FEDERAL DEPOSIT INSURANCE CORPORATION
Washington, D.C. 20429

FORM 10-K

(Mark One)

[X] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 2018

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

FDIC Certificate Number: 20568-1

LUMBEE GUARANTY BANK

(Exact Name of Issuer as Specified in Its Charter)

North Carolina (State or other jurisdiction of Incorporation of organization)	**56-0990387** (I.R.S. Employer Identification Number)
403 East Third Street **Pembroke, NC** (Address of Principal Executive Offices)	**28372** (Zip Code)

Registrant's telephone number, including area code: (910) 521-9707

Securities registered pursuant to Section 12(b) of the Exchange Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value $2.00

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. [ ] Yes [X] No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. [ ] Yes [X] No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. [X] Yes [ ] No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). [ ] Yes [ ] No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

[ ] Large accelerated filer	[ ] Accelerated filer
[ ] Non-accelerated filer	[X] Smaller reporting company
(Do not check if a smaller reporting company)	[ ] Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. [ ]

Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Act).
[ ] Yes [X] No

The aggregate market value of the voting and non-voting common equity, consisting solely of common stock, held by non-affiliates of the issuer (2,649,541 shares) computed by reference to the price at which the common equity was last sold as of June 30, 2018 is $32,456,877.

The number of shares of outstanding common stock of the issuer as of March 27, 2019 is 3,417,565.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statements to be delivered to shareholders in connection with the annual meeting of stockholders to be held May 29, 2019, are incorporated by reference into Form 10-K Part III, Items 10, 11, 12, 13, and 14.

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Part I

Item 1. Business

General Description of Business

Lumbee Guaranty Bank (the "Bank") was incorporated under the laws of North Carolina on September 29, 1971, and commenced operations as a North Carolina state-chartered bank on December 20, 1971. The Bank conducts its operations through 13 full-service offices located in Robeson, Cumberland and Hoke Counties.

History

Lumbee Guaranty Bank was founded in 1971, when a group of individuals decided there was a need for a community bank to serve the local community, which has a high concentration of Native American Indians as residents. The incorporators sold stock to roughly 750 subscribers, 97% of whom were Indian, and the Bank officially became the first Native American Indian-owned bank in the United States.

Location and Service Area

Lumbee Guaranty Bank's corporate headquarters are located in the town of Pembroke, North Carolina. The Bank operates two general banking offices in the town of Pembroke, three branches in the city of Lumberton and branches in the towns of St. Pauls, Red Springs, Maxton, Fairmont and Rowland, all in Robeson County, North Carolina. Two additional branches are located in neighboring Cumberland County in the town of Hope Mills and the city of Fayetteville. The Bank also operates a branch in the city of Raeford located in Hoke County, North Carolina.

A substantial portion of the Bank's market is located in Robeson County, North Carolina. Robeson County is the largest county in the State of North Carolina and is comprised of 29 townships serviced by mostly small business, manufacturing and service industries, the University of North Carolina at Pembroke and Southeastern Regional Medical Center. The United States Census Bureau estimated that Robeson County's population was 132,606 as of July 1, 2017. With the rural nature of the county, the Bank's business is seasonal to some extent due to the emphasis on agriculture and construction related trades located in the county.

The Bank also has a presence in North Carolina's Cumberland and Hoke Counties. These counties serve as home to Fort Bragg which is the United States' largest Army installation. The United States Census Bureau estimated that Cumberland and Hoke Counties had populations of 332,546 and 54,116 respectively, as of July 1, 2017. Fayetteville serves as Cumberland's county seat and has an estimated population of 209,889 as of July 1, 2017, making it the sixth-largest municipality in North Carolina. Fort Bragg and Pope Army Airfield contribute $4.5 billion annually into the region's economy, making Fayetteville one of the largest retail markets in the state. In addition to Fort Bragg, the area's largest employers include: Cumberland County School System, Wal-Mart retail stores and distribution center, Goodyear Tire manufacturing plant, and Cape Fear Valley Health System.

Banking Services

The Bank operates for the primary purpose of providing an adequate return to our shareholders while safely meeting the banking needs of individuals and small-to-medium sized businesses in the Bank's service area by developing personal, hometown associations with these customers.

The Bank offers a wide range of banking services including checking accounts, savings accounts, money market accounts, certificates of deposit, and individual retirement accounts. All deposit accounts are insured by the Federal Deposit Insurance Corporation ("FDIC") up to the maximum amount allowed by law.

We offer a full range of lending services including commercial, real estate, consumer, residential, and agricultural and raw land loans. We offer non-deposit investment products for sale to the public through LPL Financial.

Other services include safe deposit boxes, notary public, consumer online banking, bill payment and e-statements, wire transfers and direct deposit of payroll and social security checks. We operate automated teller machines at each of our 13 full service banking centers. The Bank also offers VISA credit and debit card services.

The Bank's primary sources of revenue are interest income from its lending activities, and, to a lesser extent, from its investment portfolio. The Bank also earns fees from lending and deposit activities. The major expenses of the Bank are interest on deposit accounts, general and administrative expenses, data processing and occupancy expenses. The Bank does not provide trust services.

Lending Activities

The Bank's lending products include commercial, real estate, consumer, residential and agricultural loans. The loan portfolio constituted 59.6% of average earning assets of the Bank for the year ended December 31, 2018 and has historically produced the highest interest rate spread above the cost of funds. The Bank's loan officers and loan committees have the authority to extend credit under limits approved by the Board of Directors. Each loan officer or loan committee is assigned a specific level of loan authority. Having loan authority gives the individual or committee the ability to authorize the extension of credit. Loan authority also sets the maximum level of credit exposure, including overdrafts, to a single borrower or related borrower(s). The Bank has two loan committees designated as Management Loan Committees – one is composed of the Chief Executive Officer, President and senior lenders and the other is composed of the Executive Vice Chairman, Chief Executive Officer, and President. Any credit request that exceeds the authority of the Management Loan Committee on which the Executive Vice Chairman sits as a member is presented to the full Board of Directors. The Management Loan Committees not only act as approval bodies to ensure consistent application of the Bank's loan policy, but also provide valuable insight through communication and pooling of knowledge, judgment and experience of its members.

At December 31, 2018, residential real estate loans represented 43.4% of the loan portfolio while commercial real estate loans were 45.3%. Commercial and consumer loans were 4.4% and 4.3%, respectively, and agricultural and raw land loans made up 2.5% of the portfolio.

The Bank's loan policies are established and approved by the Bank's Board of Directors. These policies identify criteria that should be considered when evaluating a loan request. Management has established specific policy and underwriting guidelines for each loan product offered by the Bank, consistent with the content of the policies, as well as safe and sound banking practices. Loan policies are intended to provide a framework for the consistent evaluation of loan requests presented to the Bank. However, the Board of Directors recognizes that there are times when exceptions to these policies, underwriting guidelines, and procedures will be necessary. Therefore, the Bank encourages judgmental evaluation of each loan request, and will allow for such exceptions when appropriately and properly mitigated and documented.

All loans in the Bank's portfolio are risk-rated using a combination of risk factors to quantify the risk grade. The risk grade is set at the inception of the loan through the approval process, and is periodically re-evaluated based on the approved loan servicing requirements and updated financial information. Loans are subject to risk from the conditions of the economy in the Bank's market area and also the national economy. The complexity of potential loan structures, amounts, collateral, financial conditions of the borrowers and guarantors, and the changing marketplace require the Bank to exercise judgment in evaluating the risk factors.

Investments

The Bank invests a portion of its assets in Government-sponsored enterprise debt instruments; state, county and municipal obligations; and FNMA, GNMA, and FHLMC mortgage-backed securities. The Bank's investments are managed in relation to loan demand and deposit growth and are generally used to provide for the investments of excess funds at reduced yields and risk relative to increases in loans or to offset fluctuations in deposits. The Bank does not engage in any hedging activities.

Deposit Activities

Deposits are the major source of funds for lending and other investment activities. The Bank considers the majority of its regular savings, demand, NOW and money market deposits and small denomination certificates of deposit, to be core deposits. These accounts comprised 89.1% of the Bank's total deposits at December 31, 2018. Certificates of deposit in denominations of $100,000 or more represented an additional 10.9% of deposits at year end. Large denomination certificates of deposit have historically remained a stable source of funds. At December 31, 2018 the Bank had brokered deposits in the amount of $3.7 million or 1% of total deposits.

The Bank is a participating institution in the Certificate of Deposit Account Registry Service ("CDARS"). CDARS is a technology based service that the Bank can incorporate into its traditional product offering. The service uses a web based application that allows participating institutions across the country to swap, sell, or buy deposits from other members. The CDARS program has limitations but can be used to attract new deposits, diversify our funding sources, and manage liquidity. The Bank had $2.3 million in reciprocal deposits with CDARS at December 31, 2018.

Bank Website

The Bank maintains an internet website at www.lumbeeguarantybank.com. This website contains information relating to the Bank and its business. Information on our website is not incorporated into this Form 10-K.

Employees

At December 31, 2018, the Bank had 93 full time and 5 part time employees, none of whom are represented by a union or covered by a collective bargaining agreement. Management considers employee relations to be good.

Competition

The Bank encounters strong competition both in making loans and in attracting deposits. The widespread enactment of state laws that permit multi-bank holding companies as well as an increasing level of interstate banking have created a highly competitive environment for commercial banking. In one or more aspects of its business, the Bank competes with other commercial banks, credit unions, finance companies, brokerage and investment banking companies, and other financial intermediaries. Many of these competitors have substantially greater resources and lending limits and may offer certain services that we do not currently provide. Recent federal and state legislations have heightened the competitive environment in which financial institutions must conduct their business. Accordingly, the potential for competition among financial institutions of all types has increased significantly.

We compete by relying upon specialized services, responsive handling of customer needs, and personal contacts by our officers, directors, advisory board members, and staff. Large multi-branch banking competitors tend to compete primarily by rate and the number of branch locations while smaller, independent financial institutions, like the Bank, tend to compete primarily by a combination of rate and personal service.

Currently, in Robeson County, the Bank competes with eight other commercial banks that operate 16 branches in the County. In the FDIC's Summary of Deposits for June 30, 2018, the Bank held 24.6% of the deposits in Robeson County, which represents the second largest market share of all financial institutions in the county. In Cumberland County, the Bank competes with ten other financial institutions that operate 53 branches and held 0.6%

of that county's deposits. In Hoke County, the Bank competes with three other financial institutions that operate 3 branches and held 13.4% of the county's deposits.

Government Supervision and Regulation

The following discussion is a summary of the principal laws and regulations that comprise the regulatory framework that applies to the Bank. Other laws and regulations that govern various aspects of the operations of banks are not described, although violations of such laws and regulations could result in supervisory enforcement action against the Bank. The following descriptions summarize the material terms of the principal laws and regulations and are qualified in their entirety by reference to the applicable laws and regulations:

General

Federal banking regulations applicable to all depository financial institutions, among other things: (i) provide federal bank regulatory agencies with powers to prevent unsafe and unsound banking practices; (ii) restrict preferential loans by banks to "insiders" of banks; (iii) require banks to keep information on loans to major shareholders and executive officers; and (iv) bar certain director and officer interlocks between financial institutions.

As a state-chartered bank, the Bank is subject to the provisions of the North Carolina banking statutes and to regulation by the Commissioner. The Commissioner has a wide range of regulatory authority over the activities and operations of the Bank, and the Commissioner's staff conducts periodic examinations of the Bank and its affiliates to ensure compliance with state banking laws and regulations and to assess the safety and soundness of the Bank. Among other things, the Commissioner regulates the merger of state-chartered banks, the payment of dividends, loans to officers and directors, recordkeeping, types and amounts of loans and investments, and the establishment of branches. The Commissioner also has cease and desist powers over state-chartered banks for violations of state banking laws or regulations and for unsafe or unsound conduct that is likely to jeopardize the interest of depositors. Federal and North Carolina laws govern the activities in which the Bank may engage, the investments that it may make and limit the aggregate amount of loans that may be granted to one borrower to 15% of the Bank's capital and surplus unless the loans are secured by certain types of marketable collateral. Various consumer and compliance laws and regulations also affect the Bank's operations.

The NCCOB and FDIC conduct regular examinations of the Bank and review such matters as the adequacy of loan loss reserves, quality of loans and investments, management practices, compliance with laws, and other aspects of its operations. In addition to these regular examinations, the Bank must furnish the FDIC with periodic reports containing a full and accurate statement of its affairs. Supervision, regulation and examination of banks by these agencies are intended primarily for the protection of depositors rather than shareholders.

FDIC Insurance

As a member of the FDIC, our deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC, and such insurance is backed by the full faith and credit of the United States Government. The basic deposit insurance level is generally $250,000, as specified in FDIC regulations. For this protection, each insured bank pays a quarterly statutory assessment and is subject to the rules and regulations of the FDIC.

The FDIC insurance premium is based on an institution's total assets minus its Tier 1 capital. An institution's premiums are determined based on its capital, supervisory ratings and other factors. Premium rates generally may increase if the FDIC deposit insurance fund is strained due to the cost of bank failures and the number of troubled banks. In addition, if the Bank experiences financial distress or operates in an unsafe or unsound manner, its deposit premiums may increase.

We recognized approximately $90,973 and $105,367 in FDIC insurance expense in 2018 and 2017, respectively. In November 2018, the FDIC announced that the Deposit Insurance Fund ("DIF") reserve ratio exceeded the statutory minimum of 1.35% as of September 30, 2018. Among other things, this resulted in the FDIC awarding assessment credits for banks with less than $10 billion in total assets that had contributed to the DIF in prior years. We were notified in January 2019 that we had received $80,946 in credits that could be used to offset deposit insurance assessments in the future. When the DIF reaches 1.38%, the FDIC will begin to apply the Bank's credits against our quarterly deposit insurance assessments. The DIF was 1.36% at December 31, 2018.

The FDIC may conduct examinations of and require reporting by FDIC-insured institutions. It may also prohibit an institution from engaging in any activity that it determines by regulation or order to pose a serious risk to the deposit insurance fund and may terminate the Bank's deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Legislative and Regulatory Guidance and Developments

In addition to the regulations that are described above, new legislation is introduced from time to time in the U.S. Congress that may affect our operations. In addition, the regulations governing the Bank may be amended from time to time by the Federal Reserve, the FDIC, the Securities and Exchange Commission (the "SEC"), or other agencies, as appropriate. Any legislative or regulatory changes, or changes to accounting standards, in the future could adversely affect our operations and financial condition.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

On July 21, 2010, the Dodd-Frank Act became law. The Dodd-Frank Act has had and will continue to have a broad impact on the financial services industry, including significant regulatory and compliance changes including, among other things,

- Enhanced authority over troubled and failing banks and their holding companies;
- Increased capital and liquidity requirements;
- Increased regulatory examination fees; and
- Specific provisions designed to improve supervision and safety and soundness by imposing restrictions and limitations on the scope and type of banking and financial activities.

While much of the original provisions of the Dodd-Frank Act were not directly applicable to us due to size thresholds, many of the requirements of the Dodd-Frank Act remain subject to implementation over the course of several years. While we do not currently expect the final requirements of the Dodd-Frank Act to have a material adverse impact on the Bank, we do expect them to negatively impact our profitability, require changes to certain of our business practices, including limitations on fee income opportunities, and impose more stringent capital, liquidity and leverage requirements upon the Bank. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with the new statutory and regulatory requirements.

Economic Growth, Regulatory Relief and Consumer Protection Act

In May 2018, the Economic Growth, Regulatory Relief and Consumer Protection Act (the "Economic Growth Act"), was enacted to modify or remove certain financial reform rules and regulations, including some of those implemented under the Dodd-Frank Act. While the Economic Growth Act maintains most of the regulatory structure established by the Dodd-Frank Act, it amends certain aspects of the regulatory framework for small depository institutions with assets less than $10 billion and for large banks with assets of more than $50 billion. Many of these changes could result in meaningful regulatory changes for banks and their holding companies.

The Economic Growth Act, among other matters, expands the definition of qualified mortgages which may be held by a financial institution and provides for an alternative capital rule for financial institutions and their holding companies with total consolidated assets of less than $10 billion. The Economic Growth Act instructed the federal banking regulators to establish a single "Community Bank Leverage Ratio" of between 8% and 10%, which has been proposed to be 9% by the federal regulators. The Community Bank Leverage Ratio provides for a simpler calculation of a bank's capital ratio than the Basel III provisions currently in place (see below). Any qualifying depository institution or its holding company that exceeds the Community Bank Leverage Ratio will be considered to have met generally applicable leverage and risk-based regulatory capital requirements and any qualifying depository institution that exceeds the new ratio will be considered to be "well capitalized" under the prompt corrective action rules. In addition, the Economic Growth Act includes regulatory relief for community banks of certain sizes regarding regulatory examination cycles, call reports, the Volcker Rule (proprietary trading prohibitions), mortgage disclosures and risk weights for certain high-risk commercial real estate loans. We continue to evaluate the impact that the rules issued thus far under the Economic Growth Act will have on the bank, but we currently do not believe that it will be significant. At this time, we do not expect to opt-in to the ability to utilize the Community Bank Leverage Ratio and will instead continue to use the Basel III standards.

It is difficult at this time to predict when or how any new standards under the Economic Growth Act will ultimately be applied to, or what specific impact the Economic Growth Act and the yet-to-be-written implementing rules and regulations will have on us.

Regulatory Capital Requirement under Basel III

Effective January 1, 2015, the Company and the Bank became subject to new regulatory capital rules agreed to by the Basel Committee on Banking Supervision in the accord referred to as "Basel III." Under the Basel III Capital Rules, the following were the initial minimum capital ratios applicable to the Company and the Bank as of January 1, 2015:

- 4.5% CET1 to risk-weighted assets;
- 6.0% Tier 1 capital (that is, CET1 plus Additional Tier 1 capital) to risk-weighted assets;
- 8.0% total capital (that is, Tier 1 capital plus Tier II capital) to risk-weighted assets; and
- 4.0% Tier 1 leverage ratio (that is, Tier 1 capital) to quarterly average total assets.

Common Equity Tier I capital ("CET1") is comprised of common stock and related surplus, plus retained earnings, and is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities. Tier I capital is comprised of CET1 capital plus Additional Tier I capital, which for the Company includes non-cumulative perpetual preferred stock and trust preferred securities. Total capital is comprised of Tier I capital plus certain adjustments, the largest of which for the Bank is the allowance for loan losses. Risk-weighted assets refer to the on- and off-balance sheet exposures of the Bank, adjusted for their related risk levels using formulas set forth in Federal Reserve regulations

The Basel III Capital Rules include a "capital conservation buffer," composed entirely of CET1, on top of these minimum risk-weighted asset ratios. The capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of CET1 to risk-weighted assets above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at 0.625% and is being phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). Thus, effective as of January 1, 2019, the Bank is required to maintain this additional capital conservation buffer of 2.5% of CET1, resulting in the following minimum capital ratios:

- 4.5% CET 1 to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum ratio of CET1 to risk-weighted assets of at least 7%;
- 6.0% Tier 1 capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum Tier 1 capital ratio of at least 8.5%;
- 8.0% Total capital to risk-weighted assets, plus the capital conservation buffer, effectively resulting in a minimum total capital ratio of at least 10.5%; and
- 4.0% Tier 1 leverage ratio

In addition to the minimum capital requirements described above, the regulatory framework for prompt corrective action also contains specific capital guidelines for a bank's classification as "well capitalized." The current specific guidelines are as follows:

- CET1 Capital Ratio of at least 6.50%;
- Tier 1 Capital Ratio of at least 8.00%;
- Total Capital Ratio of at least 10.00%; and a
- Leverage Ratio of at least 5.00%.

If a bank falls below "well capitalized" status in any of these three ratios, it must ask for FDIC permission to originate or renew brokered deposits. Lumbee Guaranty Bank is well-capitalized under all capital guidelines.

Current Expected Credit Loss Standard

The Financial Accounting Standards Board ("FASB") has adopted a new accounting standard that will be effective for the Bank on January 1, 2020. This standard, referred to as Current Expected Credit Loss (or "CECL"), requires FDIC-insured institutions and their holding companies (banking organizations) to recognize credit losses expected over the life of certain financial assets. CECL covers a broader range of assets than the current method of recognizing credit losses and generally results in earlier recognition of credit losses. Upon adoption of CECL, a banking organization must record a one-time adjustment to its earnings, and to affect other items, in a manner that reduces its regulatory capital. We continue our ongoing analysis on the impact of this guidance on our financial statements.

The Federal Reserve and the FDIC have adopted a rule that provides a banking organization the option to phase-in over a three-year period the effects of CECL on its regulatory capital upon the adoption of the standard.

Financial Privacy and Cybersecurity

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to non-affiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a non-affiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors. In addition, consumers may also prevent disclosure of certain information among affiliated companies that is assembled or used to determine eligibility for a product or service, such as that shown on consumer credit reports and asset and income information from applications. Consumers also have the option to direct banks and other financial institutions not to share information about transactions and experiences with affiliated companies for the purpose of marketing products or services.

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement indicates that financial institutions should design multiple layers of security controls to establish lines of defense and to ensure that their risk management processes also address the risk posed by compromised customer credentials, including security measures to reliably authenticate customers accessing Internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving destructive malware. A financial institution is also expected to develop appropriate processes to enable recovery of data and business operations and address rebuilding network capabilities and restoring data if the institution or its critical service providers fall victim to this type of cyber-attack. The Bank has multiple Information Security Programs that reflect the requirements of this guidance. If, however, we fail to observe the regulatory guidance in the future, we could be subject to various regulatory sanctions, including financial penalties.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. We employ an in-depth, layered, defensive approach that leverages people, processes and technology to manage and maintain cybersecurity controls. We employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures. While to date we have not detected a significant compromise, significant data loss or any material financial losses related to cybersecurity attacks, our systems and those of our customers and third-party service providers are under constant threat and it is possible that we could experience a significant event in the future. Risks and exposures related to cybersecurity attacks are expected to remain high for the foreseeable future due to the rapidly evolving nature and sophistication of these threats, as well as due to the expanding use of Internet banking, mobile banking and other technology-based products and services by us and our customers.

