.78 %	1,150,044	100.00 %
Gross loans	1,290,415		1,150,044	
Net deferred costs (fees)	1,122	0.09 %	1,086	0.09 %
Total loans, net of deferred costs	$ 1,291,537		$ 1,151,130	

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

39

NOTE 12 – REGULATORY CAPITAL

On April 18, 2016, the Bank's primary regulator became the Federal Deposit Insurance Corporation ("FDIC"), subject to regulation, supervision and regular examination by the Maryland Commissioner of Financial Regulation (the "Commissioner") and the FDIC. The Company is subject to regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the regulations of the Federal Reserve Board.

On January 1, 2015, the Company and Bank became subject to the new Basel III Capital Rules with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. In July 2013, the final rules were published (the "Basel III Capital Rules") establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as "Basel III" for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio ("Min. Ratio") of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer ("CCB") is also established above the regulatory minimum capital requirements. This capital conservation buffer began its phase-in period beginning January 1, 2016 at 0.625% of risk-weighted assets and will increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets.

As of June 30, 2018, and December 31, 2017, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the Basel III Capital Rules. Management believes, as of June 30, 2018 and December 31, 2017, that the Company and the Bank met all capital adequacy requirements to which they were subject.

The Company’s and the Bank’s actual regulatory capital amounts and ratios are presented in the following table.

Regulatory Capital and Ratios	The Company		The Bank	
(dollars in thousands)	June 30, 2018	December 31, 2017	June 30, 2018	December 31, 2017
Common equity	$147,246	$ 109,957	$178,367	$ 139,046
Goodwill	(10,603)	-	(10,603)	-
Core deposit intangible (net of deferred tax liability)	(2,309)	-	(2,309)	-
AOCI losses	2,182	1,191	2,182	1,191
Common Equity Tier 1 Capital	136,516	111,148	167,637	140,237
TRUPs	12,000	12,000	-	-
Tier 1 Capital	148,516	123,148	167,637	140,237
Allowable reserve for credit losses and other Tier 2 adjustments	10,776	10,545	10,776	10,545
Subordinated notes	23,000	23,000	-	-
Tier 2 Capital	$182,292	$ 156,693	$178,413	$ 150,782
Risk-Weighted Assets ("RWA")	$1,322,840	$ 1,169,341	$1,319,955	$ 1,164,478
Average Assets ("AA")	$1,569,489	$ 1,401,741	$1,566,336	$ 1,398,001

	2019 Regulatory Min. Ratio + CCB [(1)]				
Common Tier 1 Capital to RWA	7.00 %	10.32 %	9.51 %	12.70%	12.04%
Tier 1 Capital to RWA	8.50	11.23	10.53	12.70	12.04
Tier 2 Capital to RWA	10.50	13.78	13.40	13.52	12.95
Tier 1 Capital to AA (Leverage) [(2)]	***n/a***	9.46	8.79	10.70	10.03

(1) These are the fully phased-in ratios as of January 1, 2019 that include the minimum capital ratio ("Min. Ratio") + the capital conservation buffer ("CCB"). The phase-in period is more fully described in the footnote above.

(2) Tier 1 Capital to AA (Leverage) has no capital conservation buffer defined. PCA well capitalized is defined as 5.00%.

NOTE 13 - FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, *"Fair Value Measurements"* and FASB ASC Topic 825, *"The Fair Value Option for Financial Assets and Financial Liabilities"*, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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

Under FASB ASC Topic 820, the Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine the fair value. These hierarchy levels are:

Level 1 inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's quarterly valuation process. Transfers in and out of level 3 during a quarter are disclosed. There were no transfers between Level 1, 2 or 3 in the fair value hierarchy during the six months ending June 30, 2018. There was one transfer from Level 2 to Level 3 in the fair value hierarchy for the three months ended March 31, 2017 for premises and equipment held for sale. This asset was sold during the three months ended June 30, 2017. There were no transfers between Level 1, 2 or 3 in the fair value hierarchy for the remaining six months of 2017.

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

Securities Available for Sale

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

Equity Securities Carried at Fair Value Through Income

Equity securities carried at fair value through income are recorded at fair value on a recurring basis. Standard inputs include quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 equity securities include those traded on an active exchange, such as the New York Stock Exchange. Level 2 equity securities include mutual funds with asset-backed securities issued by government sponsored entities ("GSEs") as the underlying investment supporting the fund. Equity securities classified as Level 3 include mutual funds with asset-backed securities in less liquid markets.

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, or discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At June 30, 2018 and December 31, 2017, substantially all of the impaired loans were evaluated based upon the fair value of the collateral.

In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the loan as nonrecurring Level 2. When the fair value of the impaired loan is derived from an appraisal, the Company records the loan as nonrecurring Level 3. Fair value is re-assessed at least quarterly or more frequently when circumstances occur that indicate a change in the fair value. The fair values of impaired loans that are not measured based on collateral values are measured using discounted cash flows and considered to be Level 3 inputs.

Premises and Equipment Held For Sale

Premises and equipment are adjusted to fair value upon transfer of the assets to premises and equipment held for sale. Subsequently, premises and equipment held for sale are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the asset as nonrecurring Level 2. When the fair value of premises and equipment is derived from an appraisal or a cash flow analysis, the Company records the asset at nonrecurring Level 3.

As of June 30, 2018, the Company had one property (previously County First branch) held for sale with fair value totaling $600,000 that was recorded as non-recurring Level 3 asset at June 30, 2018. There were no premises and equipment held for sale as of December 31, 2017.

Other Real Estate Owned ("OREO")

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the foreclosed asset as nonrecurring Level 2. When the fair value is derived from an appraisal, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of June 30, 2018 and December 31, 2017 measured at fair value on a recurring basis.

(dollars in thousands)	June 30, 2018			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$60,704	$ -	$60,704	$ -
MBS	6,595	-	6,595	-
U.S. Agency	11,727	-	11,727	-
Total available for sale securities	$79,026	$ -	$79,026	$ -
Equity securities carried at fair value through income				
CRA investment fund	$4,367	$ -	$4,367	$ -

(dollars in thousands)	December 31, 2017			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$44,137	$ -	44,137	$ -
MBS	7,087	-	7,087	-
U.S. Agency	12,517	-	12,517	-
Bond mutual funds	4,423	-	4,423	-
Total available for sale securities	$68,164	$ -	$68,164	$ -

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of June 30, 2018 and December 31, 2017 were included in the tables below.

(dollars in thousands)	June 30, 2018			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				

Commercial real estate	$ 1,387	$ -	$ -	$ 1,387
Construction and land development	519	-	-	519
Home equity and second mtg.	79	-	-	79
Commercial loans	442	-	-	442
Commercial equipment	114	-	-	114
Total loans with impairment	$ 2,541	$ -	$ -	$ 2,541
Premises and equipment held for sale	$ 600	$ -	$ -	$ 600
Other real estate owned	$ 8,305	$ -	$ -	$ 8,305

44

(dollars in thousands)	December 31, 2017			
Description of Asset	Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$ 1,638	$ -	$ -	$ 1,638
Residential first mortgages	457	-	-	457
Residential rentals	377	-	-	377
Construction and land development	566	-	-	566
Commercial loans	164	-	-	164
Total loans with impairment	$ 3,202	$ -	$ -	$ 3,202
Other real estate owned	$ 9,341	$ -	$ -	$ 9,341

Loans with impairment had unpaid principal balances of $3.9 million and $4.2 million at June 30, 2018 and December 31, 2017, respectively, and include impaired loans with a specific allowance.

The following tables provide information describing the unobservable inputs used in Level 3 fair value measurements at June 30, 2018 and December 31, 2017.

June 30, 2018 (dollars in thousands)				**Range (Weighted**
Description of Asset	Fair Value	Valuation Technique	Unobservable Inputs	Average)
Loans with impairment	$ 2,541	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (35)%
Premises and equipment held for sale	$ 600	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-40% (38)%
Other real estate owned	$ 8,305	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (12)%

December 31, 2017 (dollars in thousands)				**Range (Weighted**
Description of Asset	Fair Value	Valuation Technique	Unobservable Inputs	Average)
	$ 3,202			

Loans with impairment		Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (24)%
Other real estate owned	$ 9,341	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0%-50% (12%)

45

NOTE 14 - FAIR VALUE OF FINANCIAL INSTRUMENTS

Financial instruments require disclosure of fair value information, whether or not recognized in the consolidated balance sheets, when it is practical to estimate the fair value. A financial instrument is defined as cash, evidence of an ownership interest in an entity or a contractual obligation which requires the exchange of cash. Certain items are specifically excluded from the financial instrument fair value disclosure requirements, including the Company's common stock, OREO, premises and equipment and other assets and liabilities.

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Therefore, any aggregate unrealized gains or losses should not be interpreted as a forecast of future earnings or cash flows. Furthermore, the fair values disclosed should not be interpreted as the aggregate current value of the Company.

Valuation Methodology

During the three months ended March 31, 2018, the Company implemented "*ASU 2016-01 - Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*." ASU 2016-01 requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The other requirements of ASU 2016-01 are described in Note 1. The standard update was adopted prospectively and the December 31, 2017 valuations reflect the methodologies used prior to the adoption of ASU 2016-01. Fair values at June 30, 2018 were measured using an "exit price" notion.

Prior to adopting the amendments included in the standard, the Company measured fair value under an entry price notion. The entry price notion previously applied by the Company used a discounted cash flows technique for loans, time deposits and debt, to calculate the present value of expected future cash flows for financial instruments. See the Company's methodologies disclosed in Note 20 of the Company's 2017 Form 10-K for the fair value methodologies used as of December 31, 2017.

The exit price notion uses a similar approach as the Company's previous methodology for valuations that used discounted cash flows, but also incorporates other factors, such as enhanced credit risk, illiquidity risk and market factors that sometimes exist in exit prices in dislocated markets. The implementation of ASU 2016-01 was most impactful to the Company's loan portfolio because the Company's other financial instruments have one or several other compensating factors (e.g., quoted market prices, lower credit risk, limited liquidity risk, short durations, etc.).

As of June 30, 2018, the technique used by the Company to estimate the exit price of the loan portfolio consisted of similar procedures to those used as of December 31, 2017, but with added emphasis on both illiquidity risk and credit risk not captured by the previously applied entry price notion. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company's loan portfolio is initially fair valued using a segmented approach, using the eight categories as disclosed in Note 11. Loans are considered a Level 3 classification.

The following summarizes the valuation methodologies used as of June 30, 2018:

Investment securities and equity securities carried at fair value through income - Fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

FHLB stock and non-marketable equity securities held at other financial institutions – Fair values are at cost, which is the carrying value of the securities.

Investment in bank owned life insurance ("BOLI") – Fair values are at cash surrender value.

Loans receivable – The fair values for non-impaired loans are estimated using credit loss severity rates derived from market data, discount rates based on recent originations and market data, and prepayment speeds based on market data. The credit mark, discount rate and prepayment assumptions all consider segmentation and product attributes, such as duration and interest rates (e.g., fixed vs. variable interest).

Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt or discounted cash flows. These loans are not valued using the method described for non-impaired loans because management believes the identification of impaired loans and specific allowance, if needed, approximates fair value.

Loans held for sale – Fair values are derived from secondary market quotations for similar instruments. There were no loans held for sale at June 30, 2018 and December 31, 2017.

Deposits - The fair value of checking accounts, saving accounts and money market accounts were the amount payable on demand at the reporting date.

Time certificates - The fair value was determined using the recent issuance rates and market rate analysis on similar products to determine a discount rate.

FHLB - Long-term debt and short-term borrowings – The fair value was determined by applying the prepayment penalty and accrued interest payable of the specific borrowings.

Guaranteed preferred beneficial interest in junior subordinated securities (TRUPs) - The fair value was determined using the recent issuance rates for trust preferred or similar borrowings to determine a discount rate.

Subordinated notes - The fair value was determined using the recent issuance rates for subordinated debt or similar borrowings to determine a discount rate.

Off-balance sheet instruments - The Company charges fees for commitments to extend credit. Interest rates on loans for which these commitments are extended are normally committed for periods of less than one month. Fees charged on standby letters of credit and other financial guarantees are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused.

The Company’s estimated fair values of financial instruments are presented in the following tables.

June 30, 2018	Carrying		Fair Value Measurements		
Description of Asset (dollars in thousands)	Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Investment securities - AFS	$79,026	$79,026	$-	$79,026	$-
Investment securities – HTM	100,842	98,001	1,000	97,001	-
Equity securities carried at fair value through income	4,367	4,367	-	4,367	-
Non-marketable equity securities in other financial institutions	249	249		249	
FHLB Stock	4,311	4,311	-	4,311	-
Loans Receivable	1,280,812	1,248,199	-	-	1,248,199
Investment in BOLI	35,843	35,843	-	35,843	-
Liabilities					
Savings, NOW and money market accounts	$877,352	$877,352	$-	$877,352	$-
Time deposits	446,516	444,711	-	444,711	-
Long-term debt	30,467	30,816	-	30,816	-
Short term borrowings	36,500	36,380	-	36,380	-
TRUPs	12,000	9,647	-	9,647	-
Subordinated notes	23,000	23,052	-	23,052	-

See the Company’s methodologies disclosed in Note 20 of the Company’s 2017 Form 10-K for the fair value methodologies used as of December 31, 2017:

47

December 31, 2017	Carrying		Fair Value Measurements		
Description of Asset (dollars in thousands)	Amount	Fair Value	Level 1	Level 2	Level 3
Assets					
Investment securities - AFS	$68,164	$68,164	$-	$68,164	$-
Investment securities – HTM	99,246	98,007	1,000	97,007	-
Non-marketable equity securities in other financial institutions	121	121	-	121	-
FHLB Stock	7,276	7,276	-	7,276	-
Loans Receivable	1,140,615	1,097,592	-	-	1,097,592
Investment in BOLI	29,398	29,398	-	29,398	-
Liabilities					
Savings, NOW and money market accounts	$654,632	$654,632	$-	$654,632	$-
Time deposits	451,605	453,644	-	453,644	-
Long-term debt	55,498	57,421	-	57,421	-
Short term borrowings	87,500	87,208	-	87,208	-
TRUPs	12,000	9,400	-	9,400	-
Subordinated notes	23,000	22,400	-	22,400	-

At June 30, 2018 and December 31, 2017, the Company had outstanding loan commitments and standby letters of credit of $77.3 million and $65.6 million, respectively and $21.8 million and $17.9 million, respectively. Additionally, at June 30, 2018 and December 31, 2017, customers had $201.8 million and $162.2 million, respectively, available and unused on lines of credit, which include lines of credit for commercial customers, home equity loans as well as builder and construction lines. Based on the short-term lives of these instruments, the Company does not believe that the fair value of these instruments differs significantly from their carrying values.

