Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, GUY HOSKINS III
Name of the Holding Company Director and Official

EVP, CFO, SEC/TREAS and DIRECTOR
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Signature of Holding Company Director and Official

3-13-18 / 4-19-18
Date of Signature

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:

- ☐ is included with the FR Y-6 report
- ☒ will be sent under separate cover
- ☐ is not prepared

For Federal Reserve Bank Use Only

RSSD ID ______
C.I. ______

Date of Report (top-tier holding company's fiscal year-end):
December 31, 2017
Month / Day / Year

N/A
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

F & M FINANCIAL CORPORATION
Legal Title of Holding Company

221 N MAIN STREET
(Mailing Address of the Holding Company) Street / P.O. Box

SALISBURY	NC	28144
City	State	Zip Code

138 N SALISBURY AVE, GRANITE QUARRY, NC 28072
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

LORI H JACKSON	ASST SEC/TREAS
Name	Title

704-762-2212
Area Code / Phone Number / Extension

704-633-5390
Area Code / FAX Number

lhjackson@fmbnc.com
E-mail Address

NONE
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? (0=No, 1=Yes) 0

In accordance with the General Instructions for this report (check only one),

1. **a letter justifying this request is being provided along with the report** ☐
2. **a letter justifying this request has been provided separately** ☐

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

REPORT FRY-6

F & M FINANCIAL CORPORATION
Granite Quarry, North Carolina
Fiscal Year Ending December 31, 2017

REPORT ITEM

1: The BHC prepares an annual report for its shareholders and is not registered with the SEC. The annual report is not included with this report. TO BE FILED WHEN PUBLISHED
Target date- May

2: a. ORGANIZATION CHART

PARENT CORPORATION
F & M Financial Corporation(OBHC)
Incorporated: 2/10/84 North Carolina
Location: Granite Quarry,N.C.
100 % Common Stock owner of
Farmers And Merchants Bank
No LEI

Farmers And Merchants Bank
Commercial Bank (state,non-member,FDIC)
Incorporated: 7/13/1909 North Carolina
Location: Granite Quarry,N.C.
100 % Common Stock owner of
F & M Investment Services, Inc.
LEI- 54930018CRFUH37BKR13

F & M Investment Services, Inc.
Incorporated: 5/23/89 North Carolina
Location: Granite Quarry,N.C.
Sell Securities and Insurance product via
Dual employee arrangement with broker/dealer
No LEI

2.B. Reviewed and verified- 1/24/18 (updated 7/30/18)

Results: A list of branches for your depository institution: FARMERS AND MERCHANTS BANK (ID_RSSD: 348720).
This depository institution is held by F & M FINANCIAL CORPORATION (1076619) of GRANITE QUARRY, NC.
The data are as of 12/31/2017 . Data reflects information that was received and processed through 01/04/2018.

Reconciliation and Verification Steps

1. In the Data Action column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the Effective Date column

Actions

OK: If the branch information is correct, enter 'OK' in the Data Action column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the Data Action column and the date when this information first became valid in the Effective Date column.
Close: If a branch listed was sold or closed, enter 'Close' in the Data Action column and the sale or closure date in the Effective Date column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the Data Action column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the Data Action column and the opening or acquisition date in the Effective Date column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure

When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:

To satisfy the FR Y-10 reporting requirements , you must also submit FR Y-10 Domestic Branch Schedules for each branch with a Data Action of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

		Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Of	348720	FARMERS AND MERCHANTS BANK	138 N SALISBURY AVE	GRANITE QUARRY	NC	28072	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	532921	CHINA GROVE BRANCH	116 NORTH MAIN STREET	CHINA GROVE	NC	28023	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	3387270	WILMAR BRANCH	635 CHURCH STREET, NORTH	CONCORD	NC	28025	CABARRUS	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	189325	FAITH BRANCH	101 S MAIN ST & MT HOPE RD	FAITH	NC	28041	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	3904585	KANNAPOLIS BRANCH	2975 DALE EARNHARDT BLVD	KANNAPOLIS	NC	28083	CABARRUS	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	533423	ROCKWELL BRANCH	418 WEST MAIN STREET	ROCKWELL	NC	28138	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	3289244	AVALON DRIVE BRANCH	102 AVALON DR	SALISBURY	NC	28146	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	2581446	BOULEVARD BRANCH	221 STATESVILLE BLVD	SALISBURY	NC	28144	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	349222	NORTH MAIN STREET BRANCH	420 NORTH MAIN STREET	SALISBURY	NC	28144	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	3353930	TRINITY OAKS BRANCH	728 KLUMAC ROAD	SALISBURY	NC	28144	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	
OK		Full Service	410627	WEST SALISBURY BRANCH	630 JAKE ALEXANDER BLVD WEST	SALISBURY	NC	28147	ROWAN	UNITED STATES	Not Required	Not Required	FARMERS AND MERCHANTS BANK	348720	

F & M FINANCIAL CORPORTION
12/31/2017

ITEM 3: SECURITIES HOLDERS

(1)

(A) NAME/ADDRESS	(B) COUNTRY	(C) NO.SHARES OWNED	(C) NO.SHARES OWNED AS % OUTSTANDING	(C) NO.SHARES OPTIONED	(C) NO.SHARES OPTIONED AS % OUTSTANDING
Fisher Woodside, LP (Paul E Fisher, Manager)	USA	250,000	17.00	0	0.00
Paul E Fisher and Immediate family *	USA	354,876	24.14	0	0.00
		604,876	41.14		

* Paul E Fisher, Fox Hollow Four, LLC , J E Fisher Jr, John M Fisher, Jean Fisher Mccombs Revocable Trust, Dorothy Lou F Mitchell, Sue P Fisher, Phyllis T Fisher, Joy K Fisher, Donald L Mitchell, J Steven Fisher, Paula F Philpot, Irvin H Philpot III, Irvin Henry Philpot IV, Kirby-Anna Fisher Philpot, Hope Ellen Holder Philpot, Polly-Rose McDaniel Philpot, SamcieJoe Smith Philpot, Paul Henry Philpot, Reuben Vance Eller Rev. Trust

GRANITE QUARRY, NC

(2) N/A

F & M FINANCIAL CORPORATION
December 31, 2017

ITEM 4. DIRECTORS AND OFFICERS OF F & M FINANCIAL CORPORATION & PRINCIPAL SECURITIES HOLDER
(FMFC = F&M FINANCIAL CORP.; FMB = F & M BANK; FMIS = F & M INVESTMENT SERVICES, INC.

