

Atlantic Community Bancshares, Inc. and Subsidiary

Camp Hill, Pennsylvania

Financial Statements

December 31, 2017



Atlantic Community Bancshares, Inc. and Subsidiary

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Independent Auditor's Report

Board of Directors and Shareholders
Atlantic Community Bancshares, Inc.
Camp Hill, Pennsylvania

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Atlantic Community Bancshares, Inc. and subsidiary, which comprise the consolidated balance sheet as of December 31, 2017 and 2016; the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended; and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Atlantic Community Bancshares, Inc. and subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

S.R. Snodgrass, P.C.

Cranberry Township, Pennsylvania
March 23, 2018

Atlantic Community Bancshares, Inc. and Subsidiary

Consolidated Balance Sheet

(Dollars in Thousands, Except Share Data)

December 31, 2017 and 2016

	2017	2016
Assets		
Cash and due from banks	\$ 36,357	\$ 10,226
Interest-bearing deposits with banks	173,240	157,383
Federal Funds Sold	20,534	76,080
Certificates of deposit	10,002	-
Cash and cash equivalents	240,133	243,689
Securities available for sale	77,993	74,578
Securities held to maturity (fair value of \$11,784 and \$13,729)	11,871	13,923
Restricted investment in regulatory bank stock	3,458	2,691
Loans, net of allowance for loan losses of \$7,971 and \$8,389	272,079	243,040
Premises and equipment, net	2,939	3,004
Cash surrender value of life insurance	21,161	20,664
Accrued interest receivable	1,075	938
Foreclosed real estate	-	489
Other assets	6,699	8,271
Total assets	<u>\$ 637,408</u>	<u>\$ 611,287</u>
Liabilities and Shareholders' Equity		
Liabilities		
Noninterest-bearing demand	\$ 247,435	\$ 249,291
Money market deposits	9,515	9,972
Time deposits	127,493	88,940
Escrow accounts	5,436	21,348
Total deposits	389,879	369,551
Federal funds purchased	87,247	103,939
Federal Home Loan Bank advances	69,938	50,892
Capital lease obligations	2,126	2,427
Accrued interest payable and other liabilities	8,441	7,987
Total liabilities	557,631	534,796
Shareholders' Equity		
Common stock, par value \$250 per share; 50,000 shares authorized in 2017 and 2016; 13,169 shares issued and 12,431 outstanding in 2017 and 13,169 shares issued and 12,291 outstanding in 2016	3,292	3,292
Paid-in capital	14,595	14,020
Retained earnings	63,743	61,160
Treasury stock, at cost, 738 shares in 2017, 878 shares in 2016	(993)	(1,074)
Accumulated other comprehensive loss	(360)	(568)
Total Atlantic Community Bancshares, Inc. shareholders' equity	80,277	76,830
Noncontrolling interest	(500)	(339)
Total liabilities and shareholders' equity	<u>\$ 637,408</u>	<u>\$ 611,287</u>

See notes to consolidated financial statements.

Atlantic Community Bancshares, Inc. and Subsidiary

Consolidated Statement of Income
(Dollars in Thousands, Except Per Share Data)
Years Ended December 31, 2017 and 2016

	2017	2016
Interest Income		
Loans, including fees	\$ 12,435	\$ 10,659
Debt securities, taxable	1,554	1,247
Debt securities, tax exempt	332	416
Federal funds sold	407	198
Other	1,387	884
Total interest income	<u>16,115</u>	<u>13,404</u>
Interest Expense		
Deposits	2,214	1,392
Federal funds purchased	855	406
Federal Home Loan Bank advances	1,131	723
Other	116	132
Total interest expense	<u>4,316</u>	<u>2,653</u>
Net interest income	11,799	10,751
Credit to Allowance for Loan Losses	-	(90)
Net interest income after credit to allowance for loan losses	<u>11,799</u>	<u>10,841</u>
Other Income		
Clearing and analysis fees	2,939	3,240
Agency federal funds fees	206	237
Earnings on cash surrender value of life insurance	551	467
BITS revenue, net of direct costs	9,290	8,788
Other	174	153
Total other income	<u>13,160</u>	<u>12,885</u>
Other Expenses		
Salaries and employee benefits	11,031	10,231
Occupancy and equipment	1,412	1,779
Data processing and servicing fees	2,983	3,130
Professional fees	1,108	1,068
Pennsylvania bank shares tax	385	340
Foreclosed real estate activity, net	15	37
Loss on disposal of premises and equipment	449	-
FDIC insurance	150	141
Other	1,328	1,355
Total other expenses	<u>18,861</u>	<u>18,081</u>
Income before income tax expense	6,098	5,645
Income Tax Expense	<u>3,483</u>	<u>1,668</u>
Net income	2,615	3,977
Net income applicable to noncontrolling interests	<u>85</u>	<u>122</u>
Net income applicable to Atlantic Community Bancshares, Inc.	<u>\$ 2,530</u>	<u>\$ 3,855</u>
Basic and Diluted Earnings Per Share	<u>\$ 205</u>	<u>\$ 305</u>

See notes to consolidated financial statements.