The fair value estimates presented herein are based on pertinent information available to management as of June 30, 2018 and December 31, 2017, respectively. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amount presented herein.

Item 2 - Management's Discussion and Analysis (“MD&A”) of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Report may not be based on historical facts and are “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements can generally be identified by the fact that they do not relate strictly to historical or current facts. They often include words like “believe,” “expect,” “anticipate,” “estimate” and “intend” or future or conditional verbs such as “will,” “would,” “should,” “could” or “may.” Statements in this report that are n strictly historical are forward-looking and are based upon current expectations that may differ materially from actual results. These forward-looking statements include, without limitation, those relating to the Company’s and Community Bank of the Chesapeake’s future growth and management’s outlook or expectations for revenue, assets, asset quality, profitability, business prospects, net interest margin, non-interest revenue, allowance for loan losses, the level of credit losses from lending, liquidity levels, capital levels, or other future financial or business performance strategies or expectations, and any statements of the plans and objectives of management for future operations products or services, including the expected benefits from, and/or the execution of integration plans relating to the County First acquisition; plans and cost savings regarding branch closings or consolidation; any statement of expectation or belief; projections related to certain financial metrics; and any statement of assumptions underlying the foregoing. These forward-looking statements express management’s current expectations or forecasts of future events, results and conditions, and by their nature are subject to and involve risks and uncertainties that could cause actual results to differ materially from those anticipated by the statements made herein. Factors that might cause actual results to differ materially from those made in such statements include, but are not limited to: the synergies and other expected financial benefits from County First acquisition may not be realized within the expected time frames; changes in The Community Financial Corporation or Community Bank of the Chesapeake’s strategy; costs or difficulties related to integration matters might be greater than expected; availability of and costs associated with obtaining adequate and timely sources of liquidity; the ability to maintain credit quality; general economic trends; changes in interest rates; loss of deposits and loan demand to other financial institutions; substantial changes in financial markets; changes in real estate value and the real estate market; regulatory changes; the possibility of unforeseen events affecting the industry generally; the uncertainties associated with newly developed or acquired operations; the outcome of litigation that may arise; market disruptions and other effects of terrorist activities; and the matters described in “Item 1A Risk Factors” in the Company’s Annual Report on Form 10-K for the Year Ended December 31, 2017, and in its other Reports filed with the Securities and Exchange Commission (the “SEC”). The Company’s forward-looking statements may also be subject to other risks and uncertainties, including those that it may discuss elsewhere in this Report or in its filings with the SEC, accessible on the SEC’s Web site at www.sec.gov. The Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unforeseen events, except as required under the rules and regulations of the SEC.

You are cautioned not to place undue reliance on the forward-looking statements contained in this document in that actual results could differ materially from those indicated in such forward-looking statements, due to a variety of factors. Any forward-looking statement speaks only as of the date of this Report, and we undertake no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date of this Report. Forward-looking statements regarding the transaction are based upon currently available information.

Critical Accounting Policies

Critical accounting policies are defined as those that involve significant judgments and uncertainties and could potentially result in materially different results under different assumptions and conditions. The Company considers its determination of the allowance for loan losses, the valuation of foreclosed real estate (OREO) and the valuation of deferred tax assets to be critical accounting policies.

The Company's Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and the general practices of the United States banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements. Accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When these sources are not available, management makes estimates based upon what it considers to be the best available information.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that exist in the loan portfolio. The allowance is based on two principles of accounting: (1) Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 450 "Contingencies," which requires that losses be accrued when they are probable of occurring and are estimable and (2) FASB ASC 310 "Receivables," which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, is determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows and values observable in the secondary markets.

The allowance for loan loss balance is an estimate based upon management's evaluation of the loan portfolio. The allowance includes a specific and a general component. The specific component consists of management's evaluation of certain classified and non-accrual loans and their underlying collateral. Management assesses the ability of the borrower to repay the loan based upon all information available. Loans are examined to determine a specific allowance based upon the borrower's payment history, economic conditions specific to the loan or borrower and other factors that would impact the borrower's ability to repay the loan on its contractual basis. Depending on the assessment of the borrower's ability to pay and the type, condition and value of collateral, management will establish an allowance amount specific to the loan.

Management uses a risk scale to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are risk rated. Residential first mortgages, home equity and second mortgages and consumer loans are monitored on an ongoing basis based on borrower payment history. Consumer loans and residential real estate loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned or higher risk rating due to a delinquent payment history.

The Company's commercial loan portfolio is periodically reviewed by regulators and independent consultants engaged by management.

In establishing the general component of the allowance, management analyzes non-impaired loans in the portfolio including changes in the amount and type of loans. This analysis reviews trends by portfolio segment in charge-offs, delinquency, classified loans, loan concentrations and the rate of portfolio segment growth. Qualitative factors also include an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends. Based upon this analysis a loss factor is applied to each loan category and the Bank adjusts the loan loss allowance by increasing or decreasing the provision for loan losses.

Management has significant discretion in making the judgments inherent in the determination of the allowance for loan losses, including the valuation of collateral, assessing a borrower's prospects of repayment and in establishing loss factors on the general component of the allowance. Changes in loss factors have a direct impact on the amount of the provision and on net income. Errors in management's assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio and may result in additional provisions. At June 30, 2018 and December 31, 2017, the allowance for loan losses was $10.7 million and $10.5 million, respectively, or 0.83% and 0.91%, respectively, of total loans. Allowance for loan loss as a percentage of loans decreased in first six months of 2018, primarily due to the addition of County First loans, after consummation of the legal merger on January 1, 2018, for which no allowance was provided for in accordance with purchase accounting standards. An increase or decrease in the allowance could result in a charge or credit to income before income taxes that materially impacts earnings.

For additional information regarding the allowance for loan losses, refer to Notes 1 and 6 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2017 and the discussion in this MD&A.

Other Real Estate Owned ("OREO")

The Company maintains a valuation allowance on its other real estate owned. As with the allowance for loan losses, the valuation allowance on OREO is based on FASB ASC 450 "Contingencies," as well as the accounting guidance on impairment of long-lived assets. These statements require that the Company establish a valuation allowance when it has determined that the carrying amount of a foreclosed asset exceeds its fair value. Fair value of a foreclosed asset is measured by the cash flows expected to be realized from its subsequent disposition. These cash flows include the costs of selling or otherwise disposing of the asset.

In estimating the fair value of OREO, management must make significant assumptions regarding the timing and amount of cash flows. For example, in cases where the real estate acquired is undeveloped land, management must gather the best available evidence regarding the market value of the property, including appraisals, cost estimates of development and broker opinions. Due to the highly subjective nature of this evidence, as well as the limited market, long time periods involved and substantial risks, cash flow estimates are highly subjective and subject to change. Errors regarding any aspect of the costs or proceeds of developing, selling or otherwise disposing of foreclosed real estate could result in the allowance being inadequate to reduce carrying costs to fair value and may require an additional provision for valuation allowances.

For additional information regarding OREO, refer to Notes 1 and 8 of the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2017.

Deferred Tax Assets

The Company accounts for income taxes in accordance with FASB ASC 740, "Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FASB ASC 740 requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

Management periodically evaluates the ability of the Company to realize the value of its deferred tax assets. If management were to determine that it was not more likely than not that the Company would realize the full amount of the deferred tax assets, it would establish a valuation allowance to reduce the carrying value of the deferred tax asset to the amount it believes would be realized. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax-planning strategies that could be implemented to realize the net deferred tax assets.

Failure to achieve forecasted taxable income might affect the ultimate realization of the net deferred tax assets. Factors that may affect the Company's ability to achieve sufficient forecasted taxable income include, but are not limited to, the following: increased competition, a decline in net interest margin, a loss of market share, decreased demand for financial services and national and regional economic conditions.

The Company's provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of management judgment and are based on the best information available at the time. The Company operates within federal and state taxing jurisdictions and is subject to audit in these jurisdictions.

For additional information regarding income taxes and deferred tax assets, refer to Notes 1 and 12 in the Consolidated Financial Statements as presented in the Company's Form 10-K for the year ended December 31, 2017.

ECONOMY

The presence of federal government agencies, as well as significant government facilities, and the related private sector support for these entities, has led to steady economic growth in our market and lower unemployment compared to national averages since the Great Recession. In addition, the Bank's entry into the greater Annapolis and Fredericksburg markets has provided the Bank with additional loan and deposit opportunities. These opportunities have positively impacted the Bank's organic growth.

Economic conditions, competition, and the monetary and fiscal policies of the Federal government significantly affect most financial institutions, including the Bank. Lending and deposit activities and fee income generation are influenced by levels of business spending and investment, consumer income, consumer spending and savings, capital market activities, and competition among financial institutions, as well as customer preferences, interest rate conditions and prevailing market rates on competing products in our market areas.

In 2017, the national economy continued to improve throughout the year. The economy (GDP) grew 2.30% in 2017, an increase from 1.50% GDP growth in 2016. Consumer confidence has increased due to positive economic trends such as lower unemployment, increased housing metrics and solid performance in the financial markets. The Mid-Atlantic region in which the Company operates continued to experience continued improved regional economic performance. The presence of several major federal facilities located within the Bank's footprint and in adjoining counties contribute to economic growth. Major federal facilities include the Patuxent River Naval Air Station in St. Mary's County, the Indian Head Division, Naval Surface Warfare Center in Charles County and the Naval Surface Warfare –Naval Support Facility in King George County. In addition, there are several major federal facilities located in adjoining markets including Andrews Air Force Base and Defense Intelligence Agency & Defense Intelligence Analysis Center in Prince Georges County, Maryland and the U.S. Marine Base Quantico, Drug Enforcement Administration Quantico facility and Federal Bureau of Investigation Quantico facility in Prince William County, Virginia. These facilities directly employ thousands of local employees and serve as an important player in the region's overall economic health.

The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector. Calvert County is home to the Dominion Power Cove Point Liquid Natural Gas Terminal, which is one of the nation's largest liquefied natural gas terminals and Dominion Power is currently constructing liquefaction facilities for exporting liquefied natural gas. Based on information from the U.S. Bureau of Labor Statistics, unemployment rates and household income in the Company's footprint have historically performed better than the national average. According to SNL Financial, the median household income in our market area is $97,000 compared to $61,000 for the United States. According to SNL Financial, the Bank's market areas have strong demographics with below average unemployment rates. The Bank's primary market areas have unemployment rates below 3.6% with projected population growth in excess of 4.25% over the next five years.

The greater Fredericksburg area, the Bank's newest area of expansion (2013), continued to experience economic growth. According to the Fredericksburg Regional Alliance, the Fredericksburg Region, including the City of Fredericksburg and the counties of Caroline, King George, Spotsylvania, and Stafford, Virginia, has been the fastest growing region in the Commonwealth of Virginia for the last five years.

For additional information regarding the local economy and its impact on the Company's business refer to the Business Section in the Company's Form 10-K for the year ended December 31, 2017 under the caption "Market Area" (*Part I. Item 1. Business Section – Market Area).*

USE OF NON-GAAP FINANCIAL MEASURES

Statements included in management's discussion and analysis include non-GAAP financial measures and should be read along with the accompanying tables, which provide a reconciliation of non-GAAP financial measures to GAAP financial measures. The Company's management uses these non-GAAP financial measures and believes that non-GAAP financial measures provide additional useful information that allows readers to evaluate the ongoing performance of the Company. Non-GAAP financial measures should not be considered as an alternative to any measure of performance or financial condition as promulgated under GAAP, and investors should consider the Company's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company. Non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the results or financial condition as reported under GAAP. See Non-GAAP reconciliation schedules that immediately follow:

52

RECONCILIATION OF NON-GAAP MEASURES (UNAUDITED)

THREE AND SIX MONTHS ENDED

Reconciliation of US GAAP Net Income, Earnings Per Share (EPS), Return on Average Assets (ROAA) and Return on Average Common Equity (ROACE) to Non-GAAP Operating Net Income, EPS, ROAA and ROACE

This 10-Q, including the accompanying financial statement tables, contains financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. This financial information includes certain operating performance measures, which exclude merger and acquisition costs and the fourth quarter 2017 income tax expense attributable to the revaluation of deferred tax assets as a result of the reduction in the corporate income tax rate under the recently enacted Tax Cuts and Jobs Act. These expenses are not considered part of recurring operations, such as "operating net income," "operating earnings per share," "operating return on average assets," and "operating return on average common equity." These non-GAAP measures are included because the Company believes they may provide useful supplemental information for evaluating the underlying performance trends of the Company.

(dollars in thousands, except per share amounts)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017
Net (loss) income (as reported)	$2,335	$ 2,543	$3,556	$ 4,885
Impact of Tax Cuts and Jobs Act	-	-	-	-
Merger and acquisition costs (net of tax)	546	227	2,681	237
Non-GAAP operating net income	$2,881	$ 2,770	$6,237	$ 5,122
Income before income taxes (as reported)	$3,163	$ 4,079	$4,917	$ 7,869
Merger and acquisition costs ("M&A")	741	238	3,609	255
Adjusted pretax income	3,904	4,317	8,526	8,124
Income tax expense	1,023	1,547	2,289	3,002
Non-GAAP operating net income	$2,881	$ 2,770	$6,237	$ 5,122
GAAP diluted earnings per share ("EPS")	$0.42	$ 0.55	$0.64	$ 1.05
Non-GAAP operating diluted EPS before M&A	$0.52	$ 0.60	$1.12	$ 1.11
GAAP return on average assets ("ROAA")	0.59 %	0.74 %	0.45 %	0.72 %
Non-GAAP operating ROAA before M&A	0.73 %	0.81 %	0.79 %	0.76 %

GAAP return on average common equity ("ROACE")	6.34 %	9.36 %	4.84 %	9.07 %
Non-GAAP operating ROACE before M&A	7.82 %	10.19 %	8.49 %	9.51 %
Net income (as reported)	$ 2,335	$ 2,543	$ 3,556	$ 4,885
Weighted average common shares outstanding	5,551,123	4,635,483	5,549,428	4,633,720
Average assets	$ 1,579,645	$ 1,373,832	$ 1,580,586	$ 1,355,922
Average equity	147,295	108,720	147,005	107,735

53

RECONCILIATION OF NON-GAAP MEASURES (UNAUDITED)

Reconciliation of US GAAP total assets, common equity, common equity to assets and book value to Non-GAAP tangible assets, tangible common equity, tangible common equity to tangible assets and tangible book value.

