blueharbor bank

Dear Fellow Shareholder:

I am very pleased to report the bank had another great year in many regards. For 2016 our Net Income was up 32% over the previous year. Our Loan Growth increased 17% and Total Assets grew 12%. Credit Quality is very clean and our Balance Sheet is in superb shape. Relative to our peers we are performing very well in a host of measurable objectives.

blueharbor wealth advisors continues to grow very nicely for us and is a nice source of noninterest income. Many customers continue to add additional resources to their managed accounts and refer their friends and family – all great indications that they are satisfied with our services. I continue to believe that we are among the best wealth management services available in this country. The website is blueharborwealthadvisors.com.

You have heard me say this before – We are in a great position for our future; it's very bright with lots of runway ahead of us. We are in one of the best markets not only in North Carolina and the Southeast but the United States. Continued projected growth for this region is strong for years to come.

There is anxious anticipation of regulatory relief for our industry that has seen layer upon layer added over many years, resulting in a very complex and stifling environment for community banks. It is well documented that for the last decade, more small businesses have died than have been created. The small business owner needs some relief and incentive to start new businesses and grow again too. Common sense regulatory reform plus lower tax rates could put additional wind in all sails.

I am so proud of our team and family of bankers that do such a great job for us all each and every day. They are true professionals and were so recognized by a recent customer "Net Promoter Score Survey." The only question we asked was, "On a scale of 1-10, how likely are you to recommend blueharbor bank to friends, family or colleagues?" We had a high response rate and our average score was 9.5 out of 10. Our team delivering world-class service combined with our common sense approach to banking are significant to our growth and bright future.

Let me close by thanking you as shareholders for your continued support and those of you that also have banking relationships with us too. We thank you very much.

As always, I enjoy hearing from you so let me know how we are doing and what we can do for you.

Sincerely,

Joe I. Marshall, Jr.

Joe I. Marshall, Jr.
President and Chief Executive Officer

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# ANNUAL REPORT

# 2016 Annual Report

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*This Annual Report to Shareholders contains forward-looking statements. Such forward-looking statements may be identified by the use of such words as "may," "will," "believe," "expect," "anticipate," should," "planned," "estimated" and "potential." Such forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, changes in the interest rate environment, management's business strategy, national, regional and local market conditions and legislative and regulatory conditions.*

*Readers should not place undue reliance on forward-looking statements, which reflect management's view only as of the date hereof. The Bank undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances.*

**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors
blueharbor bank

**Report on the Financial Statements**

We have audited the accompanying financial statements of blueharbor bank (the "Bank"), which comprise the balance sheets as of December 31, 2016 and 2015, the related statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements (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 blueharbor bank as of December 31, 2016 and 2015, 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 Decosimo, PLLC

Charlotte, North Carolina
February 28, 2017

# Balance Sheets

***December 31, 2016 and 2015***

| | 2016 | 2015 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 4,588,801 | $ 6,714,396 |
| Interest bearing deposits | 519,021 | 585,072 |
| Cash and cash equivalents | 5,107,822 | 7,299,468 |
| Investment securities available-for-sale | 15,827,939 | 16,875,805 |
| Federal Home Loan Bank stock | 448,400 | 121,900 |
| Loans held for sale | 602,500 | - |
| Loans, net of allowance for loan losses of $1,554,850 for 2016 and $1,496,711 for 2015 | 145,092,703 | 123,997,647 |
| Property and equipment, net | 1,896,590 | 1,931,155 |
| Accrued interest receivable | 408,156 | 357,015 |
| Bank owned life insurance | 2,218,396 | 2,157,822 |
| Other real estate owned | 767,000 | 867,000 |
| Other assets | 1,975,213 | 1,640,642 |
| Total assets | $ 174,344,719 | $ 155,248,454 |
| **Liabilities and Shareholders' Equity** | | |
| ***Liabilities*** | | |
| Deposits: | | |
| Noninterest-bearing | $ 22,442,120 | $ 20,155,274 |
| Interest-bearing | 120,858,121 | 110,984,485 |
| Total deposits | 143,300,241 | 131,139,759 |
| Repurchase agreements | 259,705 | 162 |
| Other borrowings | 5,260,800 | - |
| Accrued interest payable | 36,515 | 28,678 |
| Other liabilities | 1,809,271 | 1,545,686 |
| Total liabilities | 150,666,532 | 132,714,285 |
| Commitments and contingencies (Notes 3, 6 and 12) | | |
| ***Shareholders' equity*** | | |
| Preferred stock, 5,000,000 shares authorized: no shares issued and outstanding | - | - |
| Common stock, $5 par value; 20,000,000 shares authorized: 2,718,572 for 2016 and 2,719,772 for 2015 shares issued and outstanding * | 13,592,860 | 13,598,860 |
| Surplus * | 8,958,074 | 8,910,550 |
| Retained earnings * | 1,227,567 | - |
| Accumulated other comprehensive income (loss) | (100,314) | 24,759 |
| Total shareholders' equity | 23,678,187 | 22,534,169 |
| Total liabilities and shareholders' equity | $ 174,344,719 | $ 155,248,454 |

* Share data and 2015 shareholders' equity have been restated to reflect the 20% common stock dividend issued in March 2016. See Note 10.

***See Notes to Financial Statements***

# Income Statements

***For the years ended December 31, 2016 and 2015***

| | 2016 | 2015 |
|---|---|---|
| ***Interest income*** | | |
| Loans and fees on loans | $ 5,940,472 | $ 5,401,907 |
| Investment securities | 341,967 | 310,960 |
| Interest bearing deposits | 1,783 | 150 |
| Total interest income | 6,284,222 | 5,713,017 |
| ***Interest expense*** | | |
| Deposits | 585,251 | 511,267 |
| Borrowings | 18,729 | 14,127 |
| Total interest expense | 603,980 | 525,394 |
| Net interest income | 5,680,242 | 5,187,623 |
| ***Provision for loan losses*** | 17,416 | - |
| Net interest income after provision for loan losses | 5,662,826 | 5,187,623 |
| ***Noninterest income*** | | |
| Service charges on deposit accounts | 63,124 | 55,699 |
| Debit card network fees | 203,690 | 196,626 |
| Mortgage fees | 57,338 | 39,454 |
| Bank owned life insurance income | 60,574 | 62,571 |
| Wealth management income | 136,130 | 91,559 |
| Other income | 11,835 | 4,385 |
| Total noninterest income | 532,691 | 450,294 |
| ***Noninterest expense*** | | |
| Salaries and employee benefits | 2,350,636 | 2,347,455 |
| Occupancy expense | 356,953 | 346,337 |
| Equipment expense | 89,413 | 114,309 |
| Data processing expense | 609,758 | 535,823 |
| Professional services | 164,402 | 197,471 |
| Advertising expense | 30,933 | 76,937 |
| Regulatory expense | 96,573 | 111,971 |
| Other real estate expense, net | 113,897 | 35,797 |
| Other expense | 437,680 | 412,256 |
| Total noninterest expense | 4,250,245 | 4,178,356 |
| Net income before income taxes | 1,945,272 | 1,459,561 |
| Income tax expense | 717,705 | 534,354 |
| Net income | $ 1,227,567 | $ 925,207 |
| ***Basic earnings per common share **** | $ 0.45 | $ 0.34 |
| ***Diluted earnings per common share **** | $ 0.41 | $ 0.33 |
| ***Weighted average common shares outstanding **** | 2,717,172 | 2,732,022 |
| ***Weighted average dilutive common shares outstanding **** | 2,987,304 | 2,827,606 |

* Share data has been restated to reflect the 20% common stock dividend issued in March 2016. See Note 10.

