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, Ron Day
Name of the Holding Company Director and Official

President, CEO & 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

February 14, 2018
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

First Carolina Financial Services, Inc.
Legal Title of Holding Company

171 N. Winstead Ave
(Mailing Address of the Holding Company) Street / P.O. Box

| Rocky Mount | NC | 27804 |
|---|---|---|
| City | State | Zip Code |

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

| Debra Medlin | CFO |
|---|---|
| Name | Title |

252-451-2971
Area Code / Phone Number / Extension

252-443-6515
Area Code / FAX Number

debramedlin@firstcarolinabank.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.

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First Carolina Financial Services, Inc.
Rocky Mount, North Carolina
Fiscal Year Ending December 31, 2017

Report Item

1. The holding company does prepare an annual report for it securities holders and is not registered with the SEC. The audited financials are not completed.

2a. Organizational Chart

First Carolina Financial Services, Inc.

Rocky Mount, North Carolina

Incorporated in North Carolina

No LEI

First Carolina Bank

(LEI – 54930066LN6QXNO8TY84)

Rocky Mount, North Carolina

Incorporated in North Carolina

99.24%

2b. Domestic Branch listing is included in this package.

**Results:** A list of branches for your depository institution: FIRST CAROLINA BANK (ID_RSSD: 2963266).
This depository institution is held by FIRST CAROLINA FINANCIAL SERVICES, INC. (4346706) of ROCKY MOUNT, 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.

| Data Action | Effective Date | 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 Office) | 2963266 | FIRST CAROLINA BANK | 171 NORTH WINSTEAD AVE | ROCKY MOUNT | NC | 27804 | NASH | UNITED STATES | Not Required | Not Required | FIRST CAROLINA BANK | 2963266 | |
| OK | | Full Service | 5142848 | RALEIGH BRANCH | 2626 GLENWOOD AVE. STE 190 | RALEIGH | NC | 27608 | WAKE | UNITED STATES | Not Required | Not Required | FIRST CAROLINA BANK | 2963266 | |
| OK | | Full Service | 3957570 | REIDSVILLE BRANCH | 604 SOUTH SCALES STREET | REIDSVILLE | NC | 27320 | ROCKINGHAM | UNITED STATES | Not Required | Not Required | FIRST CAROLINA BANK | 2963266 | |

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First Carolina Financial Services, Inc.
Rocky Mount, North Carolina
Fiscal Year Ending December 31, 2017

Report Item 3: Securites Holders
(1)(a)(b)(c) and (2)(a)(b)(c )

Current Securities holders with ownership, control or holdings of 5% or more with power to vote as of ficscal year ending December 31, 2017

| (1)(a) Name, City, State, Country | (1)(b) Country of Citizenship | (1)(c) Number and Percentage of Each Class of Voting Securities |
|---|---|---|
| A. Donald Stallings<br>Rocky Mount, North Carolina, USA | USA | 180,250 - 6.70% Common Stock |

Securities holders not listed in 3(1)(a) through 3(1)(c ) that had ownership, control or holdings of 5% or more with power to vote during the fiscal year December 31, 2017

| (2)(a) Name, City, State, Country | (2)(b) Country of Citizenship | (2)(c) Number and Percentage of Each Class of Voting Securities |
|---|---|---|
| none | | |

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First Carolina Financial Services, Inc.
Rocky Mount, North Carolina
Fiscal Year Ending December 31, 2017

Report Item 4: Insiders
(1), (2), (3)(a)(b)(c) and (4)(a)(b)(c )

| (1) Name<br>City, State, Country | (2) Principal Occupation if other than with Holding Company | (3)(a) Title & Position with Holding Company | (3)(b) Title & Position with Subsidiaries (include names of Subsidiaries) | (3)(c ) Title & Position with Other Businesses (include names of other businesses) | (4)(a) Percentage of Voting Shares in Holding Company | (4)(b) Percentage of Voting Shares in Subsidiaries (include names of Subsidiaries) | (4)(c ) List names of other companies (includes partnerships) if 25% or more of voting securities are held (List names of companies and percentages of voting securities held) |
|---|---|---|---|---|---|---|---|
| Ronald A. Day<br>Raleigh, NC, USA | President/CEO<br>First Carolina Bank | President/CEO/Director | President/CEO<br>First Carolina Bank | n/a | 2.43% | none | n/a |
| Debra A. Medlin<br>Rocky Mount, NC | CFO<br>First Carolina Bank | CFO/Corporate Secretary | CFO<br>First Carolina Bank | n/a | 0.37% | none | n/a |
| John A. Williams<br>Cary, NC, USA | Chairman of BioSignia, Inc. | Chairman | Chairman<br>First Carolina Bank | n/a | 1.88% | none | n/a |
| Thomas A. Betts, Jr.<br>Rocky Mount, NC, USA | Retired | Director | Director<br>First Carolina Bank | n/a | 1.76% | none | n/a |
| Charles A. Robbins<br>Rocky Mount, NC, USA | CEO, COECO Office Systems | Director | Director<br>First Carolina Bank | CEO<br>-COECO | 2.89% | none | -Coeco 100% |
| John Jethro Ferebee<br>Greenville, NC, USA | President, Maritime Properties | Director | Director<br>First Carolina Bank | CEO<br>-Maritime Properties, Inc.<br>-Ferebee Property Operating Co. LLC<br>-Camp Hatteras LLC | 2.41% | none | -Maritime Properties, Inc. 100%<br>-Ferebee Property Operating Co. LLC 50%<br>-Camp Hatteras LLC 100% |
| A. Donald Stallings<br>Rocky Mount, NC, USA | Chairman/ CEO Eagle Transport | Director | Director<br>First Carolina Bank | Chairman/ CEO<br>-Eagle Transport | 6.70% | none | -Eagle Transport 100%<br>-ADS Investments 100% |
| John W. Gussenhoven<br>Wilmington, NC, USA | Retired | Director | Director<br>First Carolina Bank | Retired | 2.20% | none | n/a |
| Kaye Boone<br>Rocky Mount, NC, USA | CFO / Frontier Trailers | Director | Director<br>First Carolina Bank | CFO<br>Frontier Trailers Assoc., Inc. | 2.36% | none | FTA Parts 53.682% |
| Vincent C.Andracchio II<br>Rocky Mount, NC, USA | Chairman and CEO / Guardian Holdings Inc. | Director | Director<br>First Carolina Bank | Chairman and CEO / Guardian Holdings Inc. | 2.04% | none | Guardian Holdings, Inc. 60.97% |
| Charles A. Paul, III<br>Wilmington, NC, USA | Managing Partner, Harbor Island Partners, LLC.<br>President and CEO, Bald Head Island Limited, LLC. | Director | Director<br>First Carolina Bank | Managing Partner, Harbor Island Partners LLC.<br>President and CEO, Bald Head Island Limited, LLC. | 1.02% | none | Harbor Island Partners, LLC 100%<br>Harbor Island Capital, LLC. 33.33%<br>SouthSide Holdings, LLC 33.02%<br>Port Cape Fear Associates, LLC 25%<br>Port Cape Fear, Inc. 25%<br>Wilmington Marine Service, LLC. 25%<br>Commercial Realty Co. Inc. 25%<br>Three River Partners, LLC. 50% |

# FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY

CONSOLIDATED FINANCIAL STATEMENTS

***As of and for the Years Ended December 31, 2017 and 2016***

***And Report of Independent Auditor***

Cherry Bekaert LLP
CPAs & Advisors

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**

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Cherry Bekaert LLP
CPAs & Advisors

# Report of Independent Auditor

To the Stockholders and Board of Directors
First Carolina Financial Services, Inc. and Subsidiary
Rocky Mount, North Carolina

We have audited the accompanying consolidated financial statements of First Carolina Financial Services, Inc. and Subsidiary (collectively the "Company"), which comprise the consolidated statements of financial condition as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## Management's Responsibility for the Consolidated Financial Statements

