

Board of Governors of the Federal Reserve System

MAR 11 2018



Annual Report of Holding Companies—FR Y-6
FRB RICHMOND

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.

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2018

Month / Day / Year

na

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

Reporter's Name, Street, and Mailing Address

Frances W. Arthur Irrevocable Trust No. 2 for the Benefit of Frances Oxner Jorgenson

Legal Title of Holding Company

PO Box 769

(Mailing Address of the Holding Company) Street / P.O. Box

Union SC 29379
City State Zip Code

100 East Main Street

Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

J. Carlisle Oxner, III CEO

Name Title

864-427-1213

Area Code / Phone Number / Extension

864-466-4610

Area Code / FAX Number

coxner@arthurstatebank.com

E-mail Address

na

Address (URL) for the Holding Company's web page

I, Barry T. Kight

Name of the Holding Company Director and Official

Trustee

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

2/25/19

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 3137055
C.I.

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),

- a letter justifying this request is being provided along with the report
- 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."

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

FOJ Partners II LP

Legal Title of Subsidiary Holding Company

PO Box 769

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

Union SC 29379
City State Zip Code

100 East Main Street

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

0
City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

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City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Form FR Y-6
Frances W. Arthur Irrevocable Trust No. 2
for the Benefit of Frances Oxner Jorgenson
FOJ Partners, II, L.P.

SHAREHOLDERS

The Trust: As a trust established under South Carolina law, the Trust has no shareholders. There are no outstanding options, warrants or other securities or rights that can be converted into or exercised for interests in the Trust.

FOJ Partners II, L.P.: FOJ Partners II, L.P. ("FOJ II"), is a Georgia limited, which does not issue shares. The Trust holds 99.458% of the limited partnership interest in FOJ II. There are no outstanding options, warrants or other securities or rights that can be converted into or exercised for interests in FOJ II.

DIRECTORS AND OFFICERS

The Trust: The Trust has no directors or officers. Information concerning its sole trustee is set forth below.

FOJ II: FOJ II has no directors or officers. Its general manager is FOJ Management Company, LLC, information concerning which is set forth below.

NAMES AND ADDRESS:

The Trust: Barry Tison Kight, Columbia, S.C., is the sole trustee of the Trust.

FOJ II: The general manager of FOJ II is FOJ Management Company, LLC, Union, S.C. ("FOJMC"). FOJMC files a separate report on Form Y-6 which contains information on FOJMC.

PRINCIPAL OCCUPATION:

The Trust: Mr. Kight's principal occupation is CPA, C.C. McGregor and Company, LLC and portfolio manager, McGregor, Financial Advisors, LLC, Columbia, S.C.

FOJ II: Item 4(2) is not applicable to FOJMC.

TITLE OR POSITION

The Trust: Mr. Kight is the sole trustee of the Trust. He has no title or position with FOJ Partners, II, LP, or Arthur Financial Corporation, nor with any direct or indirect subsidiary of any of these companies. Mr. Kight is not associated with any other company as director, trustee, partner or executive officer.

FOJ II: Item 4(3) is not applicable to FOJMC.

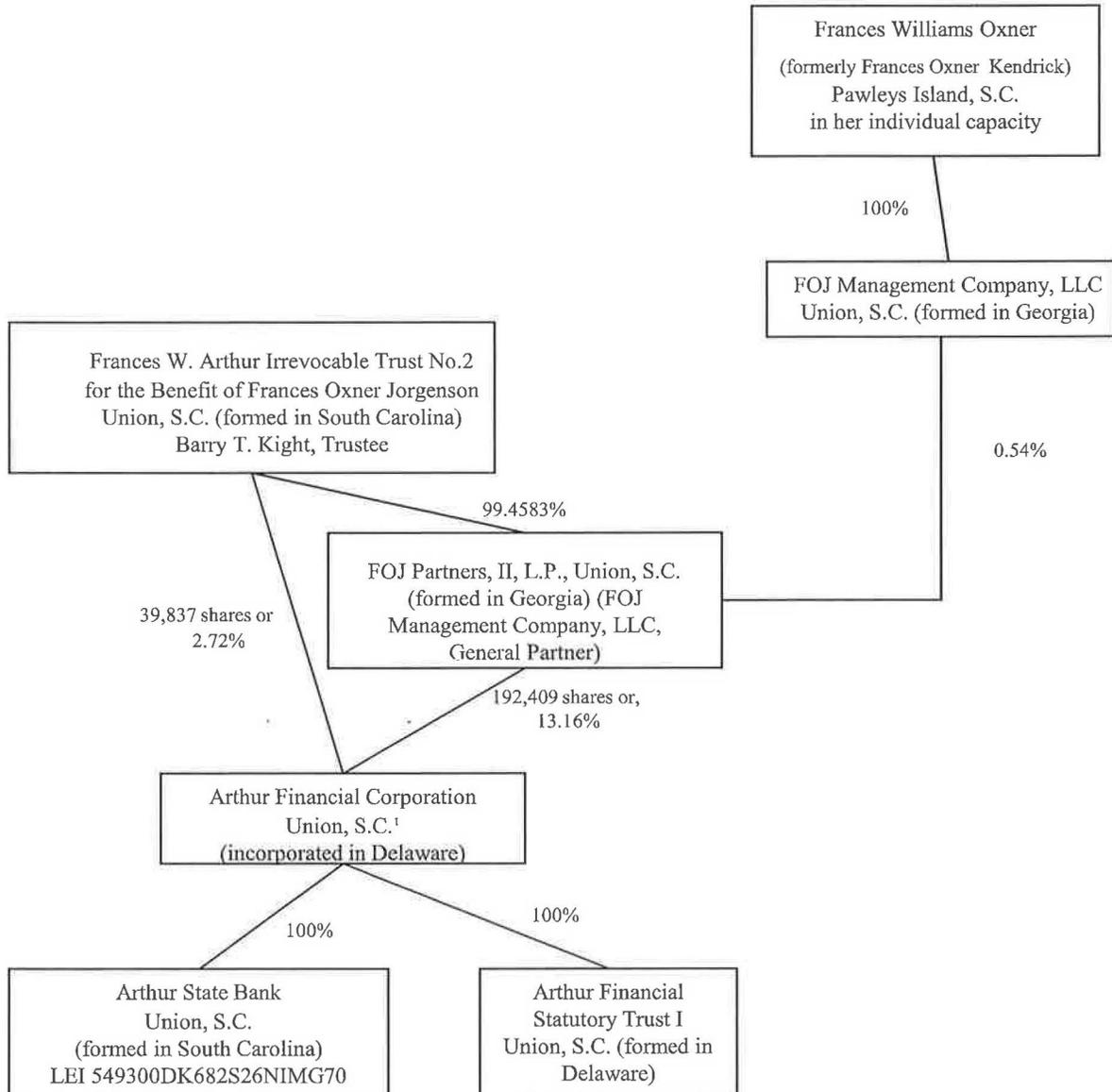
PERCENTAGE OF EACH CLASS OF VOTING SECURITIES OWNED, CONTROLLED OR HELD

The Trust and FOJ II: The Trust and FOJ II have no directors or officers.

ORGANIZATION CHART

See attached

**Frances W. Arthur
Irrevocable Trust No. 2
for the Benefit of
Frances Oxner Jorgenson**



^{1/} This company files a separate Form Y-6

No entities have a LEI except for Arthur State Bank

RECEIVED

FR Y-6
OMB Number 7100-0297
Approval expires November 30, 2019
Page 1 of 2

JUL 16 2019

Board of Governors of the Federal Reserve System



FRB RICHMOND

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.

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2018

Month / Day / Year

N/A

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

Reporter's Name, Street, and Mailing Address

I, Daniel O. Cook, Jr.

Name of the Holding Company Director and Official

EVP & CFO, COO

Title of the Holding Company Director and Official

Arthur Financial Corporation

Legal Title of Holding Company

P O Box 769

(Mailing Address of the Holding Company) Street / P.O. Box

Union SC 29379
City State Zip Code

100 East Main Street, Union, SC 29379

Physical Location (if different from mailing address)

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.

Person to whom questions about this report should be directed:

Daniel O. Cook, Jr. EVP & CFO, COO

Name Title

864-466-4504

Area Code / Phone Number / Extension

864-466-4557

Area Code / FAX Number

dcook@arthurstatebank.com

E-mail Address

www.arthurstatebank.com

Address (URL) for the Holding Company's web page

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.

Daniel O. Cook, Jr.

Signature of Holding Company Director and Official

03/11/2019

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 3196584
C.I. _____

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),

- a letter justifying this request is being provided along with the report
- 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."

FORM FR Y-6

**ARTHUR FINANCIAL CORPORATION
UNION, SOUTH CAROLINA**

YEAR ENDING DECEMBER 31, 2018

REPORT ITEM:

1: a. ARTHUR FINANCIAL CORPORATION IS NOT REQUIRED TO PREPARE
FORM 10K WITH THE SEC.

1: b. ENCLOSED IS A COPY OF THE ANNUAL REPORT PREPARED
FOR STOCKHOLDERS.

2. ORGANIZATIONAL CHART

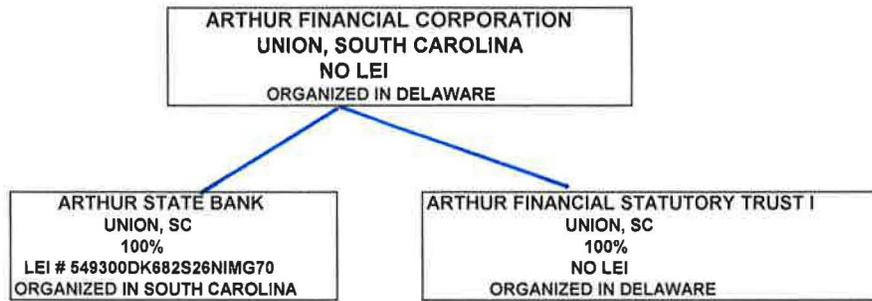
HOLDING COMPANY: ARTHUR FINANCIAL CORPORATION

SUBSIDIARIES OF HOLDING COMPANY:

ARTHUR STATE BANK - 549300DK682S26NIMG70
ARTHUR FINANCIAL STATUTORY TRUST I - NO LEI

ARTHUR FINANCIAL CORPORATION OWNS:

100% OF ARTHUR STATE BANK
100% OF ARTHUR FINANCIAL STATUTORY TRUST I



2B. SEPARATE BRANCH LISTING ATTACHED

Results: A list of branches for your depository institution: ARTHUR STATE BANK (ID_RSSD: 591320).
 This depository institution is held by JCO PARTNERS, L.P. (3136964) of UNION, SC.
 The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

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) | 591320 | ARTHUR STATE BANK | 100 EAST MAIN STREET | UNION | SC | 29379 | UNION | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 2637464 | CLINTON OFFICE | 205 JACOB'S HWY | CLINTON | SC | 29325 | LAURENS | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 335523 | BELTLINE BOULEVARD BRANCH | 2140 BELTLINE BOULEVARD | COLUMBIA | SC | 29209 | RICHLAND | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3649866 | CLEMSON ROAD BRANCH | 121 SPARKLEBERRY CROSSING | COLUMBIA | SC | 29229 | RICHLAND | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3649875 | GERVAIS STREET BRANCH | 1700 GERVAIS STREET | COLUMBIA | SC | 29201 | RICHLAND | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3178188 | GREENVILLE BRANCH | 1410 N PLEASANTBURG DR | GREENVILLE | SC | 29607 | GREENVILLE | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3220359 | GREENVILLE BRANCH AUGUSTA ROAD | 1925 AUGUSTA ROAD | GREENVILLE | SC | 29605 | GREENVILLE | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3923865 | LEXINGTON BRANCH | 5051 SUNSET BOULEVARD | LEXINGTON | SC | 29072 | LEXINGTON | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3284762 | ROCK HILL BRANCH | 201 SOUTH HERLONG AVE | ROCK HILL | SC | 29732 | YORK | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 2638395 | ROEBUCK BRANCH | 4285 SOUTH CHURCH ST EXTENSION | ROEBUCK | SC | 29376 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 2481171 | EAST MAIN STREET BRANCH | 756 EAST MAIN STREET | SPARTANBURG | SC | 29302 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 2824974 | GREENVILLE HIGHWAY BRANCH | 8770 WARREN H ABERNATHY HWY | SPARTANBURG | SC | 29301 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 726421 | MONARCH BRANCH | 1412 LOCKHART HIGHWAY | UNION | SC | 29379 | UNION | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 3220368 | PLAZA BRANCH | 1228 SOUTH DUNCAN BYPASS | UNION | SC | 29379 | UNION | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 111625 | WEST TOWNE PLAZA BRANCH | 501 NORTH DUNCAN BYPASS | UNION | SC | 29379 | UNION | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 730325 | LAURENS ROAD BRANCH | 731 LAURENS ROAD | WOODRUFF | SC | 29388 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 115829 | NORTH MAIN STREET BRANCH | 595 NORTH MAIN ST | WOODRUFF | SC | 29388 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |
| ok | | Full Service | 596026 | SOUTH MAIN STREET BRANCH | 131 SOUTH MAIN STREET | WOODRUFF | SC | 29388 | SPARTANBURG | UNITED STATES | Not Required | Not Required | ARTHUR STATE BANK | 591320 | |