The Bank has in place an online banking channel, electronic mail services and select various systems which correspond with external public and private networks not owned or operated by us. The Bank's online banking services are outsourced to a national firm specializing in internet banking and protecting its clients from cyber-attacks. Methods of defense include but are not limited to Secured Socket Layer ("SSL") security, multifactor authentication and Internet Protocol ("IP") white listing. The Bank also utilizes the services of an intrusion prevention firm to secure our inbound internet channels with real time monitoring and blocking of malicious activity. The Bank's Information

Technology staff monitors the event activity log and notifications are received if abnormalities are detected. At December 31, 2018, the Bank has not experienced any significant security incidents. Insurance coverage is in place should an incident pose financial and/or reputational risk.

Anti-Money Laundering and the USA Patriot Act

A major focus of governmental policy on financial institutions in recent years has been aimed at combating money laundering and terrorist financing. The USA PATRIOT Act of 2001 (the "USA Patriot Act") substantially broadened the scope of United States anti-money laundering laws and regulations by imposing significant new compliance and due diligence obligations on financial institutions, creating new crimes and penalties and expanding the extra-territorial jurisdiction of the United States.

On May 11, 2016, the Financial Crimes Enforcement Network ("FinCEN") issued new anti-money laundering ("AML") rules governing corporate entities doing business with banks and other financial institutions that are subject to the requirements of the USA Patriot Act. The AML rules impose significant due diligence obligations on financial institutions with respect to opening of new accounts and the monitoring of existing accounts. Under the AML rules, a financial institution must identify persons owning or controlling 25% or more of a "legal entity," whenever the legal entity opens a new account at the bank. The financial institution must also identify an individual who has substantial management authority at the legal entity, such as a CEO, CFO, or managing partner. These new AML rules became effective in May 2018.

The AML rules codify within the FinCEN regulations the "pillars" that must be included in a financial institutions AML compliance program. Regulators previously communicated their expectations with respect to four of these pillars: (1) the development of internal policies, procedures, and control; (2) the designation of a compliance officer; (3) the establishment of an ongoing employee training program; and (4) the implementation of an independent audit function to test programs. The new beneficial ownership requirement establishes a fifth pillar. Among other things, this new pillar includes the necessity to monitor and update the beneficial ownership of a legal entity, including the need to subject corporate borrowers to due diligence requests from financial institutions for certifications with respect to their beneficial owners. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Office of Foreign Assets Control Regulation

The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others which are administered by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). Failure to comply with these sanctions could have serious legal and reputational consequences, including causing applicable bank regulatory authorities not to approve merger or acquisition transactions when regulatory approval is required or to prohibit such transactions even if approval is not required.

Community Reinvestment Act

The Community Reinvestment Act of 1977 ("CRA") requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low- and moderate- income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. Furthermore, banking regulators take into account CRA ratings when considering a request for an approval of a proposed transaction. Lumbee Guaranty Bank received a rating of "satisfactory" in its most recent CRA examination. In April 2018, the U.S. Department of Treasury issued a memorandum to the federal banking regulators with recommended changes to the CRA's implementing regulations to reduce their complexity and associated burden on banks. We will continue to evaluate the impact of any changes to the regulations implementing the CRA.

<u>Tax Cuts and Jobs Act</u>

U.S. tax reform legislation was signed into law on December 22, 2017 and made broad and complex changes to the U.S. Internal Revenue Code, including reducing the U.S. statutory tax rate from 35% to 21% beginning on January 1, 2018. With the adoption of this tax reform, our deferred tax balances were reduced as of December 31, 2017 to reflect the new 21% statutory tax rate. Beginning January 1, 2018, we applied the federal tax rate of 21% to our taxable earnings.

<u>Other Safety and Soundness Regulations</u>

There are a number of obligations and restrictions imposed on depository institutions by Federal law and regulatory policy that are designed to reduce potential loss exposure to the depositors of such depository institutions and to the FDIC insurance fund in the event that the depository institution becomes in danger of default or is in default. The FDIC's claim for reimbursement is superior to claims of shareholders of the insured bank but is subordinate to claims of depositors, secured creditors and holders of subordinated debt (other than affiliates) of the insured bank.

The Federal banking agencies also have broad powers under current Federal law to take prompt corrective action to resolve problems of banks and other insured institutions. The Federal Deposit Insurance Act requires that the federal banking agencies establish five capital levels for insured depository institutions. The category levels are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." It also requires or permits such agencies to take certain supervisory actions should an insured institution's capital level fall. For example, an "adequately capitalized" institution is restricted from accepting brokered deposits. An "undercapitalized" or "significantly undercapitalized" institution must develop a capital restoration plan and is subject to a number of mandatory and discretionary supervisory actions. These powers and authorities are in addition to the traditional powers of the Federal banking agencies to deal with undercapitalized institutions. The Bank is "well capitalized" under FDIC guidelines.

Laws restrict the interest and charges which the Bank may impose for certain loans. The Bank's loan operations also are subject to certain federal laws, such as the Truth in Lending Act, the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Fair Credit Reporting Act. The deposit operations of the Bank also are subject to the Truth in Savings Act, the Right to Financial Privacy Act, the Electronic Funds Transfer Act and Regulation E, the Expedited Funds Availability Act and Regulation CC, and the Bank Secrecy Act. These and other similar laws result in significant costs to financial institutions and create the potential for liability to customers and regulatory authorities.

Federal regulatory authorities also have broad enforcement powers over the Bank, including the power to impose fines and other civil and criminal penalties, and to appoint a receiver in order to conserve the assets of any such institution for the benefit of depositors and other creditors.

The Federal Bureau of Investigation ("FBI") has sent, and will send, banking regulatory agencies lists of the names of persons suspected of involvement in terrorist attacks and other terrorist activities as they may occur and are investigated. The FBI has requested, and will request in the future, that the Bank search its records for any relationships or transactions with persons on those lists. In addition, on an ongoing basis, the Office of Foreign Assets Control ("OFAC"), a division of the Department of the Treasury, is responsible for helping to insure that United States entities do not engage in transactions with "enemies" of the United States, as defined by various Executive Orders and Acts of Congress. If the Bank finds a name on any transaction, account or wire transfer that is on an OFAC list, it must freeze that account, file a suspicious activity report and notify the FBI. The Bank actively checks all OFAC areas including, but not limited to, new accounts, wire transfers and customer files.

In October 2001, the USA Patriot Act of 2001 ("Patriot Act") was enacted in response to the September 11, 2001 terrorist attacks in New York, Pennsylvania and Northern Virginia. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism. The continuing impact on financial institutions of the Patriot Act and related regulations and policies is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws, and imposes various regulations, including standards for verifying customer identification at account opening, and rules to promote cooperation among financial institutions, regulators, and law enforcement entities to identify persons who may be involved in terrorism or money laundering.

The federal banking regulators have adopted rules that limit the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted through diversified financial companies and conveyed to outside vendors.

In June 2010, the Federal Reserve, the OCC, and the FDIC issued comprehensive final guidance on incentive compensation policies intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk taking. The guidance, which covers all employees who have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks, (ii) be compatible with effective internal controls and risk management, and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

The FDIC will review, as part of the regular, risk-focused examination process, the incentive compensation arrangements of banking organizations, such as the Bank, that are not "large, complex banking organizations". These reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination. Deficiencies will be incorporated into the organization's supervisory ratings, which can affect the organization's ability to make acquisitions and take other actions. Enforcement actions may be taken against a banking organization if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness and the organization is not taking prompt and effective measures to correct the deficiencies.

Payment of Dividends

Under North Carolina banking law, as amended during 2012, the Bank's board of directors may declare such dividends as it deems proper, provided that it may not make any distribution that reduces its capital below required levels, and it may not declare a dividend if, after the dividend, it cannot pay its debts as they become due. Under the FDIC's rules, a bank may not declare or pay any dividend if, after making the dividend payment, the bank would be "undercapitalized", as defined in regulations of the FDIC. In addition, the Bank is subject to various general regulatory policies relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. In 2018, the Bank declared total dividends of $0.21 per share, paying out a total of $717,689 in dividends to shareholders.

Economic and Monetary Polices

The Bank's operations are affected not only by general local economic conditions, but also by the economic and monetary policies of various regulatory authorities. In particular, the Federal Reserve regulates money, credit and interest rates in order to influence general economic conditions. These policies have a significant influence on overall growth and distribution of loans, investments and deposits and affect interest rates charged on loans or paid for deposits. Federal Reserve monetary policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future.

We believe that the worst of the economic downturn is in the past, but the economy still has many resources that are being underutilized. The national unemployment rate for January 2019 was 4.0%. The rate continues to improve and is down considerably from the 10% peak in October 2009. As of December 31, 2018 the unemployment rate for the North Carolina was 3.8% with the counties of Robeson, Cumberland, and Hoke being 5.5%, 5.0%% and 4.9%, respectively. Economic growth's story is similar to unemployment: gross domestic product has improved from the worst of the recession when the economy was contracting, but its recent levels are still considered subpar. Gross domestic product was 2.9% for 2018 and 2019 consensus economists' prediction for gross domestic product is 2.5%. Inflation, one of the main determinants of interest rates, continues to be close to or within the Federal Open Market Committee's comfort zone of less than 2% on an annual basis. As long as inflation and inflation expectations remain in check and unemployment remains low, it is likely that interest rates will also remain low. The Federal Reserve's raised rates four times in 2018 by a total of 1%. We believe short term rates will remain near current levels for the rest of 2019.

Item 1A. Risk Factors

Not Applicable

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The Bank is headquartered in the Main Office at 403 East Third Street, Pembroke, North Carolina. In addition, the Bank owns and operates retail banking offices in North Carolina located at 915 West Third Street in Pembroke, 600 North Pine Street in Lumberton, 2899 West Fifth Street in Lumberton, 4845 Fayetteville Road in Lumberton, 306 South Fifth Street in St. Paul's, 3500 North Main Street in Hope Mills, 104 Martin Luther King, Jr. Drive in Maxton, 215 East Fourth Street in Red Springs, 201 North Bond Street in Rowland, 301 North Walnut Street in Fairmont, 2315 Bloom Avenue in Fayetteville, and 720 Harris Avenue in Raeford, North Carolina. The Bank owns an additional facility that is utilized for its Operations Center at 410 East Third Street in Pembroke, North Carolina.

The Bank is obligated on a month to month lease for a storage facility on East 4th Street in Lumberton, North Carolina. The lease calls for monthly payments of $500 and can be terminated at any time by either party.

For additional information on properties and leases, see the Premises and Equipment note to the financial statements. All premises occupied by the Bank are considered to be adequate.

Item 3. Legal Proceedings

In the normal course of business the Bank is involved in various legal proceedings. After consultation with legal counsel, management believes that any liability resulting from such proceedings will not be material to the financial statements.

Item 4. Mine Safety Disclosures

Not Applicable

Part II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Shares of the Bank's common stock are neither listed on any stock exchange nor quoted or traded in any established public market and the stock trades infrequently. Shares of common stock have periodically been sold in a limited number of privately negotiated transactions between stockholders. As of December 31, 2018, there were approximately 1,811 record holders of the Bank's common stock.

Dividends Declared

2017:	Per Share
June	$0.09
December	$0.10

2018:	Per Share
June	$0.10
December	$0.11

Item 6. Selected Financial Data

Not applicable.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation

Cautionary Statement Regarding Forward-Looking Statements

Certain information in this report may include "forward-looking statements" as defined by federal securities law. These forward-looking statements contain the Bank's expectations, plans, future financial performance, and other statements that are not historical facts. Although the Bank believes that its assumptions regarding these forward-looking statements are based on reasonable assumptions, actual results could differ materially. The forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- Changes in general local, regional and national economic and business conditions in the Bank's market area, including downturns in certain industries.
- Changes in deposit composition and controlling the growth of deposits.
- Changes in banking laws, compliance, and the regulatory climate of the Bank.
- Changes in interest rates and the management of interest rate risk.
- Demand for banking services, both lending and deposit products, in our market area.
- Risks inherent in making loans such as repayment risks and fluctuating collateral values.
- Changes in loan quality, delinquencies and defaults by our borrowers.
- Further decline in the market value of real estate in the Bank's market.
- Increased regulatory scrutiny requiring considerable time and attention of our management and board of directors.
- Attraction and retention of key personnel, including the Bank's management team and directors.
- Changes in technology, product delivery channels, and end user demands and acceptance.
- Changes in consumer spending, borrowings, and savings habits.
- The soundness of other financial institutions.
- Risks related to cyber incidents.
- Government intervention in the U.S. financial system.
- Changes in accounting principles, policies, and guidelines.

These risks and inherent uncertainties should be considered in evaluating forward-looking statements contained in this report. We caution readers not to place undue reliance on those statements, which are specific as of the date of the report.

Overview

Management's Discussion and Analysis is provided to assist in understanding and evaluating Lumbee Guaranty Bank's financial condition and its results of operations. The following discussion should be read in conjunction with the Bank's financial statements.

Lumbee Guaranty Bank is an independent, community bank which has thirteen full-service offices operating in the three North Carolina counties of Robeson, Cumberland and Hoke. The Bank extends both commercial and consumer loans throughout its market area and offers a full range of deposit accounts for its customer base.

Critical Accounting Policies

The Bank's financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). The notes to the audited financial statements included in this annual report for the year ended December 31, 2018 contain a summary of our significant accounting policies.

Certain accounting policies involve significant judgments and assumptions by us that have a material impact on the carrying value of certain assets and liabilities. We consider these accounting policies to be critical accounting policies. The judgment and assumptions we use are based on historical experience and other factors, which we believe to be reasonable under the circumstances. Because of the nature of the judgment and assumptions we make, actual results could differ from these judgments and estimates and those differences could have a material impact on the carrying values of our assets and liabilities and our results of operations.

Allowance for Loan Losses

We believe the allowance for loan losses is the critical accounting policy that requires the most significant judgment and estimates used in preparation of our financial statements. Some of the more critical judgments supporting the amount of our allowance for loan losses include judgments about the creditworthiness of borrowers, the estimated value of the underlying collateral, the assumptions about cash flow, determination of loss factors for estimating credit losses, the impact of current events, and conditions, and other factors impacting the level of probable inherent losses.

Under different conditions or using different assumptions, the actual amount of credit losses incurred by us may be different from management's estimates provided in our financial statements. Refer to the portion of this discussion that addresses our allowance for loan losses for a more complete discussion of our processes and methodology for determining our allowance for loan losses.

Income Taxes

We use assumptions and estimates in determining income taxes payable or refundable for the current year, deferred income tax liabilities and assets for events recognized differently in our financial statements and income tax returns, and income tax expense. Determining these amounts requires analysis of certain transactions and interpretation of tax laws and regulations. Management exercises judgment in evaluating the amount and timing of recognition of resulting tax liabilities and assets. These judgments and estimates are reevaluated on a continual basis as regulatory and business factors change. No assurance can be given that either the tax returns submitted by us or the income tax reported on the financial statements will not be adjusted by either adverse rulings by the United States Tax Court, changes in the tax code, or assessments made by the Internal Revenue Service. We are subject to potential adverse adjustments, including, but not limited to, an increase in the statutory federal or state income tax rates, the permanent nondeductibility of amounts currently considered deductible either now or in future periods, and the dependency on the generation of future taxable income, including capital gains, in order to ultimately realize deferred income tax assets.

Results of Operations

Net Income

2018 Compared to 2017

Net income for the year ended December 31, 2018 was $3.1 million compared to $1.9 million for the year ended December 31, 2017, an increase of $1.2 million or 67.2%. The Bank's earnings for the year produced an annualized return on average assets of 0.95% and an annualized return on average shareholders' equity of 8.31% in comparison to 0.57% and 5.16%, respectively for 2017.

2017 Compared to 2016

Net income for the year ended December 31, 2017 was $1.9 million, a decrease of $336 thousand or 15.3% as compared to $2.2 million for the year ended December 31, 2016. The Bank's earnings for the year produced an annualized return on average assets of 0.57% and an annualized return on average shareholders' equity of 5.16% in comparison to 0.66% and 6.34% respectively for 2016.

The 2018 and 2017 financial results were impacted by the fourth quarter 2017 passage of The Tax Cuts and Jobs Act. The Tax Act reduced the Bank's federal tax rate from 34% to 21% that resulted in lower income taxes in 2018, but caused a one-time increase in income tax expense of $505 thousand in 2017. Net interest income increased by $513 thousand in 2018 over 2017 primarily due to both rate and volume increases in loans, partially offset by increased interest expense on deposit accounts.

Key Financial Ratios

The following schedule of key ratios is presented for the years December 31, 2018, 2017, and 2016.

	2018	2017	2016
Return on Assets	0.95%	0.57%	0.66%
Return on Equity	8.31%	5.16%	6.34%
Dividend Payout Ratio	23.13%	34.97%	28.06%
Equity to Assets (averages)	11.48%	10.95%	10.34%
Ending Equity to Ending Assets	11.28%	11.39%	10.45%
Average Interest Earning Assets to Average Total Assets	92.43%	92.02%	90.49%
Average Net Loans to Average Total Loans	98.61%	98.61%	98.55%
Average Interest Earning Assets to Average Interest Bearing Liabilities	154.64%	150.78%	145.59%

Net Interest Income

Net interest income, the principal source of bank earnings, is the amount of income generated by earning assets (primarily loans and investment securities) less the interest expense incurred on interest-bearing liabilities (primarily deposits used to fund earning assets). Earning assets include loans, securities, and federal funds sold. Interest bearing liabilities include deposits and borrowings. To compare the tax-exempt yields to taxable yields, amounts are adjusted to pretax equivalents based on a 21% federal corporate income tax rate.

Net interest income is affected by changes in interest rates, volume of interest-bearing assets and liabilities, and the composition of those assets and liabilities. The “interest rate spread” and “net interest margin” are two common statistics related to changes in net interest income. The interest rate spread represents the difference between the yields earned on interest earning assets and the rates paid for interest bearing liabilities. The net interest margin is defined as the percentage of net interest income to average earning assets. Earning assets obtained through noninterest bearing sources of funds such as regular demand deposits and shareholders’ equity result in a net interest margin that is higher than the interest rate spread.

2018 Compared to 2017

Net interest income before the provision for loan losses for the year ended December 31, 2018 was $12.4 million, an increase of $0.5 million as compared to the $11.9 million recorded for the year ended December 31, 2017. The increase year over year is primarily rate-driven as a result of the four interest rate hikes made by the Federal Reserve during 2018. At December 31, 2017, the Bank’s rate-sensitive assets exceeded its rate-sensitive liabilities maturing in 12 months or less by approximately $75 million. For 2018, increases in rate on interest-earning assets, partially offset by an increases rate on interest-bearing liabilities provided an increase of $471 thousand while increases in volume of interest-earning assets aided by decreases in interest-bearing liabilities provided a increase of $42 thousand.

2017 Compared to 2016

Net interest income for the year ended December 31, 2017 was $11.9 million, an increase of $0.3 million as compared to the $11.6 million recorded for the year ended December 31, 2016. For 2017, increases in the volume of interest-earning assets offset by a decrease in average interest-bearing liabilities provided an increase of $107 thousand to net interest income for 2017 while decreases in yields earned on average assets and costs of average liabilities provided an increase of $124 thousand.

The following table presents the major categories of interest-earning assets, interest-bearing liabilities and shareholders' equity with corresponding average balances, related interest income or expense, and resulting yields and rates for the periods indicated. Where appropriate, income categories and yields have been adjusted in the table to their fully taxable yield.

	Year ended December 31,								
	2018			2017			2016		
(dollars in thousands)	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate	Average Balance	Interest	Yield/ Rate
Assets									
Interest-earning assets:									
Loans[3]	$ 179,334	$ 10,621	5.92%	$ 175,022	$ 9,702	5.54%	$ 177,501	$ 9,786	5.51%
Investment securities:									
Available for sale	52,775	1,128	2.14%	56,524	1,174	2.08%	53,720	1,087	2.02%
Held to maturity	49,355	1,339	2.71%	54,377	1,528	2.81%	48,578	1,447	2.98%
Nonmarketable securities	483	26	5.38%	464	22	4.74%	450	21	4.67%
Deposits with banks	18,863	322	1.71%	15,863	146	0.92%	22,282	94	0.42%
Total earning assets	300,810	13,436	4.47%	302,250	12,572	4.16%	302,531	12,435	4.11%
Noninterest-earning assets:									
Cash and due from banks	4,384			3,496			4,325		
Premises and equipment	8,702			9,132			15,014		
Other assets	14,044			16,024			15,007		
Allowance for loan losses	(2,500)			(2,439)			(2,570)		
Total assets	$ 325,440			$ 328,463			$ 334,307		
Liabilities and Shareholders' Equity									
Interest-bearing liabilities:									
Interest checking	$ 84,986	203	0.24%	$ 87,511	149	0.17%	$ 87,473	150	0.17%
Savings deposits	24,562	36	0.15%	23,856	35	0.15%	22,157	36	0.16%
Large time deposits	29,523	141	0.48%	33,053	97	0.29%	36,972	216	0.58%
Other time deposits	51,730	578	1.12%	53,835	367	0.68%	58,876	333	0.57%
Total deposits	190,801	958	0.50%	198,255	648	0.33%	205,478	735	0.36%
FHLB Advances	1,906	70	3.67%	1,177	54	4.59%	1,309	60	4.58%
Securities sold under agreements to repurchase	1,816	26	1.43%	1,030	1	0.10%	1,015	1	0.10%
Total interest-bearing liabilities	194,523	1,054	0.54%	200,462	703	0.35%	207,802	796	0.38%
Noninterest-bearing liabilities:									
Demand deposits	89,366			87,057			81,179		
Other liabilities	4,191			4,962			10,769		
Total liabilities	288,080			292,481			299,750		
Shareholders' equity	37,360			35,982			34,557		
Total liabilities and shareholders' equity	$ 325,440			$ 328,463			$ 334,307		
Net interest income		$ 12,382			$ 11,869			$ 11,639	
Interest rate spread[1]			3.92%			3.81%			3.73%
Interest rate margin[2]			4.12%			3.93%			3.85%

[1] Net interest spread is the difference between the yield on interest-earning assets and the cost of interest-bearing liabilities.
[2] Net interest margin equals net interest income divided by total interest-earning assets.
[3] Average loan balances include nonaccrual loans

Rate/Volume Analysis

Net interest income can be analyzed in terms of the impact of changing interest rates and changing volume. The following table sets forth the effect which the varying levels of interest-earning assets and interest-bearing liabilities and the applicable rates had on changes in net interest income for the comparative periods presented. Changes attributed to both rate and volume have been allocated on a pro rata basis.