	(1) NAME/ADDRESS/STATE/COUNTRY	(2) OTHER PRINCIPAL OCCUPATON	(3)(a) & (3)(b) Title & Position with BHC Title & Position with sub name	(3.c) Title & Position with other company list company name	(4)(a) % of voting shares in BHC	(4)(b) % of voting shares in sub list name	(4) (c) List names of other companies (include partnerships) if 25% or more of voting securities are held (List Names of companies and % of voting securities held)
1)	CAROL HERNDON SALISBURY, NC	CHIEF FINANCIAL OFFICER ROWAN-SALISBURY SCHOOLS	DIR- FMFC, FMB, FMIS	N/A	0.00	NONE	N/A
2)	FISHER WOODSIDE LP SALISBURY,N.C.	N/A	N/A	N/A	17.00	NONE	N/A
3)	JOHN M.FISHER GRANITE QUARRY, NC	INSURANCE AGENT	DIR-FMFC, FMB, FMIS	PRESIDENT J E FISHER INS AGENCY, INC DBA FISHER-GREENE INSURANCE AGENCY	5.04	NONE	51% J E FISHER INS AGENCY, INC DBA FISHER-GREENE INSURANCE AGENCY
4)	C. CLIFFORD RITCHIE SALISBURY,NC	PRES/CEO CHEERWINE	DIR-FMFC, FMB, FMIS	N/A	0.03	NONE	N/A
5)	SUSAN W KLUTTZ SALISBURY,NC	N/A	DIR-FMFC, FMB, FMIS		0.21	NONE	N/A
6)	JACOB STEVEN FISHER SALISBURY, NC	N/A	FMFC-Chair/CEO/Pres/Gen Counsel FMB-Chair/CEO/Pres/Gen Counsel FMIS-Chair/CEO/Pres/Gen Counsel DIR-FMFC, FMB,FMIS	N/A	1.04	NONE	N/A
7)	WILLIAM D KENERLY SALISBURY, NC	RETIRED	DIR-FMFC, FMB, FMIS	N/A	0.26	NONE	N/A
8)	TOM E SMITH SALISBURY, NC	RETIRED FOOD LION CHAIRMAN/CEO	DIR-FMFC, FMB, FMIS	N/A	0.08	NONE	100% KLUMAC REALTY, INC 50% SAFHA, INC 100% TES PROPERTIES LLC
9)	GUY HOSKINS III SPENCER, NC	N/A	FMFC-EVP/CFO/SEC/TREAS FMB-EVP/CFO/SEC/TREAS FMIS-EVP/CFO/SEC/TREAS DIR-FMFC,FMB,FMIS	N/A	1.71	NONE	N/A
10)	Robert V Honeycutt III SALISBURY, NC	N/A	FMFC-EVP FMB-EVP/CCO DIR-FMFC,FMB,FMIS	N/A	0.17	NONE	N/A
11)	Vergel L Lattimore III	PRES - HOOD THEOLOGICAL SEMINARY	DIR-FMFC, FMB, FMIS	N/A		NONE	N/A
12)	PAUL E FISHER & IMMEDIATE FAMILY * (EXCLUDES (3) JOHN M FISHER AND (6) JACOB STEVEN FISHER)	N/A	N/A	N/A	18.05	NONE	N/A

* Paul E Fisher, Fox Hollow Four, LLC , J E Fisher Jr, Jean Fisher Mccombs Revocable Trust, Dorothy Lou F Mitchell, Sue P Fisher, Phyllis T Fisher, Joy K Fisher, Donald L Mitchell, Paula F Philpot, Irvin H Philpot III, Irvin Henry Philpot IV, Kirby-Anna Fisher Philpot, Hope Ellen Holder Philpot, Polly-Rose McDaniel Philpot, SamcieJoe Smith Philpot, Paul Henry Philpot, Reuben Vance Eller Rev. Trust

F & M Financial Corporation and Subsidiary

Report on Consolidated Financial Statements

As of and for the years ended December 31, 2017 and 2016

F & M Financial Corporation and Subsidiary

Contents

elliott davis

INDEPENDENT AUDITOR'S REPORT

Board of Directors
F&M Financial Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of F&M Financial Corporation and its subsidiary (the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "financial statements").

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of F&M Financial Corporation and its subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, PLLC

Charlotte, North Carolina
March 23, 2018

F & M Financial Corporation and Subsidiary

Consolidated Balance Sheets
As of December 31, 2017 and 2016
(in thousands)

	December 31, 2017	December 31, 2016
Assets		
Cash and due from banks	$ 2,798	$ 3,504
Interest-bearing bank deposits	112,832	111,389
Cash and cash equivalents	115,630	114,893
Securities available for sale, at fair value	22,409	22,823
Loans, net of allowance of $6,859 and $7,415	439,658	402,792
Other real estate owned	3,047	5,623
Premises, equipment and software, net	15,226	16,033
Other assets	8,285	9,141
Total assets	$ 604,255	$ 571,305
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	$ 159,745	$ 145,474
Interest-bearing	373,592	357,766
Total deposits	533,337	503,240
Other liabilities	5,679	5,296
Total liabilities	539,016	508,536
Stockholders' Equity		
Common stock, $5 par value, 5,000,000 shares authorized, 1,470,288 and 1,476,340 shares issued and outstanding at December 31, 2017 and 2016, respectively	7,351	7,382
Additional paid-in-capital	44	37
Retained earnings	57,885	55,324
Accumulated other comprehensive income	(41)	26
Total stockholders' equity	65,239	62,769
Total liabilities and stockholders' equity	$ 604,255	$ 571,305

See Notes to Consolidated Financial Statements

F & M Financial Corporation and Subsidiary

Consolidated Statements of Income

For the years ended December 31, 2017 and 2016

(in thousands, except share data)

	For the years ended December 31,	
	2017	2016
Interest income		
Loans	$ 21,590	$ 19,796
Securities:		
Taxable	270	138
Tax exempt	72	83
Other interest and dividend income	1,196	609
Total interest income	23,128	20,626
Interest expense		
Deposits	763	755
Total interest expense	763	755
Net interest income	22,365	19,871
Provision for loan losses	-	-
Net interest income after provision for loan losses	22,365	19,871
Noninterest income		
Service charges on deposit accounts	1,695	1,736
Brokerage related fees	2,329	1,928
Mortgage banking income, net	294	335
Net gain on sale of loans	207	305
Net loss on sale of OREO	(381)	(84)
Other	2,605	2,338
Total noninterest income	6,749	6,558
Noninterest expenses		
Compensation and employee benefits	12,089	11,649
Occupancy and equipment	2,226	2,274
Federal deposit insurance	385	395
Insurance	139	141
Professional services	636	616
Stationary and supplies	360	356
Other	4,517	4,854
Total noninterest expenses	20,352	20,285
Income before income taxes	8,762	6,144
Income tax expense – ordinary operations	3,168	2,303
Income tax expense – tax rate change	1,138	-
Total income tax expense	4,306	-
Net income	$ 4,456	$ 3,841
Earnings per common share		
Basic	$ 3.03	$ 2.59
Diluted	$ 2.93	$ 2.55

See Notes to Consolidated Financial Statements

F & M Financial Corporation and Subsidiary

Consolidated Statements of Comprehensive Income
For the years ended December 31, 2017 and 2016
(in thousands)

	For the years ended December 31,	
	2017	2016
Net income	$ 4,456	$ 3,841
Other comprehensive income (loss)		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the period	(107)	38
Tax effect	40	(14)
Less: reclassification for gains included in net income	-	(32)
Tax effect	-	12
Other comprehensive income (loss)	(67)	4
Comprehensive income	$ 4,389	$ 3,845

See Notes to Consolidated Financial Statements

F & M Financial Corporation and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity
For the years ended December 31, 2017 and 2016
(in thousands)

	Common Stock					
	Shares	Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholders' Equity
Balance, December 31, 2015	**1,488,951**	**$ 7,445**	**$ 55**	**$ 53,133**	**$ 22**	**$ 60,655**
Net income	-	-	-	3,841	-	3,841
Other comprehensive income	-	-	-	-	4	4
Cash dividends on common stock of $0.95 per share	-	-	-	(1,406)	-	(1,406)
Stock-based compensation	-	-	223	-	-	223
Stock options exercised	500	3	8	-	-	11
Restricted stock issued, net	5,775	29	(29)	(49)	-	(49)
Shares repurchased	(18,886)	(95)	(220)	(195)	-	(510)
Balance, December 31, 2016	**1,476,340**	**$ 7,382**	**$ 37**	**$ 55,324**	**$ 26**	**$ 62,769**
Net income	-	-	-	4,456	-	4,456
Other comprehensive income	-	-	-	-	(67)	(67)
Cash dividends on common stock of $1.15 per share	-	-	-	(1,692)	-	(1,692)
Stock-based compensation	-	-	181	-	-	181
Stock options exercised	800	4	12	-	-	16
Restricted stock issued, net	5,775	28	(25)	(58)	-	(55)
Shares repurchased	(12,627)	(63)	(161)	(145)	-	(369)
Balance, December 31, 2017	**1,470,288**	**$ 7,351**	**$ 44**	**$ 57,885**	**$ (41)**	**$ 65,239**

See Notes to Consolidated Financial Statements

F & M Financial Corporation and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2017 and 2016