***See Notes to Financial Statements***

## Statements of Comprehensive Income

***For the years ended December 31, 2016 and 2015***

| | 2016 | 2015 |
|---|---|---|
| Net income | $ 1,227,567 | $ 925,207 |
| Other comprehensive loss: | | |
| Investment securities available-for-sale: | | |
| Unrealized losses on investment securities available-for-sale arising during the period | (201,601) | (40,779) |
| Tax effect | 76,528 | 15,480 |
| Total other comprehensive loss | (125,073) | (25,299) |
| Comprehensive income | $ 1,102,494 | $ 899,908 |

***See Notes to Financial Statements***

## Statements of Changes in Shareholders' Equity

***For the years ended December 31, 2016 and 2015***

| | Common | | | | Accumulated Other | |
|---|---|---|---|---|---|---|
| | **Shares *** | **Amount** | **Surplus** | **Retained Earnings** | **Comprehensive Income (Loss)** | **Total** |
| ***Balance, December 31, 2014*** | 2,733,272 | $11,399,955 | $10,176,746 | $ 41,775 | $ 50,058 | $ 21,668,534 |
| Net income | - | - | - | 925,207 | - | 925,207 |
| Other comprehensive loss | - | - | - | - | (25,299) | (25,299) |
| Stock based compensation | - | - | 70,854 | - | - | 70,854 |
| Stock option exercise | 2,000 | 10,000 | 3,620 | - | - | 13,620 |
| Share repurchase | (15,500) | (77,500) | (41,079) | - | - | (118,579) |
| 20% stock dividend | - | 2,266,405 | (1,299,591) | (966,982) | - | (168) |
| ***Balance, December 31, 2015*** | 2,719,772 | $13,598,860 | $8,910,550 | $ - | $ 24,759 | $ 22,534,169 |
| Net income | - | - | - | 1,227,567 | - | 1,227,567 |
| Other comprehensive loss | - | - | - | - | (125,073) | (125,073) |
| Stock based compensation | - | - | 55,436 | - | - | 55,436 |
| Stock option exercise | 3,600 | 18,000 | 5,052 | - | - | 23,052 |
| Share repurchase | (4,800) | (24,000) | (12,964) | - | - | (36,964) |
| ***Balance, December 31, 2016*** | 2,718,572 | $13,592,860 | $8,958,074 | $ 1,227,567 | $ (100,314) | $ 23,678,187 |

* Share data and 2015 shareholders' equity have been restated to reflect the 20% common stock dividend issued in March 2016. See Note 10.

***See Notes to Financial Statements***

## Statements of Cash Flows

***For the years ended December 31, 2016 and 2015***

| | 2016 | 2015 |
|---|---|---|
| ***Cash flows from operating activities*** | | |
| Net income | $ 1,227,567 | $ 925,207 |
| Adjustments to reconcile net income to | | |
| net cash provided by operations: | | |
| Depreciation | 104,666 | 125,978 |
| Provision for loan losses | 17,416 | - |
| Accretion of discount on securities, net of amortization | 29,400 | 25,119 |
| Deferred income tax expense (benefit) | (95,629) | 54,678 |
| Gain on sale of other real estate owned | - | (5,714) |
| Write-downs of other real estate owned | 100,000 | 24,774 |
| Bank owned life insurance income | (60,574) | (62,571) |
| Stock based compensation | 55,436 | 70,854 |
| Originations of loans held for sale | (1,496,608) | - |
| Proceeds from sales of loans held for sale | 913,046 | - |
| Gain on sale of loans held for sale | (18,938) | - |
| Changes in assets and liabilities: | | |
| Increase (decrease) in accrued interest receivable | (51,141) | 1,212 |
| Decrease (increase) in other assets | (162,414) | 152,100 |
| Increase in accrued interest payable | 7,837 | 6,530 |
| Increase in other liabilities | 263,753 | 266,017 |
| Net cash provided by operating activities | 833,817 | 1,584,184 |
| ***Cash flows from investing activities*** | | |
| Purchases of investment securities | (5,125,514) | (6,016,650) |
| Purchases of Federal Home Loan Bank | (454,000) | (219,800) |
| Redemption of Federal Home Loan Bank | 127,500 | 437,500 |
| Principal payments on investment securities | 1,942,379 | 2,441,373 |
| Proceeds from sales or calls of investment securities | 4,000,000 | - |
| Net increase in loans | (21,112,472) | (13,467,488) |
| Proceeds from sale of other real estate owned | - | 484,640 |
| Purchases of property and equipment | (70,101) | (148,840) |
| Net cash used in investing activities | (20,692,208) | (16,489,265) |
| ***Cash flows from financing activities*** | | |
| Net increase in deposits | 12,160,482 | 24,082,548 |
| Proceeds from stock option exercise | 23,052 | 13,620 |
| Common stock share repurchase | (36,964) | (118,579) |
| Cash in lieu of fractional shares | (168) | - |
| Net increase (decrease) in repurchase agreements | 259,543 | (409,093) |
| Net increase (decrease) in other borrowings | 5,260,800 | (5,000,000) |
| Net cash provided by financing activities | 17,666,745 | 18,568,496 |
| Net increase (decrease) in cash and cash equivalents | (2,191,646) | 3,663,415 |
| ***Cash and cash equivalents, beginning*** | 7,299,468 | 3,636,053 |
| ***Cash and cash equivalents, ending*** | $ 5,107,822 | $ 7,299,468 |
| ***Supplemental disclosure of cash flow information*** | | |
| Interest paid | $ 596,143 | $ 518,864 |
| Income taxes paid | $ 584,000 | $ 242,000 |
| Transfer of loans to other real estate | $ - | $ 145,520 |
| Change in unrealized gain on investment securities | $ (201,601) | $ (40,779) |
| Stock dividend on common stock issued March 2016 | $ - | $ 4,415,123 |

***See Notes to Financial Statements***

# Notes to Financial Statements

**Note 1. Organization and Summary of Significant Accounting Policies**

***Organization***

blueharbor bank (the "Bank") was incorporated on January 3, 2008, under the laws of the State of North Carolina (NC) and commenced operations on January 8, 2008. The Bank currently serves Iredell County, NC, and northern Mecklenburg County, NC, and surrounding areas through its banking offices in Mooresville, Statesville, and Huntersville, NC. The Bank opened the Huntersville branch in November 2008 and the Statesville branch in April 2015. In addition, the Bank operates a loan production offices in Charlotte, NC, to serve clients in and surrounding Charlotte. As a state chartered bank, which is not a member of the Federal Reserve, the Bank is subject to regulation by the North Carolina Commissioner of Banks and the Federal Deposit Insurance Corporation (FDIC).

The accounting and reporting policies of the Bank follow generally accepted accounting principles (GAAP) and general practices within the financial services industry. Following is a summary of the more significant policies:

***Critical Accounting Policies***

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

***Business Segments***

The Bank reports its activities as a single business segment. In determining the appropriateness of segment definition, the Bank considers the materiality of a potential segment and components of the business about which financial information is available and regularly evaluated relative to resource allocation and performance assessment.

***Use of Estimates***

In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of deferred tax assets.

***Cash and Cash Equivalents***

For the purpose of presentation in the statement of cash flows, cash and cash equivalents are defined as those amounts included in the balance sheet caption "cash and due from banks" and "interest bearing deposits."

***Securities***

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity" and recorded at amortized costs. Trading securities are recorded at fair value with changes in fair value included in earnings. Securities not classified as held-to-maturity or trading, including equity securities with readily determinable fair values, are classified as "available-for-sale" and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

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

***Securities, continued***

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held-to-maturity and available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses. In determining whether other-than-temporary impairment exists, management considers many factors, including (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

***Loans Held for Sale***

Loans held for sale consist of residential mortgage loans, secured by one-to-four family residential properties in the markets we serve. Loans originated with the intent to sell in the secondary market are classified as held for sale. Loans held for sale are carried at cost, which is estimated to be fair value given the short period of time a loan is held for sale. The fair value of loans held for sale is impacted by changes in market interest rates; however, given that loans held for sale are generally sold within a week or two of origination, the short time they are held on the balance sheet minimizes the risk of changes in value. Mortgage loans held for sale are underwritten to the standards of the secondary market purchaser to ensure they will be purchased at cost plus the anticipated mortgage loans fee income consisting of origination fees due to blueharbor bank. The difference between the carried cost and sales price is recognized as mortgage fee income.

***Loans Receivable***

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal amount adjusted for any charge-offs and the allowance for loan losses. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Discounts and premiums on any purchased loans are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest for the current year is reversed. Interest income is subsequently recognized on the cash basis or cost recovery method, as appropriate. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past due status of loans is determined based on contractual terms.