FORM FR Y-6

ARTHUR FINANCIAL CORPORATION

FISCAL YEAR ENDING DECEMBER 31, 2018

REPORT ITEM 3: SECURITIES 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 FISCAL YEAR ENDING December 31, 2018 | | | SECURITIES HOLDERS NOT LISTED IN 3(1)(A) THROUGH 3(1)(C) THAT HAD OWNERSHIP OR HOLDINGS OF 5% OR MORE WITH POWER TO VOTE DURING THE FISCAL YEAR ENDING 12-31-2018 | | |
|--|-------------------------------------|--|---|-------------------------------------|--|
| (1)(A) NAME CITY, STATE, COUNTRY | (1)(B) COUNTRY OF CITIZENSHIP | (1)(C) NUMBER & PERCENTAGE OF EACH CLASS OF VOTING | (2)(A) NAME CITY, STATE, COUNTRY | (2)(B) COUNTRY OF CITIZENSHIP | (2)(C) NUMBER & PERCENTAGE OF EACH CLASS OF VOTING |
| J CARLISLE OXNER, III UNION, SC | USA | 43,417 - 2.969% COMMON | NONE | | |
| JCO PARTNERS II, LP UNION, SC | USA | 242,960 - 16.619% COMMON | | | |
| JCO PARTNERS, LP UNION, SC | USA | 49,048 - 3.355% COMMON | | | |
| HARRY A. OXNER GEORGETOWN, SC | USA | 42,637 - 2.916% COMMON | | | |
| HAO PARTNERS II, LP GEORGETOWN, SC | USA | 228,440 - 15.626% COMMON | | | |
| HAO PARTNERS, LP GEORGETOWN, SC | USA | 46,162 - 3.158% COMMON | | | |
| FOJ PARTNERS II, LP COLUMBIA, SC | USA | 192,409 - 13.161% COMMON | | | |
| FOJ PARTNERS, LP COLUMBIA, SC | USA | 49,108 - 3.359% COMMON | | | |

FORM FR Y - 6

ARTHUR FINANCIAL CORPORATION

FISCAL YEAR ENDING DECEMBER 31, 2018

REPORT ITEM 4: INSIDERS
(1) (2) (3)(A,B,C) AND (4) (A,B,C)

| (1) NAMES, CITY STATE, COUNTRY | (2) PRINCIPAL OCCUPATION | (3)A TITLE & POSITION WITH BHC | (3)(B) TITLE & POSITION WITH SUBSIDIARY | (3)(C) TITLE & POSITION WITH OTHER BUSINESS | (4)A % OF VOTING SHARES -BHC | (4)B % OF VOTING SHARES-SUBSIDIARIES | (4)C OTHER COMPANIES IF 25% OR MORE |
|---|---|--------------------------------------|---|---|------------------------------------|--|--|
| J CARLISLE OXNER, III UNION, SC USA | N/A | DIRECTOR AND CHAIRMAN & PRESIDENT | DIRECTOR AND PRESIDENT & CEO | N/A | 2.97% | NONE | NONE |
| JCO PARTNERS II, LP UNION, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 16.619% | NONE | NONE |
| JCO PARTNERS, LP UNION, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 3.355% | NONE | NONE |
| HARRY A OXNER GEORGETOWN, SC USA | ATTORNEY | DIRECTOR AND BOARD SECRETARY | DIRECTOR AND BOARD SECRETARY | PARTNER - OXNER & STACY LAW FIRM | 2.92% | NONE | NONE |
| HAO PARTNERS II, LP GEORGETOWN, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 15.626% | NONE | NONE |
| HAO PARTNERS, LP GEORGETOWN, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 3.158% | NONE | NONE |
| FOJ PARTNERS II, LP COLUMBIA, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 13.161% | NONE | NONE |
| FOJ PARTNERS, LP COLUMBIA, SC USA | LIMITED PARTNERSHIP (TO HOLD INDIVIDUAL BANK HOLDING COMPANY STOCK) | | STOCKHOLDER | N/A | 3.359% | NONE | NONE |
| DANIEL O. COOK, JR. CLINTON, SC USA | N/A | DIRECTOR AND EVP & CFO, COO | DIRECTOR AND CEO & CFO, COO | N/A | 0.003% | NONE | NONE |
| WILLIAM DOGAN WILSON CAMPOBELLO, SC USA | RETIRED - TEXTILES | DIRECTOR | DIRECTOR | N/A | 0.004% | NONE | NONE |
| JUSTIN A CONVERSE SPARTANBURG, SC USA | MINERALS HANDLING COAL BROKERAGE | DIRECTOR | DIRECTOR | OWNER & PRESIDENT CONVERSE & COMPANY, INC | 0.13% | NONE | 100% CONVERSE & CO |



MANAGEMENT'S REPORT
March 11, 2019

FINANCIAL STATEMENTS

Management of Arthur State Bank (a wholly owned subsidiary of Arthur Financial Corporation) is responsible for the preparation, integrity, and fair presentation of its published financial statements as of December 31, 2018, and for the year then ended, which are included in the December 31, 2018, consolidated financial statements of Arthur Financial Corporation. The consolidated financial statements of Arthur Financial Corporation have been prepared in accordance with accounting principles generally accepted in the United States of America and, as such, include some amounts that are based on judgments and estimates of management.

INTERNAL CONTROL OVER FINANCIAL REPORTING

Management of Arthur State Bank is responsible for establishing and maintaining effective internal control over financial reporting presented in conformity with accounting principles generally accepted in the United States of America and presented in conformity with such accounting principles and the Federal Financial Institutions Examination Council instructions for Reports of Condition and Income (call report instructions). The system contains monitoring mechanisms and actions are taken to correct deficiencies identified.

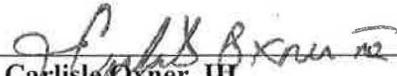
There are inherent limitations in the effectiveness of any internal control including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal control can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control may vary over time.

COMPLIANCE WITH LAWS AND REGULATIONS

Management is responsible for compliance with the federal and state laws and regulations concerning dividend restrictions and federal laws and regulations concerning loans to insiders designated by the FDIC as safety and soundness laws and regulations.

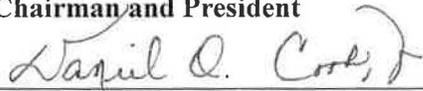
Management assessed compliance by Arthur State Bank for 2018 with the designated laws and regulations relating to safety and soundness. Based on this assessment by management, Arthur State Bank has complied with the designated safety and soundness laws and regulations.

Arthur State Bank



J. Carlisle Oxner, III

Chairman and President



Daniel O. Cook, Jr.

Chief Executive Officer, CFO, and COO

Chief Executive Officer, CFO, and COO

Arthur Financial Corporation

Report on Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

Arthur Financial Corporation
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Independent Auditor's Report

The Board of Directors
Arthur Financial Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Arthur Financial Corporation and its subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of operations, comprehensive income, changes in shareholders' 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 Arthur Financial Corporation and its subsidiaries as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
February 28, 2019

Arthur Financial Corporation
Consolidated Balance Sheets
As of December 31, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|-----------------------|-----------------------|
| Assets | | |
| Cash and due from banks | \$ 5,672,123 | \$ 5,072,672 |
| Interest bearing balances | <u>25,897,147</u> | <u>44,977,407</u> |
| Total cash and cash equivalents | <u>31,569,270</u> | <u>50,050,079</u> |
| Certificates of deposits with other financial institutions | 1,000,000 | 1,500,000 |
| Investment securities: | | |
| Securities available-for-sale | 96,990,998 | 75,137,457 |
| Securities held-to-maturity (fair market value \$1,577,860 and \$1,939,727) | 1,652,692 | 1,978,507 |
| Nonmarketable equity securities | <u>729,000</u> | <u>628,800</u> |
| Total investment securities | <u>100,372,690</u> | <u>79,244,764</u> |
| Loans receivable | 349,533,406 | 337,201,934 |
| Less allowance for loan losses | <u>2,966,791</u> | <u>3,366,703</u> |
| Loans receivable, net | <u>346,566,615</u> | <u>333,835,231</u> |
| Premises and equipment, net | 18,933,196 | 17,750,994 |
| Accrued interest receivable | 1,139,865 | 1,099,543 |
| Other real estate owned | 3,760,807 | 6,676,143 |
| Investment in trust | 310,000 | 310,000 |
| Deferred tax asset | 1,864,174 | 2,797,452 |
| Other assets | <u>1,729,322</u> | <u>1,680,288</u> |
| Total assets | <u>\$ 506,245,939</u> | <u>\$ 493,444,494</u> |
| Liabilities | | |
| Deposits: | | |
| Non-interest bearing demand deposits | \$ 144,760,668 | \$ 114,292,007 |
| Interest bearing demand deposits | 101,697,049 | 118,458,644 |
| Money market accounts | 70,121,022 | 71,711,304 |
| Savings | 80,765,822 | 74,749,269 |
| Time deposits of \$250,000 and over | 6,967,615 | 7,744,029 |
| Time deposits of under \$250,000 | <u>42,759,641</u> | <u>49,618,434</u> |
| Total deposits | 447,071,817 | 436,573,687 |
| Junior subordinated debentures | 10,310,000 | 10,310,000 |
| Securities sold under agreements to repurchase | 10,627,564 | 8,939,719 |
| Accrued interest payable | 65,307 | 75,366 |
| Other liabilities | <u>330,041</u> | <u>339,211</u> |
| Total liabilities | <u>468,404,729</u> | <u>456,237,983</u> |
| Commitments and contingencies - (Notes 4, 15, and 19) | | |
| Shareholders' equity | | |
| Preferred stock, Series A cumulative perpetual preferred stock; 0 and 8,000 shares issued and outstanding at December 31, 2018 and 2017, respectively | - | 800,000 |
| Common stock, \$.01 par value; 3,900,000 shares authorized; 1,463,688 shares issued and outstanding | 14,636 | 14,636 |
| Capital surplus | 10,141,029 | 10,141,029 |
| Retained earnings | 30,080,755 | 27,022,721 |
| Treasury stock at cost; 1,754 shares | (51,488) | (51,488) |
| Accumulated other comprehensive loss | <u>(2,343,722)</u> | <u>(720,387)</u> |
| Total shareholders' equity | <u>37,841,210</u> | <u>37,206,511</u> |
| Total liabilities and shareholders' equity | <u>\$ 506,245,939</u> | <u>\$ 493,444,494</u> |