This 10-Q, including the accompanying financial statement tables, contains financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. This financial information includes certain performance measures, which exclude intangible assets. These non-GAAP measures are included because the Company believes they may provide useful supplemental information for evaluating the underlying performance trends of the Company.

(dollars in thousands, except per share amounts)	June 30, 2018		December 31, 2017		June 30, 2017	
Total assets	$ 1,586,288		$ 1,405,961		$ 1,392,688	
Less: intangible assets						
Goodwill	10,603		-		-	
Core deposit intangible	3,186		-		-	
Total intangible assets	13,789		-		-	
Tangible assets	$ 1,572,499		$ 1,405,961		$ 1,392,688	
Total common equity	$ 147,246		$ 109,957		$ 109,293	
Less: intangible assets	13,789		-		-	
Tangible common equity	$ 133,457		$ 109,957		$ 109,293	
Common shares outstanding at end of period	5,574,511		4,649,658		4,648,199	
GAAP common equity to assets	9.28	%	7.82	%	7.85	%
Non-GAAP tangible common equity to tangible assets	8.49	%	7.82	%	7.85	%
GAAP common book value per share	$ 26.41		$ 23.65		$ 23.51	
Non-GAAP tangible common book value per share	$ 23.94		$ 23.65		$ 23.51	

54

Selected Financial Information and Ratios

	Three Months Ended (Unaudited)		Six Months Ended (Unaudited)	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
KEY OPERATING RATIOS				
Return on average assets	0.59 %	0.74 %	0.45 %	0.72 %
Return on average common equity	6.34	9.36	4.84	9.07
Average total equity to average total assets	9.32	7.91	9.30	7.95
Interest rate spread	3.21	3.27	3.28	3.28
Net interest margin	3.41	3.39	3.47	3.40
Cost of funds	0.94	0.79	0.89	0.76
Cost of deposits	0.74	0.53	0.68	0.51
Cost of debt	3.17	2.22	2.84	2.23
Efficiency ratio	73.23	62.83	78.63	63.35
Non-interest expense to average assets	2.47	2.19	2.71	2.20
Net operating expense to average assets	2.24	1.89	2.47	1.91
Avg. int-earning assets to avg. int-bearing liabilities	121.22	117.07	121.16	116.69
Net charge-offs to average loans	0.05	0.02	0.11	0.03
COMMON SHARE DATA				
Basic net income per common share	$ 0.42	$ 0.55	$ 0.64	$ 1.05
Diluted net income per common share	0.42	0.55	0.64	1.05
Cash dividends paid per common share	0.10	0.10	0.20	0.20
Weighted average common shares outstanding:				
Basic	5,551,123	4,632,911	5,549,428	4,630,647
Diluted	5,551,123	4,635,483	5,549,428	4,633,720

Selected Financial Information and Ratios (continued)

(dollars in thousands, except per share amounts)	(Unaudited) June 30, 2018	December 31, 2017	$ Change	% Change
ASSET QUALITY				
Total assets	$ 1,586,288	$ 1,405,961	$ 180,327	12.8 %
Gross loans	1,290,415	1,150,044	140,371	12.2
Classified Assets	43,536	50,298	(6,762)	(13.4)
Allowance for loan losses	10,725	10,515	210	2.0
Past due loans - 31 to 89 days	582	9,227	(8,645)	(93.7)
Past due loans >=90 days	12,347	2,483	9,864	397.3
Total past due (delinquency) loans	12,929	11,710	1,219	10.4
Non-accrual loans (a)	14,492	4,693	9,799	208.8
Accruing troubled debt restructures (TDRs) (b)	9,864	10,021	(157)	(1.6)
Other real estate owned (OREO)	8,305	9,341	(1,036)	(11.1)
Non-accrual loans, OREO and TDRs	$ 32,661	$ 24,055	$ 8,606	35.8
ASSET QUALITY RATIOS				
Classified assets to total assets	2.74 %	3.58 %		
Classified assets to risk-based capital	23.88	32.10		
Allowance for loan losses to total loans	0.83	0.91		
Allowance for loan losses to non-accrual loans	74.01	224.06		
Past due loans - 31 to 89 days to total loans	0.05	0.80		
Past due loans >=90 days to total loans	0.96	0.22		
Total past due (delinquency) to total loans	1.00	1.02		
Non-accrual loans to total loans	1.12	0.41		
Non-accrual loans and TDRs to total loans	1.89	1.28		
Non-accrual loans and OREO to total assets	1.44	1.00		
Non-accrual loans, OREO and TDRs to total assets	2.06	1.71		

56

Selected Financial Information and Ratios (continued)

(dollars in thousands, except per share amounts)	(Unaudited) June 30, 2018		December 31, 2017	
COMMON SHARE DATA				
Book value per common share	$ 26.41		$ 23.65	
Tangible book value per common share**	23.94		***	
Common shares outstanding at end of period	5,574,511		4,649,658	
OTHER DATA				
Full-time equivalent employees	195		165	
Branches (c)	12		11	
Loan Production Offices	5		5	
CAPITAL RATIOS				
Tier 1 capital to average assets	9.46	%	8.79	%
Tier 1 common capital to risk-weighted assets	10.32		9.51	
Tier 1 capital to risk-weighted assets	11.23		10.53	
Total risk-based capital to risk-weighted assets	13.78		13.40	
Common equity to assets	9.28	%	7.82	%
Tangible common equity to tangible assets **	8.49	%	***	

** Non-GAAP financial measure. See reconciliation of GAAP and NON-GAAP measures.

*** The Company had no intangible assets before January 1, 2018.

(a) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer. Non-accrual loans can include loans that are current with all loan payments.

(b) At June 30, 2018 and December 31, 2017, the Bank had total TDRs of $9.9 million and $10.8 million, respectively, with $0 and $769,000, respectively, in non-accrual status. These loans are classified as non-accrual loans for the calculation of financial ratios.

(c) The Company closed four of the five acquired County First branches in May 2018.

57

OVERVIEW

Community Bank of the Chesapeake (the "Bank") is headquartered in Southern Maryland with branches located in Maryland and Virginia. The Bank is a wholly owned subsidiary of The Community Financial Corporation (the "Company").

The Company's branches are located at its main office in Waldorf, Maryland, and 11 branch offices[1] in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Fredericksburg, Virginia. The Company maintains five loan production offices ("LPOs") in Annapolis, La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown LPO is co-located with the branch.

The Bank has increased assets primarily with organic loan growth until its first acquisition of County First Bank in January 2018. The Bank believes that its ability to offer fast, flexible, local decision-making will continue to attract significant new business relationships. The Bank focuses its business generation efforts on targeting small and medium sized commercial businesses with revenues between $5.0 million and $35.0 million as well as local municipal agencies and not-for-profits. Our business model is customer-focused, utilizing relationship teams to provide customers with specific banker contacts and a support team to address product and service demands. Our structure provides a consistent and superior level of professional service. As a community bank this is what gives us the competitive advantage. We consider excelling at customer service to be a critical part of our culture. The Bank's marketing is also directed towards increasing its balances of transactional deposit accounts, which are all deposit accounts other than certificates of deposit. The Bank believes that increases in these account types will lessen the Bank's dependence on higher-cost funding, such as certificates of deposit and borrowings. Although management believes that this strategy will increase financial performance over time, increasing the balances of certain products, such as commercial lending and transaction accounts, may also increase the Bank's noninterest expense. The Bank recognizes that certain lending and deposit products increase the possibility of losses from credit and other risks.

The Company's income is primarily earned from interest received on our loans and investments. Our primary source of funds for making these loans and investments is our deposits, on which we pay interest. Consequently, one of the key measures of our success is our amount of net interest income, or the difference between the income on our interest-earning assets, such as loans and investments, and the expense on our interest-bearing liabilities, such as deposits and borrowings. Another key measure is the spread between the yield we earn on these interest-earning assets and the rate we pay on our interest-bearing liabilities, which is called our net interest spread. In addition to earning interest on our loans and investments, we earn income through fees and other charges to our clients.

On January 1, 2018, the Company completed its previously announced merger of County First with and into the Bank, with the Bank as the surviving bank (the "Merger") pursuant to the Agreement and Plan of Merger, dated as of July 31, 2017, by and among the Company, the Bank and County First. Pursuant to the Merger Agreement, at the effective time of the Merger (the "Effective Time"), each share of common stock, par value $1.00 per share, of County First issued and outstanding immediately prior to the Effective Time was converted into the right to receive 0.9543 shares of Company common stock and $2.20 in cash (the "Merger Consideration"). The $2.20 in cash represents the sum of (i) $1.00 in cash consideration (the "Cash Consideration") plus (ii) $1.20 in Contingent Cash Consideration that was determined before the completion of the Merger in accordance with the terms of the Merger Agreement. The aggregate merger consideration consisted of 918,526 shares of the Company's common stock and $2.1 million in cash. Based upon the $38.78 per share closing price of the Company's common stock, the transaction value was $37.7 million.

The County First acquisition is being accounted for under the acquisition method of accounting with the Company treated as the acquirer. Under the acquisition method of accounting, the assets and liabilities of County First, as of January 1, 2018, will be recorded by the Company at their respective fair values, and the excess of the merger consideration over the fair value of County First net assets will be allocated to goodwill. At December 31, 2017, County First had total assets of $226.7 million, total net loans of $142.4 million and total deposits of $199.2. County First had five branch offices in La Plata, Waldorf, New Market, Prince Frederick and California, Maryland. The Bank kept the La Plata branch open and consolidated the remaining four branches with legacy Community Bank of the Chesapeake branch offices in May of 2018. See *NOTE 2 – BUSINESS COMBINATION AND GOODWILL* in this 10-Q for additional information.

[1] As of March 31, 2018, the Company had 16 branches, including the main office in Waldorf. This number included five County First Bank branches. The Company closed four County First branches in May 2018. The La Plata branch remained open.

58

2017 Operations Summary

Net income for year ended December 31, 2017 was $7.2 million or $1.56 per diluted share after the inclusion of the additional tax expense under the recently enacted Tax Cuts and Jobs Act and the expenses associated with the acquisition of County First Bank. The additional income tax and merger and acquisition costs of $724,000, net of tax, resulted in a reduction of earnings per share of approximately $0.75 per share for 2017. Net income for the year ended December 31, 2016 was $7.3 million or $1.59 per diluted share.

Income before taxes (pretax income) increased $619,000 or 18.3% to $4.0 million for the three months ended December 31, 2017 compared to $3.4 million for the three months ended December 31, 2016. The Company’s pretax returns on average assets and common stockholders’ equity for the fourth quarter of 2017 were 1.14% and 14.15%, respectively, compared to 1.04% and 12.84%, respectively, for the fourth quarter of 2016. The Company’s after-tax returns on average assets and common stockholders’ equity for the fourth quarter of 2017 were (0.13%) and (1.62%), respectively, compared to 0.62% and 7.68%, respectively, for the fourth quarter of 2016. Pretax income increased $4.6 million or 39.3% to $16.3 million for the year ended December 31, 2017 compared to $11.7 million for the year ended December 31, 2016. The Company’s pretax returns on average assets and common stockholders’ equity for 2017 were 1.19% and 14.88%, respectively, compared to 0.96% and 11.36%, respectively, for 2016. The Company’s after-tax returns on average assets and common stockholders’ equity for 2017 were 0.52% and 6.55%, respectively, compared to 0.60% and 7.09%, respectively, for 2016.

Although the increased tax expense related to the deferred tax revaluation and merger and acquisition costs decreased net income, earnings per share and returns on average assets and common equity for the year, management believes the reduced federal income tax rate and the efficiencies from the County First acquisition will be accretive in 2018. The Company completed a very strong 2017 with operating net income growing at a record pace for the Company. Operating earnings per share increased to $2.31 per share, an increase of $0.72 or 45% from $1.59 per share in 2016. Operating return on average assets and operating return on average common equity increased to 0.78% and 9.70%, respectively, compared to 0.60% and 7.09% in 2016.

We accomplished the increased profitability primarily by controlling expense growth and improving asset quality. The Company’s efficiency ratio averaged in the low 60s for the year ended December 31, 2017. The Company’s cost control efforts and continued asset growth continued to create operating leverage in 2017.

Average loans increased $125.5 million or 12.7% from $988.3 million for the year ended December 31, 2016 to $1,113.8 million for the year ended December 31, 2017. Overall, end of period loan growth for 2017 of $61.1 million or 5.6% was lower than the Company’s planned 8% to 9% growth. The Company’s two largest portfolios, commercial real estate and residential rentals grew $60.2 million or 9.0% to $727.3 million and $8.3 million or 8.2% to $110.2 million, respectively, for the year ended December 31, 2017. Other portfolios decreased a net of $7.5 million or 2.3% to $312.5 million. The decrease in other portfolios included a $630,000 decrease in the residential first mortgage portfolio to $170.4 million and a $9.1 million decrease in the construction and land development to $27.9 million.

During 2017, management directed its focus to higher yielding commercial real estate and construction loans and deemphasized residential first mortgage lending.

Deposits increased by 6.5%, or $67.4 million, to $1,106.2 million at December 31, 2017 compared to $1,038.8 million at December 31, 2016. During 2017, balance sheet growth was balanced, with deposit growth of $67.4 million slightly exceeding loan growth of $61.1 million. Retail deposits, which include all deposits except traditional brokered deposits, increased a total of $79.4 million, comprised of increases in transaction accounts of $48.6 million and time deposits of $30.8 million. These retail increases to deposits were partially offset by a decrease to brokered deposits of $12.0 million.

COMPARISON OF RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED JUNE 30, 2018 AND 2017

Earnings Summary

The Company reported net income for the three months ended June 30, 2018 of $2.3 million or diluted earnings per share of $0.42 compared to net income of $2.5 million or $0.55 per diluted share for the three months ended June 30, 2017. The second quarter results included merger and acquisition costs net of tax of $546,000 and $227,000 for the comparative quarters. The impact of merger and acquisition costs resulted in a reduction to quarterly earnings per share of approximately $0.10 for the second quarter of 2018 and $0.05 for the second quarter of 2017. The Company's return on average assets ("ROAA") and return on average common equity ("ROACE") were 0.59% and 6.34% for the three months ended June 30, 2018 compared to 0.74% and 9.36% for the three months ended June 30, 2017.