***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 uncollectibility 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 management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

## Note 1. Organization and 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 that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status and other circumstances impacting 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 obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

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

***Property and Equipment***

Bank premises, furniture and equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization computed by the straight-line method over the following estimated useful lives:

| | Years |
|---|---|
| Leasehold improvements | 2-10 |
| Furniture and equipment | 2-7 |

***Other Real Estate Owned***

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less anticipated cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management, and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other real estate expense in the accompanying income statements.

***Transfers of Financial Assets***

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

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

***Bank Owned Life Insurance***

Bank owned life insurance represents the cash surrender value of policies on a certain officer of the Bank.

***Advertising Expense***

The Bank expenses advertising costs as they are incurred. Advertising expense amounted to $30,933 and $76,937 for the years ended December 31, 2016 and 2015, respectively.

***Income Taxes***

Provision for income taxes is based on amounts reported in the income statement (after exclusion of non-taxable income such as interest on state and municipal securities) and consists of taxes currently due plus deferred taxes on temporary differences in the recognition of income and expense for tax and financial statement purposes. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets or liabilities are expected to be realized or settled. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

A deferred income tax liability relating to unrealized appreciation (or the deferred tax asset in the case of unrealized depreciation) on investment securities available-for-sale is recorded in other liabilities (assets) when applicable. Such unrealized appreciation or depreciation is recorded as an adjustment to equity in the financial statements and not included in income determination until realized. Accordingly, the resulting deferred income tax liability or asset is also recorded as an adjustment to equity.

***Basic Earnings per Share***

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of shares outstanding during the period, after giving retroactive effect to stock splits and dividends.

***Diluted Earnings per Share***

The computation of diluted earnings per share is similar to the computation of basic earnings per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares.

***Comprehensive Income***

Annual comprehensive income reflects the change in the Bank’s equity during the year arising from transactions and events other than investment by and distributions to shareholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of shareholders’ equity rather than as income or expense. The components of comprehensive income are also presented in a separate Statement of Comprehensive Income.

***Reclassifications***

Some items in the prior year financial statements were reclassified to conform to the current presentation. Such reclassifications had no effect on previously reported net income or shareholders’ equity.

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

***Fair Value of Financial Instruments***

Fair value information about financial instruments is required to be disclosed, whether or not recognized in the balance sheet. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. In that regard, the derived fair value estimates cannot be substantiated by comparison to independent markets and, in many cases, could not be realized in immediate settlement of the instruments. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Bank.

The following methods and assumptions were used by the Bank in estimating its fair value disclosures for financial instruments:

*Securities*: Fair values for securities, excluding restricted equity securities, are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. The carrying values of restricted equity securities approximate fair values.

*Impaired Loans*: Fair values for impaired loans are estimated using discounted cash flow analysis or underlying collateral values, where applicable. The carrying amount of accrued interest receivable approximates its fair value.

***Recent Accounting Pronouncements***

The following is a summary of recent authoritative pronouncements that may affect accounting, reporting, and disclosure of financial information by the Bank:

In February 2016, the FASB amended the Leases topic of the Accounting Standards Codification to revise certain aspects of recognition, measurement, presentation, and disclosure of leasing transactions. The amendments will be effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Bank is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

In May 2014, the 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. In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral, the guidance in ASU 2014-09 will be effective for the Bank for reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Bank will apply the guidance using a modified retrospective approach. The Bank does not expect these amendments to have a material effect on its financial statements.

In November 2015, the FASB amended the Income Taxes topic of the Accounting Standards Codification simplify the presentation of deferred income taxes by requiring that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments will be effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018, with early adoption permitted as of the beginning of an interim or annual reporting period. The Bank will apply the guidance prospectively. The Bank does not expect these amendments to have a material effect on its financial statements.

# Notes to Financial Statements

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

***Recent 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 Bank 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 Bank does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended several topics of the Accounting Standards Codification to make the guidance in all private company accounting alternatives effective immediately by removing their effective dates. The amendments also include transition provisions that provide that private companies are able to forgo a preferability assessment the first time they elect the private company accounting alternatives. The amendments were effective immediately. The Bank does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the implementation guidance on principal versus agent considerations and address how an entity should assess whether it is the principal or the agent in contracts that include three or more parties. The amendments will be effective for the Bank for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Bank does not expect these amendments to have a material effect on its financial statements.

In March 2016, the FASB issued guidance to simplify several aspects of the accounting for share-based payment award transactions including the income tax consequences, the classification of awards as either equity or liabilities, and the classification on the statement of cash flows. Additionally, the guidance simplifies two areas specific to entities other than public business entities allowing them apply a practical expedient to estimate the expected term for all awards with performance or service conditions that have certain characteristics and also allowing them to make a one-time election to switch from measuring all liability-classified awards at fair value to measuring them at intrinsic value. The amendments will be effective for the Bank for annual periods beginning after December 15, 2017, and interim periods within annual reporting periods beginning after December 15, 2018. The Bank does not expect these amendments to have a material effect on its financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Bank for annual periods beginning after December 15, 2020, and interim periods within annual reporting periods beginning after December 15, 2021. The Bank is currently evaluating the effect that implementation of the new standard will have on its financial position, results of operations, and cash flows.

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

**Note 2. Restrictions on Cash**

To comply with banking regulations, the Bank is required to maintain certain cash reserve balances. The daily cash reserve requirement was $218,000 and $3,914,879 at December 31, 2016 and 2015, respectively.

**Note 3. Securities**

Debt and equity securities have been classified in the balance sheet according to management's intent. The carrying amount of securities (all available-for-sale) and their approximate fair values at December 31, 2016 and 2015, are:

| | Amortized Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **2016** | | | | |
| Government sponsored enterprises | $ 13,221,557 | $ 54,959 | $ 169,345 | $ 13,107,171 |
| Mortgage-backed securities | 2,768,075 | 2,829 | 50,136 | 2,720,768 |
| | $ 15,989,632 | $ 57,788 | $ 219,481 | $ 15,827,939 |
| **2015** | | | | |
| Government sponsored enterprises | $ 15,626,832 | $ 132,223 | $ 93,680 | $ 15,665,375 |
| Mortgage-backed securities | 1,209,065 | 7,286 | 5,921 | 1,210,430 |
| | $ 16,835,897 | $ 139,509 | $ 99,601 | $ 16,875,805 |

The fair value of securities pledged for agreements to repurchase were $2,358,073 and $2,936,891 at December 31, 2016 and 2015, respectively.

There were no sales of investment securities for the years ended December 31, 2016 and 2015.

As of December 31, 2016, one government backed securities with a fair value of $811,726 and an unrealized loss of $33,002 had been in a continuous unrealized loss position for more than 12 months. As of December 31, 2015, two government backed securities with a fair value of $1,715,689 and an unrealized loss of $45,456 had been in a continuous unrealized loss position for more than 12 months.

The scheduled maturities of available-for-sale debt securities were as follows:

| | December 31, 2016 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Due in less than one year | $ - | $ - |
| Due in one to three years | 1,102,481 | 1,104,587 |
| Due in three to five years | 300,000 | 299,862 |
| Due in five to ten years | 4,568,672 | 4,576,833 |
| Due after ten years | 10,018,479 | 9,846,657 |
| Total | $ 15,989,632 | $ 15,827,939 |

**Note 3. Securities, continued**

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The unrealized losses in the Bank's investment portfolio relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. As management has the ability to hold debt securities for the foreseeable future, no declines are deemed to be other-than-temporary.

At December 31, 2016, the Bank had $550,000 and $112,500 invested in Plexus Fund III and IV, respectively, Small Business Investment Companies. The purpose of the funds are to invest in small businesses to promote growth, expansion and modernization of the sector, by working in partnership with the Small Business Administration as a source of additional funding. These investments are carried at par in other assets and are tested annually for impairment. The Bank has committed to invest a total of $1,000,000 and $1,500,000 in Plexus Fund III and IV, respectively.