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

## Auditor's Responsibility

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

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

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

## Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Cherry Bekaert LLP*

Raleigh, North Carolina
May 18, 2018

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

*DECEMBER 31, 2017 AND 2016*

| | 2017 | 2016 |
|---|---|---|
| | **(Dollars in thousands, except share and per share data)** | |
| **ASSETS** | | |
| Cash and Cash Equivalents: | | |
| Non-interest-bearing deposits | $ 2,378 | $ 1,259 |
| Interest-bearing deposits | 15,193 | 9,670 |
| Total Cash and Cash Equivalents | 17,571 | 10,929 |
| Securities available for sale, at fair value | 122,890 | 43,958 |
| Federal Home Loan Bank stock, at cost | 186 | 142 |
| Loans receivable | 179,153 | 138,221 |
| Allowance for loan losses | (954) | (706) |
| Net Loans | 178,199 | 137,515 |
| Foreclosed real estate | - | 229 |
| Premises and equipment, net | 3,931 | 3,788 |
| Goodwill | 1,792 | 1,792 |
| Other intangible assets, net | 197 | 250 |
| Deferred tax assets, net | 1,118 | 2,524 |
| Bank-owned life insurance | 4,176 | 4,036 |
| Prepaid expenses and other assets | 1,111 | 788 |
| **Total Assets** | $ 331,171 | $ 205,951 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Liabilities: | | |
| Deposits | $ 300,905 | $ 179,637 |
| Accrued expenses and other liabilities | 1,051 | 609 |
| **Total Liabilities** | 301,956 | 180,246 |
| Stockholders' Equity: | | |
| Common stock, $1 par value, authorized 40,000,000 shares; issued 2,674,605 and 2,449,105 shares at December 31, 2017 and 2016, respectively | 2,675 | 2,449 |
| Additional paid-in capital | 24,738 | 22,039 |
| Accumulated surplus | 1,917 | 1,209 |
| Accumulated other comprehensive loss | (146) | (17) |
| Noncontrolling interests | 31 | 25 |
| **Total Stockholders' Equity** | 29,215 | 25,705 |
| **Total Liabilities and Stockholders' Equity** | $ 331,171 | $ 205,951 |

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

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**
CONSOLIDATED STATEMENTS OF OPERATIONS

*YEARS ENDED DECEMBER 31, 2017 AND 2016*

| | | 2017 | | 2016 |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Interest Income: | | | | |
| Loans, including fees | $ | 6,790 | $ | 5,246 |
| Investment securities | | 2,171 | | 750 |
| Total Interest Income | | 8,961 | | 5,996 |
| Interest Expense: | | | | |
| Deposits | | 2,199 | | 956 |
| Total Interest Expense | | 2,199 | | 956 |
| Net interest income | | 6,762 | | 5,040 |
| Provision for loan losses | | 239 | | 157 |
| Net interest income after provision for loan losses | | 6,523 | | 4,883 |
| Non-Interest Income: | | | | |
| Service charges on deposit accounts | | 277 | | 214 |
| Bank-owned life insurance income | | 139 | | 36 |
| Gain on sale of securities | | 543 | | - |
| Other | | 23 | | 46 |
| Total Non-Interest Income | | 982 | | 296 |
| Non-Interest Expense: | | | | |
| Compensation and benefits | | 2,935 | | 2,227 |
| Occupancy and equipment | | 983 | | 938 |
| Data processing | | 65 | | 84 |
| Foreclosed real estate | | 49 | | 10 |
| Federal deposit insurance premiums | | 167 | | 84 |
| Professional fees | | 418 | | 336 |
| Director fees | | 69 | | 65 |
| Other | | 653 | | 599 |
| Total Non-Interest Expense | | 5,339 | | 4,343 |
| Income before income tax expense | | 2,166 | | 836 |
| Income tax expense | | (1,452) | | (323) |
| Net income | | 714 | | 513 |
| Less net income allocable to noncontrolling interests | | (6) | | (4) |
| Net income allocable to First Carolina Financial Services, Inc. | $ | 708 | $ | 509 |

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

*YEARS ENDED DECEMBER 31, 2017 AND 2016*

| | 2017 | 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Net income | $ 714 | $ 513 |
| Other Comprehensive Gain: | | |
| Unrealized holding gains on securities available for sale | 671 | 34 |
| Reclassification of realized gains on securities available for sale | (543) | (1) |
| Tax effect | 1 | (12) |
| Total Other Comprehensive Gain | 129 | 21 |
| Comprehensive income | $ 843 | $ 534 |

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

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

*YEARS ENDED DECEMBER 31, 2017 AND 2016*

| | Shares of Common Stock | Common Stock | Additional Paid-in Capital | Accumulated Surplus | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| | | | (Dollars in thousands, except share and per share data) | | | | |
| **Balance, January 1, 2016** | 1,649,105 | $ 1,649 | $ 13,970 | $ 700 | $ (38) | $ 21 | $ 16,302 |
| Net income | - | - | - | 509 | - | 4 | 513 |
| Other comprehensive income | - | - | - | - | 21 | - | 21 |
| Issuance of common stock, | | | | | | | - |
| net of offering expenses | 670,000 | 670 | 8,004 | - | - | - | 8,674 |
| Restricted stock issuance | 130,000 | 130 | 65 | - | - | - | 195 |
| **Balance, December 31, 2016** | 2,449,105 | 2,449 | 22,039 | 1,209 | (17) | 25 | 25,705 |
| Net income | - | - | - | 708 | - | 6 | 714 |
| Other comprehensive income | - | - | - | - | (129) | - | (129) |
| Issuance of common stock, | | | | | | | |
| net of offering expenses | 200,000 | 200 | 2,500 | - | - | - | 2,700 |
| Restricted stock issuance | 25,500 | 26 | 199 | - | - | - | 225 |
| **Balance, December 31, 2017** | 2,674,605 | $ 2,675 | $ 24,738 | $ 1,917 | $ (146) | $ 31 | $ 29,215 |

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

**FIRST CAROLINA FINANCIAL SERVICES, INC. AND SUBSIDIARY**
CONSOLIDATED STATEMENTS OF CASH FLOWS

*YEARS ENDED DECEMBER 31, 2017 AND 2016*

| | 2017 | 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| **Cash flows from operating activities:** | | |
| Net income | $ 714 | $ 513 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 271 | 274 |
| Loss on sale of premises and equipment | - | 1 |
| Net gains on sale of securities available for sale | (543) | (1) |
| Amortization of intangible assets | 53 | 53 |
| Accretion of fair value purchase accounting adjustments | (39) | (70) |
| Provision for loan losses | 239 | 157 |
| Deferred income tax expense | 1,426 | 298 |
| Earnings on bank-owned life insurance | (139) | (36) |
| Loss (gain) on sale of foreclosed real estate | 47 | (1) |
| Change in assets and liabilities: | | |
| Prepaid expenses and other assets | (323) | (228) |
| Accrued expenses and other liabilities | 442 | (182) |
| Net cash provided by operating activities | 2,148 | 778 |
| **Cash flows from investing activities:** | | |
| Proceeds from maturities, prepayments, and calls of securities | 22,398 | 2,841 |
| Proceeds from sales of securities available for sale | 52,264 | 2,001 |
| Purchases of securities available for sale | (153,200) | (24,614) |
| Loan originations and principal payments on loans, net | (40,884) | (23,717) |
| Proceeds from sales of foreclosed real estate | 182 | 246 |
| Purchase of FHLB stock | (44) | (41) |
| Purchase of bank-owned life insurance | (1) | (4,000) |
| Purchases of premises and equipment | (414) | (182) |
| Net cash used in investing activities | (119,699) | (47,466) |
| **Cash flows from financing activities:** | | |
| Net increase in deposits | 121,268 | 39,803 |
| Net proceeds from issuance of common stock | 2,700 | 8,674 |
| Net proceeds from issuance of restricted stock issuance | 225 | 195 |
| Net cash provided by financing activities | 124,193 | 48,672 |
| Net increase in cash and cash equivalents | 6,642 | 1,984 |
| Cash and cash equivalents, beginning of year | 10,929 | 8,945 |
| Cash and cash equivalents, end of year | $ 17,571 | $ 10,929 |
| **Supplemental disclosures of cash flow information:** | | |
| Cash payments for: | | |
| Interest on deposits and other borrowings | $ 2,135 | $ 955 |
| **Supplemental disclosures of noncash transactions:** | | |
| Change in fair value of investment securities available for sale | $ 128 | $ 33 |

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

## Note 1—Nature of business and summary of significant accounting policies

*Organization* – First Carolina Financial Services, Inc. (the "Company"), a North Carolina corporation, was incorporated on December 17, 2009 and was approved as a bank holding company on July 10, 2012. The Company is a bank holding company registered with the Board of Governors of the Federal Reserve System under the Bank Holding Company Act of 1956, as amended (the "BHCA"). The Company is the majority owner and serves as a holding company for First Carolina Bank (the "Bank"). The Company entered into a stock purchase agreement on September 13, 2011, to purchase 99.24% of the outstanding shares of First Carolina State Bank, later renamed First Carolina Bank. The Company's activities consist of managing and owning the Bank, which operates three branches in Rocky Mount, Raleigh, and Reidsville, North Carolina. In addition, the Bank has a loan production office in Wilmington, North Carolina.