Atlantic Community Bancshares, Inc. and Subsidiary

Consolidated Statement of Comprehensive Income

(Dollars in Thousands)

Years Ended December 31, 2017 and 2016

	<u>2017</u>	<u>2016</u>
Net income	\$ 2,615	\$ 3,977
Other Comprehensive Income (Loss)		
Unrealized holding gains/(losses) on available-for-sale securities	422	(1,046)
Income tax effect	<u>(155)</u>	<u>382</u>
Total other comprehensive income (loss)	<u>267</u>	<u>(664)</u>
Total comprehensive income	<u>\$ 2,882</u>	<u>\$ 3,313</u>

See notes to consolidated financial statements.

Atlantic Community Bancshares, Inc. and Subsidiary

Consolidated Statement of Shareholders' Equity

(Dollars in Thousands, Except Share and Per Share Data)
Years Ended December 31, 2017 and 2016

	Common Stock	Paid-in Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interest	Total Shareholders' Equity
Balance, December 31, 2015	\$ 3,292	\$ 13,510	\$ 57,580	\$ -	\$ 96	\$ (101)	\$ 74,377
Exercise of membership unit options	-	-	-	-	-	5	5
Repurchase of membership unit options	-	-	-	-	-	(50)	(50)
Acquisition of 1,038 shares of treasury stock	-	-	-	(1,204)	-	-	(1,204)
Sale of 160 shares of treasury stock	-	510	-	130	-	-	640
Net income	-	-	3,855	-	-	122	3,977
Contributions from members	-	-	-	-	-	21	21
Distributions to members	-	-	-	-	-	(336)	(336)
Other comprehensive loss	-	-	-	-	(664)	-	(664)
Dividends declared, \$22 per share	-	-	(275)	-	-	-	(275)
Balance, December 31, 2016	3,292	14,020	61,160	(1,074)	(568)	(339)	76,491
Repurchase of membership unit options	-	-	-	-	-	(132)	(132)
Acquisition of 20 shares of treasury stock	-	-	-	(34)	-	-	(34)
Sale of 160 shares of treasury stock	-	575	-	115	-	-	690
Net income	-	-	2,530	-	-	85	2,615
Contributions from members	-	-	-	-	-	64	64
Distributions to members	-	-	(6)	-	-	(178)	(184)
Reclassification of certain income tax effects from other comprehensive loss	-	-	59	-	(59)	-	-
Other comprehensive income	-	-	-	-	267	-	267
Balance, December 31, 2017	\$ 3,292	\$ 14,595	\$ 63,743	\$ (993)	\$ (360)	\$ (500)	\$ 79,777

See notes to consolidated financial statements.

Atlantic Community Bancshares, Inc. and Subsidiary

Consolidated Statement of Cash Flows

(Dollars in Thousands)

Years Ended December 31, 2017 and 2016

	2017	2016
Cash Flows from Operating Activities		
Net income	\$ 2,615	\$ 3,977
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of premises and equipment	679	1,064
Net amortization of premiums and discounts on securities	373	465
Amortization of deferred loan fees, net	(127)	(104)
Writedown of foreclosed real estate	-	46
Credit to allowance for loan losses	-	(90)
Earnings on cash value of life insurance	(551)	(467)
Deferred income taxes	1,785	(94)
Gain on sale of foreclosed real estate	(4)	(44)
Loss on disposal of premises and equipment	449	-
Increase in accrued interest receivable	(137)	(54)
(Decrease) increase in other assets	(225)	133
Increase in accrued interest payable and other liabilities	728	184
Net cash provided by operating activities	<u>5,585</u>	<u>5,016</u>
Cash Flows from Investing Activities		
Activity in available-for-sale securities:		
Purchases	(18,097)	(24,761)
Proceeds from maturities, calls, and repayments	14,747	12,906
Activity in held-to-maturity securities:		
Purchases	(2,045)	(3,066)
Proceeds from maturities and calls	4,080	4,310
Net increase in loans	(28,912)	(24,036)
Purchase of restricted stock	(988)	(988)
Redemption of restricted stock	221	228
Purchases of premises and equipment	(130)	(17)
Purchases of software	(24)	(119)
Proceeds from sale of foreclosed real estate	493	342
Proceeds from life insurance death benefit	216	-
Purchase of cash surrender value of life insurance	-	(3,133)
Net cash used for investing activities	<u>(30,439)</u>	<u>(38,334)</u>
Cash Flows from Financing Activities		
Net increase (decrease) in deposits	20,328	(3,355)
Proceeds from long-term borrowings	25,000	25,000
Repayments of long-term borrowings	(5,954)	(6,544)
Decrease (increase) in federal funds purchased	(16,692)	16,200
Payments on capital lease obligations	(1,513)	(1,195)
Proceeds from sale of treasury stock	690	640
Acquisition of treasury stock	(34)	(1,204)
Proceeds from exercise of membership unit options	-	5
Repurchase of membership unit options	(132)	(50)
Contributions from members	64	21
Distributions to members	(184)	(336)
Payments of dividends	(275)	(263)
Net cash provided by financing activities	<u>21,298</u>	<u>28,919</u>
Net decrease in cash and cash equivalents	<u>(3,556)</u>	<u>(4,399)</u>
Cash and Cash Equivalents, Beginning of Year	<u>243,689</u>	<u>248,088</u>
Cash and Cash Equivalents, End of Year	<u>\$ 240,133</u>	<u>\$ 243,689</u>
Supplementary Cash Flows Information		
Cash paid during the period for:		
Interest	\$ 4,197	\$ 2,632
Income taxes	1,935	1,994
Noncash activity:		
Equipment acquired under capital leases	1,213	1,456
Loans transferred to foreclosed real estate	-	298

See notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Organization and Nature of Operations

Atlantic Community Bancshares, Inc. is a Pennsylvania corporation organized as the holding company of Atlantic Community Bankers Bank (the “Bank”). The Bank provides correspondent banking services, both credit and noncredit, to financial institutions in the Mid-Atlantic and New England regions of the United States of America. The Bank is subject to regulation and supervision by the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Pennsylvania Department of Banking. The Bank’s subsidiary, ACBB-BITS, LLC, provides enhanced communication services through a hosted communications platform solely for community financial institutions. BITS is a manager managed limited liability company and the Bank controls its operations and, accordingly, the results of operations and financial condition of BITS are included in these consolidated financial statements. At December 31, 2017 and 2016, the Bank maintains a voting majority in BITS.