(in thousands)

	For the years ended December 31,	
	2017	2016
Cash flows from operating activities		
Net income	$ 4,456	$ 3,841
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	-	-
Depreciation	1,140	1,242
Stock based compensation	181	223
Amortization of securities premiums, net	4	2
Amortization of mortgage servicing rights	125	145
Origination of loans held for sale	(11,068)	(18,686)
Proceeds from sales of loans held for sale	11,687	18,699
Gain on sale of loans held for sale	(207)	(305)
Gain on sale of securities available for sale	-	(32)
Net loss on sale or write-downs on other real estate owned	381	84
Net loss on sale of premises, equipment and software	150	8
Deferred income tax expense	1,490	185
Increase in other assets	(719)	(218)
Increase in other liabilities	383	643
Net cash provided by operating activities	8,003	5,831
Cash flows from investing activities		
Proceeds from sales, calls, and maturities of securities available for sale	5,315	272
Purchase of available for sale securities	(5,012)	(9,044)
Loans principal originations, net of collections	(37,624)	(21,283)
Purchase of premises, equipment and software	(483)	(1,050)
Proceeds from sale of premises, equipment and software	-	86
Proceeds from sale of other real estate owned	2,541	940
Net cash used in investing activities	(35,263)	(30,079)
Cash flows from financing activities		
Net increase in deposits	30,097	18,021
Restricted units withheld for payment of taxes	(55)	(49)
Cash paid to repurchase common shares	(369)	(510)
Proceeds from exercise of stock options	16	11
Common stock dividends paid	(1,692)	(1,406)
Net cash provided by financing activities	27,997	16,067
Net increase (decrease) in cash and cash equivalents	737	(8,181)
Cash and cash equivalents, beginning of year	114,893	123,074
Cash and cash equivalents, end of year	$ 115,630	$ 114,893

See Notes to Consolidated Financial Statements

(in thousands)

	For the years ended December 31,			
		2017		2016
Cash paid during the year for				
Interest	$	763	$	755
Income taxes		2,827		2,179
Supplemental disclosures of noncash investing and financing activities				
Loans transferred to other real estate	$	346	$	1,133
Change in unrealized gain (loss) on available for sale securities		(107)		6

Note 1. Summary of Significant Accounting Policies

F & M Financial Corporation is a one-bank holding corporation of which Farmers and Merchants Bank (the "Bank") is a wholly owned subsidiary. The Bank is engaged in general commercial banking in Rowan, Cabarrus and Wake Counties, North Carolina and operates under the banking laws of North Carolina and the Rules and Regulations of the Federal Deposit Insurance Corporation. The Bank has one wholly owned subsidiary, F & M Investment Services, Inc. which offers securities brokerage and insurance services.

The following is a description of the significant accounting and reporting policies F & M Financial Corporation follows in preparing and presenting its consolidated financial statements.

Basis of Presentation:

The consolidated financial statements include the accounts of F & M Financial Corporation, Farmers and Merchants Bank, and F & M Investment Services, Inc. (collectively referred to as the "Corporation"). In consolidation, all significant intercompany items and transactions have been eliminated. Certain captions and amounts in the 2016 financial statements were reclassified to conform with the 2017 presentation.

Estimates:

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, as well as the amounts of income 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, including valuation allowances for impaired loans, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for loan losses and valuation of foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the useful lives and methods for depreciating premises and equipment.

Cash and Cash Equivalents:

Cash and cash equivalents include cash and due from banks and interest-bearing bank deposits. Cash and cash equivalents have maturities of three months or less at acquisition date. Banks are generally required by regulation to maintain an average cash reserve balance based on a percentage of deposits. These requirements were met by vault cash at December 31, 2017 and 2016.

Note 1. Summary of Significant Accounting Policies, Continued

Investment Securities:

Securities classified as available for sale are those debt and equity securities that the Corporation intends to hold for an indefinite period of time, but not necessarily to maturity in the case of debt securities. Any decision to sell a security classified as available for sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Corporation's assets and liabilities, liquidity needs, regulatory capital considerations, and other similar factors. Securities available for sale are carried at fair value. Premiums and discounts are amortized using a level yield method over the securities' contractual lives. Unrealized gains or losses are reported as increases or decreases in equity, net of the related deferred tax effect as a component of accumulated other comprehensive income. Realized gains or losses, determined on the basis of the cost of specific securities sold, are recorded on the trade date and included in noninterest income.

The Corporation has determined that all of their securities should be categorized as available for sale, and accordingly, such securities are reported at fair value. The fair value of the securities is determined by a third party as of the date of the reporting period. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss.

Federal Home Loan Bank Stock:

Federal law requires a member institution of the Federal Home Loan Bank (FHLB) System to hold common stock of its district FHLB according to predetermined formulas. This stock is pledged to secure FHLB borrowings. No ready market exists for the stock and it has no quoted market value and accordingly, is carried at cost. The FHLB stock with a value of $559 and $540 at December 31, 2017 and 2016, respectively, is included in equity securities (see Note 2).

Loans Held for Sale:

Mortgage loans held for sale are valued at cost, which management believes approximates fair value due to the short-term nature of these loans. Gains or losses resulting from sales of mortgage loans are recognized when the proceeds are received from investors. These loans for presentation purposes are included in net loans receivable and amounted to $0 and $412 at December 31, 2017 and 2016, respectively.

Loans and Allowance for Loan Losses:

Loans are carried at net book value. Interest income is recognized on the accrual basis. The accrual of interest income is discontinued on loans (including impaired loans) which become 90 days past due as to principal or interest unless they are well secured and in the process of collection. Any cash receipts related to nonaccrual loans (including impaired loans) are applied to the principal balance. Loans are returned to accrual status when management determines, based on an evaluation of the underlying collateral together with the borrower's payment record and financial condition, that the borrower has the ability and intent to meet the contractual obligations of the loan agreement.

Note 1. Summary of Significant Accounting Policies, Continued

Account balances are charged off against the allowance for loan losses after all means of collections have been exhausted and the potential recovery is considered remote.

Loan origination and commitment fees, as well as certain direct loan origination and commitment costs are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method.

The Corporation uses the allowance method in providing for loan losses. The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at an adequate level to cover known and inherent risk of loss in the loan portfolio. In determining the provision amount, management gives consideration to current economic conditions, the growth and composition of the loan portfolio, the relationship of the allowance for loan losses to outstanding loans, and other risk factors. Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize changes to the allowance based on their judgments of information available to them at the time of their examination.

Management considers loans to be impaired when based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Factors that influence management's judgments include, but are not limited to, loan payment pattern, source of repayment, and value of collateral. The major sources for identification of loans to be evaluated for impairment include past due and nonaccrual reports, internally generated lists of loans of certain risk grades, and regulatory reports of examination. Impaired loans are measured using either the discounted expected cash flow method using the original effective interest rate or the fair value of collateral method. Smaller, homogeneous groups of loans are evaluated collectively for impairment.

Other Real Estate Owned:

Foreclosed properties represent real estate acquired through foreclosure or deed in lieu thereof and are carried at the lower of cost or fair value, less estimated costs to sell. Generally such properties are appraised annually and the carrying value, if greater than the appraised value, is adjusted with a charge to income.

Premises, Equipment and Software:

Premises, equipment and software are carried at cost less accumulated depreciation. Depreciation is calculated principally on the straight-line method over the estimated useful lives of the assets. The useful lives range from three to seven years for furniture, equipment and software and fifteen to forty years for buildings.