**Note 4. Loans Receivable**

The major components of loans, excluding loans held for sale, on the balance sheet at December 31, 2016 and 2015, are as follows:

| | 2016 | 2015 |
|---|---|---|
| Commercial Real Estate | $ 74,647,086 | $ 63,778,282 |
| Consumer Real Estate | 53,636,362 | 43,757,171 |
| Commercial and Industrial | 17,081,466 | 17,018,201 |
| Consumer | 722,528 | 429,184 |
| Total | 146,087,442 | 124,982,838 |
| Deferred loan fees and origination costs, net | 560,111 | 511,520 |
| Allowance for loan losses | (1,554,850) | (1,496,711) |
| Loans, net of allowance | $ 145,092,703 | $ 123,997,647 |

There were $25,373,240 of loans pledged to the Federal Home Loan Bank ("FHLB") of Atlanta at December 31, 2016, to secure $5,260,800 borrowed on a $17,836,118 line of credit and $29,923,509 of loans were pledged to the FHLB of Atlanta at December 31, 2015, to secure an unused $15,211,800 line of credit.

### Note 5. Allowance for Loan Losses and Credit Quality

The following is an analysis of activity in the allowance for loan losses by portfolio segment in addition to the disaggregation of the allowance and outstanding loan balances, excluding loans held for sale, by impairment method as of and for the year ended December 31, 2016 and 2015:

| December 31, 2016 | Commercial Real Estate | Consumer Real Estate | Commercial and Industrial | Consumer | Other | Total |
|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | |
| Beginning balance | $ 607,199 | $ 491,326 | $ 187,750 | $ 36,539 | $ 173,897 | $ 1,496,711 |
| Charge-offs | - | - | - | - | - | - |
| Recoveries | 37,280 | - | 3,443 | - | - | 40,723 |
| Provision | 40,530 | 74,901 | (13,931) | (5,846) | (78,238) | 17,416 |
| Ending balance - total | $ 685,009 | $ 566,227 | $ 177,262 | $ 30,693 | $ 95,659 | $ 1,554,850 |
| Ending balance - individually evaluated for impairment | $ 1,658 | $ - | $ - | $ 24,187 | $ - | $ 25,845 |
| Ending balance - collectively evaluated for impairment | $ 683,351 | $ 566,227 | $ 177,262 | $ 6,506 | $ 95,659 | $ 1,529,005 |
| **Loans Receivable:** | | | | | | |
| Ending balance - total | $ 74,647,086 | $ 53,636,362 | $ 17,081,466 | $ 722,528 | $ - | $ 146,087,442 |
| Ending balance - individually evaluated for impairment | $ 327,529 | $ 184,466 | $ 46,278 | $ 141,025 | $ - | $ 699,298 |
| Ending balance - collectively evaluated for impairment | $ 74,319,557 | $ 53,451,896 | $ 17,035,188 | $ 581,503 | $ - | $ 145,388,144 |

| December 31, 2015 | Commercial Real Estate | Consumer Real Estate | Commercial and Industrial | Consumer | Other | Total |
|---|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | | |
| Beginning balance | $ 670,305 | $ 463,064 | $ 128,588 | $ 38,047 | $ 197,153 | $ 1,497,157 |
| Charge-offs | - | (17,546) | - | - | - | (17,546) |
| Recoveries | 17,100 | - | - | - | - | 17,100 |
| Provision | (80,206) | 45,808 | 59,162 | (1,508) | (23,256) | - |
| Ending balance - total | $ 607,199 | $ 491,326 | $ 187,750 | $ 36,539 | $ 173,897 | $ 1,496,711 |
| Ending balance - individually evaluated for impairment | $ 3,783 | $ - | $ - | $ 32,665 | $ - | $ 36,448 |
| Ending balance - collectively evaluated for impairment | $ 603,416 | $ 491,326 | $ 187,750 | $ 3,874 | $ 173,897 | $ 1,460,263 |
| **Loans Receivable:** | | | | | | |
| Ending balance - total | $ 63,778,282 | $ 43,757,171 | $ 17,018,201 | $ 429,184 | $ - | $ 124,982,838 |
| Ending balance - individually evaluated for impairment | $ 221,105 | $ 197,893 | $ 58,283 | $ 151,897 | $ - | $ 629,178 |
| Ending balance - collectively evaluated for impairment | $ 63,557,177 | $ 43,559,278 | $ 16,959,918 | $ 277,287 | $ - | $ 124,353,660 |

### Note 5. Allowance for Loan Losses and Credit Quality, continued

The following is an analysis presenting impaired loan information by loan class as of December 31, 2016 and 2015:

| December 31, 2016 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Interest Income Recognized on Impaired Loans | Average Balance of Impaired Loans |
|---|---|---|---|---|---|
| Impaired loans with no related allowance: | | | | | |
| Commercial Real Estate | $ 116,405 | $ 116,405 | $ - | $ - | $ 80,316 |
| Consumer Real Estate | 184,466 | 300,439 | - | 2,216 | 306,995 |
| Commercial and Industrial | 46,278 | 46,278 | - | 233 | 51,789 |
| Consumer | - | - | - | - | - |
| Total with no related allowance | $ 347,149 | $ 463,122 | $ - | $ 2,449 | $ 439,100 |
| Impaired loans with an allowance recorded: | | | | | |
| Commercial Real Estate | $ 211,124 | $ 211,124 | $ 1,658 | $ 8,608 | $ 216,053 |
| Consumer Real Estate | - | - | - | - | - |
| Commercial and Industrial | - | - | - | - | - |
| Consumer | 141,025 | 147,170 | 24,187 | - | 152,077 |
| Total with related allowance | $ 352,149 | $ 358,294 | $ 25,845 | $ 8,608 | $ 368,130 |
| Total impaired loans | | | | | |
| Commercial Real Estate | $ 327,529 | $ 327,529 | $ 1,658 | $ 8,608 | $ 296,369 |
| Consumer Real Estate | 184,466 | 300,439 | - | 2,216 | 306,995 |
| Commercial and Industrial | 46,278 | 46,278 | - | 233 | 51,789 |
| Consumer | 141,025 | 147,170 | 24,187 | - | 152,077 |
| Total impaired loans | $ 699,298 | $ 821,416 | $ 25,845 | $ 11,057 | $ 807,230 |

| December 31, 2015 | Recorded Investment | Unpaid Principal Balance | Related Allowance | Interest Income Recognized on Impaired Loans | Average Balance of Impaired Loans |
|---|---|---|---|---|---|
| Impaired loans with no related allowance: | | | | | |
| Commercial Real Estate | $ - | $ - | $ - | $ - | $ - |
| Consumer Real Estate | 197,893 | 313,866 | - | 6,296 | 366,468 |
| Commercial and Industrial | 58,283 | 58,283 | - | 9,760 | 116,402 |
| Consumer | - | - | - | - | - |
| Total with no related allowance | $ 256,176 | $ 372,149 | $ - | $ 16,056 | $ 482,870 |
| Impaired loans with an allowance recorded: | | | | | |
| Commercial Real Estate | $ 221,105 | $ 221,105 | $ 3,783 | $ 11,679 | $ 225,461 |
| Consumer Real Estate | - | - | - | - | - |
| Commercial and Industrial | - | - | - | - | - |
| Consumer | 151,897 | 158,042 | 32,665 | 7,328 | 160,423 |
| Total with related allowance | $ 373,002 | $ 379,147 | $ 36,448 | $ 19,007 | $ 385,884 |
| Total impaired loans | | | | | |
| Commercial Real Estate | $ 221,105 | $ 221,105 | $ 3,783 | $ 11,679 | $ 225,461 |
| Consumer Real Estate | 197,893 | 313,866 | - | 6,296 | 366,468 |
| Commercial and Industrial | 58,283 | 58,283 | - | 9,760 | 116,402 |
| Consumer | 151,897 | 158,042 | 32,665 | 7,328 | 160,423 |
| Total impaired loans | $ 629,178 | $ 751,296 | $ 36,448 | $ 35,063 | $ 868,754 |

**Note 5. Allowance for Loan Losses and Credit Quality, continued**

Internally assigned risk ratings assist the Bank in determining the risk profile of each loan in the loan portfolio and changes in the internally assigned risk ratings are useful in monitoring trends in the loan portfolio quality. The four categories used by the Bank are Pass, Special mention, Substandard and Doubtful and can be generally described as follows:

- **Pass** – these loans have a risk profile which range from superior quality with minimal credit risk to loans requiring management attention but still have an acceptable risk profile and continue to perform primarily as contracted.