See Notes to Consolidated Financial Statements

Arthur Financial Corporation
Consolidated Statements of Operations
For the years ended December 31, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|--|---------------------|---------------------|
| Interest income | | |
| Loans, including fees | \$ 16,389,070 | \$ 15,748,376 |
| Investment securities: | | |
| Taxable | 2,319,049 | 1,657,482 |
| Nonmarketable equity securities | 36,467 | 28,543 |
| Federal funds sold and other interest bearing bank balances | <u>578,468</u> | <u>296,201</u> |
| Total | <u>19,323,054</u> | <u>17,730,602</u> |
| Interest expense | | |
| Deposits | 543,078 | 602,690 |
| Other borrowings | <u>459,405</u> | <u>623,393</u> |
| Total | <u>1,002,483</u> | <u>1,226,083</u> |
| Net interest income | 18,320,571 | 16,504,519 |
| Provision (recovery) of loan losses | <u>100,000</u> | <u>(2,200,000)</u> |
| Net interest income after provision (recovery) of loan losses | <u>18,220,571</u> | <u>18,704,519</u> |
| Noninterest income | | |
| Service charges on deposit accounts | 2,304,886 | 2,149,406 |
| Other service charges and fees | 188,126 | 181,903 |
| Income from fiduciary activities | 1,402,161 | 1,164,664 |
| Gain on sale of residential mortgage loans | 44,422 | 86,355 |
| Servicing fee income | 159,813 | 174,229 |
| Other | <u>1,033,107</u> | <u>953,759</u> |
| Total | <u>5,132,515</u> | <u>4,710,316</u> |
| Noninterest expenses | | |
| Salaries and benefits | 9,374,367 | 8,819,261 |
| Net occupancy and equipment | 3,311,227 | 3,223,376 |
| Net cost of operation of other real estate owned | 1,516,031 | 547,897 |
| FDIC assessment | 196,000 | 255,000 |
| Professional fees | 336,331 | 383,660 |
| Telephone | 388,601 | 568,422 |
| Other operating | <u>2,617,846</u> | <u>2,868,068</u> |
| Total | <u>17,740,403</u> | <u>16,665,684</u> |
| Income before income taxes | 5,612,683 | 6,749,151 |
| Income tax expense related to ordinary operations | 1,314,458 | 2,316,760 |
| Income tax expense related to change in tax rate | - | <u>1,462,283</u> |
| Total income tax expense | <u>1,314,458</u> | <u>3,779,043</u> |
| Net income | 4,298,225 | 2,970,108 |
| Preferred stock dividends | <u>10,693</u> | <u>60,457</u> |
| Net income available for common shareholders | <u>\$ 4,287,532</u> | <u>\$ 2,909,651</u> |
| Income per common share: | | |
| Weighted average common shares outstanding | <u>1,461,934</u> | <u>1,461,934</u> |
| Net income per common share | <u>\$ 2.94</u> | <u>\$ 2.03</u> |

See Notes to Consolidated Financial Statements

Arthur Financial Corporation
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|---------------------|---------------------|
| Net income | \$ 4,298,225 | \$ 2,970,108 |
| Other comprehensive income | | |
| Unrealized holding losses on available-for-sale securities arising during the period | (2,170,458) | (264,954) |
| Tax effect | 511,253 | 90,083 |
| Recognized loss on interest rate swap | 53,407 | 306,262 |
| Tax effect | (17,537) | (104,130) |
| Reclassification of accumulated other comprehensive loss due to tax rate change | - | (81,501) |
| Other comprehensive loss, net of tax | <u>(1,623,335)</u> | <u>(54,240)</u> |
| Comprehensive income | <u>\$ 2,674,890</u> | <u>\$ 2,915,868</u> |

See Notes to Consolidated Financial Statements

Arthur Financial Corporation

Consolidated Statements of Changes in Shareholders' Equity For the years ended December 31, 2018 and 2017

| | Preferred Stock | | Common Stock | | Capital Surplus | Retained Earnings | Treasury Stock | | Accumulated Other Comprehensive Loss | Total |
|---|-----------------|--------------|--------------|-----------|-----------------|-------------------|----------------|-------------|--------------------------------------|---------------|
| | Shares | Amount | Shares | Amount | | | Shares | Amount | | |
| Balance, December 31, 2016 | 12,000 | \$ 1,200,000 | 1,463,688 | \$ 14,636 | \$ 10,141,029 | \$ 24,031,569 | 1,754 | \$ (51,488) | \$ (666,147) | \$ 34,669,599 |
| Net income | - | - | - | - | - | 2,970,108 | - | - | - | 2,970,108 |
| Preferred stock repurchase, net | (4,000) | (400,000) | - | - | - | - | - | - | - | (400,000) |
| Preferred dividends paid | - | - | - | - | - | (60,457) | - | - | - | (60,457) |
| Reclassification of other comprehensive loss due to tax rate change | - | - | - | - | - | 81,501 | - | - | (81,501) | - |
| Other comprehensive income, net of tax | - | - | - | - | - | - | - | - | 27,261 | 27,261 |
| Balance, December 31, 2017 | 8,000 | 800,000 | 1,463,688 | 14,636 | 10,141,029 | 27,022,721 | 1,754 | (51,488) | (720,387) | 37,206,511 |
| Net income | - | - | - | - | - | 4,298,225 | - | - | - | 4,298,225 |
| Preferred stock repurchase, net | (8,000) | (800,000) | - | - | - | - | - | - | - | (800,000) |
| Preferred dividends paid | - | - | - | - | - | (10,693) | - | - | - | (10,693) |
| Common stock dividends paid | - | - | - | - | - | (1,229,498) | - | - | - | (1,229,498) |
| Other comprehensive loss, net of tax | - | - | - | - | - | - | - | - | (1,623,335) | (1,623,335) |
| Balance, December 31, 2018 | - | \$ - | 1,463,688 | \$ 14,636 | \$ 10,141,029 | \$ 30,080,755 | 1,754 | \$ (51,488) | \$ (2,343,722) | \$ 37,841,210 |

See Notes to Consolidated Financial Statements

Arthur Financial Corporation
Consolidated Statements of Cash Flows
For the years ended December 31, 2018 and 2017

| | <u>2018</u> | <u>2017</u> |
|---|----------------------|----------------------|
| Operating activities: | | |
| Net income | \$ 4,298,225 | \$ 2,970,108 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 934,240 | 877,653 |
| Provision (recovery) of loan losses | 100,000 | (2,200,000) |
| Premium amortization less discount accretion | 134,952 | 197,239 |
| Disbursements for mortgages held for sale | (2,696,392) | (4,666,360) |
| Proceeds from sales of mortgages held for sale | 2,740,814 | 4,752,715 |
| Gain on sale of mortgages held for sale | (44,422) | (86,355) |
| Writedowns on other real estate owned | 1,525,576 | 410,802 |
| Gain (loss) on sale of other real estate owned | (119,592) | 104,404 |
| Amortization of loss on interest rate swap | 53,407 | 306,262 |
| Change in deferred tax asset | 1,005,587 | 3,500,176 |
| Increase in accrued interest receivable | (40,322) | (112,309) |
| Increase in other assets | 316,251 | 618,263 |
| Decrease in accrued interest payable | (10,059) | (28,994) |
| Decrease in other liabilities | (9,170) | (622,661) |
| Net cash provided by operating activities | <u>8,189,095</u> | <u>6,020,943</u> |
| Cash flows from investing activities: | | |
| Purchases of securities available-for-sale | (37,362,059) | (19,747,011) |
| Proceeds from maturities, calls, and paydowns of securities available-for-sale | 13,259,230 | 10,379,493 |
| Proceeds from maturities, calls, and paydowns of securities held-to-maturity | 325,815 | 5,339,707 |
| Net increase in loans receivable | (12,951,384) | (9,826,187) |
| Proceeds from the sale of certificates of deposits | 500,000 | - |
| Purchases of premises and equipment | (2,116,442) | (2,499,625) |
| Net purchase of nonmarketable equity securities | (100,200) | (153,600) |
| Proceeds from the sale of other real estate owned | 1,629,352 | 4,428,471 |
| Net cash used by investing activities | <u>(36,815,688)</u> | <u>(12,078,752)</u> |
| Cash flows from financing activities: | | |
| Net increase in deposits | 10,498,130 | 25,285,112 |
| Net increase in repurchase agreements | 1,687,845 | 259,240 |
| Net repurchase of preferred stock | (800,000) | (400,000) |
| Dividend payments | (1,240,191) | (60,457) |
| Net cash provided by financing activities | <u>10,145,784</u> | <u>25,083,895</u> |
| Net (decrease) increase in cash and cash equivalents | (18,480,809) | 19,026,086 |
| Cash and cash equivalents, beginning of year | 50,050,079 | 31,023,993 |
| Cash and cash equivalents, end of year | \$ 31,569,270 | \$ 50,050,079 |
| Supplementary disclosure: | | |
| Cash paid for interest | \$ 1,012,542 | \$ 1,255,077 |
| Cash paid for income taxes | 232,967 | 280,000 |
| Noncash investing and financing activities: | | |
| Unrealized loss on securities | \$ (2,170,458) | \$ (264,954) |
| Transfer of loans to other real estate owned | 120,000 | 49,591 |

See Notes to Consolidated Financial Statements

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies

Basis of Presentation and Consolidation:

The accompanying consolidated financial statements include the accounts of Arthur Financial Corporation (the "Company") and its wholly-owned subsidiaries. The Company owns all of the common stock of Arthur State Bank (the "Bank") and Arthur Financial Statutory Trust I (the "Trust"). The Bank provides commercial banking services to domestic markets through its offices located in South Carolina. The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiaries after elimination of all significant intercompany balances and transactions. The Trust is a special purpose subsidiary organized for the sole purposes of issuing trust preferred securities. The operations of the Trust have not been consolidated in these financial statements.

The accounting and reporting policies of the Company reflect industry practices and conform to generally accepted accounting principles in all material respects.

Management's 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported 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 losses on loans, 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 losses on loans and valuation of foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances or losses may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and valuation of foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances for losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for losses on loans and valuation of foreclosed real estate may change materially in the near term.

Concentrations of Credit Risk:

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in Union, Richland, Laurens, Greenville, and Spartanburg counties of South Carolina. The Company's loan portfolio is not concentrated in loans to any single borrower or a relatively small number of borrowers. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies, Continued

Concentrations of Credit Risk, Continued:

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully paid (i.e. balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

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

Securities Available-for-Sale:

Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in shareholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of securities available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Securities Held-to-Maturity:

Bonds, notes, and debentures for which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using the interest method over the period to maturity or to call dates.

Nonmarketable Equity Securities:

Nonmarketable equity securities include the Company's investments in the stock of the Federal Home Loan Bank and CBB Financial, as well as an investment in a Small Business Invest Fund (SBIF). The investments are carried at cost because they have no quoted market value and no ready market exists. Dividends and income received from these investments are included as a separate component in interest income. The investment in nonmarketable equity securities totaled \$729,000 and \$628,800 at December 31, 2018 and 2017, respectively.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies, Continued

Loans Held for Sale:

Loans held for sale consist of residential mortgage loans the Company originates for sale to secondary market investors. They are carried at the lower of aggregate cost or market value. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. Fees collected in conjunction with origination activities are deferred as part of the cost basis of the loan and recognized when the loan is sold. Gains or losses on sales are recognized when the loans are sold and are determined as the difference between the sales price and the carrying value of the loans.

The Company issues rate lock commitments to borrowers based on prices quoted by secondary market investors. When rates are locked with borrowers, a sales commitment is immediately entered (on a best efforts basis or mandatory delivery basis) at a specified price with a secondary market investor. Accordingly, any potential liabilities associated with rate lock commitments are offset by sales commitments to investors.

Loans Receivable:

Interest income on loans receivable is computed based upon the unpaid principal balance, net of charge offs. Interest income is recorded in the period earned.

The accrual of interest income is discontinued when a loan becomes contractually ninety days past due as to principal or interest and unpaid interest is reversed from interest income in the statements of operations. Management may elect to continue the accrual of interest when the estimated net realizable value of collateral exceeds the principal balance and accrued interest. Loans are removed from nonaccrual status when they become current as to both principal and interest, when concern no longer exists as to the collectability of the principal and interest, and sufficient history of satisfactory payment performance has been established. Impaired loans are measured based on the present value of discounted expected cash flows, observable market prices, or the fair value of collateral less any adjustments or selling costs. When it is determined that a loan is impaired, a direct charge to bad debt expense is made for the difference between the fair value and the Company's recorded investment in the related loan. The corresponding entry is to a related allowance account. Interest is discontinued on impaired loans when management determines that a borrower may be unable to meet payments as they become due.

Allowance for Loan Losses:

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

Note 1. Summary of Significant Accounting Policies, Continued

Allowance for Loan Losses, Continued:

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of the loan. The general component covers loans not considered to be impaired and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could effect Management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

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. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price, or the fair value of the collateral, less any adjustments and selling costs, if the loan is collateral dependent.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement.