Note 1. Summary of Significant Accounting Policies, Continued

Income Taxes:

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

Mortgage Servicing Rights:

The Corporation records mortgage servicing rights on loans that it originates and subsequently sells with the servicing rights maintained. The amount recorded is an estimate of the allocated cost of the loans to the mortgage servicing rights and to the mortgage loans based on relative fair values. The Corporation determines the fair value of the mortgage servicing rights using a method that approximates the present value of estimated net future servicing revenues less the estimated cost that would fairly compensate a substitute servicer to service the loans. The cost allocated to the servicing rights is amortized in proportion to and over the period of estimated net future cash flows related to servicing income. The Corporation periodically evaluates the mortgage servicing rights for impairment by disaggregating the portfolio into its predominant risk characteristics (primarily prepayment risk). The Corporation establishes a valuation allowance where it is determined that there is impairment in the mortgage servicing rights. Subsequent increases in impairment will result in additions to the valuation allowance, whereas subsequent decreases will result in reductions of the valuation allowance. In no event can the mortgage servicing rights be increased above their amortized cost basis. Mortgage servicing rights recorded in other assets approximated $244 and $300 at December 31, 2017 and 2016, respectively.

Stock Based Compensation:

All share-based payments to employees, including grants of employee stock options or restricted stock, are valued at fair value on the grant date and are expensed over the applicable vesting period. The tax benefits in excess of recognized compensation cost are reported as a financing cash flow, rather than as an operating cash flow.

Goodwill:

Goodwill arising from business combinations represents the excess of the purchase price over the fair value of the assets acquired. Goodwill is not amortized but tested annually for impairment or more frequently if circumstances indicate the possibility of impairment. An entity has the option in its annual goodwill evaluation to first assess qualitative factors to determine whether it is more likely than not, a likelihood of more than 50 percent, that the fair value of a reporting unit is less than its carrying amount. If it is more likely than not that the fair value of a reporting unit is less than its carrying amount, an entity must test for impairment quantitatively by comparing the fair value of a reporting unit with its carrying amount, including goodwill. The carrying amount of goodwill was $331 at December 31, 2017 and 2016. Management does not believe any impairment of its goodwill existed at December 31, 2017 and 2016.

(in thousands, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

Earnings Per Common Share (EPS):

Basic EPS is computed by dividing net income available to common stockholders by the weighted average number of shares of common stock outstanding for the year. Diluted EPS reflects the potential dilution that could occur if the Corporation's dilutive securities were exercised. The numerators of the basic EPS computations are the same as the numerators of the diluted EPS computations for both years presented. A reconciliation of the denominator of the basic EPS computation to the denominator of the diluted EPS computations is as follows:

	Years ended December 31,	
	2017	2016
Basic EPS denominator - weighted average number of common shares outstanding	1,471,098	1,480,949
Effect of dilutive options shares	51,590	23,648
Diluted EPS denominator	1,522,688	1,504,597

Other Comprehensive Income (Loss):

Comprehensive income (loss) and its components (revenues, expenses, gains and losses) are required to be displayed in a full set of general-purpose financial statements. All items that are recognized under accounting standards as components of comprehensive income are required to be reported in a financial statement that is displayed with the same prominence as other financial statements. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as separate components of the equity section of the balance sheet, such items, along with net income are components of comprehensive income (loss).

Advertising:

The Corporation expenses advertising and promotion costs as incurred. Advertising and promotion costs totaled $325 and $382 for the years ended December 31, 2017 and 2016, respectively.

Recent Accounting Pronouncements:

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Corporation will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The

(in thousands, except share data)

Note 1. Summary of Significant Accounting Policies, Continued

amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Corporation does not expect these amendments to have a material effect on its financial statements.

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, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Corporation does not expect these amendments to have a material effect on its financial statements.

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 Corporation for annual periods beginning after December 15, 2020, and interim periods within annual reporting periods beginning after December 15, 2021. The Corporation is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

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 Corporation's financial position, results of operations or cash flows.

Note 2. Available for Sale Securities

Available for sale securities at December 31, 2017 and 2016, consist of the following:

	2017			
	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
US treasuries and agencies	$ 19,999	$ -	$ 95	$ 19,904
State, county, and municipal obligations	1,916	30	-	1,946
Equity securities	559	-	-	559
	$ 22,474	$ 30	$ 95	$ 22,409

	2016			
	Amortized cost	Gross unrealized Gains	Gross unrealized Losses	Fair value
US treasuries and agencies	$ 20,065	$ 8	$ 17	$ 20,056
State, county, and municipal obligations	2,176	51	-	2,227
Equity securities	540	-	-	540
	$ 22,781	$ 59	$ 17	$ 22,823

(in thousands, except share data)

Note 2. Available for Sale Securities, Continued

The following table shows available for sale securities held by the Corporation by maturity category at December 31, 2017:

	Amortized cost	Fair value
Due in one year or less	$ 11,946	$ 11,920
Due after one year through five years	9,969	9,930
Due after five years through ten years	-	-
Due after ten years	-	-
Equity securities	559	559
Total	$ 22,474	$ 22,409

At December 31, 2017 and 2016, securities with carrying values of $559 and $540 were pledged to the FHLB. No other securities were pledged for public deposits or other borrowings.

Gross unrealized losses on investment securities and the fair value of the related securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2017 and 2016, were as follows:

	December 31, 2017					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
US treasuries and agencies	$ 10,949	$ 48	$ 8,996	$ 47	$ 19,945	$ 95
	$ 10,949	$ 48	$ 8,996	$ 47	$ 19,945	$ 95

	December 31, 2016					
	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
US treasuries and agencies	$ 10,993	$ 17	$ -	$ -	$ 10,993	$ 17
	$ 10,993	$ 17	$ -	$ -	$ 10,993	$ 17

The Corporation had no investments that had been in an unrealized loss position for greater than 12 months at December 31, 2016.

Note 2. Available for Sale Securities, Continued

On a periodic basis, management evaluates each security in the portfolio with an individual unrealized loss to determine if that loss represents other-than-temporary impairment. The factors considered in evaluating the securities include whether the securities were guaranteed by the U.S. government or its agencies and the securities' public ratings, if available, and how those two factors affect credit quality and recovery of the full principal balance, the relationship of the unrealized losses to increases in market interest rates, the length of time the securities have had temporary impairment, and management's intent and ability to hold the securities for the time necessary to recover the amortized cost. Management also reviews the payment performance, delinquency history and credit support of the underlying collateral for certain securities in the portfolio as part of the impairment analysis and review. Unrealized losses in the Corporation's investment portfolio were caused by fluctuations in interest rates. Because the decline in market value is not attributable to credit quality issues, and because management does not intend to sell and it is not more likely than not that it will be required to sell those securities before recovery of the amortized cost, management does not consider these securities to be other-than-temporarily impaired.

There were no sales of securities in 2017. In 2016, securities were sold for a total of $172 resulting in a gain of $32.

(in thousands, except share data)

Note 3. Loans

A summary of loans at December 31, 2017 and 2016 follows:

	December 31, 2017	December 31, 2016
Real estate - residential	$ 145,974	$ 154,699
Real estate - commercial	171,345	148,139
Commercial and industrial	26,650	25,882
Construction and development	98,494	77,210
Consumer and other	5,666	5,522
Total loans	448,129	411,452
Deferred loan fees, net	(1,612)	(1,245)
	$ 446,517	$ 410,207

Changes in the allowance for loan losses are as follows:

	Years ended December 31, 2017	Years ended December 31, 2016
Balance, beginning of year	$ 7,415	$ 8,031
Provision for loan losses	-	-
Loans charged-off	(812)	(951)
Recoveries	256	335
Balance, end of year	$ 6,859	$ 7,415

The Corporation's lending activities consist primarily of loans to customers in the Corporation's primary market area consisting of Rowan, Cabarrus, Wake and surrounding counties in North Carolina, and, accordingly, credit risk is affected by local economic conditions. The real estate and construction and development loan portfolios include loans on property, which can be affected by the condition of the local real estate market.

Loans pledged as collateral against the Federal Reserve Board discount window approximated $43,405 and $42,236 at December 31, 2017 and 2016, respectively.