(in thousands)	2018 Compared to 2017 Increase (Decrease) Due To			2017 Compared to 2016 Increase (Decrease) Due To		
	Total	Rate	Volume	Total	Rate	Volume
Interest-earning assets						
Loans	$ 919	$ 680	$ 239	$ (84)	$ 53	$ (137)
Investment securities:						
Taxable	(46)	32	(78)	87	29	58
Exempt from income tax	(189)	(48)	(141)	81	(73)	154
Dividend income	4	3	1	1	-	1
Deposits with banks	176	148	28	52	69	(17)
Total	864	815	49	137	78	59
Interest-bearing liabilities						
Interest checking	54	58	(4)	(1)	(1)	-
Savings deposits	1	-	1	(1)	(5)	4
Large time deposits	44	54	(10)	(119)	(98)	(21)
Other time deposits	211	225	(14)	34	58	(24)
Total deposits	310	337	(27)	(87)	(46)	(41)
FHLB Advance	16	(17)	33	(6)	-	(6)
Securities sold under agreements to repurchase	25	24	1	-	(1)	(1)
Total	351	344	7	(93)	(46)	(48)
Net interest income	$ 513	$ 471	$ 42	$ 230	$ 124	$ 107

Interest Rate Sensitivity

One of the principal goals of our asset and liability management strategy is to manage interest rate risk. Interest rate risk management balances the effects of interest rate changes on interest earning assets or interest-bearing liabilities, to protect us from wide fluctuations in our net interest income which could result from interest rate changes.

We actively monitor and manage our interest rate risk exposure principally by measuring our interest sensitivity "gap," and net interest income simulations. Interest sensitivity gap is the positive or negative dollar difference between assets and liabilities that are subject to interest rate repricing within a given period of time. Interest rate sensitivity can be managed by repricing assets or liabilities, selling securities available for sale, replacing an asset or liability at maturity, or adjusting the interest rate during the life of an asset or liability. Managing the amount of assets and liabilities repricing in this same time interval helps to hedge the risk and minimize the impact on net interest income of rising or falling interest rates. We generally would benefit from increasing market rates of interest when we have an asset-sensitive gap position and generally would benefit from decreasing market rates of interest when we are liability-sensitive.

The following table sets forth information regarding our rate sensitivity, as of December 31, 2018 and 2017, at each of the time intervals. The information in the table may not be indicative of our rate sensitivity position at other points in time. In addition, the maturity distribution implied in the table may differ from the contractual maturities of the earning assets and interest-bearing liabilities presented due to consideration of prepayment speeds under various interest rate change scenarios and other embedded optionality in the application of the interest rate sensitivity methods described above.

December 31, 2018	**Timeframes**							
(in thousands)	1 month	2 month	3 month	4-12 months	1-3 years	3-5 years	> 5 years	Total
Cash and cash equivalents	$ -	$ -	$ -	$ -	$ -	$ -	$ 8,652	$ 8,652
Interest-bearing deposits in other banks	18,084	-	-	-	-	-	-	18,084
Total investments	859	4,149	2,109	16,580	29,618	17,240	34,563	105,118
Total loans	88,254	4,572	4,284	26,952	40,164	17,798	(1,187)	180,837
Other Assets	-	-	-	-	-	-	23,638	23,638
Total Rate Sensitive Assets (RSA)	$ 107,197	$ 8,721	$ 6,393	$ 43,532	$ 69,782	$ 35,038	$ 65,666	$ 336,329
Noninterest bearing	$ 263	$ 261	$ 260	$ 2,297	$ 5,746	$ 5,259	$ 79,326	$ 93,412
Interest checking and savings	353	352	350	-	-	-	109,936	110,991
Time deposits	7,797	4,829	6,303	46,683	18,641	534	10	84,797
Securities sold under agreements to repurchase	1,432	-	-	-	-	-	-	1,432
FHLB advances	320	321	322	1,464	462	68	8	2,965
Other Liabilities	-	-	-	-	-	-	4,759	4,759
Total Rate Sensitive Liabilities (RSL)	$ 10,165	$ 5,763	$ 7,235	$ 50,444	$ 24,849	$ 5,861	$ 194,039	$ 298,797
Equity	$ -	$ -	$ -	$ -	$ -	$ -	$ 37,973	$ 37,973
Periodic Gap	$ 97,032	$ 2,958	$ (842)	$ (6,912)	$ 44,933	$ 29,177	$(166,346)	$ -
Periodic Gap/RSA	90.5%	33.9%	(13.2)%	(15.9)%	64.4%	83.3%	(253.3)%	-
Cumulative Gap	$ 97,032	$ 99,990	$ 99,148	$ 92,236	$ 137,169	$ 166,346	$ --	$ -
Cumulative Gap/RSA	90.5%	1,146.5%	1,550.9%	211.9%	196.6%	474.8%	-	-
RSA/RSL	9.5%	66.1%	113.2%	115.9%	35.6%	16.7%	295.5%	100.0%

December 31, 2017	**Timeframes**							
(in thousands)	1 month	2 month	3 month	4-12 months	1-3 years	3-5 years	> 5 years	Total
Cash and cash equivalents	$ -	$ -	$ -	$ -	$ -	$ -	$ 7,205	$ 7,205
Interest-bearing deposits in other banks	5,976	-	-	-	-	-	-	5,976
Total investments	963	4,966	1,950	7,794	35,563	20,784	35,241	107,261
Total loans	87,169	3,634	3,824	24,256	41,222	16,568	(1,745)	174,928
Other Assets	-	-	-	-	-	-	24,061	24,061
Total Rate Sensitive Assets (RSA)	$ 94,108	$ 8,600	$ 5,774	$ 32,050	$ 76,785	$ 37,352	$ 64,762	$ 319,431
Noninterest bearing	$ 207	$ 206	$ 205	$ 1,826	$ 4,676	$ 4,405	$ 74,527	$ 86,052
Interest checking and savings	415	414	412	-	-	-	110,214	111,455
Time deposits	6,759	7,046	6,769	39,649	18,230	674	8	79,135
Securities sold under agreements to repurchase	-	-	1,382	-	-	-	-	1,382
FHLB advances	26	26	26	241	674	66	42	1,101
Other Liabilities	-	-	-	-	-	-	3,929	3,929
Total Rate Sensitive Liabilities (RSL)	$ 7,407	$ 7,692	$ 8,794	$ 41,716	$ 23,580	$ 5,145	$ 188,720	$ 283,054
Equity	$ -	$ -	$ -	$ -	$ -	$ -	$ 36,377	$ 36,377
Periodic Gap	$ 86,701	$ 908	$ (3,020)	$ (9,666)	$ 53,205	$ 32,207	$(160,335)	$ -
Periodic Gap/RSA	92.1%	10.6%	(52.3)%	(30.2)%	69.3%	86.2%	(247.6)%	-
Cumulative Gap	$ 86,701	$ 87,609	$ 84,589	$ 74,923	$ 128,128	$ 160,335	$ -	$ -
Cumulative Gap/RSA	92.1%	1,018.7	1,465.0%	233.8	166.9%	429.3%	-	-
RSA/RSL	7.9%	89.4%	152.3%	130.2%	30.7%	13.8%	291.4%	100.0%

Provision for Loan Losses

We have established an allowance for loan losses through a provision for loan losses charged as a non-cash expense to our statement of operations. We review our loan portfolio periodically to evaluate our outstanding loans and to measure both the performance of the portfolio and the adequacy of the allowance for loan losses. Please see the discussion below under "Allowance for Loan Losses" for a description of the factors we consider in determining the amount of the provision we expense each period to maintain this allowance.

The Bank had provisions for loan losses of $167 thousand in 2018, an increase of $49 thousand and 41.0% as compared to $118 thousand recorded for 2017. The allowance for loan losses totaled $2.2 million at December 31, 2018, approximately 1.2% of gross outstanding loans at that date. Management considers the allowance for loan loss balance to be adequate to absorb probable losses inherent in our loan portfolio.

Noninterest Income

Noninterest income consists of revenue generated from a broad range of financial services and activities. The majority of noninterest income is a result of service charges on deposits, including charges for insufficient funds, ATM fees, and fees charged for non-deposit services such as safe deposit box rentals.

			2018 vs 2017	
In thousands	2018	2017	$	%
Service charges on deposit accounts	$ 1,408	$ 1,456	(48)	(3.3%)
Brokerage fee income	107	149	(42)	(27.7%)
Income from bank owned life insurance	248	254	(6)	(2.4%)
Loss on disposal of fixed assets	(20)	(89)	69	77.0%
Other operating income	451	388	63	16.2%
Total noninterest income	$ 2,194	$ 2,158	$ 36	1.7%

2018 Compared to 2017

Noninterest income increased $36 thousand or 1.7% to $2.2 million in 2018 as noted in the table above. Service charges were down slightly from the prior year but remain the largest at 64.2% of noninterest income.

2017 Compared to 2016

Noninterest income decreased $227 thousand or 9.5% to $2.4 million in 2017. More than half the decrease is attributable to a decrease in service charges on deposit accounts.

Noninterest Expense

			2018 vs 2017	
In thousands	**2018**	**2017**	**$**	**%**
Salaries and wages	$ 4,792	$ 4,791	$ 1	0.0%
Other personnel costs	1,376	1,615	(239)	(14.8%)
Occupancy and equipment expense, net	1,268	1,279	(11)	(0.9%)
Amortization expense	49	56	(7)	(12.5%)
Data processing expense	1,157	1,192	(35)	(2.9%)
FDIC insurance	91	105	(14)	(13.3%)
Foreclosed real estate expense, net	113	152	(39)	(25.3%)
Printing and office supplies	190	257	(67)	(26.1%)
Accounting fees	246	226	20	8.9%
Other operating expenses	1,509	1,498	11	0.8%
Total noninterest expense	$ 10,791	$ 11,171	($ 380)	(3.4%)

2018 Compared to 2017

Noninterest expense decreased $380 thousand or 3.4% from $11.2 million in 2017 to $10.8 million in 2018. As can be seen in the table above, we achieved an expense reduction in most of our noninterest expense categories. However, the largest component of the decrease relates to a decrease in other personnel costs which was driven by a decrease in pension expense of $202 thousand.

2017 Compared to 2016

Noninterest expense decreased $282 thousand or 2.5% from $11.4 in 2016 to $11.2 in 2017. Although we achieved an expense reduction in most of our noninterest expense categories, the largest reduction was in data processing due reduced expenses related to our core processing.

Income Taxes

Income tax expense is based on amounts reported in the statements of income (after adjustments for non-taxable income and non-deductible expenses) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. The deferred tax assets and liabilities represent the future Federal income tax return consequences of those differences, which will be taxable or deductible, depending on when the assets and liabilities are recovered or settled. The State of North Carolina lowered the corporate income tax rate from 6 percent to 5 percent effective for tax years beginning on or after January 1, 2015, to 4 percent for tax years beginning on or after January 1, 2016, and to 3 percent for tax years beginning on or after January 1, 2017 through December 31, 2018.

We recorded income tax expense of $516 thousand in 2018 as compared to $882 thousand in 2017. Our effective tax rates were 14.3% in 2018 and 32.2% in 2017. The lower effective rate in 2018 compared to 2017 is the result of the Tax Cut and Jobs Act that was signed into law on December 22, 2017, which reduced the federal statutory income tax rate from 35% to 21%. At December 31, 2017, we revalued our net deferred tax liability, which increased income tax expense by $484 thousand in 2017.

Financial Position

General

At December 31, 2018, total assets were $336.3 million, an increase of $16.9 million and 5.3% as compared to $319.4 million at December 31, 2017. The principal components of the Bank's assets at the end of the period were $26.7 million in cash and cash equivalents, $56.6 million in securities held-for-sale, $48.0 million in securities held to maturity and $183.4 million in gross loans. Total assets at December 31, 2017 were $319.4 million, a decrease of $13.1 million and 4.0% as compared to $332.6 million at December 31, 2016. The principal components of the Bank's assets at the end of the period were $13.2 million in cash and cash equivalents, $54.9 million in securities available-for-sale, $51.9 million in securities held to maturity and $177.5 million in gross loans.

Total liabilities at December 31, 2018 were $298.4 million, an increase of $15.3 million and 5.4% as compared to $283.1 million at December 31, 2017. Total deposits increased $12.5 million or 4.5% to $289.4 million from the $276.8 million recorded at December 31, 2017. Total liabilities at December 31, 2017 were $283.1 million, a decrease of $14.8 million and 5.0% as compared to $297.8 million at December 31, 2016. Total deposits decreased $14.0 million or 4.8% to $276.8 million from the $290.8 million recorded at December 31, 2016.

Average interest-earning assets increased as a percentage of total average assets. For 2018, average interest-earning assets were 92.4% of total average assets compared to 92.0% at 2017 and 90.5% at 2016. The average asset mix for 2018, 2017 and 2016 are presented in the following table.

	For the year ended December 31,					
	2018		2017		2016	
(in thousands)	Average Balance	%	Average Balance	%	Average Balance	%
Interest-earning assets:						
Loans	$ 179,334	55.10%	$ 175,022	53.29%	$ 177,501	53.10%
Investment securities:						
Taxable	52,775	16.22%	56,524	17.21%	53,720	16.07%
Exempt from income tax	49,355	15.17%	54,377	16.56%	48,578	14.53%
Nonmarketable securities	483	0.15%	464	0.14%	450	0.13%
Deposits with banks	18,863	5.79%	15,863	4.83%	22,282	6.67%
Total interest-earning assets	300,810	92.43%	302,250	92.03%	302,531	90.50%
Noninterest-earning assets:						
Cash and due from banks	4,384	1.35%	3,496	1.06%	4,325	1.29%
Premises and equipment	8,702	2.67%	9,132	2.78%	15,014	4.49%
Other assets	11,544	3.55%	13,585	4.14%	12,437	3.72%
Total noninterest-earning assets	24,630	7.57%	26,213	7.98%	31,776	9.50%
Total average assets	$ 325,440	100.00%	$ 328,463	100.00%	$ 334,307	100.00%

Investment Securities

Our investment securities portfolio consists primarily of securities for which an active market exists. Our policy is to invest primarily in securities of the U.S. Government and its agencies and in other high-grade fixed income securities to minimize credit risk. Our investment securities portfolio plays a role in the management of interest rate sensitivity and generates additional interest income. In addition, our portfolio serves as a source of liquidity and is used to meet collateral requirements.

Our investment securities portfolio consists of two components, securities held-to-maturity and securities available-for-sale. Securities are classified as held-to-maturity based on our intent and ability, at the time of purchase, to hold such securities to maturity. These securities are carried at amortized cost. Securities which may be sold in response to changes in market interest rates, changes in securities' prepayment risk, increases in loan demand, general liquidity needs, and other similar factors are classified as available-for-sale and are carried at estimated fair value.

We continually evaluate our investment securities portfolio in response to established asset/liability management objectives, changing market conditions that could affect profitability, and the level of interest rate risk to which we are exposed. These evaluations may cause us to change the level of funds we deploy into investment securities, change the composition of our investment securities portfolio, and change the proportion of investments made into the available for sale and held to maturity investment categories.

At December 31, 2018, investment securities available for sale were included on our balance sheet at a fair value of $56.6 million and consisted of government sponsored enterprises and FNMA, GNMA, and FHLMC mortgage-backed securities. Investments securities held to maturity were included on our balance sheet at an amortized cost of $48.0 million and consisted of state and municipal securities.

Gross unrealized gains in our investment securities portfolio were $522 thousand as of December 31, 2018 and $866 thousand as of December 31, 2017. Gross unrealized losses were $2.0 million as of December 31, 2018 and $1.2 million as of December 31, 2017. Management does not believe that gross unrealized losses as of December 31, 2018, represent an other-than-temporary impairment.

The following table presents the maturity distribution at amortized cost, weighted-average yield by maturity, and fair value of investment securities as of December 31, 2018, 2017 and 2016.

December 31, 2018 *(in thousands)*	Amortized Cost Due					
	Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total	Market Value
Government sponsored enterprises	$ -	$ 2,168	$ 11,578	$ -	$ 13,746	$ 13,465
FNMA, GNMA, and FHLMC mortgage-backed securities	6,796	22,254	12,873	2,209	44,132	43,152
State and municipal securities	8,961	21,068	12,511	5,442	47,982	47,790
Total	$ 15,757	$ 45,490	$ 36,962	$ 7,651	$ 105,860	$ 104,407
Weighted Average Yields						
Government sponsored enterprises	-%	1.92%	2.50%	-%	2.41%	
FNMA, GNMA, and FHLMC mortgage-backed securities	2.35%	2.38%	2.46%	2.49%	2.40%	
State and municipal securities	2.60%	2.70%	2.51%	3.34%	2.70%	
Total	2.49%	2.51%	2.49%	3.10%	2.54%	

December 31, 2017
(in thousands)

	Amortized Cost Due					
	Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total	Market Value
Government sponsored enterprises	$ -	$ 1,719	$ 14,293	$ -	$ 16,012	$ 15,817
FNMA, GNMA, and FHLMC mortgage-backed securities	7,082	18,994	11,192	2,595	39,863	39,087
State and municipal securities	4,480	27,320	13,850	6,244	51,894	52,497
Total	$ 11,562	$ 48,033	$ 39,335	$ 8,839	$ 107,769	$ 107,401

Weighted Average Yields

	Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
Government sponsored enterprises	-%	1.82%	2.49%	-%	2.15%
FNMA, GNMA, and FHLMC mortgage-backed securities	1.85%	1.80%	1.90%	1.96%	1.88%
State and municipal securities	2.73%	2.46%	2.41%	3.12%	2.68%
Total	2.29%	2.03%	2.27%	2.54%	2.24%

December 31, 2016
(in thousands)

	Amortized Cost Due					
	Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total	Market Value
Government sponsored enterprises	$ -	$ 750	$ 16,892	$ -	$ 17,642	$ 17,410
FNMA, GNMA, and FHLMC mortgage-backed securities	7,160	20,549	12,223	2,955	42,887	41,328
State and municipal securities	3,886	27,473	14,454	7,631	53,444	53,505
Total	$ 11,046	$ 48,772	$ 43,569	$ 10,586	$ 113,973	$ 112,243

Weighted Average Yields

	Within One Year	After One Through Five Years	After Five Through Ten Years	After Ten Years	Total
Government sponsored enterprises	-%	1.73%	2.47%	-%	2.10%
FNMA, GNMA, and FHLMC mortgage-backed securities	1.80%	1.81%	1.84%	1.90%	1.84%
State and municipal securities	3.82%	2.71%	2.62%	3.23%	3.10%
Total	2.81%	2.08%	2.31%	2.56%	2.44%

Loans

We make commercial, mortgage and consumer loans to our customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout the North Carolina counties of Robeson, Cumberland and Hoke. The ability of our borrowers to honor their contracts is dependent upon the general economic conditions in the area.

Total loans were $183.4 million at December 31, 2018 compared to $177.5 million at December 31, 2017, an increase of $5.9 million or 3.3%. Loans secured by real estate comprise the largest part of our loan portfolio, 91.1% at December 31, 2018 and 91.6% at December 31, 2017. Non-real estate commercial loans comprised 4.4% of our loan portfolio at December 31, 2018 compared to 4.4% at December 31, 2017, while consumer loans comprised 4.3% at December 31, 2018 compared to 3.9% at December 31, 2017.

The following table presents the composition of our loan portfolio.

(in thousands)	December 31, 2018	2017	2016	2015	2014
Commercial	$ 8,142	$ 7,944	$ 10,079	$ 8,414	$ 10,802
Commercial Real Estate	83,071	84,160	84,054	82,682	87,493
Consumer	7,886	6,991	6,513	7,276	8,677
Residential Real Estate	79,590	74,421	71,109	75,462	73,791
Agricultural and Raw Land	4,584	3,978	2,575	2,374	2,463
Other	129	(12)	65	156	76
Gross Loans	183,402	177,482	174,395	176,364	183,302
Unearned Fees	(393)	(383)	(349)	(330)	(341)
Gross Loans less Unearned Fees	183,009	177,099	174,046	176,034	182,961
Allowance for Loan Losses	(2,172)	(2,171)	(2,490)	(2,619)	(2,817)
Net Loans	$ 180,837	$ 174,928	$ 171,556	$ 173,415	$ 180,144

The following table presents fixed rate and variable rate loans by their contractual maturities.

(in thousands)	December 31, 2018 One Year or Less	Over One Year through Five Years	Over Five Years	Total
Commercial	$ 4,974	$ 3,016	$ 152	$ 8,142
Commercial Real Estate	45,582	36,524	965	83,071
Consumer	2,986	4,290	615	7,891
Residential Real Estate	50,578	24,451	4,564	79,593
Agricultural and Raw Land	1,987	2,320	277	4,584
Total	$ 106,107	$ 70,601	$ 6,573	$ 183,281
Variable rate loans	$ 85,478	$ 6,671	$ 432	$ 92,581
Fixed rate loans	20,629	63,930	6,141	90,700
Total	$ 106,107	$ 70,601	$ 6,573	$ 183,281

Allowance for Loan Losses

An allowance for loan losses is maintained at a level deemed appropriate by management to provide adequately for known and inherent losses in the loan portfolio. Management's judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which we believe to be reasonable, but which may or may not prove to be accurate.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loans identified as losses and deemed uncollectible by management are charged to the allowance. Subsequent recoveries, if any, are credited to the allowance. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions and environmental factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as additional information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired, for which an allowance is established when the discounted cash flows, collateral value, or observable market price of the loan is lower than its carrying value. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. Historical losses are categorized into risk similar loan pools and a loss ratio factor is applied to each group's loan balances to determine the allocation. The loss ratio factor is based on average loss history for the current year and two prior years to ensure the most relevant data is being used in the model following the economic recession, anemic recovery and current economic conditions.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Qualitative environmental factors include external risk factors that management believes affect our overall lending environment. Environmental factors that management routinely analyzes include: levels and trends in delinquencies and impaired loans; levels and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of changes in risk selection and underwriting practices; experience, ability, and depth of lending management and staff; national and local economic trends and conditions such as unemployment rates, housing statistics and banking industry conditions; local economic forecasts; and the effect of changes in credit concentrations.