In situations where, for economic or legal reasons related to a borrower's financial difficulties, a concession to the borrower is granted that the Company would not otherwise consider, the related loan is classified as a troubled debt restructuring. The restructuring of a loan may include the transfer from the borrower to the Company of real estate, receivables from third parties, other assets, or an equity interest in the borrower in full or partial satisfaction of the loan, modification of the loan terms, or a combination of the above.

Premises and Equipment:

Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed using both straight line and accelerated depreciation methods. Rates of depreciation are generally based on the following estimated useful lives: buildings - 39 to 40 years; furniture and equipment - 5 to 15 years; leasehold improvements - 15 years. The cost of assets sold or otherwise disposed of, and the related accumulated depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the statement of operations. Maintenance and repairs are charged to current expense as incurred, and the costs of major renewals and improvements are capitalized.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies, Continued

Mortgage Servicing Rights:

Certain loans originated by the Company are sold in the secondary market with servicing rights retained and capitalized by the Company included in other assets. These loans are held in its servicing portfolio. The Company accounts for its mortgage servicing rights using the fair value measurement method. Under this method, the Company measures servicing assets or servicing liabilities at fair value at each reporting date and reports changes in fair value in earnings in the period in which the changes occur. Fair value is determined using prices for similar characteristics, where available, or is based upon discounted cash flows using market-based assumptions. Changes in fair value are recorded in other non-interest income.

Other Real Estate Owned:

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is initially recorded at the lower of cost or fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost basis. After foreclosure, valuations are periodically performed by management and properties are carried at the lower of cost or fair value less estimated costs of disposal. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and write-downs to reduce the carrying amount to fair value less estimated costs to dispose are recorded as necessary. Revenue and expense from the operations of foreclosed assets and changes in the carrying amounts are included in net cost of operation of other real estate owned.

Derivative Financial Instruments:

The Company has entered into certain interest rate swap agreements which are derivative financial instruments ("derivatives"). The derivatives are recognized as other liabilities on the balance sheet at their fair value. On the date the derivative contract was entered into, the Company designated the derivative as a cash flow hedge. The cumulative change in fair value of the hedging derivative, to the extent that it is expected to be offset by the cumulative change in anticipated interest cash flows from the hedged exposure, or effective, will be deferred and reported as a component of other comprehensive income. The Company used the dollar-offset method for comparing the hedge effectiveness, using the cumulative approach. Any hedge ineffectiveness was charged to current earnings. Refer to Note 12 regarding termination of derivative activities during 2011.

Income and Expense Recognition:

The accrual method of accounting is used for all significant categories of income and expense. Immaterial amounts of insurance commissions and other miscellaneous fees are reported when received.

Retirement Benefits:

A trustee retirement savings plan is sponsored by the Bank, which provides retirement benefits to substantially all officers and employees who meet certain age and service requirements. The plan includes a "salary reduction" feature pursuant to Section 401(k) of the Internal Revenue Code. Under the plan and present policies, participants are permitted to make contributions up to 18% of their annual compensation. At its discretion, the Bank can make matching contributions up to 100% of the participants' contributions. Retirement savings plan costs of \$164,089 and \$154,421 were included in the Company's salaries and benefit expenses for 2018 and 2017, respectively.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies, Continued

Income Taxes:

Income taxes are the sum of amounts currently payable to taxing authorities and the net changes in income taxes payable or refundable in future years. Income taxes deferred to future years are determined utilizing a liability approach. This method gives consideration to the future tax consequences associated with differences between the financial accounting and tax bases of certain assets and liabilities, principally the allowance for loan losses.

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 of December 31, 2018, management concluded that a partial valuation allowance was required.

Advertising Expense:

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs of \$90,169 and \$79,409, were included in the Company's other operating expenses for 2018 and 2017, respectively.

Income Per Common Share:

Income per common share is calculated by dividing earnings available to common shareholders by the weighted average number of common shares outstanding during the year. The Company has no instruments which are considered common stock equivalents and therefore, diluted earnings per common share is not presented.

Statement of Cash Flows:

For purposes of reporting cash flows, the Company considers certain highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, interest-bearing bank balances, and federal funds sold.

Off-Balance-Sheet Financial Instruments:

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

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies and Activities, Continued

Comprehensive Income:

The Company reports comprehensive income in accordance with Accounting Standards Codification (ASC) 220, "Comprehensive Income." The standard requires that all items that are required to be reported under accounting standards as comprehensive income be reported in a financial statement that is displayed with the same prominence as other consolidated financial statements. The disclosure requirements have been included in the Company's consolidated statements of comprehensive income.

The following table presents changes in accumulated other comprehensive income (loss) for the years ended December 31:

| | Unrealized Gain/(Loss) on Available- for-Sale Securities | Unrealized Loss on Swap | Total |
|---|--|-------------------------------|-----------------------|
| Balance as of December 31, 2016 | \$ (428,145) | \$ (238,002) | \$ (666,147) |
| Other comprehensive income before reclassifications | (264,954) | 306,262 | 41,308 |
| Amounts reclassified from accumulated other comprehensive income | 90,083 | (104,130) | (14,047) |
| Reclassification of accumulated other comprehensive loss due to tax rate change | (81,501) | - | (81,501) |
| Net current period other comprehensive income (loss) | (256,372) | 202,132 | 54,240 |
| Balance as of December 31, 2017 | <u>\$ (684,517)</u> | <u>\$ (35,870)</u> | <u>\$ (720,387)</u> |
| Balance as of December 31, 2017 | \$ (684,517) | \$ (35,870) | \$ (720,387) |
| Other comprehensive income before reclassifications | (2,170,458) | 53,407 | (2,117,051) |
| Amounts reclassified from accumulated other comprehensive income | 511,253 | (17,537) | 493,716 |
| Net current period other comprehensive income (loss) | (1,659,205) | 35,870 | (1,623,335) |
| Balance as of December 31, 2018 | <u>\$ (2,343,722)</u> | <u>\$ -</u> | <u>\$ (2,343,722)</u> |

Recently Issued Accounting Pronouncements:

The following is a summary of recent authoritative pronouncements.

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. The guidance will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Company will apply the guidance using a modified retrospective approach. The Company's revenue is comprised of net interest income and noninterest income. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities, and derivatives. Accordingly, the majority of our revenues will not be affected. The Company is currently assessing our revenue contracts related to revenue streams that are within the scope of the standard. Our accounting policies will not change materially since the principles of revenue recognition from the ASU are largely consistent with existing guidance and current practices applied by our businesses. The Company has not identified material changes to the timing or amount of revenue recognition. Based on the updated guidance, the Company does anticipate changes in our disclosures associated with our revenues. The Company will disclose our performance obligations related to our revenue recognition and will continue to evaluate disaggregation for significant categories of revenue in the scope of the guidance.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies and Activities, Continued

Recently Issued Accounting Pronouncements, Continued:

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 Company 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 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 Company 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. Early adoption is permitted. The Company expects to adopt the guidance using the modified retrospective method and practical expedients for transition. The practical expedients allow us to largely account for our existing leases consistent with current guidance except for the incremental balance sheet recognition for lessees. The Company has started an initial evaluation of our leasing contracts and activities. The Company has also started developing our methodology to estimate the right-of use assets and lease liabilities, which is based on the present value of lease payments. The Company does not expect a material change to the timing of expense recognition, but is early in the implementation process and will continue to evaluate the impact. The Company is evaluating our existing disclosures and may need to provide additional information as a result of adoption of the ASU.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for annual periods beginning after December 15, 2020, and interim periods within annual reporting periods beginning after December 15, 2021. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption is permitted beginning in first quarter 2019, the Company does not expect to elect that option. The Company is evaluating the impact of the ASU on our consolidated financial statements. The Company expects the ASU will have no material impact on the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. In addition to our allowance for loan losses, the Company will also record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In March 2017, the FASB amended the requirements in the Receivables - Nonrefundable Fees and Other Costs Topic of the Accounting Standards Codification related to the amortization period for certain purchased callable debt securities held at a premium. The amendments shorten the amortization period for the premium to the earliest call date. The amendments will be effective for the Company for annual periods beginning after December 15, 2019, and interim periods within annual reporting periods beginning after December 15, 2020. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 1. Summary of Significant Accounting Policies, Continued

Recently Issued Accounting Pronouncements, Continued:

In February 2018, the FASB amended the Income Statement - Reporting Comprehensive Income Topic of the Accounting Standards Codification. The amendments allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company adopted this pronouncement by retrospective application to each period (or periods) in which the effect of the change in the tax rate was recognized. The impact of the reclassification from other comprehensive loss to retained earnings was \$81,501.

In February 2018, the FASB amended the Financial Instruments Topic of the Accounting Standards Codification. The amendments clarify certain aspects of the guidance issued in ASU 2016-01. The amendments are effective for the same dates as those described in ASU 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted ASU 2016-01. The Company does not expect these amendments to have a material effect on its financial statements.

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

Risks and Uncertainties:

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

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

Reclassifications:

Certain captions and amounts in the 2017 consolidated financial statements were reclassified to conform with the 2018 presentation. The reclassifications did not have an impact on net income or shareholders' equity.

Note 2. Cash and Due From Banks

The Company is required by regulation to maintain an average cash reserve balance based on a percentage of deposits. The amount of the cash reserve balances at December 31, 2018 and 2017 were approximately \$14,302,000 and \$13,753,000, respectively.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 3. Investment Securities

The amortized cost and estimated market values of securities available-for-sale were:

| | December 31, 2018 | | | Estimated Fair Value |
|----------------------------------|---------------------------|---------------------------------------|--|-------------------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Government-sponsored enterprises | \$ 5,011,971 | \$ 28,629 | \$ - | \$ 5,040,600 |
| Mortgage-backed securities | 94,012,387 | 80,990 | (3,119,831) | 90,973,546 |
| CRA Qualified Investment Fund | 1,000,000 | - | (23,148) | 976,852 |
| | <u>\$ 100,024,358</u> | <u>\$ 109,619</u> | <u>\$ (3,142,979)</u> | <u>\$ 96,990,998</u> |

| | December 31, 2017 | | | Estimated Fair Value |
|----------------------------------|---------------------------|---------------------------------------|--|-------------------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Government-sponsored enterprises | \$ 5,012,857 | \$ 165,643 | \$ - | \$ 5,178,500 |
| Mortgage-backed securities | 69,987,502 | 81,542 | (1,108,731) | 68,960,313 |
| CRA Qualified Investment Fund | 1,000,000 | - | (1,356) | 998,644 |
| | <u>\$ 76,000,359</u> | <u>\$ 247,185</u> | <u>\$ (1,110,087)</u> | <u>\$ 75,137,457</u> |

The amortized cost and estimated market values of securities held-to-maturity were:

| | December 31, 2018 | | | Estimated Fair Value |
|----------------------------|---------------------------|---------------------------------------|--|-------------------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Mortgage-backed securities | \$ 1,652,692 | \$ - | \$ (74,832) | \$ 1,577,860 |
| | <u>\$ 1,652,692</u> | <u>\$ -</u> | <u>\$ (74,832)</u> | <u>\$ 1,577,860</u> |

| | December 31, 2017 | | | Estimated Fair Value |
|----------------------------|---------------------------|---------------------------------------|--|-------------------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | |
| Mortgage-backed securities | \$ 1,978,507 | \$ - | \$ (38,780) | \$ 1,939,727 |
| | <u>\$ 1,978,507</u> | <u>\$ -</u> | <u>\$ (38,780)</u> | <u>\$ 1,939,727</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 3. Investment Securities, Continued

The following tables show gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities available-for-sale have been in a continuous unrealized loss position, at December 31, 2018 and 2017.