A summary of the lending activity to executive officers, directors, and their related interests for the year ended December 31, 2017 follows:

	2017
Balance, beginning of year	$ 977
Additions	387
Repayments	(469)
Balance, end of year	$ 895

(in thousands, except share data)

Note 3. Loans, Continued

Such loans were made on substantially the same terms as those prevailing at the time for comparable transactions with other borrowers. Management does not believe these loans involve more than the normal risks of collectability.

The detailed activity in the allowance for loan losses and the recorded investment in loans receivable as of the years ended December 31, 2017 and 2016:

December 31, 2017	Real Estate Residential	Real Estate Commercial	Commercial and Industrial	Construction and Development	Consumer and Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance December 31, 2016	$ 1,815	$ 1,567	$ 164	$ 1,440	$ 34	$ 2,395	$ 7,415
Charge-offs	(296)	(31)	(6)	(390)	(89)	-	(812)
Recoveries	177	7	14	30	28	-	256
Provisions	(178)	(101)	(82)	232	52	77	-
Ending balance December 31, 2017	$ 1,518	$ 1,442	$ 90	$ 1,312	$ 25	$ 2,472	$ 6,859
Ending balances:							
Individually evaluated for impairment	$ 94	$ -	$ 3	$ 8	$ -	$ -	$ 105
Collectively evaluated for impairment	$ 1,424	$ 1,442	$ 87	$ 1,304	$ 25	$ 2,472	$ 6,754
Loans receivable:							
Individually evaluated for impairment	$ 2,408	$ 4,567	$ 67	$ 4,382	$ -	$ -	$ 11,424
Collectively evaluated for impairment	$ 143,566	$ 166,778	$ 26,583	$ 94,112	$ 5,666	$ -	$ 436,705
Ending balance	$ 145,974	$ 171,345	$ 26,650	$ 98,494	$ 5,666	$ -	$ 448,129

(in thousands, except share data)

Note 3. Loans, Continued

December 31, 2016	Real Estate Residential	Real Estate Commercial	Commercial and Industrial	Construction and Development	Consumer and Other	Unallocated	Total
Allowance for loan losses:							
Beginning balance December 31, 2015	$ 2,508	$ 1,547	$ 299	$ 1,852	$ 63	$ 1,762	$ 8,031
Charge-offs	(202)	(206)	(3)	(413)	(127)	-	(951)
Recoveries	141	64	11	53	66	-	335
Provisions	(632)	162	(143)	(52)	32	633	-
Ending balance December 31, 2016	$ 1,815	$ 1,567	$ 164	$ 1,440	$ 34	$ 2,395	$ 7,415
Ending balances:							
Individually evaluated for impairment	$ 108	$ -	$ 3	$ -	$ -	$ -	$ 111
Collectively evaluated for impairment	$ 1,707	$ 1,567	$ 161	$ 1,440	$ 34	$ 2,395	$ 7,304
Loans receivable:							
Individually evaluated for impairment	$ 3,092	$ 5,027	$ 73	$ 4,720	$ -	$ -	$ 12,912
Collectively evaluated for impairment	$ 151,607	$ 143,112	$ 25,809	$ 72,490	$ 5,522	$ -	$ 398,540
Ending balance	$ 154,699	$ 148,139	$ 25,882	$ 77,210	$ 5,522	$ -	$ 411,452

(in thousands, except share data)

Note 3. Loans, Continued

The following tables, by loan category, present at December 31, 2017 and 2016 loans individually evaluated and considered impaired.

December 31, 2017	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance needed:					
Real estate - residential	$ 1,379	$ 1,905	$ -	$ 1,615	$ 24
Real estate - commercial	4,567	5,815	-	4,691	139
Commercial and industrial	-	-	-	-	-
Construction and development	4,283	9,140	-	4,708	92
Consumer and other	-	-	-	-	-
With an allowance recorded:					
Real estate - residential	1,029	1,136	94	1,056	49
Real estate - commercial	-	-	-	-	-
Commercial and industrial	67	67	3	70	3
Construction and development	99	181	8	103	7
Consumer and other	-	-	-	-	-
Total:					
Real estate - residential	2,408	3,041	94	2,671	73
Real estate - commercial	4,567	5,815	-	4,691	139
Commercial and industrial	67	67	3	70	3
Construction and development	4,382	9,321	8	4,811	99
Consumer and other	-	-	-	-	-
	$ 11,424	$ 18,244	$ 105	$ 12,243	$ 314

December 31, 2016	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no allowance needed:					
Real estate - residential	$ 1,889	$ 2,455	$ -	$ 1,969	$ 24
Real estate - commercial	5,027	6,209	-	5,138	181
Commercial and industrial	-	-	-	667	35
Construction and development	4,720	9,128	-	5,329	91
Consumer and other	-	-	-	-	-
With an allowance recorded:					
Real estate - residential	1,203	1,297	108	1,234	56
Real estate - commercial	-	-	-	-	-
Commercial and industrial	73	73	3	78	4
Construction and development	-	-	-	-	-
Consumer and other	-	-	-	-	-
Total:					
Real estate - residential	3,092	3,752	108	3,203	80
Real estate - commercial	5,027	6,209	-	5,138	181
Commercial and industrial	73	73	3	745	39
Construction and development	4,720	9,128	-	5,329	91
Consumer and other	-	-	-	-	-
	$ 12,912	$ 19,162	$ 111	$ 14,415	$ 391

(in thousands, except share data)

Note 3. Loans, Continued

As of December 31, 2017 and 2016, the Corporation had troubled debt restructurings totaling $9,052 and $9,669, respectively, which are included in the above impaired loans. The Corporation does not have any commitments to extend additional credit on these loans.

The Corporation categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Corporation analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on a quarterly basis. The Corporation uses the following definitions for risk categories:

Watch. Loans classified as watch have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date. Watch assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified 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.

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with 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.

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass rated loans. As of December 31, 2017 and 2016, the risk category of loans by class of loans is shown in the table below.

December 31, 2017	Pass	Watch	Substandard	Doubtful	Total
Real estate - residential	$ 132,775	$ 10,306	$ 2,893	$ -	$ 145,974
Real estate - commercial	160,898	7,967	2,480	-	171,345
Commercial and Industrial	26,210	190	250	-	26,650
Construction and development	93,523	1,088	3,883	-	98,494
Consumer and other	5,554	107	5	-	5,666
Total	$ 418,960	$ 19,658	$ 9,511	$ -	$ 448,129

(in thousands, except share data)

Note 3. Loans, Continued

December 31, 2016	Pass	Watch	Substandard	Doubtful	Total
Real estate - residential	$ 138,728	$ 12,525	$ 3,446	$ -	$ 154,699
Real estate - commercial	135,295	9,971	2,873	-	148,139
Commercial and Industrial	25,356	249	277	-	25,882
Construction and development	71,360	1,496	4,354	-	77,210
Consumer and other	5,104	410	8	-	5,522
Total	$ 375,843	$ 24,651	$ 10,958	$ -	$ 411,452

A delinquent loan is generally placed in nonaccrual status when it becomes 90 days or more past due. At the time a loan is placed in nonaccrual status, all interest, which has been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest income. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain.

Troubled debt restructurings (TDRs) are loans which have been restructured from their original contractual terms and include concessions that would not otherwise have been granted outside of the financial difficulty of the borrower. Concessions can relate to the contractual interest rate, maturity date, or payment structure of the note. As part of our workout plan for individual loan relationships, we may restructure loan terms to assist borrowers facing challenges in the current economic environment. The purpose of a TDR is to facilitate ultimate repayment of the loan.

Our policy with respect to accrual of interest on loans restructured in a TDR follows relevant supervisory guidance. That is, if a borrower has demonstrated performance under the previous loan terms and shows capacity to perform under the restructured loan terms; continued accrual of interest at the restructured interest rate is likely. If a borrower was materially delinquent on payments prior to the restructuring but shows capacity to meet the restructured loan terms, the loan will likely continue as nonaccrual going forward. Lastly, if the borrower does not perform under the restructured terms, the loan is placed on nonaccrual status. TDRs in nonaccrual status at December 31, 2017 and 2016 amounted to $3,309 and $2,778, respectively.