- **Special mention** – these loans generally have underwriting guideline tolerances and/or exceptions with no identifiable mitigating factors. These loans may also be currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Bank's position at some future date. Potential weaknesses are the result of deviations from prudent lending practices. The loans may also have adverse economic conditions that developed subsequent to the loan origination that do not jeopardize liquidation of the debt, but do substantially increase the level of risk.

- **Substandard** – these loans are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified as substandard must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt; they are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected. These loans are no longer considered to be adequately protected due to the borrower's declining net worth, lack of earnings capacity, declining collateral margins and/or unperfected collateral positions. A possibility of loss of a portion of the loan balance cannot be ruled out. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.

- **Doubtful** – these loans have all the weaknesses inherent in loans classified Substandard, plus the added characteristic that the weaknesses make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable. The ability of the borrower to service the debt is extremely weak, overdue status is constant, the debt has been placed on nonaccrual status, and no definite repayment schedule exists. Certain events may occur which would salvage the debt including an injection of capital into the borrower, alternative financing obtained by the borrower or liquidation of assets or the pledging of additional collateral by the borrower.

An analysis of the loan portfolio, excluding loans held for sale, based upon the internally assigned risk ratings as of December 31, 2016 and 2015, is as follows:

| December 31, 2016 | Commercial Real Estate | Consumer Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|
| Risk rating: | | | | | |
| Pass | $ 73,992,232 | $ 52,520,943 | $ 16,674,705 | $ 581,503 | $ 143,769,383 |
| Special mention | 327,325 | 740,187 | 360,483 | - | 1,427,995 |
| Substandard | 327,529 | 375,232 | 46,278 | 141,025 | 890,064 |
| Doubtful | - | - | - | - | - |
| Total | $ 74,647,086 | $ 53,636,362 | $ 17,081,466 | $ 722,528 | $ 146,087,442 |

**Note 5. Allowance for Loan Losses and Credit Quality, continued**

| December 31, 2015 | Commercial Real Estate | Consumer Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|
| Risk rating: | | | | | |
| Pass | $ 62,174,988 | $ 42,758,490 | $ 16,415,348 | $ 277,287 | $ 121,626,113 |
| Special mention | 1,382,190 | 609,964 | 544,570 | - | 2,536,724 |
| Substandard | 221,104 | 388,717 | 58,283 | 151,897 | 820,001 |
| Doubtful | - | - | - | - | - |
| Total | $ 63,778,282 | $ 43,757,171 | $ 17,018,201 | $ 429,184 | $ 124,982,838 |

The following is a past due aging analysis of the Bank's loan portfolio, excluding loans held for sale, by loan class as of December 31, 2016 and 2015:

| December 31, 2016 | 30-59 Days Past Due and Still Accruing | 60-89 Days Past Due and Still Accruing | Greater than 90 Days and Still Accruing | Total Past Due and Still Accruing | Nonaccrual Loans | Current Loans | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial Real Estate | $ - | $ - | $ - | $ - | $ 116,405 | $ 74,530,681 | $ 74,647,086 |
| Consumer Real Estate | 389,355 | 259,597 | - | 648,952 | 146,716 | 52,840,694 | 53,636,362 |
| Commercial and Industrial | - | - | - | - | 46,278 | 17,035,188 | 17,081,466 |
| Consumer | 724 | - | - | 724 | 141,025 | 580,779 | 722,528 |
| Total | $ 390,079 | $ 259,597 | $ - | $ 649,676 | $ 450,424 | $ 144,987,342 | $ 146,087,442 |

| December 31, 2015 | 30-59 Days Past Due and Still Accruing | 60-89 Days Past Due and Still Accruing | Greater than 90 Days and Still Accruing | Total Past Due and Still Accruing | Nonaccrual Loans | Current Loans | Total Loans |
|---|---|---|---|---|---|---|---|
| Commercial Real Estate | $ - | $ - | $ - | $ - | $ - | $ 63,778,282 | $ 63,778,282 |
| Consumer Real Estate | - | - | - | - | 159,959 | 43,597,212 | 43,757,171 |
| Commercial and Industrial | - | - | - | - | 58,283 | 16,959,918 | 17,018,201 |
| Consumer | - | - | - | - | 151,897 | 277,287 | 429,184 |
| Total | $ - | $ - | $ - | $ - | $ 370,139 | $ 124,612,699 | $ 124,982,838 |

**Note 5. Allowance for Loan Losses and Credit Quality, continued**

During the year ended December 31, 2016, there were no loans modified by the Bank that were considered to be troubled debt restructurings (TDRs). During the year ended December 31, 2015, there was one loan modified by the Bank that was considered to be a TDR. There were no TDRs that subsequently defaulted during the years ended December 31, 2016 and 2015. An analysis of the number of TDRs by loan type occurring during the year ended December 31, 2015, follows:

| | Troubled Debt Restructurings For the year ended December 31, 2015 | | |
|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| Commercial Real Estate | - | $ - | $ - |
| Consumer Real Estate | - | - | - |
| Commercial and Industrial | - | - | - |
| Consumer | 1 | 152,803 | 152,803 |
| Total | 1 | $ 152,803 | $ 152,083 |

**Note 6. Property and Equipment**

***Components of Property and Equipment***

Components of property and equipment and total accumulated depreciation at December 31, 2016 and 2015, are as follows:

| | 2016 | 2015 |
|---|---|---|
| Land | $ 1,677,575 | $ 1,677,575 |
| Buildings and improvements | 380,773 | 342,803 |
| Furniture and equipment | 245,087 | 232,633 |
| Property and equipment, total | 2,303,435 | 2,253,011 |
| Less accumulated depreciation | 406,845 | 321,856 |
| Property and equipment, net of depreciation | $ 1,896,590 | $ 1,931,155 |

Depreciation expense was $104,666 and $125,978 for the years ended December 31, 2016 and 2015, respectively.

**Note 6. Property and Equipment, continued**

***Leases***

In June 2008, the Bank entered into an operating lease for its branch facility in Huntersville. Total rent expense at the Huntersville location was $132,507 and $129,183 for the fiscal years ended December 31, 2016 and 2015, respectively. In September 2007, the Bank (in its pre-organizational phase) entered into an operating lease on the modular bank building in Mooresville. Total rent expense at the Mooresville location for the fiscal years ended December 31, 2016 and 2015, was $69,174 both years. In February 2015, the Bank entered into an operating lease for its branch facility in Statesville. Total rent expense at the Statesville location was $24,000 and $22,000 for the fiscal year ended December 31, 2016 and 2015, respectively. In May 2016, the Bank entered into an operating lease for is loan production office in Charlotte. Total rent expense at the Charlotte location was $4,550 for the fiscal year ended December 31, 2016.

Future minimum lease payments are as follows:

| | |
|---|---|
| 2017 | $ 236,042 |
| 2018 | 71,468 |
| | $ 307,510 |

**Note 7. Deposits**

The aggregate amount of time deposits in denominations that met or exceeded the FDIC insurance limit of $250,000 or more at December 31, 2016 and 2015 was $10,390,579 and $10,565,970, respectively. At December 31, 2016, the scheduled maturities of time deposits are as follows:

| | Total |
|---|---|
| 2017 | $ 19,832,068 |
| 2018 | 8,312,090 |
| 2019 | 60,947 |
| 2020 | 107,758 |
| 2021 | 70,219 |
| | $ 28,383,082 |

Brokered deposits totaled $1,996,000 and $1,980,000 as of December 31, 2016 and 2015, respectively.

**Note 8. Borrowings**

***Lines of Credit***

The Bank has established credit facilities to provide additional liquidity if and as needed. These credit facilities consist of unsecured lines of credit with correspondent banks for federal funds purchased totaling $19,500,000 and a secured line of credit with FHLB of Atlanta of $17,836,118 for a total of $37,336,118 available. Borrowings under these credit facilities were $5,260,800 at December 31, 2016. There were no borrowings under these credit facilities at December 31, 2015.