During 2016, the Company completed a private placement common stock offering of $1 par common stock at a price of $13.00 per share generating $8,674,433 in net proceeds, increasing common stock by $670,000 and additional paid-in capital by $8,004,433. During 2017, the Company completed a new private placement common stock offering of $1 par common stock at a price of $13.50 per share generating $2,700,000 in net proceeds, increasing common stock by $200,000 and additional paid-in capital by $2,500,000.

*Nature of Business* – The Bank provides mortgage, consumer, and commercial banking services primarily within Nash, Pitt, Wake, New Hanover, and Rockingham Counties, North Carolina. The Bank's primary regulators are the Federal Deposit Insurance Corporation ("FDIC") and the North Carolina Commissioner of Banks. The Bank's deposits are insured by the Deposit Insurance Fund (DIF) of the FDIC.

The following is a description of the significant accounting policies used in the preparation of the accompanying consolidated financial statements:

*Principles of Consolidation* – The consolidated financial statements include the accounts of First Carolina Financial Services, Inc. and its majority-owned subsidiary, First Carolina Bank. All significant intercompany transactions and balances have been eliminated in consolidation.

*Use of Estimates* – The preparation of 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 the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, valuation of foreclosed real estate, goodwill impairment, realization of net deferred tax assets and liabilities, and fair values of financial instruments.

*Cash and Cash Equivalents* – For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the consolidated balance sheet captions "Non-interest-bearing deposits" and "Interest-bearing deposits" with maturities of fewer than 90 days. The Company places its cash and cash equivalents on deposit with the Federal Reserve and other financial institutions in the United States. Net cash flows are reported for customer loan and deposit transactions.

## Note 1—Nature of business and summary of significant accounting policies (continued)

*Investment Securities Available for Sale* – Investment securities available for sale are reported at fair value and consist of debt instruments that are not classified as either trading securities or as held-to-maturity securities. Unrealized holding gains and losses, net of deferred income tax, on available-for-sale securities are reported as a net amount in accumulated other comprehensive income. Gains and losses on the sale of investment securities available for sale are determined using the specific-identification method. Declines in the fair value of individual investment securities available for sale below their cost that are determined to be other-than-temporary would result in write-downs of the individual securities to their fair value. Such write-downs would be included in earnings as realized losses. Premiums and discounts are recognized in interest income using the interest method over the period to maturity.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on a trade-date basis and determined using the specific-identification method.

The Company assesses other-than-temporary impairment ("OTTI") or permanent impairment based upon whether it intends to sell a security or if it is likely that it would be required to sell the security before recovery of the amortized costs basis of the investment, which may be maturity. For debt securities, if the Company intends to sell the security or it is likely that the Company will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the security and it is not likely that the Company will be required to sell the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The remaining impairment related to all other factors is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate categories within OCI. If there is an indication of additional credit losses, the security is re-evaluated according to the procedures described above.

*Federal Home Loan Bank Stock, Reported at Cost* – As a requirement for membership, the Bank invests in stock of Federal Home Loan Bank of Atlanta ("FHLB"). Management periodically evaluates FHLB stock for other-than-temporary or permanent impairment. Management's determination of whether these investments are impaired is based on its assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB, and (4) the liquidity position of the FHLB. Based upon consideration of above factors, the Company has determined there is no OTTI on FHLB stock as of December 31, 2017 and 2016.

*Originated Loans Receivable* – Originated loans receivable are stated at unpaid principal balances, less the allowance for loan losses, and net deferred loan origination fees. The Company's loan portfolio consists principally of mortgage loans collateralized by first deeds of trust on single family residences, other residential property, and commercial property and land.

## Note 1—Nature of business and summary of significant accounting policies (continued)

*Acquired Loans* – Acquired loans are recorded at their fair value at the acquisition date. Credit discounts are included in the determination of fair value; therefore, an allowance for loan losses is not recorded at the acquisition date. Acquired loans are evaluated upon acquisition and classified as either purchased impaired or purchase non-impaired. Purchased impaired loans reflect credit deterioration since origination such that it is probable at acquisition that the Company will be unable to collect all contractually required payments. For purchased impaired loans, expected cash flows at the acquisition date in excess of the fair value of loans are recorded as interest income over the life of the loans using a level yield method if the timing and amount of the future cash flows is reasonably estimable. Subsequent to the acquisition date, increases in cash flows over those expected at the acquisition date are recognized prospectively as interest income. Decreases in expected cash flows after the acquisition date are recognized immediately through the provision for loan losses. For purchased non-impaired loans, the difference between the fair value and unpaid principal balance of the loan at the acquisition date is amortized or accreted to interest income over the estimated life of the loans.

*Impaired Loans* – A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

*Troubled Debt Restructurings* – The Company may make concessions to borrowers that it would not normally consider when a borrower is experiencing financial difficulty. The concessions would be provided with the objective of maximizing the Company's investment. Loans with these types of concessions are known as troubled debt restructurings ("TDRs") and include situations in which the Company may accept a modification of the terms of the debt, including, but not limited to: (i) a reduction in the stated interest rate to below market rates; (ii) an extension of maturity at an interest rate or other terms below market; (iii) a reduction in the face amount of the debt; and/or (iv) a reduction in the accrued interest that it would not otherwise grant. TDRs are considered impaired loans. The Company had no TDRs at December 31, 2017 or 2016.

*Nonaccrual and Past Due* – Loans are placed on nonaccrual when the loan is 90 days past due and collections of interest is in doubt. A loan is considered past due when the borrower is no longer meeting their contractual obligation.

*Allowance for Loan Losses* – The allowance is an amount that management believes will be adequate to absorb probable losses inherent in the loan portfolio. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to pay, the estimated value of any underlying collateral, and current economic conditions. The loan portfolio is further analyzed by each loan type and delinquency status to determine the risk category for each loan that is used in calculating the allowance for loan losses. While management uses the best information to make evaluations, future adjustments may be necessary if economic or other conditions differ substantially from the assumptions used. In addition, regulatory examiners may require the Company to recognize changes to the allowance for loan losses based on their judgments about information available to them at the time of their examination.

## Note 1—Nature of business and summary of significant accounting policies (continued)

*Interest Income* – The Company recognizes interest income on loans using the interest method over the contractual life of the loan. The Company continues to accrue interest on loans, including loans delinquent 90 days or more, when the collection of interest is not in doubt. All interest accrued but not collected for loans that are placed on nonaccrual or charged off are reversed against interest income. Interest income is subsequently recognized only to the extent cash payments are received. The interest on these loans is accounted for on the cash-basis or cost-recovery method until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

*Loan Origination Fees and Related Costs* – Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized as an adjustment to interest income using the interest method over the contractual life of the loans, adjusted for actual prepayments.

*Foreclosed Real Estate* – Foreclosed real estate is initially recorded at estimated fair value less cost of disposal at the date of foreclosure, establishing a new cost basis. When property is acquired, the excess, if any, of the loan balance over estimated fair value is charged to the allowance for loan losses. Based on periodic evaluations by management, the carrying values are reduced where they exceed fair value minus estimated costs to sell. Costs relating to the development and improvement of the property are capitalized, while holding costs of the property are charged to expense in the period incurred.

*Premises and Equipment* – Premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of the assets. Estimated useful lives are 39 years for buildings, leasehold improvements are amortized over the estimated useful lives of the improvements, whichever is shorter, 3 to 15 years for furniture, fixtures and equipment and for computers and related equipment. Repairs and maintenance costs are charged to operations as incurred and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in current income.