| | | December 31, 2018 | | | | | |
|-------------------------------|--|----------------------------|----------------------|--------------------------|-----------------------|----------------------|-----------------------|
| | | Less than twelve months | | Twelve months or more | | Total | |
| | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Mortgage-backed securities | | \$ 27,279,667 | \$ (365,659) | \$ 55,981,199 | \$ (2,754,172) | \$ 83,260,866 | \$ (3,119,831) |
| CRA Qualified Investment Fund | | 976,852 | (23,148) | - | - | 976,852 | (23,148) |
| | | <u>\$ 28,256,519</u> | <u>\$ (388,807)</u> | <u>\$ 56,981,199</u> | <u>\$ (2,754,172)</u> | <u>\$ 84,237,718</u> | <u>\$ (3,142,979)</u> |

| | | December 31, 2017 | | | | | |
|-------------------------------|--|----------------------------|----------------------|--------------------------|----------------------|----------------------|-----------------------|
| | | Less than twelve months | | Twelve months or more | | Total | |
| | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Mortgage-backed securities | | \$ 27,065,938 | \$ (234,912) | \$ 33,736,057 | \$ (873,819) | \$ 60,801,995 | \$ (1,108,731) |
| CRA Qualified Investment Fund | | 998,644 | (1,356) | - | - | 998,644 | (1,356) |
| | | <u>\$ 28,064,582</u> | <u>\$ (236,268)</u> | <u>\$ 33,736,057</u> | <u>\$ (873,819)</u> | <u>\$ 61,800,639</u> | <u>\$ (1,110,087)</u> |

The following tables show gross unrealized losses and fair value, aggregated by investment category, and length of time that individual securities held-to-maturity have been in a continuous unrealized loss position, at December 31, 2018 and 2017.

| | | December 31, 2018 | | | | | |
|----------------------------|--|----------------------------|----------------------|--------------------------|----------------------|--------------|----------------------|
| | | Less than twelve months | | Twelve months or more | | Total | |
| | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Mortgage-backed Securities | | \$ - | \$ - | \$ 1,577,860 | \$ (74,832) | \$ 1,577,860 | \$ (74,832) |

| | | December 31, 2017 | | | | | |
|----------------------------|--|----------------------------|----------------------|--------------------------|----------------------|--------------|----------------------|
| | | Less than twelve months | | Twelve months or more | | Total | |
| | | Fair value | Unrealized losses | Fair value | Unrealized losses | Fair value | Unrealized losses |
| Mortgage-backed Securities | | \$ - | \$ - | \$ 1,939,727 | \$ (38,780) | \$ 1,939,727 | \$ (38,780) |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 3. Investment Securities, Continued

Securities classified as available-for-sale are recorded at fair market value. There were twenty securities classified as available-for-sale in an unrealized loss position for twelve months or more at December 31, 2018. The Company does not intend to sell these securities, and it is more likely than not that the Company will not be required to sell these securities before recovery of its amortized cost. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and not in the credit quality of the issuer and therefore, this loss is not considered other-than-temporary.

The amortized cost and fair values of investment securities at December 31, 2018, by contractual maturity, are shown in the following chart. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

| | Available-for-sale | | Held-to-maturity | |
|---|----------------------|----------------------|---------------------|----------------------|
| | Amortized Cost | Estimated Fair Value | Amortized Cost | Estimated Fair Value |
| Due within one year | \$ 19,597,303 | \$ 19,086,096 | \$ - | \$ - |
| Due after one through five years | 25,830,785 | 25,054,292 | - | - |
| Due after five years but within ten years | 35,282,959 | 34,244,839 | - | - |
| Due after ten years | 18,313,311 | 17,628,919 | 1,652,692 | 1,577,860 |
| Other | 1,000,000 | 976,852 | - | - |
| Total | <u>\$100,024,358</u> | <u>\$ 96,990,998</u> | <u>\$ 1,652,692</u> | <u>\$ 1,577,860</u> |

At December 31, 2018 and 2017 investment securities with a book value of \$27,209,756 and \$29,112,041 and a market value of \$26,186,184 and \$28,842,013, respectively, were pledged as collateral to secure public deposits and for other purposes.

During 2018 and 2017, the Company sold no securities.

Note 4. Loans Receivable

Following is a summary of loans by major classification:

| | December 31, | |
|---|-----------------------|-----------------------|
| | 2018 | 2017 |
| Commercial, industrial and agricultural | \$ 30,352,417 | \$ 29,500,367 |
| Consumer and other | 8,786,206 | 9,050,211 |
| Real estate - construction | 6,971,624 | 7,287,881 |
| Real estate – residential | 181,916,839 | 178,649,286 |
| Real estate - commercial | 121,506,320 | 112,714,189 |
| Total gross loans | <u>\$ 349,533,406</u> | <u>\$ 337,201,934</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2018:

| | <u>Commercial, Industrial and Agricultural</u> | <u>Consumer and Other</u> | <u>Real Estate Construction</u> | <u>Real Estate Residential</u> | <u>Real Estate Commercial</u> | <u>Total</u> |
|---------------------------------------|--|-------------------------------|-------------------------------------|------------------------------------|-----------------------------------|-----------------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 734,685 | \$ 235,986 | \$ 125,729 | \$ 2,013,872 | \$ 256,431 | \$ 3,366,703 |
| Charge-offs | (198,988) | (734,134) | - | (131,091) | (934) | (1,065,147) |
| Recoveries | 18,222 | 436,697 | - | 81,092 | 29,224 | 565,235 |
| Provision | 30,385 | 325,333 | (61,385) | (287,470) | 93,137 | 100,000 |
| Ending balance | <u>\$ 584,304</u> | <u>\$ 263,882</u> | <u>\$ 64,344</u> | <u>\$ 1,676,403</u> | <u>\$ 377,858</u> | <u>\$ 2,966,791</u> |
| Ending balances: | | | | | | |
| Individually evaluated for impairment | <u>\$ 588</u> | <u>\$ 2,795</u> | <u>\$ -</u> | <u>\$ 6,370</u> | <u>\$ 7,620</u> | <u>\$ 17,373</u> |
| Collectively evaluated for impairment | <u>\$ 583,716</u> | <u>\$ 261,087</u> | <u>\$ 64,344</u> | <u>\$ 1,670,033</u> | <u>\$ 370,238</u> | <u>\$ 2,949,418</u> |
| Loans receivable: | | | | | | |
| Ending balance - total | <u>\$ 30,352,417</u> | <u>\$ 8,786,206</u> | <u>\$ 6,971,624</u> | <u>\$ 181,916,839</u> | <u>\$ 121,506,320</u> | <u>\$ 349,533,406</u> |
| Ending balances: | | | | | | |
| Individually evaluated for impairment | <u>\$ 1,442,930</u> | <u>\$ 22,795</u> | <u>\$ -</u> | <u>\$ 2,013,468</u> | <u>\$ 2,880,695</u> | <u>\$ 6,359,888</u> |
| Collectively evaluated for impairment | <u>\$ 28,909,487</u> | <u>\$ 8,763,411</u> | <u>\$ 6,971,624</u> | <u>\$ 179,903,371</u> | <u>\$ 118,625,625</u> | <u>\$ 343,193,518</u> |

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2017:

| | <u>Commercial, Industrial and Agricultural</u> | <u>Consumer and Other</u> | <u>Real Estate Construction</u> | <u>Real Estate Residential</u> | <u>Real Estate Commercial</u> | <u>Total</u> |
|---------------------------------------|--|-------------------------------|-------------------------------------|------------------------------------|-----------------------------------|-----------------------|
| Allowance for loan losses: | | | | | | |
| Beginning balance | \$ 938,978 | \$ 340,939 | \$ 127,131 | \$ 2,793,667 | \$ 807,528 | \$ 5,008,243 |
| Charge-offs | (36,562) | (565,116) | - | (148,775) | - | (750,453) |
| Recoveries | - | 517,833 | - | 315,082 | 475,998 | 1,308,913 |
| Recovery | (167,731) | (57,670) | (1,402) | (946,102) | (1,027,095) | (2,200,000) |
| Ending balance | <u>\$ 734,685</u> | <u>\$ 235,986</u> | <u>\$ 125,729</u> | <u>\$ 2,013,872</u> | <u>\$ 256,431</u> | <u>\$ 3,366,703</u> |
| Ending balances: | | | | | | |
| Individually evaluated for impairment | <u>\$ 213</u> | <u>\$ 191</u> | <u>\$ -</u> | <u>\$ 9,463</u> | <u>\$ -</u> | <u>\$ 9,867</u> |
| Collectively evaluated for impairment | <u>\$ 734,472</u> | <u>\$ 235,795</u> | <u>\$ 125,729</u> | <u>\$ 2,004,409</u> | <u>\$ 256,431</u> | <u>\$ 3,356,836</u> |
| Loans receivable: | | | | | | |
| Ending balance - total | <u>\$ 29,500,367</u> | <u>\$ 9,050,211</u> | <u>\$ 7,287,881</u> | <u>\$ 178,649,286</u> | <u>\$ 112,714,189</u> | <u>\$ 337,201,934</u> |
| Ending balances: | | | | | | |
| Individually evaluated for impairment | <u>\$ 1,560,461</u> | <u>\$ 19,725</u> | <u>\$ -</u> | <u>\$ 2,681,208</u> | <u>\$ 4,702,138</u> | <u>\$ 8,963,532</u> |
| Collectively evaluated for impairment | <u>\$ 27,939,906</u> | <u>\$ 9,030,486</u> | <u>\$ 7,287,881</u> | <u>\$ 175,968,078</u> | <u>\$ 108,012,051</u> | <u>\$ 328,238,402</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

Credit Quality Indicators

The Company uses a risk based approach based on the following credit quality measures when analyzing the loan portfolio: pass, watch, special mention, and substandard. These indicators are used to rate the credit quality of loans for the purposes of determining the Company's allowance for loan losses.

Acceptable/Pass are deemed to be loans that are performing and are deemed adequately protected by the net worth of the borrower or the underlying collateral value. These loans are considered the least risky in terms of determining the allowance for loan losses.

Watch/Special Mention are deemed to be loans that 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 position at some future date.

Substandard/Doubtful are deemed to be loans that are considered the most risky. These loans typically have an identified weakness or weaknesses and are inadequately protected by the net worth of the borrower or collateral value.

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2018:

| | <u>Commercial, Industrial and Agricultural</u> | <u>Consumer and Other</u> | <u>Real Estate Construction</u> | <u>Real Estate Residential</u> | <u>Real Estate Commercial</u> | <u>Total</u> |
|--------------------------|--|-------------------------------|-------------------------------------|------------------------------------|-----------------------------------|-----------------------|
| Acceptable/Pass | \$ 28,709,085 | \$ 8,711,899 | \$ 6,971,624 | \$ 176,849,642 | \$ 114,596,336 | \$ 335,838,586 |
| Watch/Special Mention | 166,258 | 19,016 | - | 1,940,270 | 6,019,266 | 8,144,810 |
| Substandard | 1,477,074 | 55,291 | - | 3,126,927 | 890,718 | 5,550,010 |
| Doubtful | - | - | - | - | - | - |
| | <u>\$ 30,352,417</u> | <u>\$ 8,786,206</u> | <u>\$ 6,971,624</u> | <u>\$ 181,916,839</u> | <u>\$ 121,506,320</u> | <u>\$ 349,533,406</u> |

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2017:

| | <u>Commercial, Industrial and Agricultural</u> | <u>Consumer and Other</u> | <u>Real Estate Construction</u> | <u>Real Estate Residential</u> | <u>Real Estate Commercial</u> | <u>Total</u> |
|--------------------------|--|-------------------------------|-------------------------------------|------------------------------------|-----------------------------------|-----------------------|
| Acceptable/Pass | \$ 26,637,835 | \$ 8,995,001 | \$ 7,287,881 | \$ 170,679,377 | \$ 101,391,106 | \$ 314,991,200 |
| Watch/Special Mention | 1,020,965 | 10,172 | - | 3,952,189 | 9,480,948 | 14,464,274 |
| Substandard | 1,841,567 | 45,038 | - | 4,107,720 | 1,842,135 | 7,746,460 |
| Doubtful | - | - | - | - | - | - |
| | <u>\$ 29,500,367</u> | <u>\$ 9,050,211</u> | <u>\$ 7,287,881</u> | <u>\$ 178,649,286</u> | <u>\$ 112,714,189</u> | <u>\$ 337,201,934</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