The Bank participates in commercial and commercial real estate loans with other financial institutions throughout the Mid-Atlantic and New England regions of the United States of America and makes direct loans to financial institutions and officers and directors of financial institutions. In addition, the Bank accepts deposits and purchases federal funds from financial institutions. The Bank performs various services for its customers in an agency capacity and, therefore, these items are excluded from the Bank’s financial statements since they do not constitute assets of the Bank. The Bank had agency federal funds of \$193,436,000 and \$107,162,000 as of December 31, 2017 and 2016, respectively. The Bank had excess balance accounts of \$365,995,000 and \$276,910,000 as of December 31, 2017 and 2016, respectively. Both the agency federal funds and excess balance accounts are excluded from these financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of Atlantic Community Bancshares, Inc., its subsidiary, Atlantic Community Bankers Bank, and the bank’s subsidiaries, ACBB-BITS, LLC and 1400 Market Street, LLC. All significant intercompany accounts and transactions are eliminated in the consolidation.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Balance Sheet and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the evaluation of other-than-temporary impairment of securities, and the valuation of deferred tax assets.

1. Summary of Significant Accounting Policies (Continued)

Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located within the Mid-Atlantic and New England regions of the United States of America. The Company participates in commercial and commercial real estate loans with other financial institutions throughout the Mid-Atlantic and New England regions and makes direct loans to officers and directors of financial institutions. The loan portfolio is generally collateralized by assets of the borrower. A substantial portion of the Company's loan portfolio is concentrated in the real estate industry. Therefore, its debtors' ability to honor their contracts at December 31, 2017 and 2016, is dependent upon the real estate sector of the economy. The concentration of credit by type of loan is set forth in Note 4.

Presentation of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, federal funds sold and certificates of deposit, all of which have initial maturities of 90 days or less. Generally, federal funds are purchased or sold for one-day periods, but for those that exceed three days, are presented as term federal funds sold on the Consolidated Balance Sheet.

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. 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, net of tax, in other comprehensive income (loss). Management determines the appropriate classification of debt securities at the time of purchase and re-evaluates such designation as of each Consolidated Balance Sheet date.

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 estimating other-than-temporary impairment losses on debt securities, management considers (1) whether management intends to sell the securities, (2) if it is more likely than not that management will be required to sell the security before recovery, or (3) management does not expect to recover the entire amortized cost basis. In assessing potential other-than-temporary impairment for equity securities, consideration is given to management's intention and ability to hold the securities until recovery of unrealized losses. The Company has not recognized any other-than-temporary impairment losses in the years ended December 31, 2017 or 2016.

Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings.

Restricted Investment in Bank Stock

The required investments in Federal Reserve Bank stock and Federal Home Loan Bank stock are carried at cost.

1. Summary of Significant Accounting Policies (Continued)

Restricted Investment in Bank Stock (Continued)

Management evaluates the restricted stock for impairment. Management's determination of whether these investments are impaired is based on an assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as (1) the significance of the decline in net assets of the correspondent bank as compared to the capital stock amount of the correspondent bank and the length of time this situation has persisted, (2) commitments by the correspondent bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of the correspondent bank, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the correspondent bank.

Management believes no impairment charge was necessary related to the restricted investments in bank stock in 2017 or 2016.

Loans

Loans receivable that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances and any deferred fees or costs, net of an allowance for loan losses. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield (interest income) of the related loans. The Company is generally amortizing these amounts over the contractual life of the loan.

The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: real estate construction and land development, commercial real estate - owner occupied, commercial real estate, multi-family real estate, bank holding company, and hotel loans. Consumer loans consist of the following classes: residential real estate and other consumer loans.

For all classes of loans receivable, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. Past-due status is based on the contractual terms of the loan. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed and unpaid interest accrued in prior years is charged against the allowance for loan losses. Payments received on nonaccrual loans generally are either applied against principal or reported as interest income, according to management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses

The allowance for credit losses consists of the allowance for loan losses and the reserve for unfunded lending commitments. The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded lending commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the Consolidated Balance Sheet. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Because all identified losses are immediately charged off, no portion of the allowance for loan losses is restricted to any individual loan or groups of loans, and the entire allowance is available to absorb any and all loan losses.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions, and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, 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 pools of loans by loan class including commercial loans not considered impaired, as well as smaller-balance homogeneous loans, such as residential real estate. These pools of loans are evaluated for loss exposure based upon historical loss rates for each of these categories of loans, adjusted for qualitative factors. These qualitative risk factors include:

1. Purchase of loan participations (indirect lending).
2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral-dependent loans.
3. Nature and volume of the portfolio and terms of loans.
4. Volume and severity of past-due, classified, and nonaccrual loans as well as other loan modifications.
5. Existence and effect of any concentrations of credit and changes in the level of such concentrations.
6. Effect of internal factors, such as training and staffing.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Each factor is assigned a value to reflect improving, stable, or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

A majority of the Company's loan assets are loans to business owners of many types. The Bank makes commercial loans for real estate development and other business purposes required by the customer base.