The Company completed the acquisition of $200 million County First Bank ("County First") on January 1, 2018, increasing the Company's asset size to just under $1.6 billion. As planned, the Company closed four of the five acquired County First branches during May of 2018. The La Plata downtown branch remains open. The second quarter of 2018 results reflect temporary increases in operating expenses to support the merger with County First Bank. The closure of four branches and reductions in headcount during the second quarter are expected to positively impact the Company's operating expense run rate in the second half of 2018. The current year decrease in net income compared to the prior year was primarily due to merger-related costs, which included termination costs of County First's core processing contract as well as investment banking, legal fees and the costs of employee agreements and severance for terminations. In addition, the Company will continue to carry additional noninterest expense in the third and fourth quarters of 2018 until duplicate vendors and processes are discontinued. The increase in noninterest expense was partially offset by an increase in net interest income realized from the integrated operations of County First associated with the acquisition and from a lower effective tax rate.

The Company reported operating net income, which excludes merger-related expenses, of $2.8 million, or $0.52 per share, three months ended June 30, 2018. This compares to operating net income of $2.8 million, or $0.60 per share for the three months ended June 30, 2017. Operating net income reflects higher net interest income partially offset by lower noninterest income and higher noninterest expense, much of which is associated with the acquisition of County First. The Company's operating ROAA and ROACE were 0.73% and 7.82% for the second quarter of 2018 compared to 0.81% and 10.19% for the second quarter of 2017.

Net Interest Income

The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.

Net interest income totaled $12.4 million for the three months ended June 30, 2018, which represents a $1.5 million, or 13.5%, increase from $10.9 million for the three months ended June 30, 2017. Average total earning assets increased $169.5 million, or 13.2%, for the three months ended June 30, 2018 to $1,457.7 million compared to $1,288.2 million for the three months ended June 30, 2017. The increase in average total earning assets for the three months ended June 30, 2018 from the comparable quarter in 2017, resulted primarily from a $154.5 million, or 13.9%, increase in average loans as a result of organic growth and the acquisition of County First and a $14.9 million, or 8.5%, increase in average investments. Interest income increased $2.4 million for the three months ended June 30, 2018 compared to the second quarter of 2017. The increase in interest income resulted from larger average balances of interest-earning assets contributing $1.9 million and higher interest yields accounting for $493,000.

Average total interest-bearing liabilities increased $102.2 million, or 9.3%, for the three months ended June 30, 2018 to $1,202.5 million compared to $1,100.3 million for the three months ended June 30, 2017. During the same timeframe, average noninterest-bearing demand deposits increased $63.8 million, or 41.7%, to $217.0 million compared to $142.2 million. Interest expense increased $881,000 for the three months ended June 30, 2018 compared to the second quarter of 2017. The increase in interest expense resulted from higher interest rates accounting for $995,000, partially offset by a decrease of $114,000 in funding costs due to a change in the composition of funding liabilities. For the three month comparative periods, average short-term borrowings and long-term debt decreased $72.5 million and was replaced with increases to average transaction accounts, which include savings, demand and money market, and non-interest bearing accounts. During the three months ended June 30, 2018, average transaction accounts increased $223.3 million or 36.1% to $842.3 million from $619.0 million for the three months ended June 30, 2017. During the same timeframe average time deposits increased slightly $15.2 million or 3.4% to $458.8 million for the three months ended June 30, 2018. The Company is optimistic that our increased liquidity and funding composition changes will make us less sensitive to rising interest rates during the third and fourth quarters of 2018.

Net interest margin of 3.41% was two basis points higher than the 3.39% for the three months ended June 30, 2017. The small increase in net interest margin from the second quarter of 2017 resulted primarily from the Company's interest earning asset yields increasing at the same rate as overall funding costs. Interest earning asset yields increased 16 basis points from 4.16% for the three months ended June 30, 2017 to 4.32% for the three months ended June 30, 2018. The Company's cost of funds increased 15 basis points from 0.79% for the three months ended June 30, 2017 to 0.94% for the three months ended June 30, 2018. The 2018 second quarter's interest income was impacted from $152,000 of interest income accretion due to the recognition of the acquired performing fair value mark related to County First, the addition of higher yielding loans from the County First acquisition partially offset by non-accrual interest reversals of $117,000. Funding costs were positively impacted as the percentage of funding coming from noninterest-bearing deposits increased from 12.2% for the three months ended June 30, 2017 to 15.3% for the second quarter of 2018.

The following table shows the components of net interest income and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Three Months Ended June 30, 2018	2017	$ Change	% Change
Interest and Dividend Income				
Loans, including fees	$ 14,483	$ 12,410	$ 2,073	16.7 %
Taxable interest and dividends on investment securities	1,211	973	238	24.5 %
Interest on deposits with banks	60	12	48	400.0 %
Total Interest and Dividend Income	15,754	13,395	2,359	17.6 %
Interest Expenses				
Deposits	2,405	1,403	1,002	71.4 %
Short-term borrowings	217	283	(66)	(23.3 %)
Long-term debt	721	776	(55)	(7.1 %)
Total Interest Expenses	3,343	2,462	881	35.8 %
Net Interest Income (NII)	$ 12,411	$ 10,933	$ 1,478	13.5 %

The following table presents information on average balances and rates for deposits.

	For the Three Months Ended June 30, 2018		2017	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$ 74,470	0.07 %	$ 53,522	0.05 %
Interest-bearing demand and money market accounts	550,872	0.58 %	412,326	0.34 %
Certificates of deposit	458,801	1.39 %	443,627	0.94 %
Total interest-bearing deposits	1,084,143	0.89 %	909,475	0.62 %
Noninterest-bearing demand deposits	216,968		153,176	
	$ 1,301,111	0.74 %	$ 1,062,651	0.53 %

The following table shows the change in funding sources and the cost of funds for the comparable periods:

	For the Three Months Ended June 30, 2018			2017		
(dollars in thousands)	Average Balance	Average Rate	Percentage Funding	Average Balance	Average Rate	Percentage Funding
Interest-bearing deposits	$ 1,084,143	0.89 %	76.38 %	$ 909,475	0.62 %	72.55 %

Debt	118,384	3.17	%	8.34	%	190,875	2.22	%	15.23	%
Total interest-bearing liabilities	1,202,527	1.11	%	84.72	%	1,100,350	0.89	%	87.78	%
Noninterest-bearing demand deposits	216,968			15.28	%	153,176			12.22	%
Total funds	$1,419,495	0.94	%	100.00	%	$1,253,526	0.79	%	100.00	%

61

The following table presents information on the average balances of the Company’s interest-earning assets and interest-bearing liabilities and interest earned or paid thereon for the three months ended June 30, 2018 and 2017, respectively.

	For the Three Months Ended June 30,							
	2018				2017			
dollars in thousands	Average Balance	Interest	Avg. Yield /Cost		Average Balance	Interest	Avg. Yield /Cost	
Assets								
Commercial real estate	$818,370	$9,420	4.60	%	$697,929	$7,662	4.39	%
Residential first mortgages	164,574	1,487	3.61	%	179,574	1,730	3.85	%
Residential rentals	129,621	1,429	4.41	%	101,466	1,179	4.65	%
Construction and land development	28,120	391	5.56	%	35,881	439	4.89	%
Home equity and second mortgages	38,526	489	5.08	%	21,406	232	4.34	%
Commercial and equipment loans	97,407	1,253	5.15	%	85,911	1,159	5.40	%
Consumer loans	820	14	6.83	%	442	9	8.14	%
Allowance for loan losses	(10,608)	-	0.00	%	(10,280)	-	0.00	%
Loan portfolio (1)	1,266,830	14,483	4.57	%	1,112,329	12,410	4.46	%
Investment securities, federal funds sold and interest-earning deposits	190,849	1,271	2.66	%	175,903	985	2.24	%
Interest-Earning Assets ("IEAs")	1,457,679	15,754	4.32	%	1,288,232	13,395	4.16	%
Cash and cash equivalents	25,142				14,102			
Goodwill	10,280				-			
Core deposit intangible	3,316				-			
Other assets	83,228				71,498			
Total Assets	$1,579,645				$1,373,832			
Liabilities and Stockholders' Equity								
Savings	$74,470	$13	0.07	%	$53,522	$7	0.05	%
Interest-bearing demand and money market accounts	550,872	796	0.58	%	412,326	352	0.34	%
Certificates of deposit	458,801	1,596	1.39	%	443,627	1,045	0.94	%
Long-term debt	37,560	226	2.41	%	59,490	312	2.10	%
Short-term borrowings	45,824	217	1.89	%	96,385	283	1.17	%
Subordinated Notes	23,000	359	6.24	%	23,000	359	6.24	%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	136	4.53	%	12,000	104	3.47	%
Interest-Bearing Liabilities ("IBLs")	1,202,527	3,343	1.11	%	1,100,350	2,462	0.89	%
Noninterest-bearing demand deposits	216,968				153,176			
Other liabilities	12,855				11,586			
Stockholders' equity	147,295				108,720			
Total Liabilities and Stockholders' Equity	$1,579,645				$1,373,832			
Net interest income		$12,411				$10,933		
Interest rate spread			3.21	%			3.27	%

Net yield on interest-earning assets	3.41	%	3.39	%
Avg. loans to avg. deposits	97.37	%	104.67	%
Avg. transaction deposits to total avg. deposits **	64.74	%	58.25	%
Ratio of average IEAs to average IBLs	121.22	%	117.07	%
Cost of funds	0.94	%	0.79	%
Cost of deposits	0.74	%	0.53	%
Cost of debt	3.17	%	2.22	%

(1) Average balance includes non-accrual loans. There are no tax equivalency adjustments. There was $152,000 of accretion interest during the three months ended June 30, 2018.

** Transaction deposits excluded time deposits.

62

The following table sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

For the Three Months Ended June 30, 2018

compared to the Three Months Ended

June 30, 2017

	Due to		
dollars in thousands	Volume	Rate	Total
Interest income:			
Loan portfolio (1)	$ 1,766	$ 307	$ 2,073
Investment securities, federal funds sold and interest-earning deposits	100	186	286
Total interest-earning assets	$ 1,866	$ 493	$ 2,359
Interest-bearing liabilities:			
Savings	4	2	6
Interest-bearing demand and money market accounts	200	244	444
Certificates of deposit	53	498	551
Long-term debt	(132)	46	(86)
Short-term borrowings	(239)	173	(66)
Subordinated notes	-	-	-
Guaranteed preferred beneficial interest in junior subordinated debentures	-	32	32
Total interest-bearing liabilities	$ (114)	$ 995	$ 881
Net change in net interest income	$ 1,980	$ (502)	$ 1,478

(1) Average balance includes non-accrual loans. There are no tax equivalency adjustments. There was $152,000 of accretion interest during the three months ended June 30, 2018.

63

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

	Three Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Provision for loan losses	$ 400	$ 376	$ 24	6.4 %

The provision for loan losses increased $24,000 to $400,000 for the three months ended June 30, 2018 compared to $376,000 for the three months ended June 30, 2017. Net charge-offs of $146,000 were recognized for the three months ended June 30, 2018 compared to net charge-offs of $51,000 for the three months ended June 30, 2017. See further discussion of the provision under the caption “Asset Quality” in the Comparison of Financial Condition section of Management’s Discussion and Analysis.

Noninterest Income

Noninterest income of $893,000 for the three months ended June 30, 2018 decreased by $159,000 compared to $1.1 million for the three months ended June 30, 2017. The decrease in noninterest income was primarily due to gains on the sale of investment securities sold for the three months ended June 30, 2017 and the recognition for the three months ended June 30, 2018 of unrealized losses on equity securities due to a new accounting standard effective in the first quarter of 2018 that requires recognition of changes in the fair value flow through the Company’s statement of income. These decreases to non-interest income were partially offset by increases in service charge income due to a larger deposit base and additional income from the addition of approximately $6.3 million of Bank Owned Life Insurance acquired in the County First transaction.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Three Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 7	$ 9	$ (2)	(22.2)%
Gain on sale of asset	1	47	(46)	(97.9)%
Net gains (losses) on sale of OREO	(8)	9	(17)	(188.9)%
Net gains on sale of investment securities	-	133	(133)	(100.0)%
Unrealized gain (loss) on equity securities	(78)	-	(78)	n/a
Income from bank owned life insurance	224	194	30	15.5 %

Service charges	747	660	87	13.2 %
Total Noninterest Income	$ 893	$ 1,052	$ (159)	(15.1)%

Noninterest Expense

Noninterest expenses increased $2.2 million, or 29.4%, to $9.7 million for the three months ended June 30, 2018 compared to $7.5 million for the three months ended June 30, 2017, and decreased $1.9 million, or 16.5%, compared to $11.7 million in the first quarter of 2018. Adjusted noninterest expense, which excludes merger-related expenses and OREO related expenses increased $1.6 million, or 22.7%, to $8.8 million for the three months ended June 30, 2018 compared to $7.2 million for the three months ended June 30, 2017, and increased $86,000, or 1.0%, compared to $8.7 million in first quarter of 2018. Overall the increases in adjusted noninterest expenses comparing the second quarter of 2018 to the same quarter in 2017 were due primarily to increases in salary and employee benefits due to the addition of County First employees. Other increases from the comparable periods were to occupancy expense, data processing expense, core deposit intangible amortization and advertising expense, all of which were due primarily to the acquisition of County First. The Company closed four of the five acquired branches in May 2018. Two of the three held for sale County First branches were sold in June 2018. Branch closings are expected to positively impact the Company's expense run rate in the second half of 2018.

The Company’s efficiency ratio[3] was 73.22% for the three months ended June 30, 2018 compared to 62.83% for the three months ended June 30, 2017. The Company’s net operating expense ratio[3] was 2.24% for the three months ended June 30, 2018 compared to 1.89% for the three months ended June 30, 2017. The Company’s net operating expenses increased $2.4 million from $6.5 million for the three months ended June 30, 2017 to $8.8 million for the three months ended June 30, 2018. Merger costs increased the $2.4 million variance by $503,000. Net operating expense ratios increased in the first half of 2018 primarily due to duplicate systems and resources required to integrate County First. These costs are expected to decrease in the second half of 2018. The Company does not expect significant merger and acquisition costs related to the acquisition in the third and fourth quarters of 2018. The Company’s expected expense run rate for the balance of 2018 is $8.4 million to $8.6 million per quarter.