At both December 31, 2018 and December 31, 2017, the allowance for loan losses was $2.2 million or 1.2% of total loans. The following table presents activity in the Allowance for Loan Losses.

	For the year ended December 31,				
(in thousands)	2018	2017	2016	2015	2014
Balance at beginning of period	$ 2,171	$ 2,490	$ 2,619	$ 2,817	$ 3,246
Charge-offs:					
Commercial	-	-	(13)	-	(265)
Commercial Real Estate	(125)	(177)	(9)	(60)	(342)
Consumer	(8)	(25)	(81)	(23)	(47)
Residential Real Estate	(54)	(114)	(43)	(171)	(417)
Agricultural and Raw Land	-	-	-	-	-
Total Charge-offs	(187)	(316)	(146)	(254)	(1,071)
Recoveries:					
Commercial	38	6	3	-	7
Commercial Real Estate	3	-	-	2	-
Consumer	3	6	12	10	7
Residential Real Estate	37	19	2	7	2
Agricultural and Raw Land	-	-	-	37	-
Total Recoveries	81	31	17	56	16
Net Charge-offs	(106)	(285)	(129)	(198)	(1,055)
Provision	167	118	-	-	626
Transfers	(60)	(152)	-	-	-
Balance at end of period	$ 2,172	$ 2,171	$ 2,490	$ 2,619	$ 2,817
Net charge-offs as a percentage of average loans	0.06%	0.16%	0.07%	0.11%	0.56%

The following table presents the Allowance for Loan Losses by loan category and the loan category as a percentage of total loans. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	December 31,									
	2018		2017		2016		2015		2014	
(in thousands)	$	%[1]	$	%[1]	$	%[1]	$	%[1]	$	%[1]
Commercial	$ 33	4.5%	$ 15	4.5%	$ 18	5.8%	$ 91	4.9%	$ 218	5.9%
Commercial Real Estate	1,047	45.3%	869	47.4%	1,285	48.2%	1,158	46.9%	1,008	47.8%
Consumer	70	4.3%	148	3.9%	113	3.7%	64	4.1%	45	4.7%
Residential Real Estate	865	43.4%	886	41.9%	698	40.8%	983	42.8%	871	40.3%
Agricultural and Raw Land	44	2.5%	93	2.3%	40	1.5%	7	1.3%	-	1.3%
Unallocated	113	-%	160	-%	336	-%	316	-%	675	-%
	$ 2,172	100.0%	$ 2,171	100.0%	$ 2,490	100.0%	$ 2,619	100.0%	$ 2,817	100.0%

[1] Loan category as a percentage of total loans.

Nonperforming Loans

Loans are generally placed in non-accrual status when the collection of interest is 90 days or more past due, when the full collection of all principal and interest is unlikely (even if the amount and timing of the eventual loss are unknown), when a loan is designated as Troubled Debt Restructuring ("TDR"), or when the borrower has filed for bankruptcy. Loans that are less delinquent may also be placed on non-accrual if so directed by the Executive Vice Chairman or Chief Executive Officer.

Loans that meet these criteria guidelines may be kept on accrual if approved by the Chief Credit Officer and the loan is well secured and in the process of collection. A debt is "well secured" if collateralized by liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt in full; or by the guarantee of a financially responsible party. A debt is "in process of collection" if collection is proceeding in due course either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal actions which are reasonably expected to result in repayment of the debt or its restoration to a current status. With the approval of the Chief Credit Officer, a loan also may be kept on accrual if it is past due because of a recent maturity without a timely renewal, but the loan has been approved for renewal and is in the process of being renewed and returned to a paying status. When interest accrual is discontinued, all unpaid accrued interest is reversed.

A non-accrual loan may be returned to accrual status when we can reasonably expect continued timely payments until payment in full. All prior arrearage does not necessarily have to be eliminated, nor do all previously charged off amounts need to have been recovered. The loan can be returned to accrual status if: 1) approved by the Chief Credit Officer, and 2) the return to sustained, acceptable, payment performance, without subsequent relapse to seriously delinquent or otherwise non-performing, is likely. The two general rules that apply here are: a) all principal and interest amounts contractually due (including arrearage) are reasonably assured of repayment within a reasonable period, and b) there is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents.

The following table sets forth our nonperforming assets.

	December 31,				
(in thousands)	2018	2017	2016	2015	2014
Non-accrual loans	$ 5,043	$ 4,995	$ 4,039	$ 4,373	$ 5,425
Loans 90 days+ past due, still accruing	-	-	97	-	13
Troubled debt restructurings, still accruing	3,775	3,678	4,610	2,897	2,191
Total nonperforming loans	8,818	8,673	8,746	7,270	7,629
Foreclosed real estate	386	515	715	636	1,034
Total nonperforming assets	$ 9,204	$ 9,188	$ 9,461	$ 7,906	$ 8,663

Impaired Loans

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

At December 31, 2018, our impaired loans amounted to $8.5 million consisting of real estate, consumer, and commercial loans. These impaired loans had specific reserves set aside in an amount of $606 thousand for future losses.

Potential Problem Loans

As of December 31, 2018, our watch list loans amounted to $25.9 million, compared to $27.8 million at December 31, 2017. The watch list is the classification utilized by us when we have an initial concern about the financial health of a borrower and represents both potential problem loans and problem loans. We regularly evaluate our current risk in the watch list loans by obtaining current financial information when possible, evaluating our collateral position, and analyzing the payment history, among other credit factors. Loans of $50,000 or more are evaluated at least quarterly, and written evaluations are documented in the loan file. Loans may be moved off the watch list (upgraded) or to a more severe classification, such as "Substandard" (downgraded), after a review of the information. There are times when we may leave the loan on the watch list if, in management's opinion, there are risks that cannot be fully evaluated without the passage of time, and we want to review it on a more regular basis.

Loans past due 30-89 days and still accruing amounted to $185 thousand at December 31, 2018 as compared to $495 thousand at December 31, 2017. Past due loans are often regarded as a precursor to further credit problems which would lead to future increases in nonaccrual loans and other real estate owned. At December 31, 2018 and December 31, 2017, there were no loans past due greater than 90 days that had not already been placed on nonaccrual.

Deposits

Total deposits at December 31, 2018 were $289.4 million compared to $276.8 million at December 31, 2017. Non-interest bearing, savings and time deposits increased $7.3 million, $2.1 million and $5.7 respectively while interest-bearing deposits decreased $2.5 million.

Average interest-bearing deposits decreased from 2017 to 2018 while deposit rates increased. The weighted average rate paid for total deposits increased from 0.33% for the year ended December 31, 2017 to 0.50% for the year ended December 31, 2018. The table below presents average interest-bearing deposits and the average rate paid on each category for the year.

	December 31,					
	2018		2017		2016	
(in thousands)	Average Balances	Average Rate	Average Balances	Average Rate	Average Balances	Average Rate
Interest-bearing deposits:						
Interest checking	$ 85,651	0.24%	$ 87,511	0.17%	$ 87,473	0.17%
Savings	24,562	0.15%	23,856	0.15%	22,157	0.16%
Time deposits, $100,000 and over	29,523	0.48%	33,053	0.29%	36,972	0.58%
Other time deposits	51,730	1.12%	53,835	0.68%	58,876	0.57%
Total interest-bearing deposits	191,466	0.50%	198,255	0.33%	205,478	0.36%
Noninterest-bearing deposits	88,701		87,057		81,179	
Total average deposits	$ 280,167		$ 285,312		$ 286,657	

Total time deposits increased $5.7 million from $79.1 million at December 31, 2017 to $84.8 million at December 31, 2018. Time deposits greater than $100,000 were $31.4 million and $28.6 million at December 31, 2018 and 2017, respectively.

The following table presents a maturity analysis of time deposits of $100,000 and over at December 31.

(in thousands)	2018	2017
Less than three months	$ 5,006	$ 7,270
Three months through one year	16,665	14,513
Over one year	9,748	6,781
Total time deposits, $100,000 and over	$ 31,419	$ 28,564

Federal Home Loan Bank Advances

At December 31, 2018, we had outstanding advances from the Federal Home Loan Bank of $3.0 million compared to $1.1 million at December 31, 2017. The advances are used primarily for asset/liability management. The weighted average rate paid on the advances during 2018 was 3.66%. These advances mature between 2020 and 2024. Our remaining credit availability was $82.1 million at December 31, 2018.

Capital

Total shareholders' equity increased $1.6 million and 4.4% to $38.0 million at December 31, 2018 from $36.4 million at December 31, 2017. Unrealized losses on available for sale securities and the unfunded portion of the Bank's pension plan which are included in other comprehensive income, net of tax, decreased $791 thousand from December 31, 2017 to December 31, 2018. This change combined with dividends paid of $718 thousand offset net income of $3.1 million for the year.

The Bank is subject to various regulatory capital requirements administered by its primary federal regulator, the Federal Deposit Insurance Corporation ("FDIC"). Failure to meet the minimum regulatory capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that if undertaken, could have a direct material effect on the Bank and the financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, we must meet specific capital guidelines involving quantitative measures of our assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Our capital amounts and classification under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require us to maintain minimum amounts and ratios of: total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), and Tier 1 capital to adjusted total assets (as defined). Management believes, as of December 31, 2018, that we meet all the capital adequacy requirements to which we are subject.

As of December 31, 2018, the most recent notification from the FDIC, we were categorized as well capitalized under the regulatory framework for prompt corrective action. To remain categorized as well capitalized, we will have to maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as disclosed in the table below. There are no conditions or events since the most recent notification that management believes have changed our prompt corrective action category.

The Basel Committee provides a framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III". Basel III will require banks to maintain substantially more capital, with a greater emphasis on common equity. In July 2013, the Federal Reserve Bank, the OCC and the FDIC finalized rules to implement the Basel III capital rules in the United States. These comprehensive rules are designed to help ensure that banks maintain strong capital positions by increasing both the quantity and quality of capital held by U.S. banking organizations. The rules include new risk-based capital and leverage ratios, which became effective on January 1, 2015, and revise the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Bank are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6.0% (increased from 4.0%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4.0% for all institutions. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010 will be grandfathered for banks with assets of $15 billion or less. The rules established a "capital conservation buffer" of 2.5% above the new regulatory minimum capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital falls below that buffer amount. These limitations will establish a maximum percentage of eligible retained income that may be utilized for such actions.

Our actual and required capital amounts and ratios are as follows:

(dollars in thousands)	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2018						
Total Capital						
(to Risk-Weighted Assets)	$ 41,745	19.17%	$ 17,421	8.00%	$ 21,777	10.00%
Common Equity Tier 1 Capital						
(to Risk-Weighted Assets)	$ 39,573	18.17%	$ 9,799	4.50%	$ 14,155	6.50%
Tier I Capital						
(to Risk-Weighted Assets)	$ 39,573	18.17%	$ 13,066	6.00%	$ 17,421	8.00%
Tier I Capital						
(to Average Assets)	$ 39,573	11.65%	$ 13,585	4.00%	$ 16,982	5.00%
December 31, 2017						
Total Capital						
(to Risk-Weighted Assets)	$ 39,306	18.94%	$ 16,599	8.00%	$ 20,748	10.00%
Common Equity Tier 1 Capital						
(to Risk-Weighted Assets)	$ 37,135	17.90%	$ 9,337	4.50%	$ 13,486	6.50%
Tier I Capital						
(to Risk-Weighted Assets)	$ 37,135	17.90%	$ 12,449	6.00%	$ 16,544	8.00%
Tier I Capital						
(to Average Assets)	$ 37,135	11.31%	$ 13,162	4.00%	$ 16,453	5.00%

Effect of Inflation and Changing Prices

The effect of relative purchasing power over time due to inflation has not been taken into account in our financial statements. Rather, our financial statements have been prepared on an historical cost basis in accordance with generally accepted accounting principles.

Unlike most industrial companies, our assets and liabilities are primarily monetary in nature. Therefore, the effect of changes in interest rates will have a more significant impact on our performance than will the effect of changing prices and inflation in general. In addition, interest rates may generally increase as the rate of inflation increases, although not necessarily in the same magnitude. As discussed previously, we seek to manage the relationships between interest sensitive assets and liabilities in order to protect against wide rate fluctuations, including those resulting from inflation.

Off-Balance Sheet Risk

Commitments to extend credit are agreements to lend to a customer as long as the customer has not violated any material condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require the payment of a fee. At December 31, 2018, unfunded commitments to extend credit were $24.4 million. A significant portion of the unfunded commitments related to consumer equity lines of credit. Based on historical experience, we anticipate that a significant portion of these lines of credit will not be funded. We evaluate each customer’s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by us upon extension of credit, is based on our credit evaluation of the borrower. The type of collateral varies but may include accounts receivable, inventory, property, plant and equipment, and commercial and residential real estate.

At December 31, 2018, there were commitments totaling approximately $70 thousand under letters of credit. The credit risk and collateral involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Since most of the letters of credit are expected to expire without being drawn upon, they do not necessarily represent future cash requirements.

Liquidity

Liquidity represents the ability of a company to convert assets into cash or cash equivalents without significant loss, and the ability to raise additional funds by increasing liabilities. Liquidity management involves monitoring our sources and uses of funds in order to meet our day-to-day cash flow requirements while maximizing profits. Liquidity management is made more complicated because different balance sheet components are subject to varying degrees of management control. For example, the timing of maturities of our investment portfolio is fairly predictable and subject to a high degree of control at the time investment decisions are made. However, net deposit inflows and outflows are far less predictable and are not subject to the same degree of control.

Our liquidity position is primarily dependent upon our need to respond to loan demand and short-term demand for funds caused by withdrawals from deposit accounts and upon the liquidity of our assets. Our primary liquidity sources include cash and amounts due from other banks, federal funds sold and investments available for sale. In addition, we have the ability to borrow funds from the Federal Home Loan Bank and the Federal Reserve Bank and to purchase federal funds from other financial institutions. Management believes our liquidity sources are adequate to meet our operating needs.

Retirement Benefits

Pension Plan

We maintain a qualified defined benefit pension plan (the "Pension Plan") under which a participating employee will become eligible to receive monthly retirement benefits beginning at his or her normal retirement age of 65 and thereafter for life. All employees, including our executive officers, are eligible to participate in the Pension Plan if they are at least 21 years old and if they have been employed by us for at least twelve months during which they have worked at least 1,000 hours. Benefits, which become fully vested after five years of continuous employment, are determined based on a formula using a participant's "final average compensation," which is the participant's highest average total compensation, including deferred compensation, for any five years during the participant's final ten years of employment. A participant's normal annual "life annuity" benefit under the Pension Plan will equal (i)

0.65% of his or her final average compensation multiplied by his or her years of credited service (up to a maximum of 35 years), plus (ii) 0.65% of the amount of his or her final average compensation in excess of the applicable social security covered compensation (as in effect on the earlier of a termination of employment or age 65) multiplied by his or her years of credited service (up to a maximum of 35 years).

Participants may elect to receive benefits in a "single life annuity" or a "joint and survivor annuity." If a participant elects a joint and survivor annuity, the amount of the annual benefit will be actuarially reduced. If a participant's employment continues after age 65, his or her annual benefit will be actuarially increased to reflect the continuing accrual of benefits during the participant's extended employment and the projected reduction in the number of his or her benefit payments.

Early retirement is permitted under the Pension Plan for participants who have reached age 55 with at least ten years of service. If a participant retires early, his or her annual benefit under the Pension Plan, commencing at age 65, will be the amount accrued under the formula described above through the early retirement date. However, if he or she begins receiving benefits before age 65, the annual benefit will be actuarially reduced by 6.66% for each year of the first five years, and by 3.33% for each year of the additional five years, by which the participant's early retirement date precedes his or her normal retirement date. Upon a termination of employment due to disability, a participating employee will become eligible to receive retirement benefits at a rate which is determined using the same formula as is applied to early retirement, except that payments may begin before the participating employee reaches age 55, in which case the benefits will be further actuarially reduced according to the participant's age at the time of disability. Vested retirement benefits under the Pension Plan are not affected by a termination or change in control.

At December 31, 2018, the accrued liability for the Defined Pension Plan Obligation totaled $1,295,800 as compared to $1,169,095 at December 31, 2017.

Section 401(k) Plan

We maintain a qualified Section 401(k) voluntary savings plan that provides a vehicle for employees to defer a pre-tax portion of their compensation for retirement and receive an employer matching contribution on a portion of their voluntary deferrals. Full-time employees become eligible to participate in the plan after one full year of employment. Participants may choose to defer up to 50% of their total earnings each month, up to a maximum annual voluntary deferral amount set by the IRS which, for 2018, is $18,500 for a participant under age 50 and $24,500 for a participant who is age of 50 or older. We make a matching contribution to each participant's account equal to 50% of his or her contributions up to 6% of earnings that he or she defers, but not more than a maximum matching contribution of 3% of the participant's eligible compensation. Our Section 401(k) matching contributions during 2018 for the accounts of our executive officers named in the Summary Compensation Table above are included in the "All Other Compensation" column of the table and are listed in a footnote to the table.

Directors and Officers Deferral Plan

We maintain a nonqualified deferred compensation plan under which our executive officers and directors may elect each year, in advance, to defer receipt of up to 100% of their compensation and fees until they retire from their employment or service as directors. All amounts deferred by officers are held by an independent trustee in individual accounts for them. We do not make any contributions to, or pay any interest or other amount or guarantee any rate of return on, the officers' accounts. The trustee invests deferred amounts, as directed by the individual officers, in any one or a combination of investment funds available under the arrangement.

Employee Stock Ownership Plan

The Bank formed an Employee Stock Ownership Plan ("ESOP"), for its employees in 2013. The ESOP will purchase shares of the Bank's common stock on the open market from time to time with funds borrowed from a loan from a third party lender. All employees of the Bank meeting certain tenure requirements are entitled to participate in the ESOP. Employer contributions are discretionary. Employee contributions are not permitted.

Deferred Compensation Plan for Directors

The Bank has established a deferred compensation plan for non-employee directors of the Bank (the "Director Plan"). Each participating director may defer up to 100% of their monthly Board fees into the Director Plan. The Director Plan also provides a $25,000 death benefit payable to the Director's beneficiary. As of December 31, 2018, the Accrual Balance on our books for each of the directors/executive officers under their agreements was $186,561.

Executive Salary Continuation Agreements

During 2004 we entered into an Executive Salary Continuation Agreement with each of our executive officers. Under the agreement should executive officers remain employed by us until they reached age 65 and then retired, we would pay monthly payments for life, with annual increases of 1.75%, beginning on the first day of the next month following their retirement.

Under accounting rules that apply to us, we accrue an expense on our books each year for our liability for payments under the agreements. Upon the death of an officer while still employed but before reaching age 65, or after monthly payments have begun under his agreement, the then-current balance of the total liability we have accrued for future payments to the officer under his agreement (the officer's "Accrual Balance," as adjusted, in the case of an officer's death following retirement, for payments already made) will be paid to the officer's designated beneficiary or estate. If, prior to age 65, an officer becomes disabled for a qualified period, an amount equal to the officer's then-current Accrual Balance will be paid into a trust and held for his benefit. If he remains disabled on the date he reaches age 65, he will receive payments from the funds held for his benefit and will not be entitled to any further benefits under his agreement. However, if he has returned to service before he reaches age 65, then, in addition to payments of the above funds held in trust for his benefit, he will be entitled to a reduced retirement benefit under his agreement according to a pre-determined formula. As of December 31, 2018, the Accrual Balance on our books for each of the executive officers under their agreements was $2,525,708.

If an executive officer's employment is voluntarily terminated by him, or terminated by us without cause, other than in connection with a change in control (including by reason of death or disability), we will pay him or his beneficiary an amount equal to the officer's then-current Accrual Balance. If an executive officer dies after retiring, his designated beneficiary or estate will receive the officer's then-current Accrual Balance (as adjusted for payments made following the officer's retirement). If an executive officer's employment is terminated voluntarily or involuntarily, except for cause, within six months before or after a change in control, he will receive full retirement benefits upon reaching age 65. For purposes of the Executive Salary Continuation Agreements, a change in control will occur if there is a change in the control of 50% or more of our stock. If an executive officer's employment is terminated by us for cause, no amounts will be paid under the agreements.

Split Dollar Life Insurance Agreements

We have purchased life insurance policies on the lives of each of our executive officers and have entered into Endorsement Method Split-Dollar Agreements with them. The policies covered by the agreements are held by a third party trustee. Under the agreements, upon the death of an executive officer while he remains employed by us, 90% of the "net at risk insurance portion" of the death proceeds of the officer's policy will be paid to the officer's designated beneficiary or his estate. The net at risk insurance portion of the proceeds of a policy is equal to the total death proceeds less the cash value of the policy. If, at the time of his death, the officer no longer is employed by us, then, provided that he previously had been employed by us for at least ten years, his designated beneficiary or estate will be entitled to receive 25% of the net at risk insurance portion of the death proceeds of his policy, plus an additional 5% for each additional year of employment. We will receive the remainder of the death benefits under each policy, including the full cash value. No amount will be paid to the designated beneficiary or estate of an officer who has been terminated for cause. The amount which would have been paid to the designated beneficiaries or estates of our executive officers under their agreements if they had died on December 31, 2018, totaled $1,398,071. During 2018 and 2017, no premiums were paid.