The Company's credit policies determine advance rates against the different forms of collateral that can be pledged against commercial loans. Typically, the majority of loans will be limited to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable, and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. The assets financed through commercial loans are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversions of assets. Commercial real estate loans include long-term loans financing commercial properties. Repayment of this kind of loan is dependent upon either the ongoing cash flow of the borrowing entity or the resale of or lease of the subject property. Commercial real estate loans typically require a loan-to-value ratio of not greater than 80 percent, and they vary in terms.

Residential mortgage loans are secured by the borrower's residential real estate in either a first or second lien position. Residential mortgage loans have varying loan rates depending on the financial condition of the borrower and the loan-to-value ratio. Residential mortgages have amortizations up to 30 years.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

An allowance for loan losses is established for an impaired loan if its carrying value exceeds its fair value. The fair values of substantially all of the Company's impaired loans are measured based on the fair value of the loan's collateral.

For commercial loans secured by real estate, fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal, and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real-estate collateral, such as accounts receivable, inventory, and equipment, fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals, or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

1. Summary of Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate. Nonaccrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are designated as impaired.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors, and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for commercial and consumer loans. Credit quality risk ratings include regulatory classifications of Special Mention, Substandard, and Doubtful. Loans classified Special Mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified Substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified Doubtful have all the weaknesses inherent in loans classified Substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans not classified are rated Pass.

In addition, federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

Transfers of Financial Assets

Transfers of financial assets, including loan and loan participation sales, 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 Company, (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 Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Foreclosed Real Estate

Foreclosed real estate is comprised of property acquired through a foreclosure proceeding or an acceptance of a deed in lieu of foreclosure. Balances are initially reflected at the fair value less any estimated disposition costs, with subsequent adjustments made to reflect further declines in value. Any loss upon disposition of the property and holding costs, prior thereto, are charged against income.

1. Summary of Significant Accounting Policies (Continued)

Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the related assets. The estimated useful lives of the building and improvements range from 10 to 30 years, from 3 to 10 years for furniture and equipment, and 7 years for enhanced communication services equipment.

Cash Surrender Value of Life Insurance

Cash surrender value of life insurance is carried at its net cash surrender value as determined by the insurance companies. The value represents the amount of premiums invested and earnings thereon. Premiums for purchases of life insurance with a cash surrender value are capitalized. Earnings on the cash surrender value of life insurance are included in other income while expenses are recorded as a component of other expenses in the Consolidated Statement of Income.

Marketing and Promotion Expense

The Company follows the policy of charging the costs of marketing and promotion to expense as incurred and totaled \$65,000 and \$94,000 for the years ended December 31, 2017 and 2016, respectively.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

The Company accounts for uncertain tax positions if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment.

The Company and Bank recognize interest and penalties on income taxes as a component of income tax expense. With few exceptions, the Company and Bank are no longer subject to U.S. federal or state income tax examinations for years before 2014.

1. Summary of Significant Accounting Policies (Continued)

Share-Based Compensation

The share-based compensation cost includes compensation cost for all share-based payments granted based on the estimated grant date fair value. Compensation cost is recognized ratably using the straight-line attribution method over the expected vesting period or to the retirement eligibility date, if less than the vesting period when vesting is not contingent upon any future performance.

Comprehensive Income

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the Consolidated Balance Sheet, such items, along with net income, are components of other comprehensive income.

Common Stock Ownership

Ownership of the Company's common stock is limited to other depository institutions in the Continental United States. The number of shares for which an investor may subscribe is limited to 10 percent of the Company's capital and surplus. The maximum number of shares that any investor may vote is limited to 4.99 percent of the issued and outstanding shares of the Company.

Revenue Recognition

BITS recognizes enhanced communications services revenue based upon customer usage of the network and facilities as contracted. Generally these services are billed monthly and are recognized in the month the fees are earned. Installation revenue, including hardware and installation fees, is recognized when the equipment has been installed in accordance with contracted specifications and ready for customer use.

Earnings Per Share

The Company has a simple capital structure. Basic earnings per share represents net income divided by the weighted-average number of common shares outstanding of 12,361 and 12,640 for the years ended December 31, 2017 and 2016, respectively. Treasury shares are not deemed outstanding for earnings per share calculations.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the Consolidated Balance Sheet when they are funded.

Reclassifications

Certain amounts in the 2016 consolidated financial statements have been reclassified to conform to the 2017 presentation. Such reclassifications had no impact on net income or shareholders' equity.