We will continue to closely monitor these loans and will cease accruing interest on them if management believes that the borrowers may not continue performing based on the restructured note terms. If, after previously being classified as a TDR, a loan is restructured a second time, then that loan is automatically placed on nonaccrual status. Our policy with respect to nonperforming loans requires the borrower to make a minimum of six consecutive payments in accordance with the loan terms before that loan can be placed back on accrual status. Further, the borrower must show capacity to continue performing into the future prior to restoration of accrual status. To date, we have restored one nonaccrual loan classified as a TDR to accrual status.

(in thousands, except share data)

Note 3. Loans, Continued

The following tables, by loan category, present loans past due and in non-accrual status as of December 31, 2017 and 2016:

December 31, 2017	Accruing 30 - 59 Days Past Due	Accruing 60 - 89 Days Past Due	Accruing Greater Than 90 Days	Total Past Due and Accruing	Non-accrual	Current	Total Loans
Real estate - residential	$ 4,637	$ 92	$ 198	$ 4,927	$ 1,918	$ 139,129	$ 145,974
Real estate - commercial	849	-	116	965	1,520	168,860	171,345
Commercial and industrial	10	165	-	175	1	26,474	26,650
Construction and development	41	-	-	41	2,908	95,545	98,494
Consumer and other	293	-	-	293	-	5,373	5,666
	$ 5,830	$ 257	$ 314	$ 6,401	$ 6,347	$ 435,381	$ 448,129

December 31, 2016	Accruing 30 - 59 Days Past Due	Accruing 60 - 89 Days Past Due	Accruing Greater Than 90 Days	Total Past Due and Accruing	Non-accrual	Current	Total Loans
Real estate - residential	$ 385	$ 504	$ 138	$ 1,027	$ 2,570	$ 151,102	$ 154,699
Real estate - commercial	399	84	-	483	989	146,667	148,139
Commercial and industrial	28	49	-	77	5	25,800	25,882
Construction and development	73	945	107	1,125	3,346	72,739	77,210
Consumer and other	5	9	-	14	-	5,508	5,522
	$ 890	$ 1,591	$ 245	$ 2,726	$ 6,910	$ 401,816	$ 411,452

(in thousands, except share data)

Note 3. Loans, Continued

The following tables, by loan category, present loans determined to be TDRs during the years ended December 31, 2017 and 2016. The following loans were classified as TDR loans during the year due to a combination of below market interest rates and extended payment terms.

Troubled Debt Restructurings	For the year ended December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Nonaccrual			
Real estate - commercial	2	$ 50	$ 50
Total nonaccrual	2	$ 50	$ 50
Accrual			
Real estate - residential	1	98	98
Total accrual	1	$ 98	$ 98
Total TDRs	3	$ 148	$ 148

Troubled Debt Restructurings	For the year ended December 31, 2016		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Nonaccrual			
Real estate - residential	1	$ 113	$ 113
Total nonaccrual	1	$ 113	$ 113
Accrual			
Real estate - commercial	1	$ 402	$ 402
Real estate - residential	2	154	154
Total accrual	3	$ 556	$ 556
Total TDRs	4	$ 669	$ 669

(in thousands, except share data)

Note 3. Loans, Continued

Troubled debt restructurings are considered in default when they become thirty or more days past due. As of December 31, 2017 and 2016, there were no loans restructured during the previous twelve months that subsequently defaulted.

In the determination of the allowance for loan losses, all TDRs are reviewed to ensure that one of the three proper valuation methods (fair market value of the collateral, present value of cash flows, or observable market price) is adhered to. All TDRs are considered impaired. Under ASC 310-10, a loan is impaired when it is probable that the bank will be unable to collect all amounts due including both principal and interest according to the contractual terms of the loan agreement.

Note 4. Other Real Estate Owned

The following summarizes the activity in the other real estate owned for the years ended December 31, 2017 and 2016:

	2017	2016
Balance, beginning of year	$ 5,623	$ 5,514
Additions - foreclosures	346	1,133
Sales		
Proceeds from sales	(2,541)	(940)
Gain on sales	119	103
Write downs	(500)	(187)
Balance, end of year	$ 3,047	$ 5,623

Note 5. Premises, Equipment and Software

Premises, equipment and software consist of the following at December 31, 2017 and 2016:

	2017	2016
Land	$ 3,209	$ 3,359
Buildings	23,018	22,898
Construction in progress	134	374
Furniture, equipment and software	10,901	10,315
	37,262	36,946
Less accumulated depreciation	22,036	20,913
Premises, equipment and software, net	$ 15,226	$ 16,033

Depreciation expense was $1,140 and $1,242 for the years ended December 31, 2017 and 2016, respectively.

(in thousands, except share data)

Note 6. Mortgage Servicing Rights

The following is an analysis of capitalized mortgage servicing rights, included in other assets, for the years ended December 31:

	2017	2016
Balance, beginning of year	$ 300	$ 333
Capitalized servicing rights	69	112
Amortization	(125)	(145)
Balance, end of year	$ 244	$ 300

Mortgage loans serviced for others with unpaid principal balances of approximately $133,890 and $142,418 at December 31, 2017 and 2016, respectively, are not included in the accompanying consolidated balance sheets.

Gains on sales of loans were $207 and $305 for 2017 and 2016, respectively. The Corporation's mortgage banking income for the years ended December 31, 2017 and 2016 was $294 and $335, respectively. Capitalized mortgage servicing rights amounted to $69 and $112 for 2017 and 2016, respectively. Fees earned for servicing loans, net of amortization and impairment write-downs, were $224 and $216 in 2017 and 2016, respectively. Fees earned on brokered mortgage loans were $0 in 2017 and $7 in 2016.

Note 7. Deposits

At December 31, 2017, the scheduled maturities of all time deposits are as follows:

2018	$ 51,843
2019	34,736
2020	2,804
2021	2,005
Total time deposits	$ 91,388

The Corporation had no brokered certificates of deposit at December 31, 2017 and 2016.

The aggregate amount of time deposits with a minimum denomination of $250,000 was approximately $9,496 at December 31, 2017.

At December 31, 2017, deposits with a deficit balance of $65 were re-classified to loans, compared to $60 at December 31, 2016.

Deposits received from executive officers, directors, and their related interests totaled approximately $4,683 and $4,590 at December 31, 2017 and 2016, respectively. These deposit accounts have substantially the same terms, including interest rates, as those prevailing at the time for comparable transactions with other non-related depositors.

(in thousands, except share data)

Note 8. Federal Home Loan Bank Borrowings

The Corporation has an agreement with the FHLB under which it can borrow up to 30 percent of the Corporation's total assets, limited to qualifying collateral. Total qualifying collateral was $73,020 and $84,986 at December 31, 2017 and 2016. The Bank had no FHLB borrowings outstanding at December 31, 2017 and December 31, 2016. At December 31, 2017 and 2016, the Bank had an $11.8 million and $10.9 million unfunded letter of credit with the FHLB to secure public deposits with the State of North Carolina.

The Corporation has entered into a blanket collateral agreement with the FHLB whereby the Corporation maintains, free of other encumbrances, qualifying mortgages (as defined) with unpaid principal balances at least equal to various discounts of the unpaid principal balance, 100 percent of the total FHLB borrowings. The Corporation's FHLB stock is also pledged as collateral for the borrowings. Upon request, the stock may be sold back to the FHLB, at cost.

Note 9. 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 December 31, 2017.

The company recognized the income tax effects of the 2017 Tax Act in its 2017 financial statements in accordance with Staff Accounting Bulletin No. 118, which provides guidance for the application of ASC Topic 740, Income Taxes, in the reporting period in which the 2017 Tax Act was signed into law. As such, the company's financial results reflect the income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is complete and provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting under ASC Topic 740 is incomplete but a reasonable estimate could be determined. The company did not identify items for which the income tax effects of the 2017 Tax Act have not been completed and a reasonable estimate could not be determined as of December 31, 2017.