*Goodwill and Other Intangible Assets* – Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is not amortized but is subject to impairment tests on at least an annual basis or earlier whenever an event occurs indicating that goodwill may be impaired. Any impairment of goodwill or other intangibles will be recognized as an expense in the period of impairment. The Company completes the annual goodwill impairment test as of September 30th of each year and the test in 2017 indicated that there was no impairment of goodwill. Identifiable intangible assets are acquired assets that lack physical substance but can be distinguished from goodwill because of contractual or legal rights or because the assets are capable of being sold or exchanged on their own or in combination with a related contract, asset, or liability. The Company's identifiable intangible assets relate to premiums on purchased core deposits and are being amortized over estimated useful lives.

*Bank-Owned Life Insurance* – The Bank invested in cash value life insurance policies to fund a portion of the deferred compensation plan. The investment in the life insurance contracts is reported as an asset at the amount that could be realized under the insurance contracts at the balance sheet date.

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

## Note 1—Nature of business and summary of significant accounting policies (continued)

*Stock-Based Compensation* – The Company follows the provisions of the authoritative guidance regarding stock-based compensation. This guidance values stock-based awards at the grant date fair value and recognizes the expense over the requisite service period.

*Income Taxes* – Deferred income tax assets and liabilities are determined using the asset and liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Valuation allowances are established when necessary to reduce the deferred income tax assets to the amount expected to be realized.

*Accumulated Other Comprehensive Income (Loss)* – The Company reports as comprehensive income (loss) all changes in stockholders' equity during the year from sources other than stockholders. Other comprehensive loss refers to all components (revenues, expenses, gains, and losses) of comprehensive loss that are excluded from net income (loss). The Company's other comprehensive loss consists of unrealized gains and losses on investment securities available for sale, net of tax.

*Advertising Costs* – Advertising costs are charged to operations as incurred and totaled approximately $20,000 and $5,000 for the years ended December 31, 2017 and 2016, respectively.

## Note 2—Investment securities

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, are as follows:

| | December 31, 2017 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (Dollars in thousands) | | | |
| Securities available for sale: | | | | |
| U.S. government agency | $ 750 | $ - | $ 1 | $ 749 |
| Residential government sponsored mortgage-backed securities | 1,952 | 2 | 22 | 1,932 |
| Commercial mortgage-backed securities | 89,116 | 216 | 412 | 88,920 |
| Asset backed securities | 1,400 | 26 | - | 1,426 |
| Corporate bonds | 29,829 | 56 | 22 | 29,863 |
| | $ 123,047 | $ 300 | $ 457 | $ 122,890 |

**Note 2—Investment securities (continued)**

| | December 31, 2016 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| | (Dollars in thousands) | | | |
| Securities available for sale: | | | | |
| U.S. government agency | $ 607 | $ - | $ 1 | $ 606 |
| Residential government sponsored mortgage-backed securities | 3,594 | 11 | 27 | 3,578 |
| Commercial mortgage-backed securities | 22,761 | 43 | 77 | 22,727 |
| Asset backed securities | 16,411 | 52 | 30 | 16,433 |
| Corporate bonds | 614 | - | - | 614 |
| | $ 43,987 | $ 106 | $ 135 | $ 43,958 |

The following table shows the gross unrealized losses and fair value of the Company's investment securities with unrealized losses that are deemed to be temporarily impaired aggregated by investment category and length of time that individual securities have been in a continuous, unrealized loss position at December 31, 2017:

| | December 31, 2017 Less Than 12 Months | | December 31, 2017 More Than 12 Months | |
|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| Securities available for sale: | (Dollars in thousands) | | (Dollars in thousands) | |
| U.S. government agency | $ 749 | $ 1 | $ - | $ - |
| Residential government sponsored mortgage-backed securities | - | - | 1,925 | 22 |
| Commercial mortgage-backed securities | 33,239 | 386 | 1,854 | 26 |
| Asset backed securities | 8,643 | 19 | 1,493 | 3 |
| | $ 42,631 | $ 406 | $ 5,272 | $ 51 |

As of December 31, 2017, there were four mortgage-backed securities, three commercial mortgage-backed securities, and two asset backed securities that have been in a continuous, unrealized loss position for more than 12 months. The unrealized losses on the Company's investment securities were caused by various reasons; however, the Company believes no material impairment of value is due to deteriorating financial condition of the issuers. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment because the Company does not intend to sell, and it is more likely than not that the Company will not be required to sell these investments before anticipated recovery. The Company does not consider these investments to be other-than-temporarily impaired at December 31, 2017 and 2016.

As of December 31, 2017 and 2016, securities totaling $750,000 and $607,000, respectively, were pledged to secure public deposits. None of the Company's securities were pledged to secure borrowings at December 31, 2017 and 2016.

## Note 2—Investment securities (continued)

The amortized cost and fair values of securities as of December 31, 2017, by contractual maturity are shown below. Actual maturities may differ from contractual maturities because some issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | December 31, 2017 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| | (Dollars in thousands) | |
| Securities available for sale: | | |
| Due within one year | $ 636 | $ 437 |
| Due after one but within five years | 13,170 | 13,143 |
| Due after five but within ten years | 54,502 | 54,549 |
| Due after ten years | 54,739 | 54,761 |
| Total | $ 123,047 | $ 122,890 |

For the purposes of the maturity table, mortgage-backed securities, which are not due at a single maturity date, have been allocated over maturity groupings based on the weighted-average contractual maturities of underlying collateral. The mortgage-backed securities may mature earlier than their weighted-average contractual maturities because of principal payments.

Sales of securities available-for-sale during 2017 of approximately $52 million generated gross realized gains of approximately $543,000 and gross realized losses of $-0-. Sales of securities available-for-sale during 2016 of approximately $2.0 million generated gross realized gains of approximately $1,000 and gross realized losses of $-0-.

## Note 3—Loans receivable and allowance for loan losses

The table below presents the major types of loans recorded on the consolidated statements of financial condition at December 31:

| | 2017 | 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Mortgage loans, including lines of credit | $ 59,391 | $ 57,420 |
| Commercial and industrial loans | 102,154 | 68,010 |
| Construction loans | 13,725 | 8,201 |
| Consumer loans | 1,812 | 2,118 |
| Farm and agricultural loans | 1,981 | 2,347 |
| Total | 179,063 | 138,096 |
| Allowance for loan losses | (954) | (706) |
| Net deferred loan costs | 90 | 125 |
| Total | $ 178,199 | $ 137,515 |

## Note 3—Loans receivable and allowance for loan losses (continued)

A portion of the fair value discount on acquired loans has an accretable yield associated with those loans that is accreted into interest income over the estimated remaining life of the loans. The remaining non-accretable difference represents cash flows not expected to be collected. The changes in the carrying amount of acquired loans and accretable yield for loans receivable for the years ended December 31 are as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Accretable Yield | Non-Accretable Difference | Accretable Yield | Non-Accretable Difference |
| | (Dollars in thousands) | | (Dollars in thousands) | |
| Balance, beginning of year | $ (94) | $ - | $ (164) | $ (17) |
| Accretion | 39 | - | 70 | - |
| Balance, end of year | $ (55) | $ - | $ (94) | $ (17) |

Mortgage loans, including lines of credit, are comprised of lines of credits and loans secured by single-family residences. These loans are typically considered to involve a lesser degree of risk than other loan classes due to relative stability of collateral values compared to other collateral types, as well as expected priority of debt payments on a borrower's primary residence.

Commercial and industrial loans are comprised of loans secured by owner and non-owner occupied properties, multi-family residences, and developed and undeveloped land tracts. Other commercial loans are comprised of commercial and industrial loans, including secured and unsecured lines of credits, loans secured by equipment, inventory, and other assets, and loans to religious institutions. Loans secured by commercial real estate or commercial property generally involve a greater degree of risk compared to loans secured by single-family residences due to risks of more volatile collateral value, more volatile performance due to changes in economic and market conditions, and greater risks of collateral illiquidity.

Construction loans, including land development loans, are highly dependent on the supply and demand for commercial real estate in the markets served by the Company as well as the demand for newly constructed residential homes and lots that customers are developing. Continuing deterioration in demand could result in significant decrease in the underlying collateral values and make repayment of the outstanding loans more difficult for consumers.