***Repurchase Agreements***

The Bank had securities sold under agreements to repurchase that mature on a daily basis of $259,705 and $162 at December 31, 2016 and 2015, respectively. The weighted average interest rate on these agreements was 0.40 percent at December 31, 2016 and 2015.

**Note 9. Fair Value of Financial Instruments**

The Bank utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available-for-sale, trading securities and derivatives, if present, are recorded at fair value on a recurring basis. Additionally, from time to time, the Bank 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. Their nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

***Fair Value Hierarchy***

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

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

Level 2: Valuation is based upon quoted 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 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, U. S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

***Impaired Loans***

The Bank does not record loans at fair value on a recurring basis. From time to time, a loan is considered impaired. The fair value of impaired loans is estimated using one of several methods, including collateral value, liquidation value, and discounted cash flows. When the fair value of collateral is based on an observable market price or a current appraised value, the Bank records the impaired loan as Level 2. If the fair value of the loan is based on criteria other than observable market prices or current appraised value, the loan is recorded as Level 3.

**Note 9. Fair Value of Financial Instruments, continued**

***Other Real Estate Owned***

Other real estate owned is adjusted to fair value upon transfer of the loans to foreclosed assets. Other real estate owned is carried at the lower of the carrying value or fair value. Fair value is primarily based upon independent observable market prices or appraised values of the collateral, which the Bank considers to be Level 2 inputs. In addition, fair value may be based upon the currently listed sales price for the foreclosed asset, which the Bank considers to be Level 3 inputs. Level 3 inputs are only used in the event that the currently listed sales price of the collateral falls below the independent observable market prices or appraised values of the collateral.

***General***

The Bank has no liabilities carried at fair value or measured at fair value on a recurring or nonrecurring basis. Below is a summary of assets carried at fair value or measured at fair value on a recurring or nonrecurring basis as of December 31, 2016 and 2015:

***As of December 31, 2016:***

| Recurring Basis | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Investment in securities available-for-sale: | | | | |
| Government sponsored enterprises | $ 13,107,171 | $ - | $ 13,107,171 | $ - |
| Mortgage-backed securities | 2,720,768 | - | 2,720,768 | - |
| Total assets at fair value | $ 15,827,939 | $ - | $ 15,827,939 | $ - |

| Nonrecurring Basis | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Impaired loans, net of related allowance for credit losses | | | | |
| Commercial Real Estate | $ 325,871 | $ - | $ - | $ 325,871 |
| Consumer Real Estate | 184,466 | - | - | 184,466 |
| Commercial and Industrial | 46,278 | - | - | 46,278 |
| Consumer | 116,838 | - | - | 116,838 |
| Total impaired loans, net of related allowance for credit losses | 673,453 | - | - | 673,453 |
| Other real estate owned | 767,000 | - | - | 767,000 |
| Total assets at fair value | $ 1,440,453 | $ - | $ - | $ 1,440,453 |

**Note 9. Fair Value of Financial Instruments, continued**

***As of December 31, 2015:***

| Recurring Basis | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Investment in securities available-for-sale: | | | | |
| Government sponsored enterprises | $ 15,665,375 | $ - | $ 15,665,375 | $ - |
| Mortgage-backed securities | 1,210,430 | - | 1,210,430 | - |
| Total assets at fair value | $ 16,875,805 | $ - | $ 16,875,805 | $ - |

| Nonrecurring Basis | Total | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Impaired loans, net of related allowance for credit losses | | | | |
| Commercial Real Estate | $ 217,322 | $ - | $ - | $ 217,322 |
| Consumer Real Estate | 197,893 | - | - | 197,893 |
| Commercial and Industrial | 58,283 | - | - | 58,283 |
| Consumer | 119,232 | - | - | 119,232 |
| Total impaired loans, net of related allowance for credit losses | 592,730 | - | - | 592,730 |
| Other real estate owned | 867,000 | - | - | 867,000 |
| Total assets at fair value | $ 1,459,730 | $ - | $ - | $ 1,459,730 |

For Level 3 assets measured at fair value on a recurring or non-recurring basis as of December 31, 2015 and 2014, the significant unobservable inputs used in the fair value measurements were as follows:

| | Fair Value at December 31, 2016 | Fair Value at December 31, 2015 | Valuation Technique | Significant Unobservable Inputs | General Range of Significant Unobservable Input Values |
|---|---|---|---|---|---|
| Impaired Loans | $ 673,453 | $ 592,730 | Appraised Value/Discounted Cash Flows/Market Value of Note | Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell | 0 – 18% |
| Other Real Estate Owned | $ 767,000 | $ 867,000 | Appraised Value/Comparable Sales/Other Estimates from Independent Sources | Discounts to reflect current market conditions and estimated costs to sell | 0 – 18% |

**Note 10. Stock and Earnings per Share**

Upon opening, the Bank issued 1,900,000 shares of common stock. On February 12, 2016, the Board of Directors declared a 20 percent stock dividend that was paid on March 21, 2016, to shareholders of record at the close of business on February 29, 2016. Share data for all periods reported has been restated to reflect this transaction. The Bank is authorized to issue 20,000,000 shares of common stock with a par value of $5 per share and 5,000,000 shares of preferred stock with no par value.

**Note 10. Stock and Earnings per Share, continued**

***Earnings per Share***

The following table details the computation of basic and diluted earnings per common share for the years ended December 31, 2016 and 2015:

| | 2016 | 2015 |
|---|---|---|
| Net income available to common shareholders | $ 1,227,567 | $ 925,207 |
| Weighted average shares outstanding, basic * | 2,717,172 | 2,732,022 |
| Effect of dilutive securities * | 270,132 | 95,584 |
| Weighted average shares outstanding, diluted * | 2,987,304 | 2,827,606 |
| Basic earnings per common share * | $ 0.45 | $ 0.34 |
| Dilutive earnings per common share * | $ 0.41 | $ 0.33 |

* Share data and 2015 shareholders' equity have been restated to reflect the 20% common stock dividend issued in March 2016.

**Note 11. Income Taxes**

***Current and Deferred Income Tax Components***

The components of income tax expense (substantially all federal) for the years ended December 31, 2016 and 2015 are as follows:

| | 2016 | 2015 |
|---|---|---|
| Current | $ 813,334 | $ 479,676 |
| Deferred expense (benefit) | (95,629) | 54,678 |
| Income tax expense | $ 717,705 | $ 534,354 |

***Deferred Income Tax Analysis***

The significant components of net deferred tax assets at December 31, 2016 and 2015 are summarized as follows:

| | 2016 | 2015 |
|---|---|---|
| *Deferred tax assets* | | |
| Allowance for loan losses | $ 391,273 | $ 392,070 |
| Unrealized losses on securities | 61,378 | - |
| Pre-opening expenses | 148,636 | 176,592 |
| Supplemental executive retirement plan accrual | 524,540 | 452,929 |
| Non-qualified stock option compensation expense | 148,820 | 141,605 |
| Other real estate owned | 78,167 | 42,960 |
| Depreciation | 7,662 | - |
| Other | 40,718 | 32,432 |
| Deferred tax asset | 1,401,194 | 1,238,588 |
| *Deferred tax liabilities* | | |
| Unrealized gains on securities | - | 14,622 |
| Deferred loan costs | 323,245 | 295,139 |
| Depreciation | - | 12,396 |
| Other | 11,423 | 21,533 |
| Deferred tax liability | 334,668 | 343,690 |
| Net deferred tax asset | $ 1,066,526 | $ 894,898 |

**Note 11. Income Taxes, continued**

The income tax expense for the years ended December 31, 2016 and 2015, is reconciled to the amount of income tax computed at the federal statutory rate of 34% on income before income taxes as follows:

| | 2016 | 2015 |
|---|---|---|
| Tax expense at statutory rate | $ 661,391 | $ 496,251 |
| State income tax expense, net of federal expense | 68,680 | 66,890 |
| Increase (decrease) in taxes resulting from: | | |
| Stock based compensation | 9,619 | 11,638 |
| Other, net | (21,985) | (40,425) |
| Income tax expense | $ 717,705 | $ 534,354 |

The Bank has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions.