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

3. Securities (Continued)

	2016			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available for sale				
Mortgage-backed securities:				
U.S. government-sponsored enterprises residential	\$ 64,078	\$ 272	\$ (1,111)	\$ 63,239
Private-label residential	23	-	-	23
U.S. agency securities	9,873	-	(60)	9,813
Corporate securities	<u>1,500</u>	<u>6</u>	<u>(3)</u>	<u>1,503</u>
Total	<u>\$ 75,474</u>	<u>\$ 278</u>	<u>\$ (1,174)</u>	<u>\$ 74,578</u>

	2016			
	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Held to maturity				
Obligations of states and political subdivisions	<u>\$ 13,923</u>	<u>\$ 56</u>	<u>\$ (250)</u>	<u>\$ 13,729</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

3. Securities (Continued)

The following tables reflect temporary impairment in the investment portfolio, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position for the years ended December 31, 2017 and 2016 (in thousands):

	2017					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
Mortgage-backed securities:						
U.S. government-sponsored enterprises residential	\$ 32,869	\$ (218)	\$ 17,588	\$ (451)	\$ 50,457	\$ (669)
U.S. agency securities	-	-	9,069	(55)	9,069	(55)
Total	<u>\$ 32,869</u>	<u>\$ (218)</u>	<u>\$ 26,657</u>	<u>\$ (506)</u>	<u>\$ 59,526</u>	<u>\$ (724)</u>
Held to maturity						
Obligations of states and political subdivisions	\$ 2,318	\$ (50)	\$ 2,498	\$ (86)	\$ 4,816	\$ (136)

	2016					
	Less than Twelve Months		Twelve Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Available for sale						
Mortgage-backed securities:						
U.S. government-sponsored enterprises residential	\$ 50,609	\$ (1,111)	\$ -	\$ -	\$ 50,609	\$ (1,111)
U.S. agency securities	9,783	(60)	-	-	9,783	(60)
Corporate securities	497	(3)	-	-	497	(3)
Total	<u>\$ 60,889</u>	<u>\$ (1,174)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 60,889</u>	<u>\$ (1,174)</u>
Held to maturity						
Obligations of states and political subdivisions	\$ 6,314	\$ (250)	\$ -	\$ -	\$ 6,314	\$ (250)

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

3. Securities (Continued)

Gross unrealized losses of \$860,000 at December 31, 2017, pertain to 32 securities. Management believes that unrealized losses on these debt securities were primarily the result of changes in market interest rates. No credit risk issues have been identified that cause management to believe the declines in fair value are other than temporary. Management has the intent and ability to hold these impaired securities until maturity or recovery in value, and does not anticipate that it will have to sell these securities prior to recovery.

Amortized cost and fair value at December 31, 2017, by maturity are shown below (in thousands). Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay with or without penalties.

	<u>Available for Sale</u>		<u>Held to Maturity</u>	
	<u>Amortized Cost</u>	<u>Fair Value</u>	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 834	\$ 844	\$ -	\$ -
Due after one year through five years	46,169	45,723	1,219	1,220
Due after five years through ten years	31,464	31,426	7,168	7,163
Due after ten years	-	-	3,484	3,401
Total	<u>\$ 78,467</u>	<u>\$ 77,993</u>	<u>\$ 11,871</u>	<u>\$ 11,784</u>

During the years ended December 31, 2017 and December 31, 2016, the Company did not sell any securities.

The Company had pledged investment securities with a carrying value of \$60,179,000 and \$55,143,000 to secure borrowed monies as of December 31, 2017 and 2016, respectively.

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans

The composition of loans receivable at December 31 is as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Real estate construction and land development	\$ 15,691	\$ 10,563
Commercial real estate	95,467	91,052
Commercial real estate, owner occupied	47,168	47,570
Hotels	27,846	18,061
Multi-family real estate	21,808	5,832
Bank holding company	28,061	30,385
Other	44,274	48,274
	<u>280,315</u>	<u>251,737</u>
Less:		
Deferred loan fees	265	308
Allowance for loan losses	7,971	8,389
Net loans	<u>\$ 272,079</u>	<u>\$ 243,040</u>

The following tables summarize the activity in the allowance for loan losses by loan class for the years ended December 31, 2017 and 2016, and information in regards to the allowance for loan losses and the recorded investment in loans receivable by loan class as of December 31 (in thousands):

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

	2017							
	Real Estate Construction and Land Development	Commercial Real Estate	Commercial Real Estate, Owner Occupied	Hotels	Multi-family Real Estate	Bank Holding Company	Other	Total
Beginning balance	\$ 569	\$ 3,138	\$ 1,472	\$ 603	\$ 172	\$ 920	\$ 1,515	\$ 8,389
Charge-offs	-	(462)	-	-	-	-	-	(462)
Recoveries	-	44	-	-	-	-	-	44
Provision (credit)	(8)	147	(162)	191	337	(142)	(363)	-
Ending balance	<u>\$ 561</u>	<u>\$ 2,867</u>	<u>\$ 1,310</u>	<u>\$ 794</u>	<u>\$ 509</u>	<u>\$ 778</u>	<u>\$ 1,152</u>	<u>\$ 7,971</u>
Ending balance: individually evaluated for impairment	<u>\$ 57</u>	<u>\$ 39</u>	<u>\$ 236</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 332</u>
Ending balance: collectively evaluated for impairment	<u>\$ 504</u>	<u>\$ 2,828</u>	<u>\$ 1,074</u>	<u>\$ 794</u>	<u>\$ 509</u>	<u>\$ 778</u>	<u>\$ 1,152</u>	<u>\$ 7,639</u>

The decrease in the reserve as of December 31, 2017, is the result of a reduction in environmental factors, a reduced level of the unallocated portion of reserves and lower specific reserves related to impaired loans.