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

	Three Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Salary and employee benefits	$ 5,129	$ 4,198	$ 931	22.2 %
OREO valuation allowance and expenses	229	145	84	57.9 %
Merger and acquisition costs	741	238	503	211.3 %
Operating expenses	3,642	2,949	693	23.5 %
Total Noninterest Expense	$ 9,741	$ 7,530	$ 2,211	29.4 %

	Three Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 5,129	$ 4,198	$ 931	22.2 %
Occupancy expense	739	658	81	12.3 %
Advertising	180	140	40	28.6 %
Data processing expense	782	634	148	23.3 %
Professional fees	426	360	66	18.3 %
Merger & acquisition costs	741	238	503	211.3 %
Depreciation of premises and equipment	202	204	(2)	(1.0)%
Telephone communications	69	45	24	53.3 %
Office supplies	41	28	13	46.4 %
FDIC Insurance	113	161	(48)	(29.8)%
OREO valuation allowance and expenses	229	145	84	57.9 %
Core deposit intangible amortization	199	-	199	n/a
Other	891	719	172	23.9 %
Total Noninterest Expense	$ 9,741	$ 7,530	$ 2,211	29.4 %

Income Tax Expense

The Company's consolidated effective tax rate was 26.2% for the three months ended June 30, 2018, due to lower tax rates enacted with the passage of the Tax Cut and Jobs Act of 2017 partially offset by certain non-deductible merger-related expenses and holding company expenses that are not deductible for state tax purposes. The Company's normal effective rate as of June 30, 2018 was 27.52% (19.27% for federal; 8.25% for state). The Company's consolidated effective tax rate was 37.7% in the second quarter of 2017.

[2] Efficiency ratio is defined as noninterest expense divided by the sum of net interest income plus noninterest income.

[3] The net operating expense ratio is defined as noninterest expense less noninterest income divided by average assets.

65

COMPARISON OF RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 2018 AND 2017

Earnings Summary

The Company reported net income for the six months ended June 30, 2018 of $3.6 million or diluted earnings per share of $0.64 compared to net income of $4.9 million or $1.05 per diluted share for the six months ended June 30, 2017. The results included merger and acquisition costs net of tax of $2.7 million and $237,000 for the comparative six month periods. The impact of merger and acquisition costs resulted in a reduction to earnings per share of approximately $0.48 for the six months ended June 30, 2018 and $0.06 for the six months ended June 30, 2017. The Company's ROAA and ROACE were 0.45% and 4.84% for the six months ended June 30, 2018 compared to 0.72% and 9.07% for the six months ended June 30, 2017.

The Company completed the acquisition of $200 million County First Bank ("County First") on January 1, 2018, increasing the Company's asset size to just under $1.6 billion. As planned, the Company closed four of the five acquired County First branches during May of 2018. The La Plata downtown branch remains open. The first six months of 2018 results reflect temporary increases in operating expenses to support the merger with County First Bank. The closure of four branches and reductions in headcount during the second quarter are expected to positively impact the Company's operating expense run rate in the second half of 2018. The current year decrease in net income compared to the prior year was primarily due to merger-related costs, which included termination costs of County First's core processing contract as well as investment banking, legal fees and the costs of employee agreements and severance for terminations. In addition, the Company will continue to carry additional noninterest expense in the third and fourth quarters of 2018 until duplicate vendors and processes are discontinued. The increase in noninterest expense was partially offset by an increase in net interest income realized from the integrated operations of County First associated with the acquisition and from a lower effective tax rate.

The Company reported operating net income, which excludes merger-related expenses, of $6.2 million, or $1.12 per share, for the six months ended June 30, 2018. This compares to operating net income of $5.1 million, or $1.11 per share for the six months ended June 30, 2017. Operating net income reflects higher net interest income partially offset by higher loan loss provision and noninterest expense, much of which is associated with the acquisition of County First. The Company's operating ROAA and ROACE were 0.79% and 8.49% for the first six months of 2018 compared to 0.76% and 9.51% for the first six months of 2017.

Net Interest Income

The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.

Net interest income totaled $25.3 million for the six months ended June 30, 2018, which represents a $3.7 million, or 17.1%, increase from $21.6 million for the six months ended June 30, 2017. Average total earning assets increased $185.8 million, or 14.6%, for the six months ended June 30, 2018 to $1,457.3 million compared to $1,271.5 million for the six months ended June 30, 2017. The increase in average total earning assets for the six months ended June 30, 2018 from the comparable period in 2017, resulted primarily from a $172.6 million, or 15.7%, increase in average loans as a result of organic growth and the acquisition of County First and a $13.2 million, or 7.6%, increase in average investments. Interest income increased $5.3 million for the six months ended June 30, 2018 compared to the same period of 2017. The increase in interest income resulted from larger average balances of interest-earning assets contributing $4.1 million and higher interest yields accounting for $1.2 million.

Average total interest-bearing liabilities increased $113.2 million, or 10.4%, for the six months ended June 30, 2018 to $1,202.8 million compared to $1,089.6 million for the six months ended June 30, 2017. During the same timeframe, average noninterest-bearing demand deposits increased $70.6 million, or 47.8%, to $218.3 million compared to $147.7 million. Interest expense increased $1.6 million for the six months ended June 30, 2018 compared to the same period of 2017. The increase in interest expense resulted from higher interest rates accounting for $1.6 million. Funding costs from a change in the composition of funding liabilities resulted in a small increase of $27,000 to interest expense. For the six month comparative periods, average short-term borrowings and long-term debt decreased $42.8 million and was replaced with increases to average transaction accounts, which include savings, demand and money market, and non-interest bearing accounts. During the six months ended June 30, 2018, average transaction accounts increased $204.7 million or 33.4% to $817.1 million from $612.4 million for the six months ended June 30, 2017. During the same timeframe average time deposits increased slightly, $21.9 million or 4.7%, to $463.9 million for the six months ended June 30, 2018.

Net interest margin of 3.47% was seven basis points higher than the 3.40% for the six months ended June 30, 2017. The increase in net interest margin from the first six months of 2017 resulted primarily from the Company's interest earning asset yields increasing at faster rate than overall funding costs. Interest earning asset yields increased 20 basis points from 4.14% for the six months ended June 30, 2017 to 4.34% for the six months ended June 30, 2018. The Company's cost of funds increased 13 basis points from 0.76% for the six months ended June 30, 2017 to 0.89% for the six months ended June 30, 2018. The 2018 year to date interest income was impacted from $473,000 of interest income accretion due to the recognition of the acquired performing fair value mark related to County First as well as the addition of higher yielding loans from the County First acquisition. Funding costs were positively impacted as the percentage of funding coming from noninterest-bearing deposits increased from 11.9% for the six months ended June 30, 2017 to 15.4% for the six months ended June 30, 2018.

During the first six months of 2018, net interest margin increased as higher yielding assets more than offset the increased cost of funds. The increase in transaction accounts with the acquisition of County First as well as organic transaction deposit growth in the first six months of 2018 helped minimize deposit betas and positively impacted net interest margin.

The pay down of wholesale funding also positively impacted margins. Traditional brokered deposits and FHLB advances were paid down $123.8 million in the first six months of 2018 and replaced with retail deposits. Retail deposits, which include all deposits except traditional brokered deposits, increased $265.4 million or 26.9% from $987.2 million at December 31, 2017 to $1,252.6 million at June 30, 2018. Management is optimistic that increased liquidity and improved funding composition will partially mitigate the Company's sensitivity to rising interest rates during the remainder of 2018.

The following table shows the components of net interest income and the dollar and percentage changes for the periods presented.

	Six Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Interest and Dividend Income				
Loans, including fees	$ 29,209	$ 24,380	$ 4,829	19.8 %
Taxable interest and dividends on investment securities	2,306	1,919	387	20.2 %
Interest on deposits with banks	132	18	114	633.3 %
Total Interest and Dividend Income	31,647	26,317	5,330	20.3 %
Interest Expenses				
Deposits	4,361	2,671	1,690	63.3 %
Short-term borrowings	500	430	70	16.3 %
Long-term debt	1,485	1,609	(124)	(7.7)%
Total Interest Expenses	6,346	4,710	1,636	34.7 %

Net Interest Income (NII)	$ 25,301	$ 21,607	$ 3,694	17.1	%

67

The following table presents information on average balances and rates for deposits.

	For the Six Months Ended June 30,			
	2018		2017	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$ 74,706	0.07 %	$ 52,476	0.05 %
Interest-bearing demand and money market accounts	524,082	0.51 %	412,202	0.32 %
Certificates of deposit	463,995	1.29 %	442,086	0.90 %
Total interest-bearing deposits	1,062,783	0.82 %	906,764	0.59 %
Noninterest-bearing demand deposits	218,327		147,713	
	$ 1,281,110	0.68 %	$ 1,054,477	0.51 %

The following table shows the change in funding sources and the cost of funds for the comparable periods:

	For the Six Months Ended June 30,					
	2018			2017		
(dollars in thousands)	Average Balance	Average Rate	Percentage Funding	Average Balance	Average Rate	Percentage Funding
Interest-bearing deposits	$ 1,062,783	0.82 %	74.78 %	$ 906,764	0.59 %	73.28 %
Debt	140,027	2.84 %	9.85 %	182,861	2.23 %	14.78 %
Total interest-bearing liabilities	1,202,810	1.06 %	84.64 %	1,089,625	0.86 %	88.06 %
Noninterest-bearing demand deposits	218,327		15.36 %	147,713		11.94 %
Total funds	$ 1,421,137	0.89 %	100.00 %	$ 1,237,338	0.76 %	100.00 %

68

The following table presents information on the average balances of the Company’s interest-earning assets and interest-bearing liabilities and interest earned or paid thereon for the six months ended June 30, 2018 and 2017, respectively.

	For the Six Months Ended June 30,						
	2018				2017		
dollars in thousands	Average Balance	Interest	Avg. Yield /Cost		Average Balance	Interest	Avg. Yield /Cost	
Assets								
Commercial real estate	$817,216	$18,812	4.60	%	$683,226	$15,051	4.41	%
Residential first mortgages	166,811	3,061	3.67	%	176,967	3,396	3.84	%
Residential rentals	128,904	3,024	4.69	%	101,333	2,336	4.61	%
Construction and land development	28,480	765	5.37	%	37,229	869	4.67	%
Home equity and second mortgages	39,563	972	4.91	%	21,199	449	4.24	%
Commercial and equipment loans	98,919	2,547	5.15	%	87,236	2,262	5.19	%
Consumer loans	845	28	6.63	%	433	17	7.85	%
Allowance for loan losses	(10,663)	-	0.00	%	(10,175)	-	0.00	%
Loan portfolio (1)	1,270,075	29,209	4.60	%	1,097,448	24,380	4.44	%
Investment securities, federal funds sold and interest-bearing deposits	187,228	2,438	2.60	%	174,027	1,937	2.23	%
Interest-Earning Assets ("IEAs")	1,457,303	31,647	4.34	%	1,271,475	26,317	4.14	%
Cash and cash equivalents	25,595				12,703			
Goodwill	10,213				-			
Core deposit intangible	3,397				-			
Other assets	84,078				71,744			
Total Assets	$1,580,586				$1,355,922			
Liabilities and Stockholders' Equity								
Savings	$74,706	$25	0.07	%	$52,476	$13	0.05	%
Interest-bearing demand and money market accounts	524,082	1,339	0.51	%	412,202	660	0.32	%
Certificates of deposit	463,995	2,997	1.29	%	442,086	1,998	0.90	%
Long-term debt	43,933	510	2.32	%	60,679	677	2.23	%
Short-term borrowings	61,094	500	1.64	%	87,182	430	0.99	%
Subordinated Notes	23,000	719	6.25	%	23,000	719	6.25	%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	256	4.27	%	12,000	213	3.55	%
Interest-Bearing Liabilities ("IBLs")	1,202,810	6,346	1.06	%	1,089,625	4,710	0.86	%
Noninterest-bearing demand deposits	218,327				147,713			
Other liabilities	12,444				10,849			
Stockholders' equity	147,005				107,735			
Total Liabilities and Stockholders' Equity	$1,580,586				$1,355,922			
Net interest income		$25,301				$21,607		
Interest rate spread			3.28	%			3.28	%

Net yield on interest-earning assets	3.47	%	3.40	%
Avg. loans to avg. deposits	99.14	%	104.08	%
Avg. transaction deposits to total avg. deposits **	63.78	%	58.08	%
Ratio of average IEAs to average IBLs	121.16	%	116.69	%
Cost of funds	0.89	%	0.76	%
Cost of deposits	0.68	%	0.51	%
Cost of debt	2.84	%	2.23	%

(1) Average balance includes non-accrual loans. There are no tax equivalency adjustments. There was $473,000 of accretion interest during the six months ended June 30, 2018.

** Transaction deposits excluded time deposits.

69

The following table sets forth certain information regarding changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

For the Six Months Ended June 30, 2018

compared to the Six Months Ended

June 30, 2017

	Due to		
dollars in thousands	Volume	Rate	Total
Interest income:			
Loan portfolio (1)	$3,970	$859	$4,829
Investment securities, federal funds sold and interest bearing deposits	172	329	501
Total interest-earning assets	$4,142	$1,188	$5,330
Interest-bearing liabilities:			
Savings	7	5	12
Interest-bearing demand and money market accounts	286	393	679
Certificates of deposit	142	857	999
Long-term debt	(194)	27	(167)
Short-term borrowings	(214)	284	70
Subordinated notes	-	-	-
Guaranteed preferred beneficial interest in junior subordinated debentures	-	43	43
Total interest-bearing liabilities	$27	$1,609	$1,636
Net change in net interest income	$4,115	$(421)	$3,694

(1) Average balance includes non-accrual loans. There are no tax equivalency adjustments. There was $473,000 of accretion interest during the six months ended June 30, 2018.

70

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

	Six Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Provision for loan losses	$ 900	$ 756	$ 144	19.0 %

The provision for loan losses increased $144,000 to $900,000 for the six months ended June 30, 2018 compared to $756,000 for the six months ended June 30, 2017. Net charge-offs of $690,000 were recognized for the six months ended June 30, 2018 compared to net charge-offs of $182,000 for the six months ended June 30, 2017. See further discussion of the provision under the caption “Asset Quality” in the Comparison of Financial Condition section of Management’s Discussion and Analysis.