Consumer loans are comprised of individual lines of credit, auto loans, and recreational vehicle loans. At December 31, 2017 and 2016, this loan class is not considered a significant concentration within the Company's portfolio and consists of many smaller dollar loans.

Farm and agricultural loans are comprised of loans secured by farmland and agricultural equipment or buildings. At December 31, 2017 and 2016, this loan class is not considered a significant concentration within the Company's portfolio.

## Note 3—Loans receivable and allowance for loan losses (continued)

The following table presents, by loan class, the activity in the allowance for loan losses for the years ended December 31, 2017 and 2016, and the balance of allowance for loan losses and related recorded loan investment disaggregated by impairment methodology at December 31:

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans Including Lines of Credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Allowance for Loan Losses: | | | | | | |
| Beginning balance | $ 183 | $ 471 | $ 38 | $ 3 | $ 12 | $ 707 |
| Provision for loan losses | 79 | 128 | 18 | 10 | 2 | 237 |
| Charge-offs | (7) | - | - | (6) | - | (13) |
| Recoveries | 3 | 15 | - | 3 | 2 | 23 |
| Net (charge-offs) recoveries | (4) | 15 | - | (3) | 2 | 10 |
| Ending Balance | $ 258 | $ 614 | $ 56 | $ 10 | $ 16 | $ 954 |
| Allowance for Loan Losses: | | | | | | |
| Individually evaluated for impairment | $ - | $ 34 | $ - | $ - | $ - | $ 34 |
| Collectively evaluated for impairment | $ 258 | $ 580 | $ 56 | $ 10 | $ 16 | $ 920 |
| Total | $ 258 | $ 614 | $ 56 | $ 10 | $ 16 | $ 954 |
| Recorded Investment in Loans: | | | | | | |
| Purchase credit impaired loans | $ - | $ 506 | $ - | $ - | $ - | $ 506 |
| Individually evaluated for impairment | - | - | - | - | - | - |
| Collectively evaluated for impairment | 59,443 | 101,671 | 13,725 | 1,827 | 1,981 | 178,647 |
| Total | $ 59,443 | $ 102,177 | $ 13,725 | $ 1,827 | $ 1,981 | $ 179,153 |

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans including lines of credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Allowance for Loan Losses: | | | | | | |
| Beginning balance | $ 145 | $ 385 | $ 28 | $ 3 | $ 7 | $ 568 |
| Provision for loan losses | 65 | 69 | 9 | 11 | 3 | 157 |
| Charge-offs | (31) | - | - | (13) | - | (44) |
| Recoveries | 4 | 17 | 1 | 1 | 2 | 25 |
| Net (charge-offs) recoveries | (27) | 17 | 1 | (12) | 2 | (19) |
| Ending Balance | $ 183 | $ 471 | $ 38 | $ 2 | $ 12 | $ 706 |
| Allowance for Loan Losses: | | | | | | |
| Individually evaluated for impairment | $ - | $ 34 | $ - | $ - | $ - | $ 34 |
| Collectively evaluated for impairment | 183 | 437 | 38 | 2 | 12 | 672 |
| Total | $ 183 | $ 471 | $ 38 | $ 2 | $ 12 | $ 706 |
| Recorded Investment in Loans: | | | | | | |
| Purchase credit impaired loans | $ 234 | $ - | $ - | $ - | $ - | $ 234 |
| Individually evaluated for impairment | - | 606 | - | - | - | 606 |
| Collectively evaluated for impairment | 57,243 | 67,456 | 8,201 | 2,134 | 2,347 | 137,381 |
| Total | $ 57,477 | $ 68,062 | $ 8,201 | $ 2,134 | $ 2,347 | $ 138,221 |

## Note 3—Loans receivable and allowance for loan losses (continued)

The Company uses several credit quality indicators to manage credit risk on an ongoing basis. The Company's primary credit quality indicator is an internal credit risk rating system. The Company grades loans on a risk grade scale of 1 through 8, with grades 1 through 4 representing "pass" loans, and grades 5 through 8 representing "special mention," "substandard," "doubtful," and "loss" loans, respectively. Loans are reviewed on a regular basis internally, and at least annually by an external loan review group, to ensure loans are graded appropriately.

The following are the definitions of the Company's credit quality indicators.

*Pass* – The loans assigned a "pass" grade are typically paying in accordance with the terms of the original agreement and do not have significant weaknesses that would be an indication of probable future default in the short-term. Management believes there is a low likelihood of loss related to those loans that are considered "pass".

*Special Mention* – The loans assigned a "special mention" grade are typically not in default, but have one or more weaknesses that may, if not corrected, weaken the asset or inadequately protect that Company's collateral position at some future date. Loans considered special mention do not meet the definition of impaired; however, management assigns an additional risk factor to loans considered special mention to address additional risk of loss compared to "pass" loans.

*Substandard* – The loans assigned a "substandard" grade are typically not paying in accordance with the agreement and have one or more well defined weaknesses that may, if not corrected, result in loss to the Bank. Typical well defined weaknesses for substandard loans include declining earnings and cash flow trends, limited liquidity and secondary payment sources, and declining collateral margins. Substandard loans have a higher risk of non-performance and loss upon liquidation than special mention loans due to these well-defined weaknesses. Purchase impaired loans and loans individually evaluated for impairment outstanding at December 31, 2017 and 2016, were considered substandard.

*Doubtful* – The loans assigned a "doubtful" grade are typically loans with weaknesses that make collection or liquidation in full on the basis of currently existing facts, conditions, and collateral values highly questionable and improbable. These loans do not meet the definition of loss due to certain events that may occur which would salvage the debt. At December 31, 2017 and 2016, the Company had no loans graded "doubtful."

*Loss* – The loans assigned a "loss" grade are considered uncollectible and identified losses are immediately charged-off. At December 31, 2017 and 2016, the Company had no loans graded "loss."

## Note 3—Loans receivable and allowance for loan losses (continued)

The following table presents a summary of the recorded investment in loans, by loan class, disaggregated based on credit quality indicator at December 31:

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans including lines of credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Pass | $ 59,443 | $ 101,671 | $ 13,725 | $ 1,827 | $ 1,981 | $ 178,647 |
| Substandard | - | 506 | - | - | - | 506 |
| Total | $ 59,443 | $ 102,177 | $ 13,725 | $ 1,827 | $ 1,981 | $ 179,153 |

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans including lines of credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Pass | $ 57,243 | $ 67,456 | $ 8,201 | $ 2,134 | $ 2,347 | $ 137,381 |
| Substandard | 234 | 606 | - | - | - | 840 |
| Total | $ 57,477 | $ 68,062 | $ 8,201 | $ 2,134 | $ 2,347 | $ 138,221 |

The following table presents an aging analysis of the loan portfolio, by loan class, at December 31:

| | December 31, 2017 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans including lines of credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Current | $ 59,443 | $ 101,671 | $ 13,725 | $ 1,827 | $ 1,981 | $ 178,647 |
| 30-59 days past due | - | - | - | - | - | - |
| 60-89 days past due | - | - | - | - | - | - |
| 90 days or more past due and still accruing | - | - | - | - | - | - |
| Nonaccrual loans | - | 506 | - | - | - | 506 |
| Total | $ 59,443 | $ 102,177 | $ 13,725 | $ 1,827 | $ 1,981 | $ 179,153 |

| | December 31, 2016 | | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | Mortgage Loans including lines of credit | Commercial and Industrial Loans | Construction Loans | Consumer Loans | Farm and Agricultural Loans | Total |
| Current | $ 57,243 | $ 67,456 | $ 8,201 | $ 2,134 | $ 2,347 | $ 137,381 |
| 30-59 days past due | - | - | - | - | - | - |
| 60-89 days past due | - | - | - | - | - | - |
| 90 days or more past due and still accruing | - | - | - | - | - | - |
| Nonaccrual loans | 234 | 606 | - | - | - | 840 |
| Total | $ 57,477 | $ 68,062 | $ 8,201 | $ 2,134 | $ 2,347 | $ 138,221 |

## Note 3—Loans receivable and allowance for loan losses (continued)

At December 31, 2017 and 2016, the Company had no loans 90 days or more past due that were accruing interest. The following table presents a summary of the recorded investment in non-accrual loans, by loan class:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Mortgage Loans, including lines of credit | $ - | $ 234 |
| Commercial and Industrial Loans | 506 | 606 |
| Construction Loans | - | - |
| Consumer Loans | - | - |
| Farm and Agricultural Loans | - | - |
| Total | $ 506 | $ 840 |

Excluding purchased impaired loans, the Company had impaired loans totaling $506 and $606, with a related allowance for loan loss of $34 at December 31, 2017 and 2016. The Company made no modifications that constitute granting a concession and, therefore, has no troubled debt restructurings at December 31, 2017 and 2016.