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

	2016							
	Real Estate Construction and Land Development	Commercial Real Estate	Commercial Real Estate, Owner Occupied	Hotels	Multi-family Real Estate	Bank Holding Company	Other	Total
	Beginning balance	\$ 574	\$ 3,632	\$ 1,878	\$ 588	\$ 62	\$ 622	\$ 1,282
Charge-offs	-	(175)	(13)	-	-	-	-	(188)
Recoveries	-	27	-	-	-	-	2	29
Provision (credit)	(5)	(346)	(393)	15	110	298	231	(90)
Ending balance	<u>\$ 569</u>	<u>\$ 3,138</u>	<u>\$ 1,472</u>	<u>\$ 603</u>	<u>\$ 172</u>	<u>\$ 920</u>	<u>\$ 1,515</u>	<u>\$ 8,389</u>
Ending balance: individually evaluated for impairment	\$ 149	\$ -	\$ 287	\$ -	\$ -	\$ -	\$ -	\$ 436
Ending balance: collectively evaluated for impairment	\$ 420	\$ 3,138	\$ 1,185	\$ 603	\$ 172	\$ 920	\$ 1,515	\$ 7,953

The following tables present, by portfolio segment, those loans individually and collectively evaluated for impairment at December 31 (in thousands):

	2017		
	Loans Receivable		
	Ending Balance	Ending Balance: Individually Evaluated for Impairment	Ending Balance: Collectively Evaluated for Impairment
Real estate construction and land development	\$ 15,691	\$ 927	\$ 14,764
Commercial real estate	95,467	2,102	93,365
Commercial real estate, owner occupied	47,168	2,247	44,921
Hotels	27,846	-	27,846
Multi-family real estate	21,808	141	21,667
Bank holding company	28,061	-	28,061
Other	44,274	-	44,274
	<u>\$ 280,315</u>	<u>\$ 5,417</u>	<u>\$ 274,898</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

	2016		
	Loans Receivable		
	Ending	Ending	Ending
	Balance:	Balance:	Balance:
	Individually	Collectively	Collectively
	Evaluated for	Evaluated for	Evaluated for
	Impairment	Impairment	Impairment
	<u>Ending Balance</u>	<u>Ending Balance</u>	<u>Ending Balance</u>
Real estate construction and land development	\$ 10,563	\$ 927	\$ 9,636
Commercial real estate	91,052	-	91,052
Commercial real estate, owner occupied	47,570	2,648	44,922
Hotels	18,061	-	18,061
Multi-family real estate	5,832	-	5,832
Bank holding company	30,385	-	30,385
Other	48,274	17	48,257
	<u>48,274</u>	<u>17</u>	<u>48,257</u>
	\$ <u>251,737</u>	\$ <u>3,592</u>	\$ <u>248,145</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

The following tables summarize information in regards to impaired loans by loan portfolio class as of the years ended December 31 (in thousands):

	2017				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With a related allowance recorded:					
Real estate construction and land development	\$ 927	\$ 927	\$ 57	\$ 927	\$ 45
Commercial real estate	398	860	39	688	10
Commercial real estate, owner occupied	685	1,650	236	769	-
Hotels	-	-	-	-	-
Multi-family real estate	-	-	-	-	-
Bank holding company	-	-	-	-	-
Other	-	-	-	-	-
	<u>2,010</u>	<u>3,437</u>	<u>332</u>	<u>2,384</u>	<u>55</u>
With no related allowance recorded:					
Real estate construction and land development	-	-	-	-	-
Commercial real estate	1,704	1,704	-	1,729	95
Commercial real estate, owner occupied	1,562	1,607	-	1,619	26
Hotels	-	-	-	-	-
Multi-family real estate	141	141	-	71	19
Bank holding company	-	-	-	-	-
Other	-	-	-	-	-
	<u>3,407</u>	<u>3,452</u>	<u>-</u>	<u>3,419</u>	<u>140</u>
Total:					
Real estate construction and land development	927	927	57	927	45
Commercial real estate	2,102	2,564	39	2,417	105
Commercial real estate, owner occupied	2,247	3,257	236	2,388	26
Hotels	-	-	-	-	-
Multi-family real estate	141	141	-	71	19
Bank holding company	-	-	-	-	-
Other	-	-	-	-	-
	<u>\$ 5,417</u>	<u>\$ 6,889</u>	<u>\$ 332</u>	<u>\$ 5,803</u>	<u>\$ 195</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

	2016				
	<u>Recorded</u> <u>Investment</u>	<u>Unpaid</u> <u>Principal</u> <u>Balance</u>	<u>Related</u> <u>Allowance</u>	<u>Average</u> <u>Recorded</u> <u>Investment</u>	<u>Interest</u> <u>Income</u> <u>Recognized</u>
With a related allowance recorded:					
Real estate construction and land development	\$ 927	\$ 927	\$ 149	\$ 927	\$ 40
Commercial real estate	-	-	-	-	-
Commercial real estate, owner occupied	852	1,762	287	887	-
Hotels	-	-	-	-	-
Multi-family real estate	-	-	-	-	-
Bank holding company	-	-	-	-	-
Other	-	-	-	-	-
	<u>1,779</u>	<u>2,689</u>	<u>436</u>	<u>1,814</u>	<u>40</u>
With no related allowance recorded:					
Real estate construction and land development	-	-	-	-	-
Commercial real estate	-	-	-	-	-
Commercial real estate, owner occupied	1,796	1,796	-	1,960	70
Hotels	-	-	-	-	-
Multi-family real estate	-	-	-	-	-
Bank holding company	-	-	-	-	-
Other	17	17	-	27	1
	<u>1,813</u>	<u>1,813</u>	<u>-</u>	<u>1,987</u>	<u>71</u>
Total:					
Real estate construction and land development	927	927	149	927	40
Commercial real estate	-	-	-	-	-
Commercial real estate, owner occupied	2,648	3,558	287	2,847	70
Hotels	-	-	-	-	-
Multi-family real estate	-	-	-	-	-
Bank holding company	-	-	-	-	-
Other	17	17	-	27	1
	<u>\$ 3,592</u>	<u>\$ 4,502</u>	<u>\$ 436</u>	<u>\$ 3,801</u>	<u>\$ 111</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31 (in thousands):