Intangible Assets

The Bank purchased two retail branches in Pembroke and Raeford, North Carolina on April 6, 2012 and one retail branch in Red Springs, North Carolina on January 22, 2016. The purchase of these three branches resulted in goodwill and core deposit intangible assets for the Bank. Deposits are a liability of a bank; however their existence may create an intangible asset. The buyer receives a “built in” customer base of, usually, stable relationships when a bank is acquired. This customer base has demonstrable economic benefits to the buyer. A core deposit base consists of specific account relationships existing at the time of acquisition. These account holders will eventually pass away, relocate or move their account, and therefore the core deposit base has a limited life. At December 31, 2018, Net Intangible Assets totaled $745,290 as compared to $794,944 at December 31, 2017.

Deferred Tax Asset

The Bank’s net deferred tax asset was $1.3 million and $1.5 million at December 31, 2018 and 2017, respectively. In evaluating whether we will realize the full benefit of our net deferred tax asset, we consider both positive and negative evidence, including among other things recent earnings trends and projected earnings, and asset quality. As of December 31, 2018, management concluded that the Bank’s net deferred tax assets were fully realizable. The Bank will continue to monitor deferred tax assets closely to evaluate whether we will be able to realize the full benefit of our net deferred tax asset or whether there is any need for a valuation allowance. Significant negative trends in credit quality, losses from operations, or other factors could impact the realization of the deferred tax asset in the future. The Bank feels confident that deferred tax assets are more likely than not to be realized.

The Bank measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid. Accordingly, the company’s deferred tax assets and liabilities were remeasured to reflect the reduction in the U.S. corporate income tax rate from 34 percent to 21 percent as a result of the Tax Cut and Jobs Act which passed Congress on December 22, 2017, resulting in a $484 thousand increase in income tax expense for the year ended December 31, 2017 and a corresponding $484 thousand decrease in net deferred tax assets as of December 31, 2017.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 8. Financial Statements and Supplementary Data

elliott davis

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Board of Directors
Lumbee Guaranty Bank

Opinion on the Financial Statements

We have audited the accompanying balance sheets of Lumbee Guaranty Bank (the "Bank") as of December 31, 2018 and 2017, the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements. In our opinion, the financial statements present fairly, in all material respects, the financial position of the Bank as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on the Bank's financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Bank in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Bank is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Elliott Davis, PLLC

We have served as the Bank's auditor since 2013.

Charlotte, North Carolina
March 28, 2019

Lumbee Guaranty Bank
Statements of Condition
December 31, 2018 and 2017

	2018	2017
Assets		
Cash and due from banks	$ 5,562,308	$ 4,260,720
Interest-bearing deposits in other banks	21,174,255	8,919,744
Cash and cash equivalents	26,736,563	13,180,464
Investment securities, available for sale	56,617,167	54,903,776
Investment securities, held to maturity (fair value $47,790,231 and $52,496,982 at December 31, 2018 and 2017, respectively)	47,981,960	51,893,845
Loans	183,402,549	177,482,269
Less: Unearned fees	(393,322)	(382,477)
Allowance for loan losses	(2,171,757)	(2,171,342)
Loans, net	180,837,470	174,928,450
Premises and equipment, net	8,566,738	8,857,999
Intangible assets, net	745,290	794,944
Nonmarketable equity securities	518,400	463,600
Foreclosed real estate	385,578	515,141
Accrued interest receivable	1,429,565	1,301,365
Prepaid expenses	342,578	371,363
Cash value of bank owned life insurance	10,079,287	9,944,180
Other assets	2,088,210	2,276,341
Total assets	$ 336,328,806	$ 319,431,468
Liabilities and shareholders' equity		
Deposits:		
Noninterest-bearing	$ 93,605,657	$ 86,275,538
Interest checking	85,537,948	88,069,096
Savings	25,452,814	23,386,544
Time deposits	84,781,330	79,110,639
Total deposits	289,377,749	276,841,817
Securities sold under agreements to repurchase	1,431,999	1,381,694
Federal Home Loan Bank advances	2,964,654	1,101,385
Accrued interest payable and other expenses	3,097,177	2,958,770
Defined benefit pension plan liability	1,295,800	682,582
Other liabilities	188,480	88,246
Total liabilities	298,355,859	283,054,494
Shareholders' equity		
Common stock, $2.00 par value, 5,000,000 shares authorized; 3,417,565 shares issued and outstanding	6,835,130	6,835,130
Surplus	7,053,440	7,051,832
Undivided profits	26,443,653	24,057,990
Accumulated other comprehensive loss	(2,359,276)	(1,567,978)
Total shareholders' equity	37,972,947	36,376,974
Total liabilities and shareholders' equity	$ 336,328,806	$ 319,431,468

The accompanying notes are an integral part of the financial statements

Lumbee Guaranty Bank
Statements of Operations
For the years ended December 31, 2018 and 2017

	2018	2017
Interest income		
Interest and other fees on loans	$ 10,621,149	$ 9,702,103
Interest on securities:		
Available for sale	1,128,696	1,174,259
Held to maturity	1,339,677	1,528,284
Nonmarketable equity securities	25,689	22,288
Other interest income	321,986	145,382
Total interest income and fees	13,437,197	12,572,316
Interest expense		
Interest on interest-bearing deposits	203,576	149,367
Interest on savings	35,797	34,526
Interest on time deposits	719,023	463,909
Interest paid of fed funds purchased	17,285	-
Interest on FHLB advances	69,851	53,906
Interest on securities sold under agreements to repurchase	8,800	1,230
Total interest expense	1,054,332	702,938
Net interest income	12,382,865	11,869,378
Provision for loan losses	166,864	118,330
Net interest income after provision for loan losses	12,216,001	11,751,048
Noninterest income		
Service charges on deposit accounts	1,408,070	1,456,146
Income from bank owned life insurance	248,331	254,396
Other operating income	537,815	447,864
Total noninterest income	2,194,216	2,158,406
Noninterest expense		
Salaries and wages	4,792,782	4,790,791
Other personnel costs	1,375,561	1,614,887
Net occupancy expense	923,714	901,518
Equipment expense	344,325	377,814
Amortization	49,654	56,382
Data processing	1,156,584	1,191,699
FDIC insurance premiums	90,973	105,367
Foreclosed real estate expense, net	112,516	152,475
Printing and office supplies	189,686	256,664
Accounting fees	246,077	225,992
Other operating expenses	1,509,010	1,497,518
Total noninterest expense	10,790,882	11,171,107
Income before income taxes	3,619,335	2,738,347
Income tax expense related to ordinary operations	515,983	377,054
Income tax expense related to change in tax rate	-	505,018
Total income tax expense	515,983	882,072
Net Income	$ 3,103,352	$ 1,856,275
Basic net income per common share	$ 0.91	$ 0.54
Diluted net income per common share	$ 0.91	$ 0.54
Weighted average basic common shares outstanding	3,417,565	3,417,565
Weighted average diluted common shares outstanding	3,417,565	3,417,565

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

Lumbee Guaranty Bank
Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017

	2018	2017
Net income	$ 3,103,352	$ 1,856,275
Other comprehensive loss:		
Unrealized holding losses on available for sale securities	(288,705)	(61,505)
Tax effect	71,307	21,220
Total net of taxes	(217,398)	(40,285)
Changes to defined benefit pension plan liability	(754,409)	697,893
Tax effect	180,509	(254,393)
Total net of taxes	(573,900)	443,500
Total other comprehensive income (loss)	(791,298)	403,215
Comprehensive income	$ 2,312,054	$ 2,259,490

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

Lumbee Guaranty Bank

Statements of Changes in Shareholders' Equity

For the years ended December 31, 2018 and 2017

	Common Stock				Accumulated Other Comprehensive	Total Shareholder's
	Shares	Amount	Surplus	Undivided Profits	Loss	Equity
Balance, December 31, 2016	3,417,565	$ 6,835,130	$ 7,050,192	$ 22,572,878	$ (1,693,018)	$ 34,765,182
Net income	-	-	-	1,856,275	-	1,856,275
Other comprehensive income	-	-	-	-	403,215	403,215
Dividends declared ($0.19 per share)	-	-	-	(649,338)	-	(649,338)
Deferred tax asset tax rate adjustment	-	-	-	278,175	(278,175)	-
Stock based compensation	-	-	1,640	-	-	1,640
Balance, December 31, 2017	3,417,565	$ 6,835,130	$ 7,051,832	$ 24,057,990	$ (1,567,978)	$ 36,376,974
Net income	-	-	-	3,103,352	-	3,103,352
Other comprehensive income	-	-	-	-	(791,298)	(791,298)
Dividends declared ($0.21 per share)	-	-	-	(717,689)	-	(717,689)
Stock based compensation	-	-	1,608	-	-	1,608
Balance, December 31, 2018	3,417,565	$ 6,835,130	$ 7,053,440	$ 26,443,653	$ (2,359,276)	$ 37,972,947

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

Lumbee Guaranty Bank
Statements of Cash Flows
For the years ended December 31, 2018 and 2017

	2018	2017
Cash flows from operating activities		
Net income	$ 3,103,352	$ 1,856,275
Adjustments to reconcile net income to net cash flows provided by operating activities:		
Depreciation and amortization	426,301	480,717
Amortizations of premiums	603,933	635,765
Amortizations of intangible assets	49,654	56,381
Losses on foreclosed real estate	60,467	58,103
Income from bank owned life insurance	(135,107)	(254,395)
Provision for loan losses	166,864	118,330
Stock based compensation	1,608	1,640
Change in:		
Accrued interest receivable	(128,200)	3,391
Prepaid expenses and other assets	288,223	457,022
Accrued interest payable and other expenses	138,407	50,277
Other liabilities	139,552	(493,399)
Net cash flows provided by operating activities	4,715,054	2,970,107
Cash flows from investing activities		
Purchases of investment securities, available for sale	(11,013,933)	(5,940,549)
Purchases of investment securities, held to maturity	-	(3,621,885)
Maturities, calls and paydowns of investment securities, available for sale	8,804,789	9,465,109
Maturities and calls of investment securities, held to maturity	3,515,000	4,785,000
Purchases of nonmarketable equity securities	(54,800)	(13,600)
(Increase) decrease in loans	(6,645,013)	(3,857,046)
Purchases of premises and equipment	(155,386)	(197,800)
Proceeds from sale of premises and equipment	20,346	89,308
Proceeds from sales of foreclosed real estate	638,225	508,580
Net cash received in branch acquisition	-	-
Net cash flows provided (used) by investing activities	(4,890,772)	1,217,117
Cash flows from financing activities		
Decrease in deposits	12,535,932	(13,991,345)
Increase (decrease) in securities sold under agreements to repurchase	50,305	514,063
Decrease in FHLB advances	1,863,269	(134,414)
Dividends paid	(717,689)	(649,338)
Net cash flows used by financing activities	13,731,817	(14,261,034)
Net decrease in cash and cash equivalents	13,556,099	(10,073,810)
Cash and cash equivalents at beginning of period	13,180,464	23,254,274
Cash and cash equivalents at end of period	$ 26,736,563	$ 13,180,464
Supplemental disclosure of cash flow information		
Interest paid	$ 1,054,332	$ 711,574
Taxes paid	$ (23,167)	$ 473,000
Non-cash transactions		
Transfer from loans to foreclosed assets	$ 569,129	$ 366,459
Change in unrealized loss on securities available for sale, net of tax	$ 217,398	$ (40,285)
Changes to defined benefit pension plan liability, net of tax	$ 573,900	$ 443,500
Reclassification of accumulated other comprehensive income due to change in tax rate	$ -	$ (278,175)

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

Note 1. Organization and Summary of Significant Accounting Policies

Organization

Lumbee Guaranty Bank is an independent, community bank providing full service banking through thirteen branch offices in Robeson, Cumberland, and Hoke counties in North Carolina. The Bank extends both commercial and consumer loans throughout its market area and offers a full range of deposit accounts for its customer base. The Bank is a North Carolina state-chartered bank subject to regulation by the North Carolina Commissioner of Banks and the Federal Deposit Insurance Corporation.

The accounting and reporting policies of the Bank follow generally accepted accounting principles ("GAAP") and general practices of the financial services industry, within the Financial Accounting Standards Board's ("FASB") Accounting Standards Codification ("ASC") structure of authoritative literature. The following is a summary of the more significant policies.

Critical Accounting Policy

Management believes the policy with respect to the methodology for the determination of the allowance for loan losses involves a high degree of complexity. Management must make difficult and subjective judgments which often require assumptions or estimates about highly uncertain matters. Changes in these judgments, assumptions or estimates could cause reported results to differ materially. This critical policy and its application are periodically reviewed with the Audit Committee and Board of Directors.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, the valuation of foreclosed assets such as real estate acquired in connection with foreclosures or in satisfaction of loans, fair value of financial instruments, deferred taxes, and employee benefit plans.

Cash and Cash Equivalents

Cash and cash equivalents include cash and noninterest-bearing deposits, interest-bearing deposits, and funds sold. All amounts are readily convertible to cash and have maturities of less than 90 days.

Investment Securities

Investment securities are accounted for according to their purpose and holding period. Trading securities are those that are bought and held principally for the purpose of selling them in the near term. The Bank held no trading securities as of December 31, 2018 and 2017. Available for sale investment securities are those that may be sold before maturity due to changes in the Bank's interest rate risk profile or funding needs, and are reported at fair value with unrealized gains and losses, net of taxes, reported as a component of other comprehensive income. Held to maturity investment securities are those that management has the positive intent and ability to hold to maturity and are reported at amortized cost.

Realized gains and losses are recorded in noninterest income and expense are determined on a trade date basis using the specific identification method. Interest and dividends on investment securities are recognized in interest income on an accrual basis. Premiums and discounts are amortized or accreted into interest income using the interest method over the expected lives of the individual securities.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Investment securities, continued

The Bank conducts an other-than-temporary-impairment ("OTTI") analysis of investment securities on a quarterly basis or more often if a potential loss-triggering event occurs. A write-down of a debt security is recorded when fair value is below amortized cost in circumstances where: (1) the Bank has the intent to sell a security; (2) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis; or (3) the Bank does not expect to recover the entire amortized cost basis of the security. If the Bank intends to sell a security or if it is more likely than not that the Bank will be required to sell the security before recovery, an OTTI write-down is recognized in earnings equal to the entire difference between the security's amortized cost basis and its fair value. If the Bank does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income. To determine the amount related to credit loss on a debt security, the Bank applies a methodology similar to that used for evaluating the impairment of loans. As of December 31, 2018, management determined that the Bank did not own any investment securities that were other-than-temporarily-impaired.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future, or until maturity or pay-off, are reported at their outstanding principal amount adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Loan origination fees and costs are capitalized and recognized as an adjustment to the yield on the related loan.

The Bank grants commercial, mortgage and consumer loans to customers. A substantial portion of the loan portfolio is represented by mortgage loans throughout the North Carolina counties of Robeson, Cumberland and Hoke. The ability of the Bank's debtors to honor their contracts is dependent upon the general economic conditions in the area.

Interest is accrued on a loan and credited to income based on the principal amount outstanding. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Credit card loans and other personal loans are typically charged off no later than 90 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

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

A loan is considered impaired when, based on current information and events, it is probable that the Bank will not be able to collect all amounts due from the borrower in accordance with the contractual terms of the loan, including scheduled interest payments. Impaired loans exclude smaller balance homogeneous loans that are collectively evaluated for impairment.

When a loan has been identified as being impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the estimated fair value of the collateral, less any selling costs, if the loan is collateral-dependent. If the measurement of the impaired loan is less than the recorded investment in the loan (including accrued interest, net of deferred loan fees or costs, and unamortized premiums or discounts), an impairment is recognized by establishing or adjusting an existing allocation of the allowance, or by recording a partial charge-off of the loan to its fair value. Interest payments made on impaired loans are typically applied to principal unless collectability of the principal amount is reasonably assured, in which case interest income may be accrued or recognized on a cash basis.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Loans Modified in a Troubled Debt Restructuring

Loans are considered to have been modified in a troubled debt restructuring ("TDR") when, due to a borrower's financial difficulties; the Bank makes certain concessions to the borrower that it would not otherwise consider. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of collateral. Generally, a nonaccrual loan that has been modified in a troubled debt restructuring remains on nonaccrual status for a period of 6 months to demonstrate that the borrower is able to meet the terms of the modified loan. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on nonaccrual status.

Allowance for Loan Losses

An allowance for loan losses is maintained at a level deemed appropriate by management to adequately provide for known and inherent losses in the loan portfolio. The Bank's judgment as to the adequacy of the allowance for loan losses is based on a number of assumptions about future events, which the Bank believes to be reasonable, but which may or may not prove to be accurate.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loans identified as losses and deemed uncollectible by management are charged to the allowance. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions and environmental factors. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as additional information becomes available.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired, for which an allowance is established when the discounted cash flows, collateral value, or observable market price of the loan is lower than its carrying value. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. Historical losses are categorized into loan pools with similar risk and a loss ratio factor is applied to each group's loan balances to determine the allocation. The loss ratio factor is based on average loss history for the most recent twelve quarters and two prior years to ensure the most relevant data is being used in the model.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Qualitative environmental factors include external risk factors that management believes affect the overall lending environment of the Bank. Environmental factors that management of the Bank routinely analyze include levels and trends in delinquencies and impaired loans, levels and trends in charge-offs and recoveries, trends in volume and terms of loans, effects of changes in risk selection and underwriting practices, experience, ability, and depth of lending management and staff, national and local economic trends and conditions such as unemployment rates, and housing statistics, banking industry conditions, local economic forecasts, and the effect of changes in credit concentrations.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Bank Premises and Equipment

Land is carried at cost. Buildings and furniture and equipment are carried at cost, less accumulated depreciation and amortization computed principally by the straight-line method over the following estimated useful lives or lease terms:

	Years
Buildings and improvements	7-40
Furniture and equipment	3-10

Foreclosed Real Estate

Properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less anticipated costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses during the holding period and gains and losses on sales are included in foreclosed real estate expense.

Securities Sold Under Agreements to Repurchase

The Bank enters into sales of securities under agreements to repurchase. Fixed-coupon repurchase agreements are treated as financing, with the obligation to repurchase securities sold being reflected as a liability and the securities underlying the agreements remaining as assets.

Postretirement Benefit Plan

A qualified defined pension plan (the "Plan") is provided to all employees who meet the eligibility requirements of 21 years of age and one year of service in which they have worked a minimum of 1,000 hours. To maintain the Plan's funding adequacy, the Bank contributes an appropriate amount which is deductible for federal income tax purposes. Benefits under the plan are accrued by periodic charges to income as determined by the Plan's actuary.

To the extent accumulated plan assets, including current period cash contributions, are less than projected benefit obligations, the Bank accrues such obligations through either a charge to income or other comprehensive income.

The Bank recognizes in its balance sheet an asset for a plan's overfunded status or a liability for a plan's underfunded status. The Bank also measures the Plans' assets and obligations that determine its funded status as of the end of the fiscal year and recognizes those changes in other comprehensive income, net of tax.

Stock Based Compensation

The Bank may grant stock based compensation to employees and non-employee directors in the form of stock options and stock awards. The Stock Option Plan is administered by our Personnel Committee, which is authorized to make all determinations regarding the persons to whom, and numbers of shares for which, options and awards will be granted, to specify certain of the terms of options and awards, and to interpret and establish rules, make all determinations, and take all other actions necessary or advisable in the administration of the Stock Option Plan. The Bank recognizes compensation expense related to stock option grants on a straight-line basis over the vesting period. The fair value of stock options is estimated at the date of grant using a Black-Scholes option pricing model and related assumptions.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Employee Stock Ownership Plan

The Bank established an Employee Stock Ownership Plan ("ESOP") for the exclusive benefit of all eligible employees and their beneficiaries subject to authority to amend, from time to time, or terminate, the ESOP. The ESOP is primarily designed to invest in common stock of the Bank and is permitted to purchase Bank common stock with contributions to the ESOP made by the Bank. Also, the ESOP is permitted to borrow money and use the loan proceeds to purchase Bank common stock. The money and Bank common stock in the ESOP are intended to grow tax free until retirement, death, disability or other termination of employment with the Bank.

Advertising and Public Relations Expense

The Bank expenses advertising and public relations costs as they are incurred. Advertising costs were $159,268 and $127,253 for the years ended December 31, 2018 and 2017, respectively.

Income Taxes

Provision for income taxes is based on amounts reported in the statements of income (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes.

Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

The Bank had adopted ASU 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" which is considered a change in accounting principle. Because the required adjustment of deferred taxes is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (commonly referred to as "stranded" tax effects) would not reflect the appropriate tax rate. Adoption of this ASU eliminates the "stranded" tax effects associated with the change in the federal corporate income tax rate in the Tax Cuts and Jobs Act of 2017. The Bank has reclassified "stranded" tax effects totaling $278 thousand from accumulated other comprehensive income (loss) to retained earnings and these reclassified amounts are reflected in the accompanying balance sheets, statements of income, statements of comprehensive income, statements of changes in shareholders' equity, and statements of cash flows.

Income per Share

Basic income per share is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding for the period, assuming conversion of all potentially dilutive common stock equivalents.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Accumulated Other Comprehensive Income

Accumulated other comprehensive income reflects the change in the Bank's equity during the period from transactions and events other than investments by and distributions to shareholders. It consists of certain changes in assets and liabilities that are reported as separate components of shareholders' equity rather than as income or expense. The following table shows the changes in accumulated other comprehensive income by component.

	Unrealized Losses on Available for Sale Securities	Defined Benefit Pension Items	Total
Balance, December 31, 2016	$ (576,527)	$ (1,116,491)	$ (1,693,018)
Net unrealized losses on investment securities, net of tax			
Other comprehensive income before reclassifications	(40,285)	-	(40,285)
Defined benefit pension items, net of tax			
Net gain	-	87,720	87,720
New prior service cost	-	324,288	324,288
Amortization of transition	-	1,669	1,669
Amortization of prior service cost	-	(23,140)	(23,410)
Amortization of net actuarial losses	-	52,963	52,963
Adjustment related to tax rate change	(131,431)	(146,744)	(278,175)
Balance, December 31, 2017	$ (748,243)	$ (819,735)	$ (1,567,978)
Net unrealized losses on investment securities, net of tax			
Other comprehensive income before reclassifications	(217,398)	-	(217,398)
Defined benefit pension items, net of tax			
Net gain	-	(594,895)	(594,895)
New prior service cost	-	-	-
Amortization of transition	-	1,997	1,997
Amortization of prior service cost	-	(51,059)	(51,059)
Amortization of net actuarial losses	-	70,057	70,057
Balance, December 31, 2018	$ (965,641)	$ (1,393,635)	$ (2,359,276)

Note 1. Organization and Summary of Significant Accounting Policies, continued

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank enters into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

Concentrations of Credit Risk

Financial instruments, which potentially subject the Bank to concentrations of credit risk, consist principally of loans, investment securities, and amounts due from banks.