Officers and directors of the Company were indebted to the Company for loans made in the ordinary course of business. The following is an analysis of the loans to officers and directors:

| | Year Ended December 31, 2017 | Year Ended December 31, 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Balance, beginning of year | $ 5,047 | $ 4,778 |
| Originations | 4,721 | 2,809 |
| Payments received | (3,219) | (2,540) |
| Balance, end of year | $ 6,549 | $ 5,047 |

## Note 4—Foreclosed real estate

The following summarizes the activity on foreclosed real estate:

| | 2017 | 2016 |
|---|---|---|
| Balance, beginning of year | $ 229 | $ 474 |
| Proceeds from sales | (182) | (246) |
| (Loss) gain on sales | (47) | 1 |
| Balance, end of year | $ - | $ 229 |

## Note 5—Premises and equipment

Premises and equipment consist of the following:

| | 2017 | 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Land | $ 1,707 | $ 1,707 |
| Land improvements | 4 | 4 |
| Buildings and improvements | 2,195 | 2,169 |
| Furniture and equipment | 1,295 | 979 |
| Construction in process | 52 | - |
| | 5,253 | 4,859 |
| Less accumulated depreciation | (1,322) | (1,071) |
| | $ 3,931 | $ 3,788 |

Depreciation expense for the years ended December 31, 2017 and 2016, amounted to $270,857 and $273,981, respectively.

## Note 6—Federal Home Loan Bank ("FHLB") Atlanta Stock

As of December 31, 2017, the Bank had 1,856 shares of $100 par value capital stock totaling $185,500 in FHLB stock. The Bank had 1,415 shares of $100 par value capital stock totaling $141,500 in FHLB stock as of December 31, 2016. Based on redemption provisions of FHLB, the stock has no quoted market value and is carried at cost.

## Note 7—Deposits

Deposits are summarized as follows:

| | 2017 | 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Demand accounts: | | |
| Money market | $ 84,720 | $ 55,465 |
| Demand deposits | 20,396 | 19,627 |
| NOW accounts | 56,933 | 14,934 |
| Passbook savings | 1,523 | 1,436 |
| Total demand deposits | 163,572 | 91,462 |
| Certificates of deposit | 137,333 | 88,175 |
| Total deposits | $ 300,905 | $ 179,637 |

## Note 7—Deposits (continued)

At December 31, 2017, the scheduled maturities of certificates of deposit are as follows:

| Years Ending December 31, | Amount (Dollars in thousands) |
|---|---|
| 2018 | $ 105,332 |
| 2019 | 25,009 |
| 2020 | 3,977 |
| 2021 and thereafter | 3,015 |
| | $ 137,333 |

The aggregate amount of jumbo certificates of deposit with a minimum denomination of $250,000 at December 31, 2017 and 2016, was approximately $39 million and $21 million, respectively.

Interest expense on deposits is summarized as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Certificates of deposit | $ 1,427 | $ 704 |
| NOW and money market | 772 | 252 |
| Total interest expense | $ 2,199 | $ 956 |

At December 31, 2017 and 2016, the aggregate amount of overdraft deposit accounts reclassified as loans receivable were $25,155 and $5,319, respectively.

In the normal course of business, the Company has outstanding deposits with its directors, executive officers, and their affiliates which amounted to $16,105,406 and $15,784,081 as of December 31, 2017 and 2016, respectively.

## Note 8—Retirement plan

The Company maintains a 401(k) plan for all employees that have completed one month of service. Under the plan, employees may contribute up to an annual maximum as determined by the Internal Revenue Code. The Company matches 50% of employee contributions up to 6% of the participant's compensation. The plan provides that employees' contributions are 100% vested at all times, and the Company's contributions vest at 25% at the end of each year of service until 100% of the Company's contributions are vested after the completion of the fourth year of service. The expenses related to this plan for the years ended December 31, 2017 and 2016 amounted to $54,501 and $49,216, respectively.

## Note 9—Goodwill and other intangibles

The goodwill and other intangible assets activity for the years ended December 31 is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Goodwill | Other Intangible Assets | Goodwill | Other Intangibles Assets |
| | (Dollars in thousands) | | (Dollars in thousands) | |
| Balance, beginning of year | $ 1,792 | $ 250 | $ 1,792 | $ 303 |
| Amortization | - | (53) | - | (53) |
| Balance, end of year | $ 1,792 | $ 197 | $ 1,792 | $ 250 |

The following table (dollars in thousands) presents the gross carrying amount and accumulated amortization for the Company's core deposit intangible asset, which is the only identifiable intangible asset subject to amortization at December 31, 2017:

| | |
|---|---|
| Gross carrying amount | $ 529 |
| Accumulated amortization | (332) |
| Net book value | $ 197 |

The following table presents estimated amortization for the Company's core deposit intangible asset for the years ending December 31:

| | |
|---|---|
| 2018 | $ 53 |
| 2019 | 53 |
| 2020 | 53 |
| 2021 and thereafter | 38 |
| Total | $ 197 |

## Note 10—Income taxes

Allocation of income tax expense between current and deferred portions is as follows:

| | Year Ended December 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (Dollars in thousands) | |
| Current tax expense: | | |
| Federal | $ 26 | $ 24 |
| State | - | 1 |
| | 26 | 25 |
| Deferred tax expense: | | |
| Federal | 1,370 | 264 |
| State | 56 | 34 |
| | 1,426 | 298 |
| Total tax expense | $ 1,452 | $ 323 |

The difference between the provision for income taxes and the amounts applied by applying the statutory federal income tax rate of 34% to income before income taxes is summarized below:

| | Year Ended December 31, | |
|---|---|---|
| | 2017 | 2016 |
| | (Dollars in thousands) | |
| Expense computed at statutory rate of 34% | $ 737 | $ 284 |
| Change in tax law | 607 | - |
| Other, net | 108 | 39 |
| Total | $ 1,452 | $ 323 |

## Note 10—Income taxes (continued)

The tax effects of temporary differences that gave rise to significant portions of the net deferred tax asset are as follows:

| | December 31, 2017 | December 31, 2016 |
|---|---|---|
| | (Dollars in thousands) | |
| Deferred tax assets: | | |
| Nonaccrual interest | $ 70 | $ 32 |
| Allowance for loan losses | 223 | 260 |
| Foreclosed real estate | - | 147 |
| Fair value adjustments to acquired loans | 13 | 40 |
| Unrealized loss on securities available for sale | 37 | 12 |
| Net operating loss carryforward | 898 | 2,193 |
| Alternative minimum tax credit | 49 | 23 |
| Restricted stock | 52 | 49 |
| Other | - | 22 |
| Total deferred tax assets | 1,342 | 2,778 |
| Deferred tax liabilities: | | |
| Premises and equipment | 116 | 122 |
| Core deposit intangible | 46 | 92 |
| Deferred loans fees | 7 | 40 |
| Other | 55 | - |
| Total deferred tax liabilities | 224 | 254 |
| Net deferred tax asset | $ 1,118 | $ 2,524 |

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. As part of the ongoing evaluation of positive and negative factors, in 2016, the Company determined it is more likely than not that it will generate sufficient taxable income to utilize its deferred tax assets. Therefore, there was no requirement for a valuation allowance in 2016. Included in deferred tax assets are the tax benefits derived from federal net operating loss carry forwards of $5.9 million and state net operating loss carry forwards of $7.2 million which begin to expire in 2031 and 2023, respectively. In 2017, the Company also determined it is more likely than not that it will generate sufficient taxable income to utilize its deferred tax assets. Therefore, there was no requirement for a valuation allowance in 2017. Included in deferred tax assets are the tax benefits derived from federal net operating loss carry forwards of $3.7 million and state net operating loss carry forwards of $4.3 million which begin to expire in 2031 and 2023, respectively.