The Bank files income tax returns with the federal government and the State of North Carolina. With few exceptions, the Bank is no longer subject to federal and state income tax examinations by tax authorities for tax years prior to 2013.

**Note 12. Commitments and Contingencies**

***Litigation***

In the normal course of business, the Bank may be involved in various legal proceedings. The Bank was involved in foreclosure proceedings during the fiscal years ended December 31, 2016 and 2015.

***Financial Instruments with Off-balance-sheet Risk***

The Bank is 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 and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the balance sheet.

The Bank'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 is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as for on-balance-sheet instruments.

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

Standby letters of credit are conditional financial commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Bank deems necessary.

**Note 12. Commitments and Contingencies, continued**

***Financial Instruments with Off-balance-sheet Risk, continued***

At December 31, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

| | 2016 | 2015 |
|---|---|---|
| Commitments to grant loans | $ 21,760,795 | $ 14,895,114 |
| Unfunded commitments under lines of credit | $ 18,111,847 | $ 14,849,093 |
| Standby letters of credit | $ 263,277 | $ 829,400 |

***Concentrations of Credit Risk***

Substantially all of the Bank's loans and commitments to extend credit have been granted to customers in the Bank's market area and such customers are generally depositors of the Bank. The concentrations of credit by type of loan are set forth in Note 4. The Bank's primary focus is toward consumer and small business transactions, and accordingly, it does not have a significant number of loans or commitments to any single borrower or group of related borrowers in excess of $2,000,000.

The Bank from time to time may have cash and cash equivalents on deposit with financial institutions that exceed federally-insured limits.

**Note 13. Regulatory Restrictions**

***Dividends***

The Bank, as a North Carolina banking corporation, may pay dividends only out of undivided profits (retained earnings) as determined pursuant to North Carolina General Statutes Section 53C. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the bank.

***Capital Requirements***

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory (and possibly additional discretionary) actions by regulators that, if undertaken, could have a direct material effect on the Bank'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 classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier I capital, and Common Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as all those terms are defined in the applicable regulations. As of December 31, 2016 and 20154, the Bank met all capital adequacy requirements to which it was subject.

**Note 13. Regulatory Restrictions, continued**

***Capital Requirements, continued***

As of December 31, 2016 and 2015, the Bank met the criteria to be considered well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage ratios. These minimum requirements as well as the Bank's actual capital amounts and ratios are presented in the following table:

| | Actual | | Minimum Capital Requirement | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | *(thousands)* | | | |
| ***December 31, 2016*** | | | | | | |
| Total Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 25,334 | 16.5% | $ 12,312 | 8.0% | $ 15,390 | 10.0% |
| Tier 1 Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 23,779 | 15.5% | $ 9,234 | 6.0% | $ 12,312 | 8.0% |
| Common Equity Tier 1 Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 23,779 | 15.5% | $ 6,925 | 4.5% | $ 10,003 | 6.5% |
| Tier 1 Capital | | | | | | |
| (to Average Assets) | $ 23,779 | 13.8% | $ 6,868 | 4.0% | $ 8,585 | 5.0% |

| | Actual | | Minimum Capital Requirement | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | | | *(thousands)* | | | |
| ***December 31, 2015*** | | | | | | |
| Total Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 23,993 | 18.0% | $ 10,682 | 8.0% | $ 13,353 | 10.0% |
| Tier 1 Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 22,496 | 16.8% | $ 8,012 | 6.0% | $ 10,682 | 8.0% |
| Common Equity Tier 1 Capital | | | | | | |
| (to Risk-Weighted Assets) | $ 22,496 | 16.8% | $ 6,009 | 4.5% | $ 8,679 | 6.5% |
| Tier 1 Capital | | | | | | |
| (to Average Assets) | $ 22,496 | 14.6% | $ 6,160 | 4.0% | $ 7,700 | 5.0% |

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

**Note 13. Regulatory Restrictions, continued**

***Capital Requirements, continued***

The rules include new risk-based capital and leverage ratios, which became effective on January 1, 2015, and revise the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Bank are: (i) a new common equity Tier 1 capital ratio of 4.5 percent; (ii) a Tier 1 capital ratio of 6.0% (increased from 4.0 percent); (iii) a total capital ratio of 8.0 percent (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4.0 percent for all institutions. The rules eliminate the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010, will be grandfathered for companies with consolidated assets of $15 billion or less. The rules also establish a "capital conservation buffer" of 2.5 percent above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0 percent, (ii) a Tier 1 capital ratio of 8.5 percent and (iii) a total capital ratio of 10.5 percent. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625 percent of risk-weighted assets and will increase by that amount each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that may be utilized for such actions.

**Note 14. Transactions with Related Parties**

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

| | 2016 | 2015 |
|---|---|---|
| Beginning balance | $ 603,202 | $ 566,907 |
| New loans and advances | 545,465 | 449,157 |
| Repayments | (411,184) | (412,862) |
| Ending balance | $ 737,483 | $ 603,202 |

Deposits and repurchase agreements from related parties held by the Bank at December 31, 2016 and 2015, amounted to $3,355,862 and $3,229,410, respectively.

**Note 15. Employee Benefit Plans**

***Defined Contribution Plan***

The Bank maintains a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). The plan covers substantially all full-time employees who are 21 years of age and have completed 90 days of service. Participants may contribute a percentage of compensation, subject to a maximum allowed under the Code. In addition, the Bank matches certain contributions and may make additional contributions at the discretion of the Board of Directors. The Bank's contributions were $64,487 and $63,407 for the years ended December 31, 2016 and 2015, respectively.

**Note 15. Employee Benefit Plans, continued**

***Supplemental Executive Retirement Plan***

The Bank maintains a Supplemental Executive Retirement Plan (SERP) for its President and Chief Executive Officer, Joe I. Marshall, Jr., to which benefits will be contributed to the extent permitted by Section 409A of the Code upon the Bank obtaining profitability. The SERP provides for an annual retirement benefit of 70 percent of Mr. Marshall's average annual compensation from the Bank during the three calendar years preceding his retirement, continuing on a monthly basis thereafter for a period of 20 years and vesting 10 percent annually from the date the agreement was signed and 100 percent upon a Change in Control. The expense related to funding the SERP was $221,705 and $185,289 for the years ended December 31, 2016 and 2015, respectively.

***Stock Option Plans***

The Bank has adopted both an Incentive Stock Option Plan and a Nonstatutory Stock Option Plan (each a "Plan" and collectively, the "Plans"). On February 12, 2016, the Board of Directors declared a 20 percent stock dividend that was paid on March 21, 2016, to shareholders of record at the close of business on February 29, 2016. Share data has been restated to reflect this transaction. Under each Plan up to 273,600 shares may be issued for a total of 547,200 shares. Options granted under both Plans expire no more than 10 years from the date of grant. The exercise price for each option shall be set by the Board of Directors at the date of grant, but shall not be less than 100 percent of fair market value of the related stock at the date of the grant. Under both Plans, option vesting terms shall be set by the Board of Directors at the date of grant. All options granted so far under the Plans vest annually over a five-year period from the date of the grant. Compensation expense related to options granted was $55,435 and $70,854 for the years ended December 31, 2016 and 2015, respectively.