The Bank makes loans to individuals and small businesses for personal and commercial purposes primarily in Robeson, Cumberland, and Hoke counties in North Carolina and surrounding areas. The Bank's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.) and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. Additionally, there are industry practices that could subject the Bank to increased credit risk should economic conditions change over the course of a loan's life. For example, the Bank makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Bank to unusual credit risk.

The Bank's investment portfolio consists principally of obligations of the United States, its agencies or its corporations as well as state and municipal securities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Bank places its deposits and correspondent accounts with high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

Risks and Uncertainties

In the normal course of its business, the Bank encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk and market risk. The Bank is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Bank's loan portfolio that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Bank.

The Bank is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Bank also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Revenue Recognition

On January 1, 2018, the Bank adopted ASU No. 2014-09 *"Revenue from Contracts with Customers" (Topic 606)* and all subsequent ASUs that modified Topic 606. As stated in Note 1 *Summary of Significant Accounting Policies*, the implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment opening retained earnings was not deemed necessary. Results for reporting periods beginning January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with the Bank's historic accounting under Topic 606.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities, which comprise the majority of the Bank's revenue. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in the scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees, and sale transactions related to foreclosed real estate. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all the Bank's revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts

Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Bank 's performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Bank's performance obligation is satisfied and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers' accounts.

Other Operating Income

Other operating income primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Bank's debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Bank cardholder uses a non-Bank ATM or a non-Bank cardholder uses a Bank ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees Other service charges include revenue from processing wire transfers, bill pay service, cashier's checks, and other services. The Bank's performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

	Year Ended December 31,			
	2018		2017	
Noninterest Income				
In-scope of Topic 606:				
Service charges on deposit accounts	$	1,408,070	$	1,456,146
Other operating income		268,058		314,282
Noninterest income (in-scope of Topic 606)		1,676,128		1,770,428
Noninterest income (out-of-scope of Topic 606)		518,088		387,978
Total Noninterest Income	**$**	**2,194,216**	**$**	**2,158,406**

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recently Issued Accounting Pronouncements

The following is a summary of recent authoritative pronouncements.

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Bank expects to adopt the guidance using the modified retrospective method and practical expedients for transition. The practical expedients allow the Bank to largely account for existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. The Bank has started an initial evaluation of its leasing contracts and activities. The Bank has also started developing its methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments. The Bank expects that the adoption of ASU 2016-02 will result in the recognition of lease liabilities totaling $97,128 and the recognition of right-of-use assets totaling $98,810, with a corresponding increase to retained earnings of approximately $1,682. The Company does not expect a material change to the timing of expense recognition. The Company is evaluating existing disclosures and may need to provide additional information as a result of adoption of the ASU.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Bank for reporting periods beginning after December 15, 2020. The Bank is currently evaluating the effect that implementation of the new standard will have on its financial statements.

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Bank for reporting periods beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Bank does not expect these amendments to have a material effect on its financial statements.

In March 2017, the FASB amended the requirements in the Receivables—Nonrefundable Fees and Other Costs Topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Bank for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. The Bank does not expect these amendments to have a material effect on its financial statements.

In March 2018, the FASB updated the Debt Securities and the Regulated Operations Topics of the Accounting Standards Codification. The amendments incorporate into the Accounting Standards Codification recent SEC guidance which was issued in order to make the relevant interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The amendments were effective upon issuance and did not have a material effect on the financial statements.

In March 2018, the FASB updated the Income Taxes Topic of the Accounting Standards Codification. The amendments incorporate into the Accounting Standards Codification recent SEC guidance related to the income tax accounting implications of the Tax Cuts and Jobs Act. The amendments were effective upon issuance and did not have a material effect on the financial statements.

In May 2018, the FASB amended the Financial Services—Depository and Lending Topic of the Accounting Standards Codification to remove outdated guidance related to Circular 202. The amendments were effective upon issuance and did not have a material effect on the financial statements.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recently Issued Accounting Pronouncements, continued

In June 2018, the FASB amended the Compensation—Stock Compensation Topic of the Accounting Standards Codification. The amendments expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606. The Company does not expect these amendments to have a material effect on its financial statements.

In July 2018, the FASB amended the Leases Topic of the Accounting Standards Codification to make narrow amendments to clarify how to apply certain aspects of the new lease standard. The amendments are effective for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In July 2018, the FASB amended the Leases Topic of the Accounting Standards Codification to give entities another option for transition and to provide lessors with a practical expedient. The amendments will be effective for the Company for reporting periods beginning after December 15, 2018. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Fair Value Measurement Topic of the Accounting Standards Codification. The amendments remove, modify, and add certain fair value disclosure requirements based on the concepts in the FASB Concepts Statement, Conceptual Framework for Financial Reporting—Chapter 8: Notes to Financial Statements. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of this ASU and delay adoption of the additional disclosures until their effective date. The Company does not expect these amendments to have a material effect on its financial statements.

In August 2018, the FASB amended the Intangibles—Goodwill and Other Topic of the Accounting Standards Codification to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In October 2018, the FASB amended the Derivatives and Hedging Topic of the Accounting Standards Codification to expand the list of U.S. benchmark interest rates permitted in the application of hedge accounting. The amendments will be effective for the Company for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In October 2018, the FASB amended the Consolidation topic of the Accounting Standards Codification for determining whether a decision-making fee is a variable interest. The amendments require organizations to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company will apply a full retrospective approach in which financial statements for each individual prior period presented and the opening balances of the earliest period presented are adjusted to reflect the period-specific effects of applying the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

In November 2018, the FASB amended the Collaborative Arrangements Topic of the Accounting Standards Codification to clarify the interaction between the guidance for certain collaborative arrangements and the new revenue recognition financial accounting and reporting standard. The amendments will be effective for the Company for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Note 1. Organization and Summary of Significant Accounting Policies, continued

Recently Issued Accounting Pronouncements, continued

In November 2018, the FASB issued guidance to amend the Financial Instruments—Credit Losses topic of the Accounting Standards Codification. The guidance aligns the implementation date of the topic for annual financial statements of nonpublic companies with the implementation date for their interim financial statements. The guidance also clarifies that receivables arising from operating leases are not within the scope of the topic, but rather, should be accounted for in accordance with the lease topic. The amendments will be effective for the Company for reporting periods beginning after December 15, 2019. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently in the process of evaluating the impact of adoption of this guidance on the financial statements.

In December 2018, the FASB issued guidance that providing narrow-scope improvements for lessors, that provides relief in the accounting for sales, use and similar taxes, the accounting for other costs paid by a lessee that may benefit a lessor, and variable payments when contracts have lease and non-lease components. The amendments will be effective for the Company for reporting periods beginning after December 15, 2018. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Bank's financial position, results of operations or cash flows.

Note 2. Restrictions on Cash and Due from Banks

To comply with banking regulations, the Bank is required to maintain certain average cash reserve balances with the Federal Reserve Bank. The daily average cash reserve requirement was approximately $2,700,000 and $4,200,000 at December 31, 2018 and 2017, respectively.

Note 3. Investment Securities

Debt and equity securities have been classified in the balance sheets according to management's intent. The amortized cost of securities and their approximate fair values at December 31 follow:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2018				
Available for Sale:				
Government sponsored enterprises	$ 13,745,603	$ -	$ (280,496)	$ 13,465,107
FNMA, GNMA, and FHLMC mortgage-backed securities	44,131,698	156,167	(1,135,805)	43,152,060
	$ 57,877,301	$ 156,167	$ (1,416,301)	$ 56,617,167
Held to Maturity:				
State and municipal securities	$ 47,981,960	$ 365,359	$ (557,088)	$ 47,790,231
2017				
Available for Sale:				
Government sponsored enterprises	$ 16,012,075	$ 33,669	$ (228,701)	$ 15,817,043
FNMA, GNMA, and FHLMC mortgage-backed securities	39,863,130	571	(776,968)	39,086,733
	$ 55,875,205	$ 34,240	$ (1,005,669)	$ 54,903,776
Held to Maturity:				
State and municipal securities	$ 51,893,845	$ 832,217	$ (229,080)	$ 52,496,982

Note 3. Investment Securities, continued

At December 31, 2018, the Bank had three held to maturity securities that were taxable with an amortized cost of $1,971,781 and three held to maturity securities that were taxable with an amortized cost of $1,994,842, at December 31, 2017.

The scheduled maturities of securities available for sale and securities held to maturity at December 31, 2018, are shown below. Actual expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

	Due in one year or less	Due in one year through five years	Due in five years through ten years	Due after ten years
Available for Sale:				
Government sponsored enterprises	$ -	$ 2,133,901	$ 11,331,206	$ -
FNMA, GNMA, and FHLMC mortgage-backed securities	6,999,572	21,423,886	12,101,781	2,626,821
	$ 6,999,572	$ 23,557,787	$ 23,432,987	$ 2,626,821
Held to Maturity:				
State and municipal securities	$ 8,961,076	$ 21,067,809	$ 12,511,424	$ 5,441,651

Investment securities with an amortized cost of approximately $58,972,606 and $65,249,550 were pledged at December 31, 2018 and 2017, respectively, to secure certain deposits and for other purposes required by law.

The bank had no gross realized gains and losses recognized for the years ended December 31, 2018 and 2017.

The following tables detail unrealized losses and related fair values in the Bank's investment securities portfolio. This information is aggregated by the length of time that individual securities have been in a continuous unrealized loss position as of December 31.

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2018						
Government sponsored enterprises	$ 1,661,294	$ (3,793)	$11,803,813	$ (276,703)	$13,465,107	$ (280,496)
FNMA, GNMA, and FHLMC mortgage-backed securities	-	-	32,104,267	(1,135,805)	32,104,267	(1,135,805)
State and municipal securities	4,449,476	(60,739)	20,055,618	(496,349)	24,505,094	(557,088)
Total temporarily impaired securities	$ 6,110,770	$ (64,532)	$63,963,698	$(1,908,857)	$70,074,468	$ (1,973,389)

	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2017						
Government sponsored enterprises	$4,891,931	$ (34,121)	$ 8,357,390	$ (194,580)	$13,249,321	$ (228,701)
FNMA, GNMA, and FHLMC mortgage-backed securities	17,274,915	(188,225)	21,321,317	(588,743)	38,596,232	(776,968)
State and municipal securities	6,605,966	(42,730)	13,223,398	(186,350)	19,829,364	(229,080)
Total temporarily impaired securities	$28,772,812	$ (265,076)	$42,902,105	$ (969,673)	$71,674,917	$ (1,234,749)

Management evaluates securities for other-than–temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects if the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Note 3. Investment Securities, continued

The Bank does not believe that gross unrealized losses as of December 31, 2018, which was comprised of 150 securities, represent an other-than temporary impairment. At December 31, 2018, the Bank had 24 government sponsored enterprise securities, 67 FNMA, GNMA, and FHLMC mortgage-backed securities and 45 state and municipal securities that had been in an unrealized loss position for more than twelve months. Management believes these losses are temporary and are a result of the current interest rate environment. The Bank does not intend to sell these securities and it is more likely than not that the Bank will not be required to sell these securities before recovery of their amortized cost.

Note 4. Loans Receivable

The major segmented components of loans at December 31, 2018 and 2017 are as follows:

	2018	2017
Commercial	$ 8,141,923	$ 7,943,802
Commercial Real Estate	83,071,228	84,160,230
Consumer	7,890,654	6,990,880
Residential Real Estate	79,593,165	74,421,625
Agricultural and Raw Land	4,584,063	3,977,712
Total Principal Balance	183,281,033	177,494,249
Overdrafts	129,497	58,373
Loans in Process	(7,981)	(70,353)
Gross Loans	183,402,549	177,482,269
Unearned Fees	(393,322)	(382,477)
Allowance for Loan Losses	(2,171,757)	(2,171,342)
Net Loans	$ 180,837,470	$ 174,928,450

The Bank had no subprime residential loans at December 31, 2018 and 2017.

Note 5. Allowance for Loan Losses

The following table presents activity in the allowance for loan losses for the years-ended December 31, 2018 and 2017 on a portfolio segment basis. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Allowance for loan losses	Commercial	Commercial Real Estate	Consumer	Residential Real Estate	Agricultural Raw Land	QE Factors	Total
Balance-December 31, 2017	$ 15,089	$ 869,417	$ 148,207	$ 886,005	$ 92,598	$ 160,026	$ 2,171,342
Charge-Offs	-	(125,452)	(8,258)	(53,655)	-	-	(187,365)
Recoveries	37,550	3,114	2,655	37,208	-	-	80,527
Provisions	(19,374)	300,166	(72,432)	(4,615)	(49,125)	12,244	166,864
Transfers	-	-	-	-	-	(59,611)	(59,611)
Balance – December 31, 2018	$ 33,265	$ 1,047,245	$ 70,172	$ 864,943	$ 43,473	$ 112,659	$ 2,171,757
Balance-December 31, 2016	$ 18,469	$ 1,284,678	$ 113,104	$ 697,951	$ 39,741	$ 335,729	$ 2,489,672
Charge-Offs	-	(177,202)	(24,558)	(113,987)	-	-	(315,747)
Recoveries	5,960	-	5,917	19,485	-	-	31,362
Provisions	(9,340)	(238,059)	53,744	282,556	52,857	(23,428)	118,330
Transfers	-	-	-	-	-	(152,275)	(152,275)
Balance – December 31, 2017	$ 15,089	$ 869,417	$ 148,207	$ 886,005	$ 92,598	$ 160,026	$ 2,171,342
December 31, 2018							
Allowance for Loan Losses ending balance:							
Individually evaluated for impairment	$ -	$ 359,573	$ -	$ 246,347	$ -	$ -	$ 605,920
Collectively evaluated for impairment	$ 33,265	$ 687,672	$ 70,172	$ 618,596	$ 43,473	$ 112,659	$ 1,565,837
Loans Receivable:							
Ending Balance – Total	$ 8,141,923	$ 83,071,228	$ 7,890,654	$ 79,593,165	$ 4,584,063	$ -	$ 183,281,033
Ending balances:							
Individually evaluated for impairment	$ 44,386	$ 5,254,703	$ 3,342	$ 3,122,450	$ 45,791	$ -	$ 8,470,672
Collectively evaluated for impairment	$ 8,097,537	$ 77,816,525	$ 7,887,312	$ 76,470,715	$ 4,538,272	$ -	$ 174,810,361
December 31, 2017							
Allowance for Loan Losses ending balance:							
Individually evaluated for impairment	$ -	$ 435,634	$ 304	$ 321,188	$ 3,713	$ -	$ 760,839
Collectively evaluated for impairment	$ 15,089	$ 433,783	$ 147,903	$ 564,817	$ 88,885	$ 160,026	$ 1,410,503
Loans Receivable:							
Ending Balance – Total	$ 7,943,802	$ 84,160,230	$ 6,990,880	$ 74,421,625	$ 3,977,712	$ -	$ 177,494,249
Ending balances:							
Individually evaluated for impairment	$ 56,515	$ 4,978,806	$ 8,274	$ 3,235,257	$ 46,545	$ -	$ 8,325,397
Collectively evaluated for impairment	$ 7,887,287	$ 79,181,424	$ 6,982,606	$ 71,186,368	$ 3,931,167	$ -	$ 169,168,852

QE factors include external risk factors that management believes affect our overall lending environment. Environmental factors that management routinely analyzes include: levels and trends in delinquencies and impaired loans; levels and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of changes in risk selection and underwriting practices; experience, ability, and depth of lending management and staff; national and local economic trends and conditions such as unemployment rates, housing statistics and banking industry conditions; local economic forecasts; and the effect of changes in credit concentrations.

Note 5. Allowance for Loan Losses, continued

Past Due Loans

A loan is considered past due if the required principal and interest payment has not been received as of the due date. The following schedule is an aging of past due loans receivable by portfolio segment as of December 31, 2018 and 2017. *(in thousands)*

December 31, 2018

	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due	Current	Total Loans Receivable	90 Days+ Still Accruing
Commercial	$ -	$ -	$ 8	$ 8	$ 8,134	$ 8,142	$ -
Commercial Real Estate	406	24	314	744	82,327	83,071	-
Consumer	2	3	28	33	7,858	7,891	-
Residential Real Estate	70	170	759	999	78,594	79,593	-
Agricultural and Raw Land	-	-	-	-	4,584	4,584	-
	$ 478	$ 197	$ 1,109	$ 1,784	$ 181,497	$ 183,281	$ -

December 31, 2017

	30-59 Days Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due	Current	Total Loans Receivable	90 Days+ Still Accruing
Commercial	$ 7	$ -	$ 7	$ 14	$ 7,930	$ 7,944	$ -
Commercial Real Estate	18	372	807	1,197	82,963	84,160	-
Consumer	90	11	48	149	6,842	6,991	-
Residential Real Estate	241	372	1,493	2,106	72,315	74,421	-
Agricultural and Raw Land	1	-	-	1	3,977	3,978	-
	$ 357	$ 755	$ 2,355	$ 3,467	$ 174,027	$ 177,494	$ -

Non-accrual Loans

Loans are generally placed in non-accrual status when the collection of interest is 90 days or more past due, when the full collection of all principal and interest is unlikely, (even if the amount and timing of the eventual loss are unknown), when a loan is designated as Troubled Debt Restructuring, or when the Borrower has filed for bankruptcy. Loans that are less delinquent may also be placed on non-accrual if so directed by the Executive Vice Chairman, Chief Executive Officer, or President.

Loans that meet these criteria guidelines may be kept on accrual if approved by the Chief Credit Officer and one of the following apply: 1) The loan is well secured and in the process of collection. 2) The loan is past due because of a recent maturity without a timely renewal, but the loan has been approved for renewal and is in the process of being renewed and returned to a paying status. A debt is "well secured" if collateralized by liens on or pledges of real or personal property, including securities, that have a realizable value sufficient to discharge the debt in full; or by the guarantee of a financially responsible party. A debt is "in process of collection" if collection is proceeding in due course either through legal action, including judgment enforcement procedures, or, in appropriate circumstances, through collection efforts not involving legal actions which are reasonably expected to result in repayment of the debt or its restoration to a current status. When interest accrual is discontinued, all unpaid accrued interest is reversed.

A non-accrual loan may be returned to accrual status when the Bank can reasonably expect continued timely payments until payment in full. All prior arrearage does not necessarily have to be eliminated, nor do all previously charged off amounts need to have been recovered. The loan can be returned to accrual status if: 1) Approved by the Chief Credit Officer, and 2) the return to sustained, acceptable, payment performance, without subsequent relapse to seriously delinquent or otherwise non-performing, is likely. The two general rules that apply here are: a) All principal and interest amounts contractually due (including arrearage) are reasonably assured of repayment within a reasonable period, and b) There is a sustained period of repayment performance (generally a minimum of six months) by the borrower, in accordance with the contractual terms involving payments of cash or cash equivalents.

Note 5. Allowance for Loan Losses, continued

Nonaccrual loans as of December 31, 2018 and 2017 are as follows:

	December 31, 2018	December 31, 2017
Commercial	$ 7,740	$ 7,000
Commercial Real Estate	3,513,191	2,878,699
Consumer	34,887	64,223
Residential Real Estate	1,486,953	2,045,330
Agricultural and Raw Land	-	-
	$ 5,042,771	$ 4,995,252

Impaired Loans

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

All nonaccrual loans are considered to be impaired however only those meeting certain thresholds are individually evaluated for impairment.

The following tables present impaired loans by class of loan as of December 31, 2018 and 2017:

	Recorded[1] Investment	Unpaid[2] Principal Balance	Related Allowance	Average Recorded Investment	Income Recognized
December 31, 2018					
With no related allowance recorded:					
Commercial	$ 44,386	$ 44,386	$ -	$ 48,116	$ 2,643
Commercial Real Estate	2,620,257	2,620,257	-	2,160,327	86,403
Consumer	3,342	3,342	-	7,444	622
Residential Real Estate	1,411,839	1,411,839	-	1,313,192	65,714
Agricultural and Raw Land	45,791	45,791	-	3,816	3,311
	4,125,615	4,125,615	-	3,532,895	158,693
With an allowance recorded:					
Commercial	-	-	-	-	-
Commercial Real Estate	2,634,446	2,634,446	359,573	2,994,984	116,589
Consumer	-	-	-	8,374	-
Residential Real Estate	1,710,611	1,711,003	246,347	2,241,782	92,277
Agricultural and Raw Land	-	-	-	42,148	-
	4,345,057	4,345,449	605,920	5,287,288	208,866
Combined:					
Commercial	44,386	44,386	-	48,116	2,643
Commercial Real Estate	5,254,703	5,254,703	359,573	5,155,311	202,992
Consumer	3,342	3,342	-	15,818	622
Residential Real Estate	3,122,450	3,122,842	246,347	3,554,974	157,991
Agricultural and Raw Land	45,791	45,791	-	45,964	3,311
	$ 8,470,672	$ 8,471,064	$ 605,920	$ 8,820,183	$ 367,559

Note 5. Allowance for Loan Losses, continued

	Recorded[1] Investment	Unpaid[2] Principal Balance	Related Allowance	Average Recorded Investment	Income Recognized
December 31, 2017					
With no related allowance recorded:					
Commercial	$ 56,515	$ 56,515	$ -	$ 77,156	$ 4,778
Commercial Real Estate	1,841,135	2,070,181	-	2,495,035	47,720
Consumer	4,683	4,683	-	9,159	277
Residential Real Estate	632,680	694,304	-	1,474,313	17,392
Agricultural and Raw Land	-	-	-	35,434	-
	2,535,013	2,825,683	-	4,091,097	70,167
With an allowance recorded:					
Commercial	-	-	-	46,266	-
Commercial Real Estate	3,137,671	3,137,671	435,634	2,737,740	141,981
Consumer	3,591	3,591	304	4,693	357
Residential Real Estate	2,602,577	2,602,577	321,188	2,643,746	129,073
Agricultural and Raw Land	46,545	46,545	3,713	11,636	3,783
	5,790,384	5,790,384	760,839	5,444,081	275,194
Combined:					
Commercial	56,515	56,515	-	123,422	4,778
Commercial Real Estate	4,978,806	5,207,852	435,634	5,232,775	189,701
Consumer	8,274	8,274	304	13,852	634
Residential Real Estate	3,235,257	3,296,881	321,188	4,118,059	146,465
Agricultural and Raw Land	46,545	46,545	3,713	47,070	3,783
	$ 8,325,397	$ 8,616,067	$ 760,839	$ 9,535,178	$ 345,361

[1] The amount of investment in a loan, which is not net of a valuation allowance, but which does reflect any direct write-down of the investment.
[2] The contractual amount due, which reflects paydowns applied in accordance with loan documents, but which does not reflect direct write-downs.