Income tax expense allocated to net income consists of the following for the years ended December 31, 2017 and 2016:

	Current	Deferred	Total
December 31, 2017:			
Federal	$ 2,636	$ 1,416	$ 4,052
State	180	74	254
	$ 2,816	$ 1,490	$ 4,306
December 31, 2016:			
Federal	$ 1,924	$ 70	$ 1,994
State	194	115	309
	$ 2,118	$ 185	$ 2,303

(in thousands, except share data)

Note 9. Income Taxes, Continued

The reconciliation of federal income tax rates to the effective income tax rates for the years ended December 31, 2017 and 2016, is as follows:

	2017	2016
Statutory federal income tax rate	34.0%	34.0%
Increase (decrease) in tax rates resulting from:		
State and local income taxes, net of federal income tax benefit	1.9	3.3
Tax exempt income	(0.8)	(1.2)
Remeasurement of deferred taxes under TCJA	13.0	-
Other, net	1.0	1.4
Effective rate	**49.1%**	**37.5%**

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities, included in other assets, at December 31, 2017 and 2016 are presented below:

	2017	2016
Deferred income tax assets:		
Loan loss reserves	$ 1,576	$ 2,668
Deferred compensation	624	1,026
Unrealized loss on securities available for sale	15	-
Other	432	885
Total gross deferred income tax assets	2,647	4,579
Deferred income tax liabilities:		
Unrealized gain on securities available for sale	-	(15)
Depreciable basis of fixed assets	(386)	(641)
Mortgage servicing rights	(130)	(273)
Other	(118)	(178)
Total gross deferred income tax liabilities	(634)	(1,107)
Net deferred income tax asset	$ 2,013	$ 3,472

The company 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, resulting in a $1,138 increase in income tax expense for the year ended December 31, 2017 and a corresponding $1,138 decrease in net deferred tax assets as of December 31, 2017.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax asset will not be realized. Management considers recoverable taxes paid in prior years, projected future taxable income, and tax planning strategies in making this assessment. It is management's belief that the realization of the net deferred tax assets is more likely than not.

Note 9. Income Taxes, Continued

The Corporation 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.

The Corporation and its subsidiaries file income tax returns with the federal government and the state of North Carolina. With few exceptions, the Corporation is no longer subject to federal or state income tax examinations by tax authorities for years before 2014.

Note 10. Employee Benefits

The Corporation has available to its employees a benefit plan which was created by combining an existing defined contribution profit sharing plan and an employee stock ownership plan (ESOP). In addition, the Corporation added a 401(k) provision to the combined plan calling the plan a KSOP. Substantially all employees of the Corporation who work 1,000 hours per year and have attained the age of 18 are covered under the defined contribution KSOP. As of December 31, 2017 and 2016, the Corporation had expenses of $239 and $260 related to the KSOP match.

Common stock of the Corporation previously contributed to the KSOP has a put feature available to the KSOP participants since the stock is not "readily tradable on an established market". The put feature permits the participants to sell their common shares obtained from the KSOP to the Corporation at the fair market value of such shares. At December 31, 2017 and 2016, there were 23,442 and 24,779 shares in the KSOP.

The Corporation provides a salary continuation plan for current and former senior employees. Participants in the plan are eligible to receive an annual retirement benefit beginning at age 65 equal to a prescribed percentage of their last annual salary. Currently, such percentages range from 45 percent to 65 percent. The retirement benefit is paid in monthly installments for fifteen years following retirement. As of December 31, 2017 and 2016, the Corporation had related accrued liabilities of approximately $2,715 and $2,850, respectively and is included in other liabilities on the consolidated balance sheets. The Corporation has indirectly and partially funded the retirement benefits through the purchase of life insurance. The cash surrender value of life insurance at December 31, 2017 and 2016 was $3,000 and $2,686, respectively and is included in other assets on the consolidated balance sheets.

Note 11. Stock Compensation

The Corporation has stock option agreements in which options were periodically granted to directors and employees of the Corporation, at a price equal to the fair market value of the shares at the date of grant. The option agreements vary with some having immediate vesting.

Of the granted options, 37,478 were outstanding at December 31, 2017, of which 37,478 were exercisable. The exercise prices for the options outstanding at December 31, 2017 range from $21.40 to $33.25 per share. The weighted average remaining contractual life of options outstanding at December 31, 2017 was approximately 6.4 years. The following is a summary of the options outstanding at December 31, 2017:

(in thousands, except share data)

Note 11. Stock Compensation, Continued

Option price	Options outstanding	Exercisable	Contractual remaining life
$ 25.25	16,778	16,778	11 years
33.25	9,500	9,500	½ years
30.60	1,000	1,000	1 ½ years
28.25	1,000	1,000	2 ½ years
26.50	1,000	1,000	3 ½ years
24.70	1,000	1,000	4 ½ years
21.40	7,200	7,200	5 ½ years
	37,478	37,478	

There were no stock options granted in 2017 or 2016. The following data summarizes the option activity related to the grants discussed above:

	Number of options		Average exercise price per share
	Available for future grants	Granted options	
As of December 31, 2015	-	119,278	32.45
Exercised	-	(500)	21.40
Expired/Forfeited	-	(2,000)	35.40
As of December 31, 2016	-	116,778	32.45
Exercised	-	1,300	24.13
Expired/Forfeited	-	78,000	35.31
As of December 31, 2017	-	**37,478**	**26.78**

Effective May 12, 2015, the F&M Financial Corporation Restricted Unit Program was established. Pursuant to the Program, the Corporation may issue restricted units that entitle the recipient to receive, upon vesting, shares of common stock. The Corporation granted 120,000 restricted units as of June 30, 2015 to senior officers at a fair market value of $23 per share. The units vest in equal annual installments over fifteen or twenty year periods. During 2017 and 2016, 7,625 units vested resulting in 5,775 shares issued and 1,850 units withheld for payment of taxes. As of December 31, 2017, there were 104,750 restricted units outstanding, none of which are vested. The Corporation recorded compensation expense of $175 in 2017 and 2016 related to the grants.

Note 12. Commitments and Contingencies

In the normal course of business there are outstanding commitments for extension of credit which are not reflected in the consolidated financial statements. At December 31, 2017 and 2016, pre-approved but unused lines of credit and other loan commitments were approximately $174,454 and $172,378, of which $46,509 and $50,433 related to home equity lines of credit, respectively. At December 31, 2017 and 2016, the Corporation had $989 and $2,308 in commitments to originate and to sell loans held for sale, respectively. The fair value of these commitments was not material.

Note 12. Commitments and Contingencies, Continued

Additionally, the Corporation has outstanding letters of credit, which are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. The Corporation would incur a credit loss in the event that the counterparty draws on the commitment and subsequently fails to perform under the terms of the lending agreement. The Corporation's maximum exposure to credit loss in the event of nonperformance by the counterparties for commitments on standby letters of credit is represented by the contract amount of those instruments. At December 31, 2017 and 2016 the maximum risk of potential loss under standby letters of credit was $716 and $2,191, respectively.

The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. If these commitments are drawn, the Corporation will obtain collateral if it is deemed necessary based on management's credit evaluation of the counterparty. Management believes that these commitments can be funded through normal operations.

In the ordinary course of business, the Corporation may, from time to time, become a party to legal claims and disputes. At December 31, 2017, management, after consultation with legal counsel, is not aware of any pending or threatened litigation or un-asserted claims or assessments that could result in losses, if any, that would be material to the consolidated financial statements.

Note 13. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

The use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach are required. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants

Note 13. Fair Value of Financial Instruments, Continued

would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, a fair value hierarchy is established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

Fair Value Hierarchy -

Level 1: Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that the Corporation has the ability to access.