The following is an aging analysis of our loan portfolio at December 31, 2018:

| | <u>30 - 59 Days Past Due</u> | <u>60 - 89 Days Past Due</u> | <u>Greater Than 90 Days</u> | <u>Total Past Due</u> | <u>Current</u> | <u>Total Loans Receivable</u> | <u>Recorded Investment > 90 Days and Accruing</u> |
|--|----------------------------------|----------------------------------|-------------------------------------|---------------------------|-----------------------|-----------------------------------|--|
| Commercial, industrial and agricultural | \$ 360,114 | \$ - | \$ - | \$ 360,114 | \$ 29,992,303 | \$ 30,352,417 | \$ - |
| Consumer and other | 34,984 | 6,788 | 22,795 | 64,567 | 8,721,639 | 8,786,206 | - |
| Real estate - construction | 27,662 | - | - | 27,662 | 6,943,962 | 6,971,624 | - |
| Real estate - commercial | 12,288 | - | - | 12,288 | 121,494,032 | 121,506,320 | - |
| Real estate - residential | <u>1,299,060</u> | <u>335,271</u> | <u>354,638</u> | <u>1,988,969</u> | <u>179,927,870</u> | <u>181,916,839</u> | - |
| | <u>\$ 1,734,108</u> | <u>\$ 342,059</u> | <u>\$ 377,433</u> | <u>\$ 2,453,600</u> | <u>\$ 347,079,806</u> | <u>\$ 349,533,406</u> | <u>\$ -</u> |

The following is an aging analysis of our loan portfolio at December 31, 2017:

| | <u>30 - 59 Days Past Due</u> | <u>60 - 89 Days Past Due</u> | <u>Greater Than 90 Days</u> | <u>Total Past Due</u> | <u>Current</u> | <u>Total Loans Receivable</u> | <u>Recorded Investment > 90 Days and Accruing</u> |
|--|----------------------------------|----------------------------------|-------------------------------------|---------------------------|-----------------------|-----------------------------------|--|
| Commercial, industrial and agricultural | \$ 313,182 | \$ - | \$ - | \$ 313,182 | \$ 29,187,185 | \$ 29,500,367 | \$ - |
| Consumer and other | 90,793 | 54,677 | 1,027 | 146,497 | 8,903,714 | 9,050,211 | - |
| Real estate - construction | - | - | - | - | 7,287,881 | 7,287,881 | - |
| Real estate - commercial | 468,826 | - | 272,060 | 740,886 | 111,973,303 | 112,714,189 | - |
| Real estate - residential | <u>1,524,811</u> | <u>185,250</u> | <u>370,630</u> | <u>2,080,691</u> | <u>176,568,595</u> | <u>178,649,286</u> | - |
| | <u>\$ 2,397,612</u> | <u>\$ 239,927</u> | <u>\$ 643,717</u> | <u>\$ 3,281,256</u> | <u>\$ 333,920,678</u> | <u>\$ 337,201,934</u> | <u>\$ -</u> |

The following is an analysis of our impaired loan portfolio detailing the related allowance recorded at December 31, 2018:

| | <u>Recorded Investment</u> | <u>Unpaid Principal Balance</u> | <u>Related Allowance</u> | <u>Average Recorded Investment</u> | <u>Interest Income Recognized</u> |
|---|--------------------------------|---|------------------------------|--|---|
| With no related allowance needed: | | | | | |
| Commercial, industrial and agricultural | \$ 1,422,798 | \$ 1,422,798 | \$ - | \$ 1,486,785 | \$ 57,864 |
| Consumer and other | - | - | - | - | - |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | 2,453,579 | 2,711,634 | - | 2,525,463 | 133,901 |
| Real estate - residential | <u>1,507,003</u> | <u>1,558,098</u> | - | <u>1,641,301</u> | <u>75,962</u> |
| | <u>5,383,380</u> | <u>5,692,530</u> | - | <u>5,653,549</u> | <u>267,727</u> |
| With an allowance recorded: | | | | | |
| Commercial, industrial and agricultural | 20,132 | 20,132 | 588 | 23,514 | 1,922 |
| Consumer and other | 22,795 | 22,795 | 2,795 | 42,534 | 641 |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | 427,116 | 427,116 | 7,620 | 442,082 | 25,602 |
| Real estate - residential | <u>506,465</u> | <u>547,592</u> | <u>6,370</u> | <u>521,191</u> | <u>29,819</u> |
| | <u>976,508</u> | <u>1,017,635</u> | <u>17,373</u> | <u>1,029,321</u> | <u>57,984</u> |
| Total: | | | | | |
| Commercial, industrial and agricultural | 1,442,930 | 1,442,930 | 588 | 1,510,299 | 59,786 |
| Consumer and other | 22,795 | 22,795 | 2,795 | 45,534 | 641 |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | 2,880,695 | 3,138,750 | 7,620 | 2,967,545 | 159,503 |
| Real estate - residential | <u>2,013,468</u> | <u>2,105,690</u> | <u>6,370</u> | <u>2,162,492</u> | <u>105,781</u> |
| | <u>\$ 6,359,888</u> | <u>\$ 6,710,165</u> | <u>\$ 17,373</u> | <u>\$ 6,682,870</u> | <u>\$ 325,711</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

The following is an analysis of our impaired loan portfolio detailing the related allowance recorded at December 31, 2017:

| | <u>Recorded Investment</u> | <u>Unpaid Principal Balance</u> | <u>Related Allowance</u> | <u>Average Recorded Investment</u> | <u>Interest Income Recognized</u> |
|---|--------------------------------|---|------------------------------|--|---|
| With no related allowance needed: | | | | | |
| Commercial, industrial and agricultural | \$ 1,549,056 | \$ 1,549,056 | \$ - | \$ 1,601,502 | \$ 64,137 |
| Consumer and other | - | - | - | - | - |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | 4,702,138 | 4,960,193 | - | 4,823,130 | 245,342 |
| Real estate - residential | <u>2,251,027</u> | <u>2,302,123</u> | - | <u>2,310,430</u> | <u>105,206</u> |
| | <u>8,502,221</u> | <u>8,811,372</u> | - | <u>8,735,062</u> | <u>414,685</u> |
| With an allowance recorded: | | | | | |
| Commercial, industrial and agricultural | 11,405 | 11,405 | 213 | 16,864 | 4,408 |
| Consumer and other | 19,725 | 141,095 | 191 | 26,723 | 1,652 |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | - | - | - | - | - |
| Real estate - residential | <u>430,181</u> | <u>471,306</u> | <u>9,463</u> | <u>444,859</u> | <u>22,509</u> |
| | <u>461,311</u> | <u>623,806</u> | <u>9,867</u> | <u>488,446</u> | <u>28,569</u> |
| Total: | | | | | |
| Commercial, industrial and agricultural | 1,560,461 | 1,560,461 | 213 | 1,618,366 | 68,545 |
| Consumer and other | 19,725 | 141,095 | 191 | 26,723 | 1,652 |
| Real estate - construction | - | - | - | - | - |
| Real estate - commercial | 4,702,138 | 4,960,193 | - | 4,823,130 | 245,342 |
| Real estate - residential | <u>2,681,208</u> | <u>2,773,429</u> | <u>9,463</u> | <u>2,755,289</u> | <u>127,715</u> |
| | <u>\$ 8,963,532</u> | <u>\$ 9,435,178</u> | <u>\$ 9,867</u> | <u>\$ 9,223,508</u> | <u>\$ 443,254</u> |

The following is an analysis of our nonaccrual loan portfolio recorded at December 31:

| | <u>2018</u> | <u>2017</u> |
|---|-------------------|-------------------|
| Commercial, industrial and agricultural | \$ - | \$ - |
| Consumer and other | 22,795 | 1,027 |
| Real estate - construction | - | - |
| Real estate - commercial | 123,622 | 272,060 |
| Real estate - residential | <u>461,445</u> | <u>512,155</u> |
| | <u>\$ 607,862</u> | <u>\$ 785,242</u> |

Troubled Debt Restructurings

The following table summarizes the carrying balance of troubled debt restructurings (TDRs) at December 31:

| | <u>2018</u> | <u>2017</u> |
|--------------------|---------------------|---------------------|
| Performing TDRs | \$ 5,188,460 | \$ 7,060,481 |
| Nonperforming TDRs | <u>104,824</u> | <u>189,917</u> |
| Total TDRs | <u>\$ 5,293,284</u> | <u>\$ 7,250,398</u> |

Loans classified as TDRs may be removed from this status for disclosure purposes if subsequently restructured and the agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, and the loan is performing in accordance with the terms specified by the restructured agreement.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

No loans were identified as TDRs during 2018.

The following is an analysis of TDRs identified during 2017:

| | <u>For the year ended December 31, 2017</u> | | |
|---|---|---|--|
| | <u>Number of Contracts</u> | <u>Pre-Modification Outstanding Recorded Investment</u> | <u>Post-Modification Outstanding Recorded Investment</u> |
| Troubled Debt Restructurings | | | |
| Commercial, industrial and agricultural | - | \$ - | \$ - |
| Consumer and other | - | - | - |
| Real estate - construction | - | - | - |
| Real estate - commercial | - | - | - |
| Real estate - residential | <u>1</u> | <u>111,209</u> | <u>111,209</u> |
| | <u>1</u> | <u>\$ 111,209</u> | <u>\$ 111,209</u> |

During the year ended December 31, 2017, we modified one loan that was considered to be a troubled debt restructuring. We extended the term for this loan.

During the years ended December 31, 2018 and 2017, no loans that had previously been restructured subsequently defaulted during the year. In the determination of the allowance for loan losses, management considers TDRs and subsequent defaults in these restructurings using the fair value method.

At December 31, 2018, the Company had pledged approximately \$29,454,511 in commercial and residential real estate loans as collateral for advances from the Federal Home Loan Bank.

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit, and loans sold with limited recourse. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet position. The contractual or notional amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit written is represented by the contractual or notional amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 4. Loans Receivable, Continued

Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since 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 counter-party.

Loans sold with limited recourse are 1-4 family residential mortgages originated by the Company and sold to various other financial institutions. These loans are sold with the agreement that a loan may be returned to the Company within 90 days or if any one of the loan's first four payments are missed. The Company's exposure to credit loss in the event of nonperformance by the other party to the loan is represented by the contractual notional amount of the loan. Since none of the loans sold have ever been returned to the Company, the total loans sold with limited recourse amount does not necessarily represent future cash requirements. The Company uses the same credit policies in making loans sold as it does for on-balance-sheet instruments.

Collateral held for commitments to extend credit and standby letters of credit varies but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

The following table summarizes the Company's off-balance-sheet financial instruments whose contractual amounts represent credit risk:

| | <u>December 31,</u> | |
|------------------------------|---------------------|---------------|
| | <u>2018</u> | <u>2017</u> |
| Commitments to extend credit | \$ 56,374,000 | \$ 60,900,000 |
| Letters of credit | 931,170 | 922,603 |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 5. Premises and Equipment

Premises and equipment is summarized as follows:

| | <u>December 31,</u> | |
|-------------------------------|----------------------|----------------------|
| | <u>2018</u> | <u>2017</u> |
| Land | \$ 4,438,916 | \$ 4,438,916 |
| Leasehold improvements | 610,444 | 610,444 |
| Building and improvements | 19,568,823 | 18,003,075 |
| Furniture and equipment | 11,681,408 | 11,305,754 |
| Software | 3,357,692 | 3,228,316 |
| In progress | <u>66,785</u> | <u>21,121</u> |
| | 39,724,068 | 37,607,626 |
| Less accumulated depreciation | <u>20,790,872</u> | <u>19,856,632</u> |
| Premises and equipment, net | <u>\$ 18,933,196</u> | <u>\$ 17,750,994</u> |

Depreciation expense was \$934,240 and \$877,653 for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018, premises and equipment in progress consisted primarily of improvements to existing facilities and technology.

Note 6. Other Real Estate Owned

The following summarizes the activity in other real estate owned:

| | <u>2018</u> | <u>2017</u> |
|----------------------------|---------------------|---------------------|
| Balance, beginning of year | \$ 6,676,143 | \$ 11,570,229 |
| Additions | 120,000 | 49,591 |
| Sales | (1,509,760) | (4,532,875) |
| Writedowns | <u>(1,525,576)</u> | <u>(410,802)</u> |
| Balance, end of year | <u>\$ 3,760,807</u> | <u>\$ 6,676,143</u> |

Note 7. Deposits

At December 31, 2018, the scheduled maturities of time deposit are as follows:

| | |
|------|----------------------|
| 2019 | \$ 36,338,815 |
| 2020 | 8,906,522 |
| 2021 | 3,372,631 |
| 2022 | 742,431 |
| 2023 | <u>366,857</u> |
| | <u>\$ 49,727,256</u> |

The Company had no brokered deposits as of December 31, 2018 and 2017.