Noninterest Income

Noninterest income was flat at $1.9 million for the six months ended June 30, 2018 and 2017, respectively. Noninterest income decreased due to gains on the sale of investment securities, OREO and assets sold for the six months ended June 30, 2017 and the recognition for the six months ended June 30, 2018 of unrealized losses on equity securities due to a new accounting standard effective in the first quarter of 2018 that require recognition of changes in the fair value flow through the Company’s statement of income. These decreases to non-interest income were offset by increases in service charge income due to a larger deposit base from the County First acquisition and an increase in income from the addition of approximately $6.3 million of Bank Owned Life Insurance acquired in the County First transaction.

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

	Six Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 60	$ 56	$ 4	7.1 %
Gain on sale of assets	1	47	(46)	(97.9)%
Net gains (losses) on sale of OREO	(8)	36	(44)	(122.2)%
Net gains on sale of investment securities	-	133	(133)	(100.0)%
Unrealized gain (loss) on equity securities	(78)	-	(78)	n/a
Income from bank owned life insurance	450	385	65	16.9 %

Service charges	1,499	1,270	229	18.0 %
Total Noninterest Income	$ 1,924	$ 1,927	$ (3)	(0.2)%

Noninterest Expense

Noninterest expenses increased $6.5 million, or 43.6%, to $21.4 million for the six months ended June 30, 2018 compared to $14.9 million for the six months ended June 30, 2017. Adjusted noninterest expense, which excludes merger-related expenses and OREO related expenses increased $3.1 million, or 21.7%, to $17.4 million for the six months ended June 30, 2018 compared to $14.3 million for the six months ended June 30, 2017. Overall the increases in adjusted noninterest expenses were due primarily to increases in salary and employee benefits due to the addition of County First employees. Other increases from the comparable periods were to occupancy expense, data processing expense, core deposit intangible amortization and advertising expense, all of which were due primarily to the acquisition of County First. The Company closed four of the five acquired branches in May 2018. Two of the three held for sale County First branches were sold in June 2018. Branch closings are expected to positively impact the Company’s expense run rate in the second half of 2018.

The Company’s efficiency ratio was 78.63% for the six months ended June 30, 2018 compared to 63.35% for the six months ended June 30, 2017. The Company’s net operating expense ratio was 2.47% for the six months ended June 30, 2018 compared to 1.91% for the six months ended June 30, 2017. The Company’s net operating expenses increased $6.5 million from $13.0 million for the six months ended June 30, 2017 to $19.5 million for the six months ended June 30, 2017. Merger costs increased the $6.5 million variance by $3.4 million. Net operating expense ratios increased in the first half of 2018 primarily due to duplicate systems and resources required to integrate County First. These costs are expected to decrease in the second half of 2018. The Company does not expect significant merger and acquisition costs related to the acquisition in the third and fourth quarters of 2018. The Company’s expected expense run rate for the balance of 2018 is $8.4 million to $8.6 million per quarter.

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

	Six Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Salary and employee benefits	$ 10,176	$ 8,511	$ 1,665	19.6 %
OREO valuation allowance and expenses	343	340	3	0.9 %
Merger and acquisition costs	3,609	255	3,354	1315.3 %
Operating expenses	7,280	5,803	1,477	25.5 %
Total Noninterest Expense	$ 21,408	$ 14,909	$ 6,499	43.6 %

	Six Months Ended June 30,			
(dollars in thousands)	2018	2017	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$ 10,176	$ 8,511	$ 1,665	19.6 %
Occupancy expense	1,505	1,311	194	14.8 %
Advertising	339	248	91	36.7 %
Data processing expense	1,465	1,211	254	21.0 %
Professional fees	778	680	98	14.4 %
Merger and acquisition costs	3,609	255	3,354	1315.3 %
Depreciation of premises and equipment	401	403	(2)	(0.5)%
Telephone communications	168	96	72	75.0 %
Office supplies	81	60	21	35.0 %
FDIC Insurance	311	327	(16)	(4.9)%
OREO valuation allowance and expenses	343	340	3	0.9 %
Core deposit intangible amortization	404	-	404	n/a
Other	1,828	1,467	361	24.6 %
Total Noninterest Expense	$ 21,408	$ 14,909	$ 6,499	43.6 %

Income Tax Expense

The Company’s consolidated effective tax rate was 27.7% for the six months ended June 30, 2018, due to lower tax rates enacted with the passage of the Tax Cut and Jobs Act of 2017 partially offset by certain non-deductible merger-related expenses and holding company expenses that are not deductible for state tax purposes. The Company’s normal effective rate as of June 30, 2018 was 27.52% (19.27% for federal; 8.25% for state). The Company’s consolidated effective tax rate was 37.9% for the six months ended June 30, 2017.

COMPARISON OF FINANCIAL CONDITION AT JUNE 30, 2018 AND DECEMBER 31, 2017

Assets

Total assets increased $180.3 million, or 12.8%, to $1.6 billion at June 30, 2018 compared to total assets of $1.4 billion at December 31, 2017, primarily as a result of the acquisition of County First. Cash and cash equivalents increased $5.0 million, or 32.2%, to $20.4 million and total securities increased $16.9 million, or 10.1%, to $184.5 million. Gross loans increased 12.2% or $140.4 million from $1,151.1 million at December 31, 2017 to $1,291.5 million at June 30, 2018, primarily due to the acquisition. The differences in allocations between the cash and investment categories reflect operational needs.

72

The following table shows the Company's assets and the dollar and percentage changes for the periods presented.

(dollars in thousands)	June 30, 2018	December 31, 2017	$ Change	% Change	
Cash and due from banks	$ 16,718	$ 13,315	$ 3,403	25.6	%
Interest-bearing deposits with banks	3,667	2,102	1,565	74.5	%
Securities available for sale (AFS), at fair value	79,026	68,164	10,862	15.9	%
Securities held to maturity (HTM), at amortized cost	100,842	99,246	1,596	1.6	%
Equity securities carried at fair value through income	4,367	-	4,367	n/a	
Non-marketable equity securities held in other financial institutions	249	121	128	105.8	%
FHLB stock - at cost	4,311	7,276	(2,965)	(40.8	)%
Net Loans	1,280,812	1,140,615	140,197	12.3	%
Goodwill	10,603	-	10,603	n/a	
Premises and equipment, net	22,472	21,391	1,081	5.1	%
Premises and equipment held for sale	600	-	600	n/a	
Other real estate owned (OREO)	8,305	9,341	(1,036)	(11.1	)%
Accrued interest receivable	4,786	4,511	275	6.1	%
Investment in bank owned life insurance	35,843	29,398	6,445	21.9	%
Core deposit intangible	3,186	-	3,186	n/a	
Net deferred tax assets	6,624	5,922	702	11.9	%
Other assets	3,877	4,559	(682)	(15.0	)%
Total Assets	$ 1,586,288	$ 1,405,961	$ 180,327	12.8	%

The acquisition of County First led to a slight shift in the composition of the loan portfolios during 2018 compared to December 31, 2017. Regulatory concentrations for non-owner occupied commercial real estate and construction decreased from 309.6% and 65.5% at December 31, 2017 to 294.8% and 65.1% at June 30, 2018.

The following is a breakdown of the Company's loan portfolio at June 30, 2018 and December 31, 2017:

	June 30, 2018					December 31, 2017		
(dollars in thousands)	PCI	All other loans**	Total	% of Gross Loans		Total	% of Gross Loans	
Commercial real estate	$ 1,503	$ 826,941	$ 828,445	64.20	%	$ 727,314	63.25	%
Residential first mortgages	470	162,621	163,090	12.64	%	170,374	14.81	%
Residential rentals	1,274	126,195	127,469	9.88	%	110,228	9.58	%
Construction and land development	272	28,375	28,647	2.22	%	27,871	2.42	%

Home equity and second mortgages	319	36,707	37,026	2.87	%	21,351	1.86	%
Commercial loans	-	57,519	57,519	4.46	%	56,417	4.91	%
Consumer loans	-	801	801	0.06	%	573	0.05	%
Commercial equipment	-	47,418	47,418	3.67	%	35,916	3.12	%
Gross loans	3,838	1,286,577	1,290,415	100.00	%	1,150,044	100.00	%
Net deferred costs (fees)	-	1,122	1,122	0.09	%	1,086	0.09	%
Total loans, net of deferred costs	$3,838	$1,287,699	$1,291,537			$1,151,130		
Less: allowance for loan losses	-	(10,725)	(10,725)	-0.83	%	(10,515)	-0.91	%
Net loans	$3,838	$1,276,974	$1,280,812			$1,140,615		

**All other loans include acquired Non-PCI pools.

73

The following is a breakdown of acquired and non-acquired loans as of June 30, 2018:

BY ACQUIRED AND NON-ACQUIRED	June 30, 2018	%	December 31, 2017	%
Acquired loans - performing	$ 115,157	8.92 %	$ -	0.00 %
Acquired loans - purchase credit impaired ("PCI")	3,838	0.30 %	-	0.00 %
Total acquired loans	118,995	9.22 %	-	0.00 %
Non-acquired loans**	1,171,420	90.78 %	1,150,044	100.00 %
Gross loans	1,290,415		1,150,044	
Net deferred costs (fees)	1,122	0.09 %	1,086	0.09 %
Total loans, net of deferred costs	$ 1,291,537		$ 1,151,130	

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

In terms of accounting designations, compared to December 31, 2017, (i) non-acquired loans, which include certain renewed and/or restructured acquired performing loans that are re-designated as non-acquired, increased $21.4 million, or 1.9%, to $1,174.4 million at June 30, 2018; (ii) acquired performing loans were $115.2 million at June 30, 2018; and (iii) purchase credit impaired (“PCI”) loans were $3.8 million at June 30, 2018. At June 30, 2018, performing acquired loans, which totaled $115.2 million, included a $2.2 million net acquisition accounting fair market value adjustment, representing a 1.84% “mark;” and PCI loans which totaled $3.8 million, included a $671,000 adjustment, representing a 14.89% “mark.” During the three and six months ended June 30, 2018 there was $152,000 and $473,000, respectively, of accretion interest.

The non-acquired portfolios increased $21.4 million or 3.7% annualized from $1,150.0 million at December 31, 2017 to $1.171.4 million at June 30, 2018. The Bank’s higher yielding commercial real estate portfolio has grown $29.1 million at an 8.0% annualized rate during the first six months of 2018, which has been partially offset by a net decrease in other loan portfolios of $7.8 million.

The following is a breakdown of the Company’s non-acquired loan portfolios at June 30, 2018 and December 31, 2017:

Non-Acquired Loan Portfolios						Annualized
(dollars in thousands)	June 30, 2018	%	December 31, 2017	%	$ Change	% Change

Commercial real estate	$ 756,452	64.57 %	$ 727,314	63.25 %	$ 29,138	8.01 %
Residential first mortgages	162,621	13.88 %	170,374	14.81 %	(7,753)	-9.10 %
Residential rentals	106,967	9.13 %	110,228	9.58 %	(3,261)	-5.92 %
Construction and land development	27,611	2.36 %	27,871	2.42 %	(260)	-1.87 %
Home equity and second mortgages	21,334	1.82 %	21,351	1.86 %	(17)	-0.16 %
Commercial loans	53,853	4.60 %	56,417	4.91 %	(2,564)	-9.09 %
Consumer loans	564	0.05 %	573	0.05 %	(9)	-3.14 %
Commercial equipment	42,018	3.59 %	35,916	3.12 %	6,102	33.98 %
	$ 1,171,420	100.00 %	$ 1,150,044	100.00 %	$ 21,376	3.72 %

74

Asset Quality

The following tables show asset quality ratios at June 30, 2018 and December 31, 2017.

(dollars in thousands, except per share amounts)	June 30, 2018	December 31, 2017	$ Change	% Change
ASSET QUALITY				
Total assets	$ 1,586,288	$ 1,405,961	$ 180,327	12.8 %
Gross loans	1,290,415	1,150,044	140,371	12.2
Classified Assets	43,536	50,298	(6,762)	(13.4)
Allowance for loan losses	10,725	10,515	210	2.0
Past due loans - 31 to 89 days	582	9,227	(8,645)	(93.7)
Past due loans >=90 days	12,347	2,483	9,864	397.3
Total past due (delinquency) loans	12,929	11,710	1,219	10.4
Non-accrual loans (a)	14,492	4,693	9,799	208.8
Accruing troubled debt restructures (TDRs) (b)	9,864	10,021	(157)	(1.6)
Other real estate owned (OREO)	8,305	9,341	(1,036)	(11.1)
Non-accrual loans, OREO and TDRs	$ 32,661	$ 24,055	$ 8,606	35.8
ASSET QUALITY RATIOS				
Classified assets to total assets	2.74 %	3.58 %		
Classified assets to risk-based capital	23.88	32.10		
Allowance for loan losses to total loans	0.83	0.91		
Allowance for loan losses to non-accrual loans	74.01	224.06		
Past due loans - 31 to 89 days to total loans	0.05	0.80		
Past due loans >=90 days to total loans	0.96	0.22		
Total past due (delinquency) to total loans	1.00	1.02		
Non-accrual loans to total loans	1.12	0.41		
Non-accrual loans and TDRs to total loans	1.89	1.28		
Non-accrual loans and OREO to total assets	1.44	1.00		
Non-accrual loans, OREO and TDRs to total assets	2.06	1.71		

(a) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer. Non-accrual loans can include loans that are current with all loan payments.

(b) At June 30, 2018 and December 31, 2017, the Bank had total TDRs of $9.9 million and $10.8 million, respectively, with $0 and $769,000, respectively, in non-accrual status. These loans are classified as non-accrual loans for the calculation of financial ratios.

The Company continues to pursue its approach of maximizing contractual rights with individual classified customer relationships. The objective is to expeditiously resolve non-performing or substandard credits that are not likely to become performing or passing credits in a reasonable timeframe. Management believes this strategy is in the best long-term interest of the Company.