There were 3,600 stock options granted during both years ended December 31, 2016 and 2015. The weighted average fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

| | 2016 | 2015 |
|---|---|---|
| Expected volatility | 44.33% | 61.74% |
| Expected dividend | 0.00% | 0.00% |
| Expected term (years) | 5.00 | 5.00 |
| Risk free rate | 2.16% | 1.77% |

There were 3,600 and 2,000 options exercised during the year ended December 31, 2016 and 2015, respectively. Activity under each Plan during the years ended December 31, 2016 and 2015 is summarized below:

| | Incentive Plan | | Nonstatutory Plan | |
|---|---|---|---|---|
| | Available for Grant | Granted | Available for Grant | Granted |
| ***Balance December 31, 2014*** | 132,780 | 140,820 | 79,196 | 194,404 |
| Forfeited | 7,200 | (7,200) | - | - |
| Granted | (3,600) | 3,600 | - | - |
| Exercised | - | (2,400) | - | - |
| ***Balance December 31, 2015*** | 136,380 | 134,820 | 79,196 | 194,404 |
| Forfeited | 5,700 | (5,700) | - | - |
| Granted | (3,600) | 3,600 | - | - |
| Exercised | - | (3,600) | - | - |
| ***Balance December 31, 2016*** | 138,480 | 129,120 | 79,196 | 194,404 |

**Note 15. Employee Benefit Plans, continued**

A summary of option activity under the Plans during the periods ended December 31, 2016 and 2015, is presented below:

| | Options Outstanding | Weighted Average Exercise Price | Average Remaining Contractual Term | Aggregate Intrinsic Value [(1)] |
|---|---|---|---|---|
| Outstanding at December 31, 2014 | 335,224 | $ 7.17 | 5.56 years | $ 323,165 |
| Exercisable at December 31, 2014 | 236,261 | $ 7.38 | 4.30 years | $ 176,627 |
| Granted | 3,600 | 9.48 | | |
| Forfeited | (7,200) | 6.85 | | |
| Exercised | (2,400) | 5.68 | | |
| Outstanding at December 31, 2015 | 329,224 | $ 7.21 | 4.58 years | $ 303,209 |
| Exercisable at December 31, 2015 | 259,084 | $ 7.32 | 3.61 years | $ 209,199 |
| Granted | 3,600 | 7.50 | | |
| Forfeited | (5,700) | 6.97 | | |
| Exercised | (3,600) | 6.40 | | |
| Outstanding at December 31, 2016 | 323,524 | $ 7.23 | 3.56 years | $ 292,658 |
| Exercisable at December 31, 2016 | 270,844 | $ 7.30 | 2.82 years | $ 225,032 |

[(1)] The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2016, 2015 and 2014. This amount changes based on changes in the market value of the Bank's stock. The fair value (present value of the estimated future benefit to the option holder) of each option grant is estimated on the date of grant using the Black-Scholes option pricing model.

Options vested during the twelve months ended December 31, 2016 and 2015, totaled 17,520 and 30,983, respectively. Total unrecognized compensation expense related to outstanding non-vested stock options will be recognized over the following periods:

| | |
|---|---|
| 2017 | $ 57,274 |
| 2018 | 57,274 |
| 2019 | 44,086 |
| 2020 | 4,522 |
| 2021 | 2,261 |
| Total | $ 165,417 |

**Note 16. 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, 2017, the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.

# Board of Directors and Employees

## ***Board of Directors***

Kyle Cerminara ........................................ blueharbor wealth advisors
Kelley Earnhardt Miller (Chairman) ........................................ JR Motorsports
Abigail Jennings ........................................ Lake Norman Realty
Jim Marshall ........................................ blueharbor bank
Bynum Marshall ........................................ MSC Industrial Supply
Rock Pickard, Jr. ........................................ Central Carolina Insurance Agency
Bill Pope (Vice Chairman) ........................................ Pope McMillan, P.A.
R. B. Sloan, Jr. ........................................ Southeastern Data Cooperative
Louis Stanfield, Jr. ........................................ Stanfield & Blackman, LLC and Stanfield & Company, LLC
Rick Teague ........................................ Techmet Carbides, Inc.

## ***Employees***

Jim Marshall ........................................ President and Chief Executive Officer
Don Flowe ........................................ Senior Vice President and Chief Credit Officer
Carl Larson ........................................ Senior Vice President and Chief Financial Officer
Chris Nichols ........................................ Senior Vice President and Senior Commercial Lender
Doug Hendrix ........................................ Senior Vice President and Market Executive
Stuart Hester ........................................ Senior Vice President and Market Executive
Gerald Huffman ........................................ Vice President and Commercial Lender
Cliff Hunnicutt ........................................ Vice President and Branch Manager
Stan Reece ........................................ Vice President and Commercial Lender
Danielle Johnson ........................................ Vice President and Deposit Operations Manager
Sandi Long ........................................ Vice President and Compliance Manager
Beth Mills ........................................ Vice President and Loan Operations Manager
Dava Brown ........................................ Assistant Vice President and Mortgage Specialist
John Childress ........................................ Assistant Vice President and Commercial Lender
Patti Wooten ........................................ Corporate Secretary and Executive Assistant
Tony Cornacchione ........................................ Credit Analyst
Dawn Bradley ........................................ Lead Universal Associate
Michelle Hancock ........................................ Lead Universal Associate - Lending
Robin Myers ........................................ Lead Universal Associate - Operations
Christine Glidden ........................................ Universal Associate
Shelia Lockhart ........................................ Universal Associate
Kelsey Norwood ........................................ Universal Associate
Stacie Overcash-Ingle ........................................ Universal Associate
Carol Root ........................................ Universal Associate
Tara Summers ........................................ Universal Associate

# Shareholders' Information

## *Annual Meeting*

The 2017 Annual Meeting of Shareholders of the Bank will be held on April 24, 2017, at 2:00 p.m., Eastern Daylight Saving Time, at Langtree Plantation, 554 Langtree Road, Mooresville, North Carolina 28117.

## *Requests for Information*

Requests for information should be directed to Mr. Carl T. Larson, Senior Vice President and Chief Financial Officer, at blueharbor bank, Post Office Box 3546, Mooresville, North Carolina 28117.

Independent Auditors

Elliott Davis Decosimo, PLLC
700 E. Morehead Street, Suite 400
Charlotte, NC 28202

Stock Transfer Agent

Broadridge Corporate Issuer Solutions, Inc.
Post Office Box 1342
Brentwood, NY 11717

## *Federal Deposit Insurance Corporation*

The Bank is a member of the Federal Deposit Insurance Corporation. This Annual Report has not been reviewed, or confirmed for accuracy or relevance by the Federal Deposit Insurance Corporation.

## *Mailing Address*

blueharbor bank
Post Office Box 3546
Mooresville, North Carolina 28117

## *Internet Address*

http://www.blueharborbank.com/

## *Stock Information*

*Market Information*. The Bank's common stock began trading on July 7, 2008. As of February 28, 2017, there were approximately 540 holders of record, not including the number of persons or entities whose stock is held in nominee or street name through various brokerage firms or banks. The Bank's stock is traded on the Over-The-Counter Bulletin Board under the symbol BLHK.

*Dividend Information*. As of December 31, 2015, the Bank had not paid any cash dividends to shareholders since its formation on January 3, 2008. On January 28, 2013, the Board of Directors declared a 20 percent stock dividend that was paid on March 5, 2013, to shareholders of record at the close of business on February 15, 2013. On February 12, 2016, the Board of Directors declared a 20 percent stock dividend that was paid on March 21, 2016, to shareholders of record at the close of business on February 29, 2016. In determining whether to declare future dividends, the Board of Directors will take into account the Bank's operating results, capital requirements, financial condition, tax considerations and other relevant factors including federal and state regulatory restrictions on dividends. Also, the Bank's ability to declare and pay future cash dividends will be dependent upon, among other things, restrictions imposed by bank regulators and capital requirements of federal and state law.

*Stock Buyback*. On January 29, 2013, the Bank reported the approval of a stock repurchase plan to repurchase up to $250,000 of common stock over a twelve month period, representing approximately 2.5 percent of the common stock outstanding. No shares were repurchased during the approved twelve month period. On October 21, 2015, the Bank reported the approval of a stock repurchase plan to repurchase up to $400,000 of common stock over a twelve month period, representing approximately 2.4 percent of the common stock outstanding. A total of 20,300 shares of common stock were repurchased under this plan with a weighted-average per share price of $7.66.

blueharbor bank

## FOUR GREAT LOCATIONS SERVING IREDELL COUNTY AND THE CHARLOTTE METRO AREA

**Mooresville Branch**
Located in Morrison Plantation
106 Corporate Park Drive
Mooresville, NC 28117
(704) 662-7700

**Huntersville Branch**
Located in Huntersville Square
104 North Statesville Road
Huntersville, NC 28078
(704) 990-7200

**Statesville Branch**
Located in Downtown Statesville
245 East Front Street
Statesville, NC 28677
(704) 380-3101

**Loan Production Office**
1244 East Blvd., Suite 2C
Charlotte, NC 28203
(704) 691-4761



*www.blueharborbank.com*