Overdrawn deposit accounts in the amount of \$419,175 and \$390,545 are classified as loans as of December 31, 2018 and 2017, respectively.

Time deposits that meet or exceed the FDIC insurance limit of \$250,000 as of December 31, 2018 and 2017 were \$6,967,615 and \$7,744,029, respectively.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 8. Securities Sold Under Agreements To Repurchase

Securities sold under agreements to repurchase mature on a one to thirty day basis. Under the terms of the agreements, the Company sells an interest in securities issued by government sponsored enterprises, and the Company agrees to repurchase the same securities the following business day. The average outstanding balance during the year amounted to \$9,830,554 and \$9,789,183 for 2018 and 2017, respectively at an average rate of 0.25% for both years. The maximum month-end balance during 2018 and 2017 was \$16,157,872 and \$18,963,700, respectively. At December 31, 2018 and 2017, the outstanding balance totaled \$10,627,564 and \$8,939,719, respectively. As of December 31, 2018, the book value and market value of the securities held by the third-party for the underlying agreements were \$4,395,840 and \$4,166,654, respectively. In addition, the Bank has four irrevocable letters of credit with the Federal Home Loan Bank totaling \$16,500,000 at December 31, 2018 and 2017, that are utilized for collateral for securities sold under agreements to repurchase and public deposits.

Note 9. Short Term Borrowings From Federal Reserve Bank

The Federal Reserve Discount Window provides credit facilities to financial institutions, which are designed to ensure adequate liquidity by providing a source of short-term funds. Discount Window advances are typically overnight and must be secured by collateral acceptable to the lending Federal Reserve Bank. At December 31, 2018 and 2017, the Company had no short-term borrowings outstanding with the Federal Reserve.

Note 10. Borrowings

Although the Company had no advances from Federal Home Loan Bank at December 31, 2018, the Bank has the ability to borrow. As collateral, the Company has pledged first mortgage loans on one to four family residential loans aggregating \$29,454,511 and \$38,412,830 at December 31, 2018 and 2017, respectively and its investment in Federal Home Loan Bank stock having a carrying value of \$441,600 and \$416,400 at December 31, 2018 and 2017, respectively.

Note 11. Junior Subordinated Debentures

On April 28, 2006, the Company formed Arthur Financial Statutory Trust I (the "Trust") for the purpose of issuing trust preferred securities, which enabled the Company to obtain Tier 1 capital on a consolidated basis for regulatory purposes. On April 28, 2006, the Company closed a private offering of \$10,000,000 of floating rate preferred securities offered and sold by the Trust. The proceeds from such issuance, together with the proceeds from a related issuance of common securities of the Trust purchased by the Company in the amount of \$310,000, were invested by the Trust in floating rate Junior Subordinated Debentures issued by the Company (the "Debentures") totaling \$10,310,000. The Debentures are due and payable on April 28, 2036 and were redeemable by the Company after five years. The Debentures presently qualify as Tier 1 capital for regulatory reporting. The sole assets of the Trust are the Debentures. The Company owns 100% of the common securities of the Trust. The Debentures are unsecured and rank junior to all senior debt of the Company. At December 31, 2018, the floating rate preferred securities and the Debentures had an annual interest rate of 4.29%. The interest rate adjusts quarterly and will equal three-month LIBOR plus 1.50%. The interest payments on the Debentures have been deferred at the Company's discretion. The Company has the option to defer up to 20 consecutive quarters of interest payments.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 11. Junior Subordinated Debentures, Continued

As of December 31, 2018 and 2017, the accrued interest payable on the Debentures totaled \$18,421 and \$15,037, respectively.

Note 12. Derivative Instruments and Hedging Activities

During 2011, the Company had two interest rate swap agreements as a risk management tool to hedge the interest rate risk of the variable interest rate of its junior subordinated debentures in amounts of \$5,000,000 each, for a total of \$10,000,000. Under the swap agreement, the Company paid a fixed rate of 6.01% on one interest rate swap of \$5,000,000 and 6.10% on the other \$5,000,000 interest rate swap and received interest rate payments equal to the three-month LIBOR rate plus 150 basis points.

Risk management results for the year ended 2010 related to the cash flow hedge indicate that the hedges were 100% effective and that there was no component of the derivative instruments' gain or loss which was excluded from the assessment of hedge effectiveness.

In August, 2011, as a result of the Company's ongoing evaluation of its asset/liability position as well as its interest rate risk management, the Company determined it was appropriate to terminate its interest rate swap agreements which were accounted for as cash flow hedges. Generally Accepted Accounting Principles require that any accumulated other comprehensive income or loss on a terminated cash flow hedge must be amortized or accreted into earnings over the original hedging period. As a result of the termination of the swaps, accumulated other comprehensive losses of \$917,000 and \$1,077,000 are to be expensed on a straight-line basis over the hedging periods, which had contractual maturities in 2017 and 2018, respectively. Expenses related to the termination of the swaps amounted to \$53,407 and \$306,262 for 2018 and 2017, respectively, and were included in other operating expenses. As of December 31, 2018, no amount remained to be expensed.

Note 13. Related Party Transactions

Certain parties (principally certain directors and stockholders of the Company, their immediate families and business interests) were loan customers of, and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability. The aggregate dollar amount of loans to related parties was \$1,323,283 and \$1,392,746 at December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017 related party deposits totaled \$204,296 and \$909,040, respectively.

During 2017 and 2016, the Company issued 2,000 and 12,000 shares, respectively, of noncumulative preferred stock totaling \$200,000 and \$1,200,000, respectively, to three members of the Board of Directors. Additionally during 2017 and 2018, the Company repurchased 6,000 and 8,000 of the aforementioned preferred shares issued.

Arthur Financial Corporation**Notes to Consolidated Financial Statements****December 31, 2018 and 2017**

Note 14. Unused Lines of Credit

At December 31, 2018, the Company may borrow \$108,557,250 from the Federal Home Loan Bank based on a predetermined formula, of which the Company had no borrowings. Advances are subject to approval by the Federal Home Loan Bank and may require the Company to pledge additional collateral.

The Federal Reserve Discount Window provides credit facilities to financial institutions, which are designed to ensure adequate liquidity by providing a source of short-term funds. Discount Window advances are typically overnight and must be secured by collateral acceptable to the lending Federal Reserve Bank.

Note 15. Commitments and Contingencies

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2018, management, after consultation with legal counsel, is not aware of any pending or threatened litigation or unasserted claims or assessments that could result in losses, if any, that would be material to the financial statements.

Note 16. Restrictions on Subsidiary Dividends, Loans, or Advances

South Carolina banking regulations restrict the amount of dividends that can be paid to shareholders. All of the Bank's dividends to the Company are payable only from the undivided profits of the Bank. At December 31, 2018 the Bank is in an accumulated earnings position of \$19,521,994. The Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last Federal or State regulatory examination. Under Federal Reserve Board regulations, the amounts of loans or advances from the Bank to the Company are also restricted.

Note 17. Mortgage Servicing Rights

The Company retains the right to service the residential mortgage loans that it sells to the Federal Home Loan Mortgage Corporation (FHLMC). The Company accounts for residential mortgage servicing rights (MSRs) at fair value. The changes in fair value are recorded in the consolidated statements of operations in other income.

During 2018, an updated third party valuation was performed resulting in an increase in market value of \$2,539, which increased the mortgage servicing rights value to \$430,500 at December 31, 2018 from \$427,961 at December 31, 2017, which is recorded within other assets. The valuation incorporates changes in discount rates and prepayment speed assumptions, mostly due to changes in interest rates. Discount rates are assigned on a product level basis, and reflect the rates of returns buyers of similar products require. The model for prepayment speeds considers loan characteristics including interest rate, product type, loan age, and original term, as well as current market conditions including short and long-term interest rate levels. The fair value of MSRs is sensitive to changes in interest rates, including their effect on prepayment speeds.

At December 31, 2018 and 2017, the aggregate amount of loans serviced by the Company for the benefit of others totaled \$72,068,180 and \$71,663,840, respectively.

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 18. Income Taxes

Income tax expense is summarized as follows:

| | <u>2018</u> | <u>2017</u> |
|--------------------|---------------------|---------------------|
| Current portion: | | |
| Federal | \$ 97,275 | \$ 95,590 |
| State | 211,596 | 183,277 |
| | <u>308,871</u> | <u>278,867</u> |
| Deferred taxes | 1,005,587 | 3,500,176 |
| Income tax expense | <u>\$ 1,314,458</u> | <u>\$ 3,779,043</u> |

Net deferred income taxes were presented separately on the consolidated balance sheets at December 31, 2018 and 2017. Deferred income taxes result from temporary differences in the recognition of certain items of income and expense for tax and financial reporting purposes.

The gross amounts of deferred tax assets and deferred tax liabilities are as follows:

| | <u>2018</u> | <u>2017</u> |
|--|---------------------|---------------------|
| Deferred tax assets: | | |
| Allowance for loan losses | \$ 623,026 | \$ 704,822 |
| Net operating losses | 459,505 | 1,388,714 |
| Self insured health plan | 420 | 10,080 |
| Deferred compensation | 32,492 | 32,191 |
| Interest on nonaccruing loans | 8,963 | 12,271 |
| Federal and state tax credits | - | 382,821 |
| Other real estate owned | 1,008,036 | 955,415 |
| Capitalized interest | 4,642 | 4,799 |
| Unrealized loss on securities available for sale | 667,016 | 211,886 |
| Gross deferred tax assets | <u>2,804,100</u> | <u>3,702,999</u> |
| Valuation allowance | 482,408 | 460,580 |
| Net deferred tax assets | <u>2,321,692</u> | <u>3,242,419</u> |
| Deferred tax liabilities: | | |
| Interest rate swap | - | (13,560) |
| Accumulated depreciation | (412,723) | (407,703) |
| Other | (44,795) | (23,704) |
| Total deferred tax liabilities | <u>(457,518)</u> | <u>(444,967)</u> |
| Net deferred tax asset | <u>\$ 1,864,174</u> | <u>\$ 2,797,452</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
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Note 18. Income Taxes, Continued

Deferred tax assets represent the future tax benefit of deductible items. The Company, under the Current Internal Revenue Code, is allowed an up to two year carryback and a twenty year carryforward of these timing items. A valuation allowance is established if it is more likely than not that a tax asset will not be realized. The valuation allowance reduces the recorded deferred tax assets to a net realizable value. As of December 31, 2018, management has established a valuation allowance of \$482,408 to reflect the portion of the deferred income tax asset that is not able to be offset against net operating loss carrybacks and reversals of net future taxable temporary differences projected to occur in future years. The valuation allowance was increased by \$21,828 in 2018. When the Company generates future taxable income, it will be able to reevaluate the amount of the valuation allowance.

The Company has state net operating losses of \$11,633,038 at December 31, 2018. These net operating losses will begin to expire in the year 2022. Tax returns for 2015 and subsequent years are subject to examination by taxing authorities.

As of December 31, 2018, the Company had no material unrecognized tax benefits or accrued interest and penalties. It is the Company's policy to account for interest and penalties accrued relative to unrecognized tax benefits as a component of income tax expense.

A reconciliation between the income tax expense (benefit) and the amount computed by applying the Federal statutory rate of 21% and 34%, respectively, to income before income taxes follows for the years ended December 31, 2018 and 2017:

| | <u>2018</u> | <u>2017</u> |
|--|---------------------|---------------------|
| Tax expense at statutory rate | \$ 1,178,663 | \$ 2,294,711 |
| State income tax, net of federal income tax effect | 167,161 | 120,963 |
| Tax-exempt interest income | (4,694) | (7,554) |
| Disallowed interest expense | 31 | 61 |
| Valuation allowance | 21,828 | 39,633 |
| Impact of federal rate change on deferred taxes | - | 1,462,283 |
| Other, net | (48,531) | (131,054) |
| Total | <u>\$ 1,314,458</u> | <u>\$ 3,779,043</u> |

Note 19. Leases

The Company has entered into agreements to lease properties in Greenville, South Carolina Rock Hill, South Carolina, and Spartanburg, South Carolina for branch offices. Each of these leases are considered operating leases. The lease term of the Greenville property began July 1, 2003 and is for fifteen years. The lease requires monthly payments of \$6,746 during the final five years of the lease. The lease has a renewal option for four additional five-year terms. The lease term of the Rock Hill property began on January 1, 2004 and was for ten years. The lease was renewed on December 16, 2013 and is for ten years, expiring December 31, 2023. The lease requires monthly payment of \$9,669 during the first five years, and \$10,830 monthly for each of the remaining five years. The lease has a renewal option for two additional five-year terms. The Spartanburg lease term is for five years commencing on January 1, 2018 and expiring December 31, 2023, with monthly rent of \$3,000. Rent expense for the years ended December 31, 2018 and 2017 was \$227,062 and \$222,823, respectively.