As a result of tax law changes enacted in December 2017, the Company is required by GAAP to revalue deferred tax assets and associated valuation allowance in accordance with the enacted rate in which deferred tax items will reverse. Therefore the Company has revalued deferred taxes based on the newly enacted Federal rate of 21%. As a result the Company recognized income tax expense of approximately $607. This repricing adjustment does not impact cash taxes payable for the year ending December 31, 2017.

## Note 11—Regulatory capital

The Company and the Bank 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 additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

In July 2013, the Federal Reserve Board approved and published the final Basel III Capital Rules establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel III Committee's December 2010 framework ("Basel III") for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules, among other things, (i) introduce a new capital measure called "Common Equity Tier 1" ("CET1"), (ii) specify that Tier 1 capital consists of CET1 and "Additional Tier 1 capital" instruments meeting specified requirements, (iii) define CET1 narrowly by requiring that most deductions/adjustments to regulatory capital measures be made to CET1 and not to the other components of capital, and (iv) expand the scope of the deductions from and adjustments to capital as compared to existing regulations. The Basel III Capital Rules were effective for the Bank on January 1, 2015 (subject to a phase-in period for certain components). CET1 capital for the Bank consists of retained earnings, less accumulated gains on securities available-for-sale, goodwill net of associated deferred tax liabilities, intangible assets, other than goodwill and mortgage servicing assets, and a deferred tax asset derived from net operating loss carryforward.

Quantitative measures established by regulations to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table on the next page) of Tier 1 Capital (as defined in the regulations) to adjusted total assets (as defined), and minimum ratios of Tier 1, CET1 (as defined) and Total Capital (as defined) to risk-weighted assets (as defined). To be considered adequately capitalized (as defined) under the regulatory framework for prompt corrective action, the Bank must maintain minimum Tier 1 leverage, Tier 1 risk-based, CET1, and total risk-based ratios as set forth in the tables on the following page.

## Note 11—Regulatory capital (continued)

| | Actual | | Minimum Capital Requirement | |
|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio |
| | (Dollars in thousands) | | | |
| **December 31, 2017:** | | | | |
| Total Capital to Risk-Weighted Assets: | | | | |
| Consolidated | $ 27,287 | 14.4% | $ 15,161 | 8.0% |
| Bank | 27,023 | 14.3% | 15,161 | 8.0% |
| CET1 to Risk-Weighted Assets: | | | | |
| Consolidated | 26,333 | 13.9% | 8,528 | 4.5% |
| Bank | 26,069 | 13.8% | 8,528 | 4.5% |
| Tier 1 Capital to Risk-Weighted Assets: | | | | |
| Consolidated | 26,333 | 13.9% | 11,371 | 6.0% |
| Bank | 26,069 | 13.8% | 11,371 | 6.0% |
| Tier 1 Capital to Average Assets: | | | | |
| Consolidated | 26,333 | 8.6% | 12,251 | 4.0% |
| Bank | 26,069 | 8.5% | 12,251 | 4.0% |
| **December 31, 2016:** | | | | |
| Total Capital to Risk-Weighted Assets: | | | | |
| Consolidated | $ 21,788 | 16.9% | $ 10,373 | 8.0% |
| Bank | 21,524 | 16.6% | 10,373 | 8.0% |
| CET1 to Risk-Weighted Assets: | | | | |
| Consolidated | 21,082 | 16.4% | 5,835 | 4.5% |
| Bank | 20,818 | 16.1% | 5,835 | 4.5% |
| Tier 1 Capital to Risk-Weighted Assets: | | | | |
| Consolidated | 21,082 | 16.4% | 7,780 | 6.0% |
| Bank | 20,818 | 16.1% | 7,780 | 6.0% |
| Tier 1 Capital to Average Assets: | | | | |
| Consolidated | 21,082 | 11.6% | 7,214 | 4.0% |
| Bank | 20,818 | 11.5% | 7,214 | 4.0% |

## Note 12—Other non-interest expense

The major components of other non-interest expense for the years ended December 31 were as follows:

| | 2017 | 2016 |
|---|---|---|
| Advertising | $ 20 | $ 5 |
| Bank services | 81 | 76 |
| Insurance | 59 | 59 |
| Telephone | 95 | 87 |
| Dues and memberships | 49 | 43 |
| Travel | 52 | 45 |
| Other | 297 | 284 |
| Total | $ 653 | $ 599 |

## Note 13—Operating leases

The Company leases certain assets under long-term leases. The majority of the Company's leases are operating leases for a period of two to five years with renewal options.

Rental expense amounted to $97,583 and $71,107 during the years ended December 31, 2017 and 2016, respectively, is included in occupancy and equipment expense on the accompanying consolidated statements of operations. Future minimum lease payments are as follows:

| Years Ending December 31, | |
|---|---|
| 2018 | $ 229,946 |
| 2019 | 213,714 |
| 2020 | 178,838 |
| 2021 | 184,011 |
| 2022 | 156,387 |
| Total | $ 962,896 |

## Note 14—Commitments and contingencies

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

*Off-Balance Sheet Risk* – The Company is a party to financial instruments with off-balance sheet credit risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. Those instruments involve, to varying degrees, elements of credit, and interest rate risk in excess of the amount recognized in the balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

### Note 14—Commitments and contingencies (continued)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on management's credit evaluation of the borrower. Collateral obtained varies but may include real estate, stocks, bonds, and certificates of deposit.

A summary of the contract amounts (in thousands) of the Company's exposure to off-balance sheet credit risk as of December 31 is as follows:

| | 2017 | 2016 |
|---|---|---|
| Financial instruments whose contract amounts represent credit risk: | | |
| Commitments to extend credit | $ 6,206 | $ 6,033 |
| Undisbursed lines of credit | 15,008 | 7,935 |
| Undisbursed portion of construction loans | 6,464 | 11,969 |
| Total | $ 27,678 | $ 25,937 |

### Note 15—Fair value of financial instruments

Financial instruments for which fair value disclosures are required include cash and due from banks, interest-bearing deposits, securities available for sale, loans, Federal Home Loan Bank stock, bank owned life insurance, deposit accounts, and borrowings. Fair value estimates are made at a specific moment 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 Company's entire holdings of a particular financial instrument. Because no active market readily exists for a portion of the Company'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.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

*Cash and Due from Banks and Interest-Bearing Deposits* – The carrying amounts for cash and due from banks and interest-bearing deposits approximate fair value because of the short maturities of those instruments.

*Securities Available for Sale* – Fair values for investment securities equals quoted market price if such information is available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments.

*Loans* – For certain homogenous categories of loans, such as residential mortgages, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. No adjustment has been made for illiquidity in the market on loans as there is no information from which to reasonably base this estimate.

## Note 15—Fair value of financial instruments (continued)

*Federal Home Loan Bank Stock* – The carrying value of Federal Home Loan Bank stock approximates fair value based on the redemption provisions of the Federal Home Loan Bank.

*Investment in Bank-Owned Life Insurance* – The carrying value of life insurance approximates fair value because this investment is carried at cash surrender value, as determined by the insurer.

*Accrued Interest Receivable and Accrued Interest Payable* – The carrying amount of accrued interest is assumed to approximate fair value.

*Deposits and Borrowings* – The fair value of demand, savings, money market, and NOW deposits is the amount payable on demand at the reporting date. The fair value of time deposits and borrowings is estimated by discounting expected future cash flows using the rates currently offered for instruments of similar remaining maturities.

*Financial Instruments with Off-Balance Sheet Risk* – With regard to financial instruments with off-balance sheet risk discussed in Note 13, it is not practicable to estimate the fair value of future financing commitments.