	2017	2016
Real estate construction and land development	\$ -	\$ -
Commercial real estate	398	-
Commercial real estate, owner occupied	1,678	1,916
Hotels	-	-
Multi-family real estate	-	-
Bank holding company	-	-
Other	-	-
	<u>\$ 2,076</u>	<u>\$ 1,916</u>

The following tables present the classes of the loan portfolio summarized by the aggregate Pass rating and the classified ratings of Special Mention, Substandard, and Doubtful within the Company's internal risk rating system as of December 31 (in thousands):

		2017						
		Real Estate Construction and Land Development	Commercial Real Estate	Commercial Real Estate, Owner Occupied	Hotels	Multi-family Real Estate	Bank Holding Company	Other
Pass	\$	14,453	\$ 90,168	\$ 44,921	\$ 27,846	\$ 21,667	\$ 26,061	\$ 44,070
Special Mention		311	3,197	-	-	-	2,000	204
Substandard		927	2,102	2,247	-	141	-	-
Doubtful		-	-	-	-	-	-	-
Ending balance	\$	<u>15,691</u>	<u>\$ 95,467</u>	<u>\$ 47,168</u>	<u>\$ 27,846</u>	<u>\$ 21,808</u>	<u>\$ 28,061</u>	<u>\$ 44,274</u>
		2016						
		Real Estate Construction and Land Development	Commercial Real Estate	Commercial Real Estate, Owner Occupied	Hotels	Multi-family Real Estate	Bank Holding Company	Other
Pass	\$	9,300	\$ 84,835	\$ 44,922	\$ 18,061	\$ 5,832	\$ 28,135	\$ 48,046
Special Mention		336	6,217	-	-	-	2,250	211
Substandard		927	-	2,648	-	-	-	17
Doubtful		-	-	-	-	-	-	-
Ending balance	\$	<u>10,563</u>	<u>\$ 91,052</u>	<u>\$ 47,570</u>	<u>\$ 18,061</u>	<u>\$ 5,832</u>	<u>\$ 30,385</u>	<u>\$ 48,274</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

The performance and credit quality of the loan portfolio are also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past-due status as of December 31 (in thousands):

	2017					
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total
Real estate construction and land development	\$ -	\$ -	\$ -	\$ -	\$ 15,691	\$ 15,691
Commercial real estate	-	-	398	398	95,069	95,467
Commercial real estate, owner occupied	-	-	685	685	46,483	47,168
Hotels	-	-	-	-	27,846	27,846
Multi-family real estate	-	-	-	-	21,808	21,808
Bank holding company	-	-	-	-	28,061	28,061
Other	-	-	204	204	44,070	44,274
Total	\$ -	\$ -	\$ 1,287	\$ 1,287	\$ 279,028	\$ 280,315

	2016					
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Current	Total
Real estate construction and land development	\$ -	\$ -	\$ -	\$ -	\$ 10,563	\$ 10,563
Commercial real estate	-	-	-	-	91,052	91,052
Commercial real estate, owner occupied	-	-	-	-	47,570	47,570
Hotels	-	-	-	-	18,061	18,061
Multi-family real estate	-	-	-	-	5,832	5,832
Bank holding company	-	-	-	-	30,385	30,385
Other	956	-	211	1,167	47,107	48,274
Total	\$ 956	\$ -	\$ 211	\$ 1,167	\$ 250,570	\$ 251,737

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

4. Loans (Continued)

As of December 31, 2017, there was one loan receivable secured by stock with a balance of \$204,000 which was greater than 90 days past due and still accruing. In 2016, there was one loan receivable secured by stock with a balance of \$211,000 which was greater than 90 days past due and still accruing.

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring (TDR). The Company may modify loans through rate reductions, extensions of maturity, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrower's operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

During the year ended December 31, 2017, the terms of one multi-family real estate loan with a balance of \$141,000 were modified as a troubled debt restructuring. The loan was extended for an additional year at a below market interest rate. There were no loans modified as troubled debt restructurings that occurred during the year ended December 31, 2016. As of December 31, 2017 and 2016, there were no troubled debt restructurings that defaulted within the past 12 months.

5. Premises and Equipment

The components of premises and equipment at December 31 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Land	\$ 125	\$ 125
Building and improvements	1,530	1,507
Furniture, fixtures, and equipment	4,245	3,780
Enhanced communication services equipment	<u>2,120</u>	<u>6,047</u>
	8,020	11,459
Less accumulated depreciation	<u>(5,081)</u>	<u>(8,455)</u>
Total	<u>\$ 2,939</u>	<u>\$ 3,004</u>

Certain components of premises and equipment have been acquired using proceeds from capital leases. The amount of premises and equipment acquired using proceeds from capital leases totaled \$4,841,000 and \$8,429,000 at December 31, 2017 and 2016, respectively. The related accumulated depreciation on these assets was \$2,741,000 and \$4,035,000 at December 31, 2017 and 2016, respectively.