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a TDR. Management strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. All loan modifications are made on a case-by-case basis.

During the years ended December 31, 2018 and 2017, the Bank did not modify any loans that were considered to be Troubled Debt Restructurings. No loans that were modified as Troubled Debt Restructurings in 2016 went into default during 2017.

Note 5. Allowance for Loan Losses, continued

Credit Quality

The Bank uses several metrics as credit quality indicators of current or potential risks as part of the ongoing monitoring of the credit quality of its portfolio. The credit quality indicators are periodically reviewed and updated on a case-by-case basis. The Bank uses the following definitions for the internal risk rating grades, listed from the least risk to the highest risk.

Pass

Loans that are not adversely rated, are contractually current as to principal and interest, and are otherwise in compliance with the contractual terms of the loan agreement. Management believes that there is a low likelihood of loss related to those loans that are considered pass.

Weak Pass

This grade is given to acceptable loans that show signs of weakness in either adequate sources of repayment or collateral, but have demonstrated mitigating factors that minimize the risk of delinquency or loss. Loans assigned Weak Pass may demonstrate some or all of the following characteristics: a) Additional exceptions to the Bank's policy requirements, product guidelines or underwriting standards that present a higher degree of risk to the Bank. Although the combination and/or severity of identified exceptions is greater, all exceptions have been properly mitigated by other factors; b) Unproved, insufficient or marginal primary sources of repayment that appear sufficient to service the debt at this time. Repayment weaknesses may be due to minor operational issues, financial trends, or reliance on projected (not historic) performance; and c) Marginal or unproven secondary sources to liquidate the debt, including combinations of liquidation of collateral and liquidation value to the net worth of the borrower or guarantor.

For existing loans, payments have generally been made as agreed with only minor and isolated delinquencies.

Special Mention

Watch List or Special Mention loans include the following characteristics: a) Loans with underwriting guideline tolerances and/or exceptions with no identifiable mitigating factors; b) Extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date. Potential weaknesses are the result of deviations from prudent lending practices; and c) Loans where adverse economic conditions that develop subsequent to the loan origination do not jeopardize liquidation of the debt, but do substantially increase the level of risk, may also warrant this rating.

Note 5. Allowance for Loan Losses, continued

Substandard

A Substandard loan is inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as Substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Loans consistently not meeting the repayment schedule should be downgraded to substandard.

Loans in this category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The weaknesses may include, but are not limited to: high debt to worth ratios, declining or negative earnings trends, declining or inadequate liquidity, improper loan structure, questionable repayment sources, lack of well-defined secondary repayment source, and unfavorable competitive comparisons.

Such loans are no longer considered to be adequately protected due to the borrower's declining net worth, lack of earnings capacity, declining collateral margins and/or unperfected collateral positions. A possibility of loss of a portion of the loan balance cannot be ruled out. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.

Doubtful

Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. However, these loans are not yet rated as loss because certain events may occur which would salvage the debt. Among these events are: the injection of capital, alternative financing, or the liquidation of assets or the pledging of additional collateral.

The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on non-accrual status, and no definite repayment schedule exists.

Doubtful is a temporary grade where a loss is expected but is presently not quantified with any degree of accuracy. Once the loss position is determined, the amount is charged off.

Loss

Loans classified Loss are considered uncollectable and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this worthless loan even though partial recovery may be affected in the future.

Probable Loss portions of Doubtful assets should be charged against the Allowance for Loan Losses. Loans may reside in this classification for administrative purposes for a period not to exceed the earlier of thirty (30) days or calendar quarter-end.

Note 5. Allowance for Loan Losses, continued

The following is a schedule of the credit quality of loans receivable, by portfolio segment, as of December 31, 2018 and 2017.

December 31, 2018

	Commercial	Commercial Real Estate	Consumer	Residential Real Estate	Agricultural and Raw Land	Total
Pass or better	$ 6,445,393	$ 32,357,010	$ 6,450,819	$ 28,804,272	$ 2,705,655	$ 76,763,149
Weak Pass	1,569,516	33,889,052	1,374,161	42,886,294	872,676	80,591,699
Special Mention	57,651	8,907,043	5,323	3,935,780	786,084	13,691,881
Substandard or worse	69,363	7,918,123	60,351	3,966,819	219,648	12,234,304
Total	$ 8,141,923	$ 83,071,228	$ 7,890,654	$ 79,593,165	$ 4,584,063	$ 183,281,033

December 31, 2017

	Commercial	Commercial Real Estate	Consumer	Residential Real Estate	Agricultural and Raw Land	Total
Pass or better	$ 6,101,371	$ 30,881,871	$ 5,617,461	$ 28,233,171	$ 2,292,526	$ 73,126,400
Weak Pass	1,647,371	36,245,444	1,245,974	37,401,452	572,775	77,113,016
Special Mention	100,662	9,640,348	37,046	5,263,702	996,163	16,037,921
Substandard or worse	94,398	7,392,567	90,399	3,523,300	116,248	11,216,912
Total	$ 7,943,802	$ 84,160,230	$ 6,990,880	$ 74,421,625	$ 3,977,712	$ 177,494,249

Note 6. Premises and Equipment

A summary of premises and equipment at December 31, 2018 and 2017 follows:

	2018	2017
Land	$ 2,225,595	$ 2,225,595
Buildings	9,595,241	9,553,241
Equipment	3,075,459	2,987,773
	14,896,295	14,766,609
Less accumulated depreciation	(6,329,557)	(5,908,610)
	$ 8,566,738	$ 8,857,999

Depreciation expense for 2018 and 2017 was $426,301 and $480,717 respectively.

Leases

The Bank is obligated on a month to month lease for a storage facility on East 4th Street in Lumberton, North Carolina. The lease is classified as an operating lease with monthly payments of $500 and can be terminated at any time by either party. The Bank also has financial lease obligations for office equipment used at the branch locations.

Minimum lease obligations, excluding operating leases, were as follows:

2019	$ 27,184
2020	27,184
2021	27,184
2022	20,590
Thereafter	739
Total	$ 102,881

Note 7. Intangible Assets

The Bank purchased two retail branches in Pembroke and Raeford, North Carolina on April 6, 2012 and one retail branch in Red Springs, North Carolina on January 22, 2016. The purchase of these three branches resulted in goodwill and core deposit intangible assets for the Bank. Deposits are a liability of a bank; however their existence may create an intangible asset. The buyer receives a "built in" customer base of, usually, stable relationships when a bank is acquired. This customer base has demonstrable economic benefits to the buyer. A core deposit base consists of specific account relationships existing at the time of acquisition. These account holders will eventually pass away, relocate or move their account, and therefore the core deposit base has a limited life.

In order to value the goodwill and core deposit intangible, the Bank acquired the services of a third party. During their review the use of three methods: (i) cost savings approach, (ii) future income approach, and (iii) market approach were used to determine these values.

A summary of intangible assets at December 31, 2018 and 2017 follows:

	2018		2017	
	Gross Carrying Value	Accumulated Amortization	Gross Carrying Value	Accumulated Amortization
Amortized intangible assets:				
Core deposit intangibles	$ 382,793	$ (228,650)	$ 382,793	$ (178,996)
Goodwill	$ 591,147		$ 591,147	

Management reviews goodwill on an annual basis for impairment and adjusts accordingly. As of December 31, 2018, management did not consider goodwill to be impaired.

The core deposit premium is amortized over 10 years using a 150% declining balance. Amortization expense for 2018 and 2017 was $49,654 and $56,381, respectively.

Note 8. Foreclosed Real Estate

Transactions in other real estate owned for the years ended December 31, 2018 and 2017:

	2018	2017
Balance, beginning of year	$ 515,141	$ 715,365
Additions	569,129	366,459
Sales	(638,225)	(508,580)
Write-downs and losses on sales	(60,467)	(58,103)
Balance, end of period	$ 385,578	$ 515,141

Note 9. Deposits

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2018 and 2017 was approximately $7,101,958 and $4,180,560, respectively.

Maturities of time deposits are scheduled as follows:

	Less Than $250,000	$250,000 or More	Total
2019	$ 56,141,021	$ 4,270,060	$ 60,411,081
2020 thru 2021	20,547,382	2,580,068	23,127,450
2022 - 2026	990,969	251,830	1,242,899
	$ 77,679,372	$ 7,101,958	$ 84,781,330

Note 10. Borrowings

Securities Sold under Agreements to Repurchase

Securities sold under repurchase agreements are summarized as follows for the years ended December 31, 2018 and 2017:

	2018	2017
Amount outstanding at year end	$ 1,431,999	$ 1,381,694
Average amount outstanding during year	$ 1,206,861	$ 1,029,670
Maximum amount outstanding at any month-end	$ 1,431,999	$ 1,381,694
Weighted average rate paid at year-end	1.92%	0.13%
Weighted average rate paid during the year	0.73%	0.12%

Federal Home Loan Bank Advances

The following information is provided for balances, rates, and maturities with the FHLB as of December 31:

	2018			2017	
Advance Type	Maturity	Rate	Amount	Rate	Amount
Principal Reducing Rate	12/14/20	5.17%	$ 790,832	5.17%	$ 899,358
Principal Reducing Rate	3/27/24	2.00%	173,822	2.00%	202,027
Fixed Rate Hybrid	07/29/19	2.49%	2,000,000	-	-
			$ 2,964,654		$ 1,101,385

As of December 31, 2018 and 2017, the Bank had investment securities with an amortized cost of $2.5 million pledged to the FHLB.

Unsecured Lines of Credit

The Bank had unsecured lines of credit with correspondent banks available for overnight borrowing totaling approximately $14.5 million at December 31, 2018. The Bank had credit availability of approximately $14.5 million through a secured borrowing facility at December 31, 2017.

Note 11. Regulatory Capital

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

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of: total risk-based capital and Tier 1 capital to risk-weighted assets (as defined in the regulations), and Tier 1 capital to adjusted total assets (as defined). Management believes, as of December 31, 2018, that the Bank met all the capital adequacy requirements to which it was subject.

As of December 31, 2018, the most recent notification from the FDIC, the Bank was categorized as well capitalized under the regulatory framework for prompt corrective action. To remain categorized as well capitalized; the Bank will have to maintain minimum total risk-based, Tier 1 risk-based, Common Equity Tier 1, and Tier 1 leverage ratios as disclosed in the table below. There are no conditions or events since the most recent notification that management believes have changed the Bank's prompt corrective action category.

Note 11. Regulatory Capital, continued

The Basel Committee provides a framework for strengthening international capital and liquidity regulation, now officially identified by the Basel Committee as "Basel III". Basel III will require banks to maintain substantially more capital, with a greater emphasis on common equity. In July 2013, the Federal Reserve Bank, the OCC and the FDIC finalized rules to implement the Basel III capital rules in the United States. These comprehensive rules are designed to help ensure that banks maintain strong capital positions by increasing both the quantity and quality of capital held by U.S. banking organizations. The rules include new risk-based capital and leverage ratios, which became effective on January 1, 2015, and revise the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Bank are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6.0% (increased from 4.0%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4.0% for all institutions. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010 will be grandfathered for banks with assets of $15 billion or less. The rules established a "capital conservation buffer" of 2.5% above the new regulatory minimum capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% or risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital falls below that buffer amount. These limitations will establish a maximum percentage of eligible retained income that may be utilized for such actions.

The Bank's actual and required capital amounts and ratios are as follows (dollars in thousands):

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2018						
Total Capital						
(to Risk-Weighted Assets)	$ 41,745	19.17%	$ 17,421	8.00%	$ 21,777	10.00%
Common Equity Tier 1 Capital						
(to Risk-Weighted Assets)	$ 39,573	18.17%	$ 9,799	4.50%	$ 14,155	6.50%
Tier I Capital						
(to Risk-Weighted Assets)	$ 39,573	18.17%	$ 13,066	6.00%	$ 17,421	8.00%
Tier I Capital						
(to Average Assets)	$ 39,573	11.65%	$ 13,585	4.00%	$ 16,982	5.00%
December 31, 2017						
Total Capital						
(to Risk-Weighted Assets)	$ 39,306	18.94%	$ 16,599	8.00%	$ 20,748	10.00%
Common Equity Tier 1 Capital						
(to Risk-Weighted Assets)	$ 37,135	17.90%	$ 9,337	4.50%	$ 13,486	6.50%
Tier I Capital						
(to Risk-Weighted Assets)	$ 37,135	17.90%	$ 12,449	6.00%	$ 16,544	8.00%
Tier I Capital						
(to Average Assets)	$ 37,135	11.31%	$ 13,162	4.00%	$ 16,453	5.00%

Note 12. Income per Share

The following table details the computation of basic and diluted income per share for each year ended December 31:

	2018	2017
Net income	$ 3,103,352	$ 1,856,275
Weighted average basic shares outstanding	3,417,565	3,417,565
Weighted average diluted shares outstanding	3,417,565	3,417,565
Basic net income per common share	$ 0.91	$ 0.54
Diluted net income per common share	$ 0.91	$ 0.54

Note 13. Income Taxes

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (the "2017 Tax Act"). The 2017 Tax Act includes a number of changes to existing U.S. tax laws that impact the company, most notably a reduction of the U.S. corporate income tax rate from 34 percent to 21 percent for tax years beginning after December 31, 2017.

The provision for income taxes for 2018 and 2017 consists of the following:

	2018	2017
Income tax expense		
Current tax expense		
Federal	$ (5,533)	$ 221,851
State	106,527	53,778
Total	100,994	275,629
Deferred tax benefit		
Federal	429,177	594,619
State	(14,188)	11,824
Total	414,989	606,443
	$ 515,983	$ 882,072

The provision for federal income taxes differs from that computed by applying federal statutory rates to income before federal income tax expense, as indicated in the following analysis:

	2018	2017
Federal statutory income tax at 21% for 2018 and 34% for 2017	$ 760,060	$ 931,038
Tax exempt interest	(262,711)	(504,442)
Non-taxable life insurance income	(52,150)	(85,342)
Effect of state income taxes	72,948	43,298
Effect of Tax reform (TCJA)	-	505,018
Other	(2,164)	(7,497)
	$ 515,983	$ 882,073

Note 13. Income Taxes, continued

A cumulative net deferred tax asset is included in other assets. The components of the asset are as follows:

	2018	2017
Deferred tax assets:		
Allowance for loan losses	$ 422,310	$ 399,741
Net unrealized losses on available for sale securities	294,493	223,186
Pension obligations	425,020	244,511
Stock compensation	35,814	35,814
Alternative minimum tax ("AMT") carryforward	54,773	631,980
Interest income on nonaccrual loans	7,829	13,062
Deferred compensation	145,807	-
Other	19,913	59,933
Total deferred tax assets	1,405,959	1,608,227
Deferred tax liabilities:		
Accumulated depreciation	123,481	107,803
Total deferred tax liabilities	123,481	107,803
Net deferred tax assets	$ 1,282,478	$ 1,500,424

The bank measures deferred tax assets and liabilities using enacted tax rates that will apply in the years in which the temporary differences are expected to be recovered or paid. Accordingly, the bank's deferred tax assets and liabilities were re-measured to reflect the reduction in the U.S. corporate income tax rate from 34 percent to 21 percent, resulting in a $484 thousand increase in income tax expense for the year ended December 31, 2017 and a corresponding $484 thousand decrease in net deferred tax assets as of December 31, 2017. The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with applicable FIN 48 regulations.

The federal income tax returns of the Bank for 2018, 2017, 2016 and 2015 are subject to examination by the IRS and North Carolina, generally for three years after they were filed.

Note 14. Employee Benefit Plans

Pension Plan

The Bank maintains a noncontributory qualified benefit plan ("the Plan") covering all eligible employees who work 1,000 hours or more as of the beginning of the plan's fiscal year. Benefits are based on years of service. The Plan was amended in 2018 to revise the future benefit formula.

Under the amended plan, a participant may retire at normal retirement age with the greater of:

(1) For Service prior to January 1, 2018. If you were a Participant on December 31, 2017, you shall receive as a normal retirement benefit of not less than your Accrued Benefit as of December 31, 2017, which is equal to one-twelfth (1/12) of the sum of the greater of (A) or (B):

A. One percent (1.0) % of your "2012 Average Annual Compensation" multiplied by your number of Years of Benefit Service prior to August 15, 2013 subject to a maximum of 35 Years of Benefit Service, plus
Sixty-five one-hundredths of one percent (0.65%) of your "2012 Average Monthly Compensation" in excess of your applicable Covered Compensation as provided in the 2012 Covered Compensation Table multiplied by your number of Years of Benefit Service prior to August 15, 2013 (up to a maximum of 35 years); or if greater

B. Sixty-five one-hundredths of one percent (0.65%) of your "2017 Average Annual Compensation" multiplied by your number of Years of Benefit Service prior to January 1, 2018 subject to a maximum of 35 Years of Benefit Service, plus

(2) For all Years of Benefit Service. You shall receive the sum of (A) plus (B) below, but not less than your Accrued Benefit as of December 31, 2017, as determined in (1) above.

A. One-half of one percent (0.50%) of your Final Average Annual Compensation multiplied by your total number of Years of Benefit Service, plus

B. One half of one percent (0.50%) of such Final Average Annual Compensation in excess of your applicable Covered Compensation multiplied by your total number of Years of Benefit Service (up to a maximum of 35 years). In determining your benefit, the current applicable Covered Compensation Table is the one in effect at the beginning of the Plan Year in which your termination of employment occurs, or in which the accrual date falls. The applicable Covered Compensation Table shall be updated each calendar year.

The enrolled actuary of the Plan have indicated that the amount of contribution with respect to a specified person cannot be individually calculated under the actuarial cost method used in determining aggregate contribution requirements for the Plan. For the years ending December 31, 2018 and 2017, contributions of $150,000 and $776,000 were made to the Plan, respectively.

Pension expense charged to operations was $100,267 in 2018 and $290,804 in 2017.

Note 14. Employee Benefit Plans, continued

The following table provides a reconciliation of changes in benefit obligation and fair value of plan assets, as well as the funded status recognized in the Bank's balance sheets for the plan for the years ended December 31:

	2018	2017
Benefit obligation, beginning of year	$ (6,336,659)	$ (6,424,716)
Service cost	(110,624)	(190,380)
Interest cost	(311,443)	(329,794)
Plan Amendments	-	510,300
Actuarial losses (gains)	(145,451)	(131,793)
Employer benefits paid	296,063	229,724
Benefit obligation, end of year	(6,608,114)	(6,336,659)
Fair value of plan assets, beginning of year	5,654,077	4,479,621
Actual return on plan assets	(195,700)	628,180
Employer contributions	150,000	776,000
Employer benefits paid	(296,063)	(229,724)
Fair value of plan assets, end of year	5,312,314	5,654,077
Funded status, end of year	$ (1,295,800)	$ (682,582)

The following represents the amounts included on the Bank's Balance Sheets as of December 31:

	2018	2017
Funded status, end of year	$ (1,295,800)	$ (682,582)
Accrued (prepaid) pension cost	(522,855)	(381,644)
Defined benefit pension plan liability	$ (1,818,655)	$ (1,064,226)

The following presents the amounts recognized in accumulated other comprehensive income ("AOCI") for the plan as of December 31:

	2018	2017
Unrecognized transition obligation	$ 7,875	$ 10,501
Unrecognized net prior service cost	(895,997)	(963,116)
Unrecognized net loss	2,281,757	132,880
Amount recognized in AOCI, net of tax	$ 1,393,635	$ (819,735)

Components of net periodic pension cost are presented in the following table:

	2018	2017
Service cost	$ 110,624	$ 190,380
Interest cost	311,443	329,794
Expected return on plan assets	(440,857)	(358,350)
Amortization of:		
Transition obligation	2,626	2,626
Prior service cost	(67,119)	(36,413)
Net actuarial losses	92,092	83,343
Net pension expense	$ 8,809	$ 211,380

The estimated transition, prior service cost, and net (gain)/loss that will be amortized from accumulated other comprehensive income into 2019 net periodic pension cost are $3,000, $(67,000), and $120,000.

Note 14. Employee Benefit Plans, continued

Assumptions used to determine the benefit obligations as of December 31, 2018 and 2017 for the Plan were as follows:

	2018	2017
Weighted Average Assumptions		
Discount rate	4.90%	4.90%
Compensation Rate Increase	3.00%	3.00%

Assumptions used to determine the net periodic cost for the Plan for the years ended December 31, 2018 and 2017 were as follows:

	2018	2017
Weighted Average Assumptions		
Discount rate	4.90%	5.25%
Expected Long-term Rate of Return on Plan Assets	8.00%	8.00%
Compensation Rate Increase	3.00%	3.00%

The Bank's overall investment strategy is to maintain the purchasing power of the current assets and all future contributions by producing positive rates of return on plan assets; maximize returns within reasonable and prudent levels of risk; and control costs of administering the plan and managing the investments.