The carrying amounts and estimated fair values of the Company's financial instruments, none of which are held for trading purposes, are as follows at December 31:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (Dollars in thousands) | | (Dollars in thousands) | |
| Financial Assets: | | | | |
| Cash and equivalents | $ 17,571 | $ 17,571 | $ 10,929 | $ 10,929 |
| Securities available for sale | 122,890 | 122,890 | 43,958 | 43,958 |
| Loans, net | 178,199 | 179,332 | 137,515 | 138,954 |
| Federal Home Loan Bank stock | 186 | 186 | 142 | 142 |
| Accrued interest receivable | 801 | 801 | 514 | 514 |
| Financial Liabilities: | | | | |
| Deposits | 300,905 | 300,904 | 179,637 | 179,632 |
| Accrued interest payable | 140 | 140 | 76 | 76 |

### Note 16—Fair value measurements

The Company utilizes fair value measurements to record fair value adjustments for certain assets and liabilities and to determine fair value disclosures. Securities available for sale are recorded at fair value on a monthly basis. Additionally, from time to time, the Company may be required to record other assets at fair value, such as loans held for investment and certain other assets. These nonrecurring fair value adjustments usually involve writing the asset down to fair value or the lower of cost or market value.

The Company groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair values. These levels are:

Level 1 – Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 – Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

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

*Securities Available for Sale* – 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 the present value of future cash flows. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets, and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds, and corporate debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. As of December 31, 2017 and 2016, all of the Bank's securities are Level 2.

## Note 16—Fair value measurements (continued)

The following tables summarize the Company's financial assets by level within the fair value hierarchy that were measured at fair value on a recurring basis:

| December 31, 2017 (in thousands) | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Securities available for sale: | | | | |
| U.S. government agency | $ 749 | $ - | $ 749 | $ - |
| Residential government sponsored mortgage-backed securities | 1,932 | - | 1,932 | - |
| Commercial mortgage-backed securities | 88,920 | - | 88,920 | - |
| Asset backed securities | 1,426 | - | 1,426 | - |
| Corporate bonds | 29,863 | - | 29,863 | - |
| Total assets at fair value | $ 122,890 | $ - | $ 122,890 | $ - |

| December 31, 2016 (in thousands) | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Securities available for sale: | | | | |
| U.S. government agency | $ 606 | $ - | $ 606 | $ - |
| Residential government sponsored mortgage-backed securities | 3,578 | - | 3,578 | - |
| Commercial mortgage-backed securities | 22,727 | - | 22,727 | - |
| Asset backed securities | 16,433 | | 16,433 | |
| Corporate bonds | 614 | - | 614 | - |
| Total assets at fair value | $ 43,958 | $ - | $ 43,958 | $ - |

*Foreclosed Real Estate* – Foreclosed real estate is recorded at fair value less estimated selling costs upon transfer of the loans to foreclosed real estate. Subsequently, foreclosed real estate is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral, or management's estimation of the value of the collateral. When the fair value of the collateral is based on a current appraised value, the Company records the foreclosed real estate as nonrecurring Level 3. 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 Company records the foreclosed real estate as nonrecurring Level 3. For substantially all of the Company's foreclosed real estate as of December 31, 2017 and 2016, the valuation methodology utilized by the Company was collateral based measurements such as real estate appraisal. Appraised values may be discounted to reflect current market conditions and ultimate collectability. These discounts typically ranged from 0% to 20% for each of the respective periods.

*Impaired Loans* – Impairment of a loan is based on a loan's observable market price or the fair value of the collateral of a collateral dependent loan. Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

### Note 16—Fair value measurements (continued)

The following tables summarize the Company's financial assets by level within the fair value hierarchy that were measured at fair value on a non-recurring basis:

| December 31, 2017 (in thousands) | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Purchased credit impaired loans | $ 506 | - | - | $ 506 |
| Total | $ 506 | $ - | $ - | $ 506 |

| December 31, 2016 (in thousands) | Fair Value | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Foreclosed real estate | $ 229 | $ - | $ - | $ 229 |
| Purchased credit impaired loans | 234 | - | - | 234 |
| Loan individually evaluated for impairment | 606 | - | - | 606 |
| Total | $ 1,069 | $ - | $ - | $ 1,069 |

*Level 3 Valuation Techniques* – For Level 3 assets and liabilities measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016, the significant unobservable inputs used in the fair value measurements were as follows (dollars in thousands):

| | Fair Value at December 31, 2017 | Valuation Technique | Significant Unobservable Inputs | Significant Unobservable Inputs Value |
|---|---|---|---|---|
| Purchased credit impaired loans | 506 | Appraised Value / Comparable Sales | Discount to reflect current market conditions | 0%-10% |

| | Fair Value at December 31, 2016 | Valuation Technique | Significant Unobservable Inputs | Significant Unobservable Inputs Value |
|---|---|---|---|---|
| Foreclosed Real Estate | $ 229 | Appraised Value / Comparable Sales | Discount to reflect current market conditions | 0% - 20% |
| Purchased credit impaired loans | 234 | Appraised Value / Comparable Sales | Discount to reflect current market conditions | 0%-10% |
| Loan individually evaluated for impairment | 606 | Appraised Value / Comparable Sales | Discount to reflect current market conditions | 0%-10% |

## Note 17–Restricted stock award

In 2011, the Company awarded 7,500 shares of restricted stock with a fair value of $10 per share to members of the Board of Directors at that time. In 2016, the Company awarded 65,000 shares of restricted stock with a fair value of $10 per share to members of the Board of Directors at that time. The Company also awarded 65,000 shares of restricted stock with a fair value of $10 per share to members of executive management. The shares of restricted stock awarded to members of the Board of Directors and executive management will vest over ten years and five years, respectively. In 2017, the Company awarded 6,500 shares of restricted stock with a fair value of $13 to a new member of the Board of Directors. The Company also awarded 4,000 shares of restricted stock with a fair value of $13 per share to members of executive management. In 2017, the Company also awarded an additional 15,000 shares of restricted stock with a fair value of $13.50 in 2017 to two additional members of executive management.

The Company measures the fair value of restricted stock based on the price paid for common stock during the period near the grant date and compensation expense is recorded over the vesting period. The related compensation expense recognized for restricted stock awards was approximately $225,000 and $195,000, respectively, for the years ended December 31, 2017 and 2016.

## Note 18—Parent company financial data

Following are condensed financial statements of First Carolina Financial Services, Inc. as of December 31, 2017 and 2016 and for each of the years in the two-year period ended December 31, 2017.

**Condensed Balance Sheets**

| | December 31, | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | (Dollars in thousands) | | | |
| **ASSETS** | | | | |
| Cash | $ | 236 | $ | 264 |
| Investment in First Carolina Bank | | 29,127 | | 25,416 |
| **Total Assets** | $ | 29,363 | $ | 25,680 |
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | | | |
| Stockholders' equity | $ | 29,363 | $ | 25,680 |
| **Total Liabilities and Stockholders' Equity** | $ | 29,363 | $ | 25,680 |

**Condensed Statements of Income**

| | Years Ended December 31, | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | (Dollars in thousands) | | | |
| Equity in income of First Carolina Bank | $ | 743 | $ | 549 |
| Other professional fees | | (29) | | (34) |
| Other expense | | - | | (2) |
| Net income | $ | 714 | $ | 513 |

## Note 18—Parent company financial data (continued)

**Condensed Statements of Cash Flows**

| | Years Ended December 31 | |
|---|---|---|
| | **2017** | **2016** |
| | (Dollars in thousands) | |
| **Cash flows from operating activities:** | | |
| Net income | $ 714 | $ 513 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Equity income of First Carolina Bank | (743) | (549) |
| Net cash used in operating activities | (29) | (36) |
| **Cash flows from investing activities:** | | |
| Investment in First Carolina Bank | (2,924) | (8,655) |
| Net cash used in investing activities | (2,924) | (8,655) |
| **Cash flows from financing activities:** | | |
| Net proceeds from issuance of common stock | 2,700 | 8,674 |
| Issuance of restricted stock | 225 | 195 |
| Net cash provided by financing activities | 2,925 | 8,869 |
| Net (decrease) increase in cash and equivalents | (28) | 178 |
| Cash and cash equivalents, beginning of year | 264 | 86 |
| Cash and cash equivalents, end of year | $ 236 | $ 264 |

## Note 19—Subsequent events

The Company has evaluated all subsequent events for potential recognition and disclosure through May 18, 2018, in connection with these consolidated financial statements, which is the date these consolidated financial statements were available to be issued.