Level 2: Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the assets or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Corporation's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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

Securities Available for Sale - Investment securities available for sale are recorded at fair value on a recurring basis. 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. Level 2 securities include mortgage-backed securities issued by government sponsored entities and municipal bonds.

Loans - The Corporation 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 losses 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 agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment by estimating the fair value of the impaired loan using one of several methods; including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2017 and 2016, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. For impaired loans that have

Note 13. Fair Value of Financial Instruments, Continued

an allowance established based on the fair value of collateral, a classification in the fair value hierarchy is required. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

Other Real Estate Owned (OREO) – Foreclosed assets are adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, based upon comparable sales within one year, the Corporation records the OREO as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the OREO as nonrecurring Level 3.

Mortgage Servicing Rights - The Corporation generally retains the right to service mortgage loans sold to others. The cost allocated to the mortgage servicing rights retained has been recognized as a separate asset and is being amortized in proportion to and over the period of estimated net servicing income.

Mortgage servicing rights are periodically evaluated for impairment based on the fair value of those rights. Fair values are estimated using discounted cash flows based on current market rates of interest and current expected future prepayment rates. The amount of impairment recognized is the amount, if any, by which the amortized cost of the rights for each stratum exceed their fair value.

(in thousands, except share data)

Note 13. Fair Value of Financial Instruments, Continued

Assets and Liabilities Measured at Fair Value on a Recurring Basis – The table below presents the Corporation's assets measured at fair value on a recurring basis as of December 31, 2017 and 2016, aggregated by the level in the fair value hierarchy within which those measurements fall. There were no liabilities measured at fair value on a recovery basis as of December 31, 2017 or 2016.

	Level 1	Level 2	Level 3	Total
December 31, 2017				
Assets:				
Securities available for sale:				
US treasuries and agencies	$ -	$ 19,904	$ -	$ 19,904
State, county, and municipal obligations	-	1,946	-	1,946
Mortgage servicing rights	-	-	244	244
Total assets at fair value	**$ -**	**$ 21,850**	**$ 244**	**$ 22,094**

	Level 1	Level 2	Level 3	Total
December 31, 2016				
Assets:				
Securities available for sale:				
US treasuries and agencies	$ -	$ 20,056	$ -	$ 20,056
State, county, and municipal obligations	-	2,227	-	2,227
Mortgage servicing rights	-	-	300	300
Total assets at fair value	**$ -**	**$ 22,283**	**$ 300**	**$ 22,583**

(in thousands, except share data)

Note 13. Fair Value of Financial Instruments, Continued

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Mortgage Servicing Rights
Balance, December 31, 2015	$ 333
Total net losses included in net income	(33)
Balance, December 31, 2016	300
Total net losses included in net income	(56)
Balance, December 31, 2017	**$ 244**

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis - The Corporation may be required, from time to time, to measure certain assets and liabilities at fair value on a nonrecurring basis. These include assets and liabilities that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. The table below presents the Corporation's assets measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016 aggregated by the level in the fair value hierarchy within which those measurements fall. There were no liabilities measured at fair value on a nonrecurring basis as of December 31, 2017 or 2016.

December 31, 2017	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Impaired loans	$ -	$ -	$ 11,319	$ 11,319
Other real estate owned	-	-	3,047	3,047
Total assets at fair value	$ -	$ -	$ 14,366	$ 14,366

December 31, 2016	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets:				
Impaired loans	$ -	$ -	$ 12,801	$ 12,801
Other real estate owned	-	-	5,623	5,623
Total assets at fair value	$ -	$ -	$ 18,424	$ 18,424

(in thousands, except share data)

Note 13. Fair Value of Financial Instruments, Continued

For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2017 and 2016, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2017	Fair Value at December 31, 2016	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired Loans	$ 11,319	$ 12,801	Appraised Value/Discounted Cash Flows/Market Value of Note	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0 – 18%
Other Real Estate Owned	$ 3,047	$ 5,623	Appraised Value/Comparable Sales/Other Estimates from Independent Sources	Discounts to reflect current market conditions and estimated costs to sell	8 – 10%

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Corporation's entire holdings of a particular financial instrument. Because no market exists for a portion of the Corporation's financial instruments, fair value estimates are based on judgments regarding future expected loss experience, current economic conditions, risk characteristics of various financial instruments, and other factors. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates are based on existing on and off balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets or liabilities not considered financial instruments include deferred tax assets and premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered.

Note 14. Regulatory Matters

All bank holding companies and banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications 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 Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier I capital (as defined) to average assets (as defined). Management believes, as of December 31, 2017, that the Corporation and the Bank meet all capital adequacy requirements to which it is subject.

As of December 31, 2017, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios as set forth in the table. There are no conditions or events since that notification that management believes have changed any of the Corporation's and/or Bank's categories.

In July 2013, the Federal Reserve and the FDIC approved revisions to their capital adequacy guidelines and prompt corrective action rules that implement the revised standards of the Basel Committee on Banking Supervision, commonly called "Basel III," and address relevant provision of the Dodd-Frank Act. Basel III refers to two consultative documents released by the Basel Committee on Banking Supervision in December 2009, the rules text released in December 2010, and loss absorbency rules issued in January 2011, which include significant changes to bank capital, leverage, and liquidity requirements.

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 percent; (ii) a Tier 1 capital ratio of 6.0 percent (increased from 4.0 percent); (iii) a total capital ratio of 8.0 percent (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4.0 percent 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 companies with consolidated assets of $15 billion or less. The rules also establish a "capital conservation buffer" of 2.5 percent above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0 percent, (ii) a Tier 1 capital ratio of 8.5 percent and (iii) a total capital ratio of 10.5 percent. The new capital conservation buffer phase-in requirement began in January 2016 at 0.625 percent 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 level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that may be utilized for such actions.

(in thousands, except share data)

Note 14. Regulatory Matters, Continued

The Corporation's and Bank's required and actual capital amounts and ratios are presented in the table below.

	Actual		Fully Phased-In Minimum Capital		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017						
Corporation						
Common equity tier 1 capital (to risk-weighted assets)	$ 64,834	14.41%	$ 31,489	7.00%	$ N/A	N/A
Total capital (to risk-weighted assets)	70,469	15.67%	47,233	10.50%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	64,834	14.41%	38,236	8.50%	N/A	N/A
Tier 1 capital (to average assets)	64,834	10.64%	24,374	4.00%	N/A	N/A
Bank						
Common equity tier 1 capital (to risk-weighted assets)	$ 64,645	14.38%	$ 31,469	7.00%	$ 29,221	6.50%
Total capital (to risk-weighted assets)	70,280	15.63%	47,203	10.50%	44,955	10.00%
Tier 1 capital (to risk-weighted assets)	64,645	14.38%	38,212	8.50%	35,964	8.00%
Tier 1 capital (to average assets)	64,645	10.61%	24,362	4.00%	30,453	5.00%
December 31, 2016						
Corporation						
Common equity tier 1 capital (to risk-weighted assets)	$ 62,292	14.91%	$ 29,240	7.00%	$ N/A	N/A
Total capital (to risk-weighted assets)	67,539	16.17%	43,860	10.50%	N/A	N/A
Tier 1 capital (to risk-weighted assets)	62,292	14.91%	35,505	8.50%	N/A	N/A
Tier 1 capital (to average assets)	62,292	10.81%	23,040	4.00%	N/A	N/A
Bank						
Common equity tier 1 capital (to risk-weighted assets)	$ 62,130	14.88%	$ 29,229	7.00%	$ 27,141	6.50%
Total capital (to risk-weighted assets)	67,377	16.14%	43,843	10.50%	41,755	10.00%
Tier 1 capital (to risk-weighted assets)	62,130	14.88%	35,492	8.50%	33,404	8.00%
Tier 1 capital (to average assets)	62,130	10.79%	23,033	4.00%	28,792	5.00%

Note 15. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before consolidated financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 23, 2018, the date the consolidated financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.