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Notes to Consolidated Financial Statements
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Note 19. Leases, Continued

Minimum future rental payments under noncancellable operating leases having remaining terms in excess of one year for each of the next five years in the aggregate are:

| | | |
|---------------------|----|------------------|
| 2019 | \$ | 246,910 |
| 2020 | | 246,910 |
| 2021 | | 246,910 |
| 2022 | | 246,910 |
| 2023 and thereafter | | <u>246,910</u> |
| | \$ | <u>1,234,550</u> |

Note 20. Capital Requirements

The Bank is 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 material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and 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 Bank to maintain minimum ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 ("CET1"), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the Bank consists of common stockholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Bank is also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement. All others are subject to maintaining ratios 1% to 2% above the minimum.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank Act"), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank will also be required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer will be required to consist solely of CET1, but the buffer will apply to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer will be phased in incrementally over time, beginning January 1, 2016 at 0.625% and becoming fully effective on January 1, 2019, and will ultimately consist of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets.

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Note 20. Capital Requirements, Continued

To be considered “well-capitalized,” the Bank must maintain total risk-based capital of at least 10%, Tier 1 capital of at least 8%, and a leverage ratio of at least 5%. To be considered “adequately capitalized” under these capital guidelines, the Bank must maintain a minimum total risk-based capital of 8%, with at least 6% being Tier 1 capital. In addition, the Bank must maintain a minimum Tier 1 leverage ratio of at least 4%.

The following table summarizes the capital amounts and ratios of the Bank and the regulatory minimum requirements:

| | Actual | | For Capital Adequacy Purposes | | To Be Well-Capitalized Under Prompt Corrective Action Provisions | |
|---|---------------|--------|-------------------------------|-------|--|--------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| December 31, 2018 | | | | | | |
| The Bank | | | | | | |
| Total capital (to risk-weighted assets) | \$ 49,925,000 | 14.11% | \$ 28,315,000 | 8.00% | \$ 35,394,000 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 47,082,000 | 13.30% | 21,236,000 | 6.00% | 28,315,000 | 8.00% |
| Tier 1 capital (to average assets) | 47,082,000 | 9.20% | 20,464,000 | 4.00% | 25,580,000 | 5.00% |
| Common Equity Tier 1 Capital, (to risk-weighted assets) | 47,082,000 | 13.30% | 15,927,000 | 4.50% | 23,006,000 | 6.50% |
| December 31, 2017 | | | | | | |
| The Bank | | | | | | |
| Total capital (to risk-weighted assets) | \$ 47,673,000 | 14.38% | \$ 26,525,000 | 8.00% | \$ 33,157,000 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 44,465,000 | 13.41% | 19,894,000 | 6.00% | 26,525,000 | 8.00% |
| Tier 1 capital (to average assets) | 44,465,000 | 9.07% | 19,615,000 | 4.00% | 24,519,000 | 5.00% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | 44,465,000 | 13.41% | 14,920,000 | 4.50% | 21,552,000 | 6.50% |

Note 21. Fair Value of Financial Instruments

Generally Accepted Accounting Principles (GAAP) provide a framework for measuring and disclosing fair value which requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

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

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

Note 21. Fair Value of Financial Instruments, Continued

Fair Value Hierarchy

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

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

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

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

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

Investment Securities Available-for-Sale

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

Loans

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan 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 are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2018 and 2017 substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the 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 Company records the loan as nonrecurring Level 3.

Arthur Financial Corporation

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Note 21. Fair Value of Financial Instruments, Continued

Mortgage Servicing Rights

Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The Company stratifies its mortgage servicing portfolio on the basis of loan type. The assumptions used in the discounted cash flow model are those that market participants would use in estimating future net servicing income. Assumptions in the valuation of mortgage servicing rights may include estimated loan repayment rates, the discount rate, servicing costs, and the timing of cash flows, among other factors.

Other Real Estate Owned

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

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

| | December 31, 2018 | | | |
|----------------------------------|----------------------|-------------|----------------------|-------------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Government-sponsored enterprises | \$ 5,040,600 | \$ - | \$ 5,040,600 | \$ - |
| Mortgage-backed securities | 90,973,546 | - | 90,973,546 | - |
| CRA Qualified Investment Fund | 976,852 | - | 976,852 | - |
| Mortgage servicing rights | 430,500 | - | - | 430,500 |
| Total | <u>\$ 97,421,598</u> | <u>\$ -</u> | <u>\$ 96,991,098</u> | <u>\$ 430,500</u> |

| | December 31, 2017 | | | |
|----------------------------------|----------------------|-------------|----------------------|-------------------|
| | Total | Level 1 | Level 2 | Level 3 |
| Government-sponsored enterprises | \$ 5,178,500 | \$ - | \$ 5,178,500 | \$ - |
| Mortgage-backed securities | 68,960,313 | - | 68,960,313 | - |
| CRA Qualified Investment Fund | 998,644 | - | 998,644 | - |
| Mortgage servicing rights | 427,961 | - | - | 427,961 |
| Total | <u>\$ 75,565,418</u> | <u>\$ -</u> | <u>\$ 75,137,457</u> | <u>\$ 427,961</u> |

Arthur Financial Corporation
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Note 21. Fair Value of Financial Instruments, Continued

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

| | <u>Mortgage Servicing Rights</u> |
|---------------------------------------|--|
| Balance, December 31, 2016 | \$ 504,419 |
| Total net gains (losses) included in: | |
| Net loss | <u>(76,458)</u> |
| Balance, December 31, 2017 | 427,961 |
| Total net gains (losses) included in: | |
| Net income | <u>2,539</u> |
| Balance, December 31, 2018 | <u>\$ 430,500</u> |

The Company has no liabilities measured at fair value on a recurring basis.

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of December 31, 2018 and 2017 for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2018 and 2017.

| | <u>December 31, 2018</u> | | | |
|--|--------------------------|----------------|----------------------|----------------|
| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Other real estate owned | \$ 3,760,807 | \$ - | \$ 3,760,807 | \$ - |
| Impaired loans, net specific reserve: | | | | |
| Commercial, industrial and agricultural | 1,442,342 | - | 1,442,342 | - |
| Consumer and other | 20,000 | - | 20,000 | - |
| Real estate - construction | - | - | - | - |
| Real estate - commercial | 2,873,075 | - | 2,873,075 | - |
| Real estate - residential | 2,007,098 | - | 2,007,098 | - |
| Total impaired loans, net specific reserve | <u>6,342,515</u> | <u>-</u> | <u>6,342,515</u> | <u>-</u> |
| Total | <u>\$ 10,103,322</u> | <u>\$ -</u> | <u>\$ 10,103,322</u> | <u>\$ -</u> |
| | | | | |
| | | | | |
| | <u>December 31, 2017</u> | | | |
| | <u>Total</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> |
| Other real estate owned | \$ 6,676,143 | \$ - | \$ 6,676,143 | \$ - |
| Impaired loans, net specific reserve: | | | | |
| Commercial, industrial and agricultural | 1,560,248 | - | 1,560,248 | - |
| Consumer and other | 19,534 | - | 19,534 | - |
| Real estate - construction | - | - | - | - |
| Real estate - commercial | 4,702,138 | - | 4,702,138 | - |
| Real estate - residential | 2,671,745 | - | 2,671,745 | - |
| Total impaired loans, net specific reserve | <u>8,953,665</u> | <u>-</u> | <u>8,953,665</u> | <u>-</u> |
| Total | <u>\$ 15,629,808</u> | <u>\$ -</u> | <u>\$ 15,629,808</u> | <u>\$ -</u> |

The Company has no liabilities measured at fair value on a nonrecurring basis.

Arthur Financial Corporation

Notes to Consolidated Financial Statements

December 31, 2018 and 2017

Note 22. Arthur Financial Corporation (Parent Company Only)

Following is condensed financial information of Arthur Financial Corporation (parent company only) for the years ended December 31:

Condensed Balance Sheets

| | <u>December 31,</u> | |
|---|----------------------|----------------------|
| | <u>2018</u> | <u>2017</u> |
| Assets | | |
| Cash | \$ 1,855,866 | \$ 368,081 |
| Investment in subsidiaries | 44,811,771 | 44,118,853 |
| Premises and equipment | 125,000 | 125,000 |
| Investment in trust | 310,000 | 310,000 |
| Other real estate owned | 1,057,500 | 1,057,500 |
| Deferred tax asset | 121,300 | 1,029,446 |
| Income tax receivable | - | 636,658 |
| Total assets | <u>\$ 48,281,437</u> | <u>\$ 47,645,538</u> |
| Liabilities and Shareholders' Equity | | |
| Junior subordinated debentures | \$ 10,310,000 | \$ 10,310,000 |
| Other liabilities | 130,227 | 129,027 |
| Shareholders' equity | <u>37,841,210</u> | <u>37,206,511</u> |
| Total liabilities and shareholders' equity | <u>\$ 48,281,437</u> | <u>\$ 47,645,538</u> |

Condensed Statements of Operations

| | <u>For the years ended</u> | |
|--|----------------------------|---------------------|
| | <u>December 31,</u> | |
| | <u>2018</u> | <u>2017</u> |
| Income | | |
| Dividends from subsidiary | \$ 2,350,000 | \$ 1,600,000 |
| Other income | <u>16,378</u> | <u>8,379</u> |
| Total income | <u>2,366,378</u> | <u>1,608,379</u> |
| Expenses | | |
| Interest expense | 431,825 | 597,021 |
| Other expenses | <u>137,148</u> | <u>197,657</u> |
| Total expenses | <u>568,973</u> | <u>794,678</u> |
| Income before income taxes and equity in undistributed earnings of subsidiaries | 1,797,405 | 813,701 |
| Equity in undistributed income of subsidiaries | 2,352,125 | 2,472,833 |
| Income tax expense | <u>148,695</u> | <u>316,426</u> |
| Net income | 4,298,225 | 2,970,108 |
| Preferred stock dividends | <u>10,693</u> | <u>60,457</u> |
| Net income available for common shareholders | <u>\$ 4,287,532</u> | <u>\$ 2,909,651</u> |

Arthur Financial Corporation
Notes to Consolidated Financial Statements
December 31, 2018 and 2017

Note 22. Arthur Financial Corporation (Parent Company Only), Continued

Condensed Statements of Cash Flows

| | For the years ended | |
|---|----------------------------|-------------------|
| | December 31, | |
| | 2018 | 2017 |
| Operating activities | | |
| Net income | \$ 4,298,225 | \$ 2,970,108 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Equity in undistributed income of subsidiaries | (2,352,125) | (2,563,916) |
| Amortization of loss on interest rate swap | 53,407 | 306,262 |
| Decrease in deferred tax asset | 890,611 | 1,044,166 |
| Increase (decrease) in income tax receivable | 636,658 | (636,658) |
| Increase in other liabilities | 1,200 | 24,437 |
| Net cash provided by operating activities | <u>3,527,976</u> | <u>1,144,399</u> |
| Financing activities | | |
| Preferred stock repurchase | (800,000) | (400,000) |
| Preferred dividends paid | (10,693) | (60,457) |
| Common stock dividends paid | (1,229,498) | - |
| Net change in note payable | - | (349,999) |
| Net cash used by financing activities | <u>(2,040,191)</u> | <u>(810,456)</u> |
| Increase in cash | 1,487,785 | 333,943 |
| Cash, beginning of year | <u>368,081</u> | <u>34,138</u> |
| Cash, end of year | <u>\$ 1,855,866</u> | <u>\$ 368,081</u> |

Note 23. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before 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. Nonrecognized 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 February 28, 2019, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.