Classified assets decreased $6.8 million from $50.3 million at December 31, 2017 to $43.5 million at June 30, 2018. Management considers classified assets to be an important measure of asset quality. The following is a breakdown of the Company's classified and special mention assets at June 30, 2018, March 31, 2018 and December 31, 2017, 2016, 2015 and 2014, respectively:

Classified Assets and Special Mention Assets

(dollars in thousands)	As of 06/30/2018	As of 03/31/2018	As of 12/31/2017	As of 12/31/2016	As of 12/31/2015	As of 12/31/2014
Classified loans						
Substandard	$ 34,559	$ 34,772	$ 40,306	$ 30,463	$ 31,943	$ 46,735
Doubtful	103	-	-	137	861	-
Loss	-	-	-	-	-	-
Total classified loans	34,662	34,772	40,306	30,600	32,804	46,735
Special mention loans	854	2,033	96	-	1,642	5,460
Total classified and special mention loans	$ 35,516	$ 36,805	$ 40,402	$ 30,600	$ 34,446	$ 52,195
Classified loans	34,662	34,772	40,306	30,600	32,804	46,735
Classified securities	569	612	651	883	1,093	1,404
Other real estate owned	8,305	9,352	9,341	7,763	9,449	5,883
Total classified assets	$ 43,536	$ 44,736	$ 50,298	$ 39,246	$ 43,346	$ 54,022
Total classified assets as a percentage of total assets	2.74 %	2.84 %	3.58 %	2.94 %	3.79 %	4.99 %
Total classified assets as a percentage of Risk Based Capital	23.88 %	24.81 %	32.10 %	26.13 %	30.19 %	39.30 %

Non-accrual loans and OREO to total assets increased from 1.00% at December 31, 2017 to 1.44% at June 30, 2018. Non-accrual loans, OREO and TDRs to total assets increased $8.6 million from $24.1 million or 1.71% at December 31, 2017 to $32.7 million or 2.06% at June 30, 2018. The $8.6 million increase was principally due to of one well-secured classified relationship of $10.3 million that was placed on non-accrual during the second quarter of 2018, which resulted in the reversal of approximately $120,000 of interest income.

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) increased $9.8 million from $4.7 million or 0.41% of total loans at December 31, 2017 to $14.5 million or 1.12% of total loans at June 30, 2018. Non-accrual loans can be current but classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. In accordance with the Company's policy, interest income is recognized on a cash basis or cost-recovery method, until qualifying for return to accrual status.

At June 30, 2018, non-accrual loans of $14.5 million included 30 loans, of which $11.7 million, or 80% represented 11 loans and two customer relationships. At December 31, 2017, non-accrual loans of $4.7 million included 24 loans, of which $3.3 million, or 71% represented 10 loans and five customer relationships. During the six months ended June 30, 2018, non-accrual loans increased $9.8 million primarily as a result of one well-secured classified relationship of $10.3 million that was placed on non-accrual during the second quarter of 2018, which resulted in the reversal of approximately $120,000 of interest income. During the year ended December 31, 2017 non-accrual loans decreased $3.0 million due to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Before the foreclosure, the loans in this relationship were TDRs. Additionally, during the third quarter of 2017, non-accrual loans decreased $607,000 due to the foreclosure of a commercial office building.

Non-accrual loans included no TDRs at June 30, 2018 and one TDR totaling $769,000 at December 31, 2017. This loan was classified solely as non-accrual for the calculation of financial ratios.

Loan delinquency (90 days or greater delinquent and 31-89 days delinquent) increased $1.2 million from $11.7 million, or 1.02% of loans, at December 31, 2017 to $12.9 million, or 1.00% of loans, at June 30, 2018.

76

TDRs decreased $926,000 due to principal paydowns and payoffs for the six months ended June 30, 2018. There were no TDRs added during the six months ended June 30, 2018. The Company had specific reserves of $393,000 on three TDRs totaling $2.3 million at June 30, 2018. The Company had specific reserves of $413,000 on seven TDRs totaling $3.0 million at December 31, 2017. During the year ended December 31, 2017, TDR disposals, which included payoffs and refinancing decreased by seven loans totaling $3.9 million, of which $3.0 million related to the foreclosure of the stalled residential development project. TDR loan principal curtailment was $385,000 for the year ended December 31, 2017. There were no TDRs added during the year ended December 31, 2017.

The following is a breakdown by loan classification of the Company's TDRs at June 30, 2018 and December 31, 2017:

	June 30, 2018		December 31, 2017	
(dollars in thousands)	Dollars	Number of Loans	Dollars	Number of Loans
Commercial real estate	$ 8,396	8	$ 9,273	9
Residential first mortgages	517	2	527	2
Residential rentals	218	1	221	1
Construction and land development	729	2	729	2
Commercial loans	4	1	4	1
Commercial equipment	-	-	36	1
Total TDRs	$ 9,864	14	$ 10,790	16
Less: TDRs included in non-accrual loans	-	-	(769)	(1)
Total accrual TDR loans	$ 9,864	14	$ 10,021	15

The Company recorded a $400,000 and $900,000 provision for loan loss expense for the three and six months ended June 30, 2018 compared to loan loss provisions of $376,000 and $756,000 for the three and six months ended June 30, 2017. Net charge-offs of $146,000 and $690,000 were recognized for the three and six months ended June 30, 2018. Net charge-offs of $51,000 and $182,000 for the same periods in 2017. Allowance for loan loss levels decreased to 0.83% of total loans at June 30, 2018 compared to 0.91% at December 31, 2017 due to the addition of County First loans for which no allowance was provided for in accordance with purchase accounting standards. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to: overall loss experience; current economic conditions; size, growth and composition of the loan portfolio; financial condition of the borrowers; current appraised values of underlying collateral and other relevant factors that, in management's judgment, warrant recognition in determining an adequate allowance. Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as slower portfolio growth, were offset by increases in other qualitative factors. The specific allowance is based on management's estimate of realizable value for particular loans. Management believes that the allowance is adequate.

The following is a summary roll-forward of the allowance and a breakdown of the Company's general and specific allowances as a percentage of gross loans at and for the three and six months ended June 30, 2018 and 2017 and year ended December 31, 2017:

(dollars in thousands)	Three Months Ended June 30, 2018	Three Months Ended June 30, 2017	Six Months Ended June 30, 2018	Six Months Ended June 30, 2017	Year Ended December 31, 2017
Beginning of period	$ 10,471	$ 10,109	$ 10,515	$ 9,860	$ 9,860
Charge-offs	(164)	(68)	(744)	(216)	(482)
Recoveries	18	17	54	34	127
Net charge-offs	(146)	(51)	(690)	(182)	(355)
Provision for loan losses	400	376	900	756	1,010
End of period	$ 10,725	$ 10,434	$ 10,725	$ 10,434	$ 10,515
Net charge-offs to average loans (annualized)	-0.05 %	-0.02 %	-0.11 %	-0.03 %	-0.03 %

Breakdown of general and specific allowance as a percentage of gross loans	June 30, 2018	June 30, 2017	December 31, 2017
General allowance	$ 9,359	$ 8,958	$ 9,491
Specific allowance	1,366	1,476	1,024
	$ 10,725	$ 10,434	$ 10,515
General allowance	0.72 %	0.78 %	0.82 %
Specific allowance	0.11 %	0.13 %	0.09 %
Allowance to gross loans	0.83 %	0.91 %	0.91 %
Allowance to non-acquired gross loans	0.92 %	0.91 %	0.91 %
Total acquired loans	118,996	-	-
Non-acquired loans**	1,171,419	1,142,010	1,150,044
Gross loans	1,290,415	1,142,010	1,150,044

** Non-acquired loans include loans transferred from acquired pools following release of acquisition accounting FMV adjustments.

The OREO balance decreased $1.0 from $9.3 million at December 31, 2017 to $8.3 million at June 30, 2018. During the six months ended June 30, 2018 and 2017, OREO additions were $238,000 and $2.8 million, respectively. During the six months ended June 30, 2018, additions of $238,000 were for $95,000 of capitalized costs to improve a development project and $143,000 for commercial real estate. During the six months ended June 30, 2017, additions of $2.8 million to OREO were related to the foreclosure of a stalled residential development project. During the six months ended June 30, 2018 and 2017, there were OREO disposals of $991,000 and $1.1 million, respectively. The Company recognized net losses of $8,000 on disposals of multiple residential lots of $188,000, a commercial building of $476,000 and a commercial lot of $327,000 for the six months ended June 30, 2018. The Company recognized net gains of $36,000 on disposals of $1.1 million of four residential properties and multiple residential lots for the six months ended June 30, 2017. The Bank provided $200,000 in financing for one residential property and the three residential lots which were transferred from OREO to loans during the first quarter of 2017. The transaction qualified for full accrual sales treatment under ASC Topic 360-20-40 “Property Plant and Equipment – Derecognition. Additions to the valuation allowances of $283,000 and $313,000 were taken to adjust properties to current appraised values for the six months ended June 30, 2018 and 2017, respectively. OREO carrying amounts reflect management’s estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs.

At June 30, 2018, greater than 99%, or $179.3 million of the asset-backed securities and bonds issued by GSEs and U.S. Agencies and others were rated AAA by Standard & Poor’s or the equivalent credit rating from another major rating agency compared to greater than 99%, or $162.3 million, at December 31, 2017. Debt securities are evaluated quarterly to determine whether a decline in their value is OTTI. No OTTI charge was recorded for the six months ended June 30, 2018 and the year ended December 31, 2017, respectively. Classified securities decreased $82,000 from $651,000 at December 31, 2017 to $569,000 at June 30, 2018.

Gross unrealized losses on HTM and AFS securities increased from $3.1 million at December 31, 2017 to $6.0 million at June 30, 2018 (see Note 10 in Consolidated Financial Statements). Gross unrealized losses at June 30, 2018 and December 31, 2017 for AFS securities were $3.0 million and $1.7 million, respectively, of amortized cost of $82.0 million and $69.9 million, respectively. Gross unrealized losses at June 30, 2018 and December 31, 2017 for HTM securities were $3.0 million and $1.4 million, respectively, of amortized cost of $100.8 million and $99.2 million, respectively. The change in unrealized losses was the result of changes in interest rates, while credit risks remained stable. The Bank holds over 97% of its AFS and HTM securities as asset-backed securities of GSEs or U.S. Agencies, GSE agency bonds or U.S. government obligations. The Company intends to, and has the ability to, hold both AFS and HTM securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. The Company believes that the AFS and HTM securities with unrealized losses will either recover in market value or be paid off as agreed.

Liabilities

The following table shows the Company’s liabilities and the dollar and percentage changes for the periods presented.

(dollars in thousands)	June 30, 2018	December 31, 2017	$ Change	% Change	
Deposits					
Non-interest-bearing deposits	$ 214,249	$ 159,844	$ 54,405	34.0	%
Interest-bearing deposits	1,109,619	946,393	163,226	17.2	%
Total deposits	1,323,868	1,106,237	217,631	19.7	%
Short-term borrowings	36,500	87,500	(51,000)	(58.3	)%
Long-term debt	30,467	55,498	(25,031)	(45.1	)%
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000	-	0.0	%
Subordinated notes - 6.25%	23,000	23,000	-	0.0	%
Accrued expenses and other liabilities	13,207	11,769	1,438	12.2	%
Total Liabilities	$ 1,439,042	$ 1,296,004	$ 143,038	11.0	%

Deposits and Borrowings

Total deposits increased $217.7 million, or 19.7%, to $1,323.9 million at June 30, 2018, compared to $1,106.2 million at December 31, 2017. Retail deposits increased $265.5 million or 26.9%, while traditional brokered deposits decreased $47.8 million. Noninterest bearing demand deposits increased $54.4 million, or 34.0%, to $214.2 million (16.2% of total deposits). The Company uses both traditional and reciprocal brokered deposits. Traditional brokered deposits were $71.3 million at June 30, 2018 compared to $118.9 million at December 31, 2017. Reciprocal brokered deposits are used to maximize FDIC insurance available to our customers. Reciprocal brokered deposits were $152.8 million at June 30, 2018 compared to $92.9 million at December 31, 2017.

Transaction deposit accounts increased $222.7 million from $654.6 million (59% of deposits) at December 31, 2017 to $877.4 million (66% of deposits) at June 30, 2018. The Company is optimistic that the increase in transaction deposits during the first and second quarters of 2018 will be less sensitive to rising interest rates than wholesale funding.

79

Details of the Company's deposit portfolio at June 30, 2018, March 31, 2018 and December 31, 2017 are presented below:

	June 30, 2018		March 31, 2018		December 31, 2017	
(dollars in thousands)	Balance	%	Balance	%	Balance	%
Noninterest-bearing demand	$214,249	16.18 %	$229,612	17.86 %	$159,844	14.45 %
Interest-bearing:						
Demand	307,986	23.26 %	217,039	16.88 %	215,447	19.48 %
Money market deposits	281,975	21.30 %	284,449	22.12 %	226,351	20.46 %
Savings	73,142	5.52 %	76,360	5.94 %	52,990	4.79 %
Certificates of deposit	446,516	33.73 %	478,476	37.21 %	451,605	40.82 %
Total interest-bearing	1,109,619	83.82 %	1,056,324	82.14 %	946,393	85.55 %
Total Deposits	$1,323,868	100.00%	$1,285,936	100.00%	$1,106,237	100.00%
Transaction accounts	$877,352	66.27 %	$807,460	62.79 %	$654,632	59.18 %

Federal Home Loan Bank ("FHLB") long-term debt and short-term borrowings decreased $76.0 million, or 53.2%, to $67.0 million at June 30, 2018 compared to $143.0 million at December 31, 2017. Wholesale funding, which includes traditional brokered deposits and FHLB advances, decreased $123.8 million or 47% from $261.9 million (18.7% of assets) at December 31, 2017 to $138.2 million (8.7% of assets) at June 30, 2018. Wholesale funding at 8.7% of assets is at its lowest point since 2012. Cash and the sale of securities from the County First acquisition were used to pay down debt and brokered deposits. In addition, the Company was able to further reduce wholesale funding with second quarter 2018 organic transaction deposit growth of $69.9 million.

The Company uses brokered deposits and other wholesale funding to supplement funding when loan growth exceeds core deposit growth and for asset-liability management purposes.

Liquidity has improved with the increase in transaction deposits and decrease in wholesale funding. The Company's net loan to deposit ratio has decreased from 103.1% at December 31, 2017 to 96.7% at June 30, 2018.

The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and other commercial banks. FHLB long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. At June 30, 2018 and December 31, 2017, 100% of the Bank's long-term debt was fixed for rate and term, as the conversion optionality of the advances have either been exercised or expired.