The fair values of the Retirement Plan assets for the years ended December 31, 2018 and 2017 by asset category were as follows:

	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
December 31, 2018				
Cash and Equivalents	$ 52,561	$ -	$ -	$ 52,561
Domestic Equity Mutual Funds	5,004,855	-	-	5,004,855
Lumbee Guaranty Bank Common Stock	-	113,198	-	113,198
Certificates of Deposit	141,700	-	-	141,700
Total	$ 5,199,116	$ 113,198	$ -	$ 5,312,314
December 31, 2017				
Cash and Equivalents	$ 49,474	$ -	$ -	$ 49,474
Domestic Equity Mutual Funds	5,341,406	-	-	5,341,406
Lumbee Guaranty Bank Common Stock	-	123,178	-	123,178
Certificates of Deposit	140,019	-	-	140,019
Total	$ 5,530,899	$ 123,178	$ -	$ 5,654,077

Quoted prices for these investments were available in active markets, and therefore were classified as Level 1 measurements in the fair value hierarchy.

The Bank expects to contribute $310,000 to the Plan in 2018.

Note 14. Employee Benefit Plans, continued

Estimated future benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

Year	Amount
2019	$ 310,000
2020	320,000
2021	330,000
2022	330,000
2023	360,000
2024 - 2028	1,940,000

Long-Term Stock Option Compensation Plan

Under our Long-Term Stock Compensation Plan (the "Stock Option Plan"), the Bank is authorized to grant stock options and stock awards to our officers, other key employees and directors. The Stock Option Plan is administered by our Personnel Committee, which is authorized to make all determinations regarding the persons to whom, and numbers of shares for which, options and awards will be granted, to specify certain of the terms of options and awards, and to interpret and establish rules, make all determinations, and take all other actions, necessary or advisable in the administration of the Plan.

At the Personnel Committee's discretion, options granted to officers and employees may be incentive stock options ("ISOs") pursuant to Section 422(a) of the Internal Revenue Code of 1986, as amended, or they may be nonqualified stock options ("NQSOs"). Only NQSOs may be granted to directors. To date, only stock options that qualify as ISOs have been granted under the Stock Option Plan.

On March 22, 2018, the Bank's Board of Directors adopted the 2018 Employee Stock Option Plan (the "2018 Stock Option Plan") under which up to 341,756 options to purchase shares of stock may be granted at the Board's discretion. The termination date of the plan is March 22, 2028. The 2018 Stock Option Plan replaces the Long-Term Stock Compensation Plan which expired May 23, 2016.

Outstanding equity awards at December 31, 2018 were as follows:

	Option Awards			
Name	Number of Securities Underlying Unexercised Stock Options (Exercisable)	Number of Securities Underlying Unexercised Stock Options (Unexercisable)	Option Exercise Price	Option Expiration Date
Kyle R. Chavis	1,200	-	12.25 (1)	7/19/2021
Bryan K Maynor	1,200	-	12.25 (1)	7/19/2021
Larry R. Chavis	1,200	-	12.25 (1)	7/19/2021

(1) The options became exercisable as to one-third of the covered shares each July 19, beginning July 19, 2019 through July 19, 2021.

401(k) Plan

The Bank adopted a 401(k) plan for its employees effective April 1997. All employees are eligible provided they have attained 21 year of age and completed 1,000 hours of service. The bank contributes a matching contribution of $0.50 per cash dollar up to a maximum of 3% of an employee's eligible contribution. The Bank's expense for the plan was $83,162 and $90,728 for the years ended December 31, 2018 and 2017, respectively.

Note 14. Employee Benefit Plans, continued

Employee Stock Ownership Plan

The Bank formed an Employee Stock Ownership Plan ("ESOP"), for its employees in 2013. The ESOP will purchase shares of the Bank's common stock on the open market from time to time with funds borrowed from a loan from a third party lender. All employees of the Bank meeting certain tenure requirements are entitled to participate in the ESOP. Employer contributions are discretionary. Employee contributions are not permitted. There were 71,493 shares in the ESOP at December 31, 2018.

Note 15. Deferred Compensation Plan for Directors/Executives

The Bank has established a deferred compensation plan for non-employee directors of the Bank (the "Director Plan"). Each participating director may defer up to 100% of their monthly Board fees into the Director Plan. The Director Plan also provides a $25,000 death benefit payable to the Director's beneficiary. The Bank also adopted a deferred compensation plan for the benefit of key employees. While the plan is to be funded from the general assets of the Bank, life insurance policies were acquired for the purpose of serving as the primary funding source. Under the plan, cash values on life insurance policies increased $248,331 and $254,396 in 2018 and 2017, respectively for the annual administration of the plan.

Note 16. Related Party Transactions

The Bank has entered into transactions with its directors, executive officers, significant shareholders (own voting shares of 10% or more) and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate loan transactions with related parties were as follows:

	2018	2017
Balance, beginning	$ 2,557,824	$ 1,530,990
New loans and advances	56,643	1,192,310
Repayments	(323,044)	(165,476)
Balance, ending	$ 2,291,423	$ 2,557,824

The Bank had related party deposits in the amount of $1,905,256 and $1,731,814 at December 31, 2018 and 2017, respectively.

Note 17. Commitments and Contingencies

In the normal course of business the Bank is involved in various legal proceedings. After consultation with legal counsel, management believes that any liability resulting from such proceedings will not be material to the financial statements.

Note 18. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the bank has outstanding commitments and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the balance sheet. The Bank had reserves for off-balance sheet commitments of $211,886 and $152,275 as of December 31, 2018 and 2017 respectively.

Financial instruments whose contract amount represents credit risk at December 31, were as follows:

	2018	2017
Commitments to extend credit	$ 25,488,908	$ 20,608,188
Standby letters of credit	70,050	108,444

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

Standby letters of credit are conditional lending commitments issued by the Bank to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit. The Bank holds first deeds of trust, certificates of deposit and/or marketable securities as collateral supporting those commitments for which collateral is deemed necessary.

The Bank enters into a variety of interest rate contracts including interest rate caps and floors in its trading activities and in managing interest rate exposure.

Note 19. Fair Value

Financial Instruments

For assets and liabilities that are not presented on the balance sheet at fair value, the Bank uses the following methods to determine fair value:

During 2018, the Bank adopted Accounting Standard Update ("ASU") 2016-01 "Recognition and Measurement of Financial Assets and Liabilities". These amendments, which are applied prospectively, require the company to use an exit price notion to estimate fair value of financial instruments measure at amortized cost on the balance sheet. Prior to adoption, the company measured fair value for such instruments using and entry price notion which used discounted cash flows to measure the present value of expected future cash flows. The exit price notion includes these factors, but also incorporates credit risk, illiquidity risk and market risk factors.

The fair value of off-balance sheet financial instruments is considered immaterial. These off-balance sheet financial instruments are commitments to extend credit and are either short-term in nature or subject to immediate repricing.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Bank's financial instruments as of December 31, 2018 and 2017. These tables exclude financial instruments for which the carrying amount approximates fair value and which would be classified as Level 1. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization.

The estimated fair values of the Bank's financial instruments are as follows (dollars in thousands):

			Fair Value Measurements		
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018					
Financial Instruments - Assets					
Cash and due from banks	$ 26,737	$ 26,737	$ 26,737	$ -	$ -
Investment securities, available for sale	56,617	56,617	-	56,617	-
Investment securities, held to maturity	47,982	47,790	-	47,790	-
Loans, net of allowance for loan losses	180,837	180,095	-	-	180,095
Federal Home Loan Bank stock	416	N/A	N/A	N/A	N/A
Accrued interest receivable	1,430	1,430	-	1,430	-
Financial Instruments – Liabilities					
Deposits	289,378	289,702	-	289,702	-
Securities under the agreement to repurchase	1,432	1,432	-	1,432	-
Federal Home Loan Bank advances	2,965	2,965	-	-	2,965
Accrued interest payable	151	151	-	151	-
December 31, 2017					
Financial Instruments - Assets					
Cash and due from banks	$ 13,180	$ 13,180	$ 13,180	$ -	$ -
Investment securities, available for sale	54,904	54,904	-	54,904	-
Investment securities, held to maturity	51,894	52,497	-	52,497	-
Loans, net of allowance for loan losses	174,928	172,184	-	-	172,184
Federal Home Loan Bank stock	348	N/A	N/A	N/A	N/A
Accrued interest receivable	1,301	1,301	-	1,301	-
Financial Instruments – Liabilities					
Deposits	276,842	263,319	-	263,319	-
Securities under the agreement to repurchase	1,382	1,382	-	1,382	-
Federal Home Loan Bank advances	1,101	1,101	-	-	1,101
Accrued interest payable	63	63	-	63	-

Note 19. Fair Value, continued

Fair Value Hierarchy

Under FASB ASC Topic 820 "Fair Value Measurements and Disclosures" ("FASB ASC 820"), the Bank groups assets and liabilities at fair values in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

Level 1 — Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2 — Valuation is based upon quoted price for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3 — Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques.

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

Cash

The carry amounts of cash and short-term instruments approximate fair values and are classified as Level 1. As of December 31, 2018 and 2017, $26.7 million and $13.2 million were classified as Level 1.

Investment Securities Available for Sale

Investment securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon 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, U.S. 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, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

Loans

The Bank 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. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2018 and 2017, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. The fair value of Impaired Loans is generally based on judgment and therefore classified as nonrecurring Level 3.

Note 19. Fair Value, continued

Foreclosed Real Estate

Foreclosed real estate is adjusted to fair value upon transfer of the loans to foreclosed real estate. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. The fair value of foreclosed assets is generally based on judgment and therefore is classified as nonrecurring Level 3.

FHLB Stock

It is not practical to determine the fair value of FHLB stock due to restrictions placed on its transferability.

Deposits

The fair value disclosed or demand deposits (e.g., interest and noninterest checking, savings, certificates of deposit, and certain types of money market accounts) are by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amount) resulting in a Level 2 classification. The carry amounts of variable rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification.

Securities under the agreement to repurchase

The carry amounts of securities under the agreement to repurchase generally maturing within 90 days, approximate their fair values resulting in a Level 2 classification.

Federal Home Loan Bank advances

The fair values of the Bank's Federal Home Loan Bank advances are estimated using discounted cash flow analyses based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 3 classification.

Note 19. Fair Value, continued

Accrued Interest Receivable/Payable

The carrying amounts of accrued interest approximate fair value resulting in a Level 2 classification.

Fair value of assets and liabilities measured on a recurring basis at December 31, 2018 and December 31, 2017 are as follows:

	Fair Value	Level 1	Level 2	Level 3
December 31, 2018				
Available for sale securities				
Government sponsored entities	$ 13,465,107	$ -	$ 13,465,107	$ -
FNMA, GNMA, AND FHLMC				
mortgage-backed securities	43,152,060	-	43,152,060	-
Total assets at fair value	$ 56,617,167	$ -	$ 56,617,167	$ -
December 31, 2017				
Available for sale securities				
Government sponsored entities	$ 15,817,043	$ -	$ 15,817,043	$ -
FNMA, GNMA, AND FHLMC				
mortgage-backed securities	39,086,733	-	39,086,733	-
Total assets at fair value	$ 54,903,776	$ -	$ 54,903,776	$ -

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Bank may be required from time to time, to measure certain assets at fair value on a nonrecurring basis. These include assets that are measured at the lower cost or market that were recognized at fair value below cost at the end of the period. Balances are net of specific reserves. Assets measured at fair value on a nonrecurring basis are included in the table below.

	Total	Level 1	Level 2	Level 3
December 31, 2018				
Impaired loans	$ 7,864,752	$ -	$ -	$ 7,864,752
Foreclosed real estate	385,578	-	-	385,578
Total assets at fair value	$ 8,250,330	$ -	$ -	$ 8,250,330
December 31, 2017				
Impaired loans	$ 7,564,558	$ -	$ -	$ 7,564,558
Foreclosed real estate	515,141	-	-	515,141
Total assets at fair value	$ 8,079,699	$ -	$ -	$ 8,079,699

Note 19. Fair Value, continued

Level 3 Valuation Techniques

For Level 3 assets measured at fair value on a recurring or nonrecurring basis as of December 31, 2018 and 2017, the valuation techniques and the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2018	Fair Value at December 31, 2017	Valuation Technique	Significant Unobservable Inputs	Significant Unobservable Input Value
Impaired Loans					
Commercial	$ 44,386	$ 56,515	Appraised Value/	Collateral discounts	6-10%
			Discounted Cash Flows	Discount rate	5-16%
Commercial Real Estate	4,895,130	4,543,172	Appraised Value/	Collateral discounts	6-10%
			Discounted Cash Flows	Discount rate	5-16%
Consumer	3,342	7,970	Appraised Value/	Collateral discounts	6-10%
			Discounted Cash Flows	Discount rate	5-16%
Residential Real Estate	2,876,103	2,914,069	Appraised Value/	Collateral discounts	6-10%
			Discounted Cash Flows	Discount rate	5-16%
Agricultural and Raw Land	45,791	42,832	Appraised Value/	Collateral discounts	6-10%
			Discounted Cash Flows	Discount rate	5-16%
Foreclosed real estate	385,578	515,141	Appraised Value	Collateral discounts	6-10%

Note 20. Subsequent Events

The Bank evaluated events and transactions for potential recognition or disclosure in the financial statements through the date the financial statements were issued.

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of the Disclosure Committee, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Bank's disclosure controls and procedures in accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"). The Disclosure Committee ensures that information required to be disclosed under the Exchange Act is communicated to our Chief Executive Officer and Chief Financial Officer. Internal audits conducted by our outsourced internal auditor are reviewed by certifying officers to assist in assessing the adequacy of the Bank's internal controls. Based on these evaluations, the Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2018, the Bank's disclosure controls and procedures were effective to provide reasonable assurance that the Bank is able to record, process, summarize, and report in a timely manner the information required to be disclosed in the reports it files under the Exchange Act.

Management's Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Exchange Act Rules 13a-15(f). A system of internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of management, including the principal executive officer and the principal financial officer, the Bank's management has evaluated the effectiveness of its internal control over financial reporting as of December 31, 2018 based on the criteria established "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013 and the interpretive guidance issued by the Securities and Exchange Commission in Release No. 34-55929. Based on this evaluation, the Bank's management has concluded that the Bank's internal control over financial reporting was effective as of December 31, 2018.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting. A material weakness in internal control over financial reporting is a control deficiency, or combination of control deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected on a timely basis.

This annual report does not include an attestation report of the Bank's independent registered public accounting firm regarding internal control over financial reporting. The Dodd-Frank Act exempted the Bank from complying with Section 404(b) and our registered public accounting firm was not required to issue an attestation on our internal controls over financial reporting pursuant to rules of the Securities and Exchange Commission.

Item 9B. Other Information

None.

Part III

Item 10. Directors, Executive Officers, and Corporate Governance

With the exception of the disclosure provided below, the information required by Item 10 of Form 10-K is incorporated herein by reference from the information that appears under the headings or captions "Proposal 1: Election of Directors," "Code of Ethical Conduct," "Executive Officers," and "Section 16(a) Beneficial Ownership Reporting Compliance" in the Bank's proxy statement for its 2019 annual meeting of stockholders.

Rules of the Securities and Exchange Commission, which are adopted by the FDIC, require that the Bank disclose whether its Board of Directors has determined that its Audit Committee includes a member who qualifies as an "audit committee financial expert" as that term is defined in the SEC's rules. To qualify as an audit committee financial expert under the SEC's rules, a person must have a relatively high level of accounting and financial knowledge or expertise which he or she has acquired through specialized education or training or through experience in certain types of positions. We currently do not have an independent director who our Board believes can be considered an "audit committee financial expert" as the term is defined by the SEC and, for that reason, there is no such person who the Board can appoint to our Audit Committee.

Item 11. Executive Compensation

The information required by Item 11 of Form 10-K is incorporated herein by reference from the information that appears under the headings or captions "Executive Compensation" and "Director Compensation" in the Bank's proxy statement for its 2019 annual meeting of stockholders.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

With the exception of the disclosure provided below, the information required by Item 12 of Form 10-K is incorporated herein by reference from the information that appears under the headings or captions "Beneficial Ownership of Our Common Stock" in the Bank's proxy statement for its 2019 annual meeting of stockholders.

The following table summarizes all compensation plans and individual compensation arrangements which were in effect on December 31, 2018 and under which shares of the Bank's common stock have been authorized for issuance. The Bank's only compensation plan or individual compensation arrangement under which shares of the Bank's common stock have been authorized for issuance is the Bank's 2018 Employee Stock Option Plan.

EQUITY COMPENSATION PLAN INFORMATION

Plan Category	Number of Shares to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Shares Remaining Available for Future Issuance under Equity Compensation Plans (excluding shares reflected in column (a))
Equity compensation plans approved by shareholders..........	3,600	$12.25	338,156
Equity compensation plans not approved by shareholders..........	-0-	--	-0-
Total	3,600	$12.25	338,156

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by Item 13 of Form 10-K is incorporated herein by reference from the information that appears under the headings or captions "Director Independence" and "Transactions with Related Persons" in the Bank's proxy statement for its 2019 Annual Meeting of stockholders.

Item 14. Principal Accountant Fees and Services

The information required by Item 14 of Form 10-K is incorporated herein by reference from the information that appears under the heading or caption "Proposal 5: Ratification of Appointment of Independent Accountants - Service and Fees for 2018 and 2017" in the Bank's proxy statement for its 2019 Annual Meeting of stockholders.

Part IV

Item 15. Exhibits, Financial Statements Schedules

(a) The following documents are filed as part of this Report:

1. Financial Statements

Report of Independent Registered Public Accounting Firm
Balance Sheets
Statements of Income
Statements of Comprehensive Income
Statements of Changes in Shareholders' Equity
Statements of Cash Flows
Notes to Financial Statements

2. Financial Statement Schedules:

All schedules are omitted as the required information is inapplicable or the information is presented in the Financial Statements or related notes.

Exhibit Index

3.1	Articles of Incorporation (incorporated herein by reference to the 2012 Annual Report on Form 10-K)
3.2	Bylaws of Lumbee Guaranty Bank, as amended effective March 21, 2019 (incorporated herein by reference to Current Report on Form 8-K dated March 21, 2019)
10.1	Severance Compensation Agreement (incorporated herein by reference to the 2013 Annual Report on Form 10-K)
10.2	2018 Employee Stock Option Plan (incorporated herein by reference to Current Report on Form 8-K dated May 30, 2018)
10.3	Form of Employee Stock Option Agreement (filed herewith)
10.4	Split Dollar Life Insurance Agreement (incorporated herein by reference to the 2013 Annual Report on Form 10-K)
10.5	Executive Salary Continuation Agreement (incorporated herein by reference to the 2013 Annual Report on Form 10-K)
21	Subsidiaries of Lumbee Guaranty Bank (incorporated herein by reference to the 2012 Annual Report on Form 10-K)
31.1	Certification of Chief Executive Officer pursuant to Rule 13 a-14(a) under the Securities Exchange Act of 1934 (filed herewith)
31.2	Certification of Chief Financial Officer pursuant to Rule 13 a-14(a) under the Securities Exchange Act of 1934 (filed herewith)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith)
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith

Signatures

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

Lumbee Guaranty Bank

Date: March 28, 2019

By: /s/ Larry R. Chavis
Larry R. Chavis
Executive Vice Chairman and
Acting Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, on behalf of the Registrant and in the capacities and on the dates indicated.

Signatures	Title	Date
/s/Kyle R. Chavis Kyle R. Chavis	Chief Executive Officer	March 28, 2019
/s/Bryan K. Maynor Bryan K. Maynor	President	March 28, 2019
/s/Arnold Locklear Arnold Locklear	Chairman	March 28, 2019
/s/Larry R. Chavis Larry R. Chavis	Executive Vice Chairman	March 28, 2019
/s/Larry T. Brooks Larry T. Brooks	Director	March 28, 2019
/s/Sybil J. Bullard Sybil J. Bullard	Director	March 28, 2019
/s/Redell Collins Redell Collins	Director	March 28, 2019
/s/Charles A. Maynor Charles A. Maynor	Director	March 28, 2019
/s/Derrick R. Staten Derrick R. Staten, Sr.	Director	March 28, 2019
/s/James E. Thomas James E. Thomas	Director	March 28, 2019

Exhibit 31.1
Certification by Chief Executive Officer
Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Kyle R. Chavis, certify that:

1. I have reviewed this annual report on Form 10-K of Lumbee Guaranty Bank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: **March 28, 2019**

/s/Kyle R. Chavis
Kyle R. Chavis
Chief Executive Officer

Exhibit 31.2
Certification by Chief Financial Officer
Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Larry R. Chavis, certify that:

1. I have reviewed this annual report on Form 10-K of Lumbee Guaranty Bank;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: **March 28, 2019**

/s/ Larry R. Chavis
Larry R. Chavis
Executive Vice Chairman and
Acting Chief Financial Officer

Exhibit 32.1

Certification by the Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned hereby certifies that, (i) the Form 10-K filed by Lumbee Guaranty Bank (the "Issuer") for the year ended December 31, 2018 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer on the dates and for the periods presented therein.

LUMBEE GUARANTY BANK

Date: March 28, 2019

By: /s/Kyle R. Chavis
Kyle R. Chavis
Chief Executive Officer

This Certification is being furnished solely to accompany this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed "filed" by the Bank for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Bank under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 has been provided to the Bank and will be retained by the Bank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.

Exhibit 32.2

Certification by the Chief Financial Officer (or equivalent) Pursuant to 18 U.S.C. Section 1350
As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The undersigned hereby certifies that, (i) the Form 10-K filed by Lumbee Guaranty Bank (the "Issuer") for the year ended December 31, 2018 (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Issuer on the dates and for the periods presented therein.

LUMBEE GUARANTY BANK

Date: **March 28, 2019**

By: **/s/ Larry R. Chavis**
Larry R. Chavis
Executive Vice Chairman and
Acting Chief Financial Officer

This Certification is being furnished solely to accompany this Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed “filed" by the Bank for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Bank under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 has been provided to the Bank and will be retained by the Bank and furnished to the Federal Deposit Insurance Corporation or its staff upon request.