Stockholders' Equity

Total stockholders' equity increased $37.3 million, or 33.9%, to $147.3 million at June 30, 2018 compared to $110.0 million at December 31, 2017. This increase primarily resulted from the issuance of 918,526 shares of common stock, valued at $35.6 million (based on the $38.78 per share closing price), as the stock component of the merger consideration paid in the County First acquisition. In addition, stockholders' equity increased due to net income of $3.6 million and net stock related activities related to stock-based compensation of $247,000. These increases to stockholders' equity were partially offset by decreases due to common dividends paid of $1.1 million, an increase in accumulated other comprehensive losses of $991,0000 and repurchases of common stock of $67,000.

Common stockholders' equity of $147.3 million and $110.0 million at June 30, 2018 and December 31, 2017 resulted in a book values per common share of $26.41 and $23.65, respectively. Tangible book value at June 30, 2018 was $23.94. Tangible book value was the same as book value prior to December 31, 2017 because the Company had no intangible assets. The Company's ratio of tangible common equity to tangible assets increased to 8.49% at June 30, 2018 from 7.82% at December 31, 2017. The Company's Common Equity Tier 1 ("CET1") ratio was 10.32% at June 30, 2018 compared to 9.51% at December 31, 2017. The Company remains well capitalized at June 30, 2018 with a Tier 1 capital to average assets (leverage ratio) of 9.46% at June 30, 2018 compared to 8.79% at December 31, 2017.

The following table shows the Company’s equity and the dollar and percentage changes for the periods presented.

(dollars in thousands)	June 30, 2018	December 31, 2017	$ Change	% Change
Common Stock at par of $0.01	$ 56	$ 46	$ 10	21.7 %
Additional paid in capital	84,106	48,209	35,897	74.5 %
Retained earnings	66,021	63,648	2,373	3.7 %
Accumulated other comprehensive loss	(2,182)	(1,191)	(991)	83.2 %
Unearned ESOP shares	(755)	(755)	-	0.0 %
Total Stockholders' Equity	$ 147,246	$ 109,957	$ 37,289	33.9 %

81

LIQUIDITY AND CAPITAL RESOURCES

Capital Resources

The Company has no business other than holding the stock of the Bank and does not have significant operating cash needs, except for the payment of dividends declared on common stock, and the payment of interest on subordinated debentures and subordinated notes, and noninterest expense.

The Company evaluates capital resources by our ability to maintain adequate regulatory capital ratios. The Company and the Bank annually update a three-year strategic capital plan. In developing its plan, the Company considers the impact to capital of asset growth, income accretion, dividends, holding company liquidity, investment in markets and people and stress testing. Our capital position is reflected in shareholders' equity, subject to certain adjustments for regulatory purposes. Shareholders' equity, or capital, is a measure of our net worth, soundness, and viability. We continue to remain in a well-capitalized position. Shareholders' equity at June 30, 2018 was $147.2 million, compared to $110.0 million at December 31, 2017. The increase in capital during the first six months of 2018 was principally due to a $35.6 million issuance of stock for the County First acquisition.

During the six months ended June 30, 2018 and 2017, the Company performed ongoing assessments using regulatory capital ratios and determined that the Company meets the new requirements specified in the Basel III rules upon full adoption of such requirements. Our subsidiary bank made the election to retain the AOCI treatment under the prior capital rules in a March 2015 regulatory filing.

Federal banking regulations require the Company and the Bank to maintain specified levels of capital. As of June 30, 2018, and December 31, 2017, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the Basel III Capital Rules. Management believes, as of March 31, 2018 and December 31, 2017, that the Company and the Bank met all capital adequacy requirements to which they were subject. See Note 12 of the Consolidated Financial Statements.

Liquidity

Liquidity is our ability to meet cash demands as they arise. Such needs can develop from loan demand, deposit withdrawals or acquisition opportunities. Potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers are other factors affecting our liquidity needs. Many of these obligations and commitments are expected to expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position.

Based on management's going concern evaluation, we believe that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the Company's or the Bank's ability to continue as a going concern, within one year of the date of the issuance of the financial statements.

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. Liquid assets include cash, federal funds sold, and short-term investments in cash deposits with other banks. Liquidity is also provided by access to funding sources, which include core depositors and brokered deposits. Other sources of funds include our ability to borrow, such as purchasing federal funds from correspondent banks, sales of securities under agreements to repurchase and advances from the FHLB.

At June 30, 2018 and December 31, 2017, the Bank had $76.3 million and $65.6 million, respectively, in loan commitments outstanding. In addition, at June 30, 2018 and December 31, 2017, the Bank had $21.8 million and $17.9 million, respectively, in letters of credit and approximately $201.8 million and $162.2 million, respectively, available under lines of credit. Certificates of deposit due within one year of June 30, 2018 and December 31, 2017 totaled $280.8 million or 62.9% and $312.4 million, or 69.2%, respectively, of total certificates of deposit outstanding. If maturing deposits do not remain, the Bank will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposits. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

The Company's principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank’s principal sources of funds for investment and operations are net income, deposits, sales of loans, borrowings, principal and interest payments on loans, principal and interest received on investment securities and proceeds from the maturity and sale of investment securities. The Bank’s principal funding commitments are for the origination or purchase of loans, the purchase of securities and the payment of maturing deposits. Deposits are considered the primary source of funds supporting the Bank’s lending and investment activities. The Bank also uses borrowings from the FHLB of Atlanta to supplement deposits. The amount of FHLB advances available to the Bank is limited to the lower of 30% of Bank assets or the amount supportable by eligible collateral including FHLB stock, loans and securities. In addition, the Bank has established unsecured and secured lines of credit with the Federal Reserve Bank and commercial banks.

For additional information on these agreements, including collateral, see Note 11 of the Consolidated Financial Statements as presented in the Company’s Form 10-K for the year ended December 31, 2017.

The Bank’s most liquid assets are cash, cash equivalents and federal funds sold. The levels of such assets are dependent on the Bank’s operating, financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows.

Cash and cash equivalents as of June 30, 2018 totaled $20.4 million, an increase of $5.0 million from the December 31, 2017 total of $15.4 million. Ending cash balances increased primarily due to proceeds from the sale of investment securities, excess of principal collected over loan originations, and cash from the County First acquisition. These increases were partially offset by decreases in net deposits and total debt outstanding. Changes to the level of cash and cash equivalents have minimal impact on operational needs as the Bank has substantial sources of funds available from other sources.

During the six months ended June 30, 2018, all financing activities used $58.7 million in cash compared to $57.7 million in cash provided for the same period in 2017. The Company used $116.5 million of additional cash from financing activities in the six months ended June 30, 2018 compared to the six months ended June 30, 2017 primarily due to less growth in deposits of $30.8 million and net decreases of $58.8 million in long-term debt and short- term borrowings and an increase in dividends paid of $185,000. During the first quarter of 2018, the Company used cash and the sale of securities acquired in the County First acquisition to pay down wholesale brokered deposits and FHLB debt, which represents the reduction in both deposits and debt. Acquired deposits of approximately $200 million are not included on the cash flow statement.

During the six months ended June 30, 2018, all investing activities provided $56.9 million in cash compared to $53.8 million in cash used for the same period in 2017. The increase in cash provided of $110.7 million was primarily the result of net increases in cash provided from $32.4 million of cash from the County First acquisition, $21.4 million for securities transactions, $55.8 million from loan activities, and $158,000 less cash used for purchases of premises and equipment. The Company received $34.9 million from the sale of securities from the County First acquisition in the first six months of 2018 compared to $7.3 million from sales in the comparable prior year period. Cash provided increased as principal received on loans for the six months ended June 30, 2018 increased over the prior year comparable period. Principal collected on loans increased $17.1 million from $126.9 million from the six months ended June 30, 2017 to $144.0 million for the six months ended June 30, 2018. Cash used decreased for the funding of loans originated, which decreased $38.6 million from $182.7 million for the six months ended June 30, 2017 to $144.1 million for the six months ended June 30, 2018.

Operating activities provided cash of $6.9 million, or $5.7 million more cash, for the six months ended June 30, 2018 compared to $1.2 million of cash provided for the same period of 2017.

83

ITEM 3. Quantitative and qualitative Disclosure about Market Risk

Interest rate risk is defined as the exposure to changes in net interest income and capital that arises from movements in interest rates. Depending on the composition of the balance sheet, increasing or decreasing interest rates can negatively affect the Company’s results of operations and financial condition.

The Company measures interest rate risk over the short and long term. The Company measures interest rate risk as the change in net interest income (“NII’) caused by a change in interest rates over twelve and twenty-four months. The Company’s NII simulations provide information about short-term interest rate risk exposure. The Company also measures interest rate risk by measuring changes in the values of assets and liabilities due to changes in interest rates. The economic value of equity (“EVE”) is defined as the present value of future cash flows from existing assets, minus the present value of future cash flows from existing liabilities. EVE simulations reflect the interest rate sensitivity of assets and liabilities over a longer time period, considering the maturities, average life and duration of all balance sheet accounts.

The Board of Directors has established an interest rate risk policy, which is administered by the Bank’s Asset Liability Committee (“ALCO”). The policy establishes limits on risk, which are quantitative measures of the percentage change in NII and EVE resulting from changes in interest rates. Both NII and EVE simulations assist in identifying, measuring, monitoring and controlling interest rate risk and are used by management and the ALCO Committee to ensure that interest rate risk exposure will be maintained within Board policy guidelines. The ALCO Committee reports quarterly to the Board of Directors. Mitigating strategies are used to maintain interest rate risk within established limits.

The Company’s interest rate risk (“IRR”) model uses assumptions which include factors such as call features, prepayment options and interest rate caps and floors included in investment and loan portfolio contracts. Additionally, the IRR model estimates the lives and interest rate sensitivity of the Company’s non-maturity deposits. These assumptions have a significant effect on model results. The assumptions are developed primarily based upon historical behavior of Bank customers. The Company also considers industry and regional data in developing IRR model assumptions. There are inherent limitations in the Company’s IRR model and underlying assumptions. When interest rates change, actual movements of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. The Company prepares a current base case and several alternative simulations at least quarterly. Current interest rates are shocked by +/- 100, 200, 300, and 400 basis points (“bp”). In addition, the Company simulates additional rate curve scenarios (e.g., bear flattener). The Company may elect not to use particular scenarios that it determines are impractical in a current rate environment. The Company’s internal limits for parallel shock scenarios are as follows:

Shock in Basis Points	**Net Interest Income**	**Economic Value of Equity**

	("NII")	**("EVE")**
+ - 400	25%	40%
+ - 300	20%	30%
+ - 200	15%	20%
+ - 100	10%	10%

It is management's goal to manage the portfolios of the Bank so that net interest income at risk over a twelve-month and twenty-four month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels. As of June 30, 2018, March 31, 2018, and December 31, 2017, the Company did not exceed any Board approved sensitivity limits. Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. The below schedule estimates the changes in net interest income over a twelve-month period for parallel rate shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Net Interest Income			
Change in Interest Rates:	**+ 200** bp	**+ 100** bp	**- 100** bp
Policy Limit	(15.00)%	(10.00)%	(10.00)%
June 30, 2018	(2.77)%	(1.22)%	0.40 %
March 31, 2018	0.72 %	0.47 %	(0.05)%
December 31, 2017	(1.28)%	(0.54)%	(1.30)%

84

Measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The below schedule estimates the changes in the economic value of equity at parallel shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Economic Value of Equity (EVE)			
Change in Interest Rates:	**+ 200** bp	**+ 100** bp	**- 100** bp
Policy Limit	(20.00)%	(10.00)%	(10.00)%
June 30, 2018	(1.00)%	0.19 %	18.14 %
March 31, 2018	(6.54)%	(3.08)%	7.92 %
December 31, 2017	(13.15)%	(6.01)%	18.35 %

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, management of the Company carried out an evaluation, under the supervision and with the participation of the Company's principal executive officer and principal financial officer, of the effectiveness of the Company's disclosure controls and procedures. Based on this evaluation, the Company's principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934, as amended, (1) is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (2) is accumulated and communicated to the Company's management, including its principal executive and financial officers as appropriate to allow timely decisions regarding required disclosure. It should be noted that the design of the Company's disclosure controls and procedures is based in part upon certain reasonable assumptions about the likelihood of future events, and there can be no reasonable assurance that any design of disclosure controls and procedures will succeed in achieving its stated goals under all potential future conditions, regardless of how remote, but the Company's principal executive and financial officers have concluded that the Company's disclosure controls and procedures are, in fact, effective at a reasonable assurance level. There were no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2018 that have materially affected, or are reasonable likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

-

Item 1 - Legal Proceedings – The Company is not involved in any pending legal proceedings. The Bank is not involved in any pending legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the financial condition and results of operations of the Company.

Item 1A - Risk Factors - In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, “Item 1A- Risk Factors” in the Form 10-K that we filed with the Securities and Exchange Commission, which could materially affect our business, financial condition or future results. The risks described are not the only risks that we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2 – Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable

(b) Not applicable

(c) On May 4, 2015, the Board of Directors approved a repurchase plan (“2015 repurchase plan). The 2015 repurchase plan authorizes the repurchase of up to 250,000 shares of outstanding common stock. The 2015 repurchase plan will continue until it is completed or terminated by the Company’s Board of Directors. During the quarter ended December 31, 2015, the 2015 repurchase plan began with the termination of the 2008 repurchase program. As of June 30, 2018, 186,757 shares were available to be repurchased under the 2015 repurchase program. The following schedule shows repurchases during the three months ended June 30, 2018.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
April 1-30, 2018	-	$ -	-	188,478

May 1-31, 2018	1,721	37.11	1,721	186,757
June 1-30, 2018	-	-	-	186,757
Total	1,721	$ 37.09	1,721	186,757

Item 3 - Defaults Upon Senior Securities - None

Item 4 – Mine Safety Disclosures – Not Applicable

Item 5 - Other Information – None

Item 6 – Exhibits

Exhibit 31	-	Rule 13a-14(a) Certifications
Exhibit 32	-	Section 1350 Certifications
Exhibit 101.0	-	The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended June 30, 2018, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Cash Flows; and (v) the Notes to the Consolidated Financial Statements.

86

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	THE COMMUNITY FINANCIAL CORPORATION
Date: August 8, 2018	By: /s/ William J. Pasenelli William J. Pasenelli President and Chief Executive Officer
Date: August 8, 2018	By: /s/ Todd L. Capitani Todd L. Capitani Chief Financial Officer

87