Depreciation expense was \$679,000 and \$1,064,000 for the years ended December 31, 2017 and 2016, respectively.

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

6. Deposits

In return for services provided by the Company, member banks are required to maintain noninterest-bearing demand deposits at the Company. In lieu of paying interest on these demand deposit accounts, the Bank provides an earnings credit to member banks to reduce the overall expense to member banks for using the Bank's services. Due to the nature of the Company's operations, it is not uncommon for the member banks demand deposit account balances to exceed \$250,000.

At December 31, 2017, the scheduled maturities of time deposits are as follows (in thousands):

Years ending December 31:

2018	\$	51,833
2019		8,775
2020		27,705
2021		19,463
2022		<u>19,717</u>
Total	\$	<u>127,493</u>

Individual time deposit accounts with balances of \$250,000 or more totaled \$30.1 million and \$25.7 million at December 31, 2017 and 2016, respectively.

7. Federal Funds

Federal funds purchased had interest rates ranging from .71 percent to 1.46 percent throughout the year ended December 31, 2017, and at December 31, 2017, the federal funds purchase rate was 1.46 percent. Federal funds are reported on a gross basis. Federal funds sold are stated as assets and federal funds purchased are stated as liabilities. Federal funds purchased had interest rates ranging from 0.46 percent to 0.71 percent throughout the year ended December 31, 2016, and at December 31, 2016, the federal funds purchase rate was 0.71 percent.

8. Borrowings

The Bank has a \$102,062,000 line of credit available through the Federal Reserve Bank (FRB) secured by a blanket floating lien on all qualifying loans. At December 31, 2017 and 2016, the Bank had no balance outstanding with the FRB on this line of credit. At both December 31, 2017 and 2016, the Bank also had \$52,400,000 available under line of credit agreements with other financial institutions. There were no advances outstanding on these lines at December 31, 2017 and 2016.

The Bank has borrowing agreements with the Federal Home Loan Bank (FHLB) of Pittsburgh consisting of 17 fixed-rate long-term advances. There are eight amortizing advances with monthly principal and interest payments. Two of the amortizing advances are for five years, two are for six years, two are for seven years, one is for four years and one is for nine years. Additionally, nine advances are non-amortizing advances with quarterly interest payments only. One of these non-amortizing advances is for four years, six are for five years, and two are for six years. The Bank is permitted to borrow provided sufficient collateral is in place. Currently, collateral is provided by pledging government securities. At December 31, 2017, the Bank had pledged collateral of \$73,939,000 to secure credit provided of \$69,938,229. The maximum borrowing capacity at December 31, 2017, based on the current fair value of collateral pledged was \$71,106,000.

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

8. Borrowings (Continued)

A summary of the long-term FHLB borrowings at December 31 is as follows (dollars in thousands):

Description	Maturity Range		Weighted- Average Interest Rate	Stated Interest Rate Range		2017	2016
	From	To		From	To		
Fixed rate nonamortizing	12/03/18	11/07/23	1.89 %	1.42 %	2.32 %	\$ 45,000	\$ 30,000
Fixed rate amortizing	04/13/18	11/24/24	1.83	1.26	2.34	<u>24,938</u>	<u>20,892</u>
	Total					<u>\$ 69,938</u>	<u>\$ 50,892</u>

A summary of the FHLB debt as of December 31, 2017, is as follows (in thousands):

2018	\$ 11,270
2019	6,029
2020	15,087
2021	12,799
2022	17,001
Thereafter	<u>7,752</u>
Total	<u>\$ 69,938</u>

9. Lease Commitments

BITS has entered into operating leases for its office and secured operating space for its enhanced communications services equipment. The leases have terms of 24 to 60 months. The Bank is a guarantor for BITS on these leases. Operating lease expense totaled \$669,000 and \$701,000 for 2017 and 2016, respectively.

Long-term lease transactions relating to the financing of equipment and other assets are accounted for as capital leases. Capital lease obligations reflect future lease payments, less an interest amount implicit in the lease.

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9. Lease Commitments (Continued)

At December 31, 2017, minimum future lease obligations under operating and capital lease obligations are as follows (in thousands):

	<u>Operating Lease Obligation</u>	<u>Capital Lease Obligation</u>
Years ending December 31:		
2018	\$ 491	\$ 897
2019	506	723
2020	534	352
2021	549	206
2022	548	111
Thereafter	<u>775</u>	<u>-</u>
Total	<u>\$ 3,403</u>	
Amounts representing interest		<u>(163)</u>
Capital lease obligation		<u>\$ 2,126</u>

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10. Income Taxes

Allocation of income tax expense is as follows for the years ended December 31 (in thousands):

	<u>2017</u>	<u>2016</u>
Current	\$ 1,698	\$ 1,762
Deferred	182	(94)
Change in corporate tax rate	<u>1,603</u>	<u>-</u>
Total	<u>\$ 3,483</u>	<u>\$ 1,668</u>

The components of the federal deferred tax assets, included in other assets, at December 31 are as follows (in thousands):

	<u>2017</u>	<u>2016</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,913	\$ 3,062
Employee benefit plans	831	1,308
Foreclosed real estate valuation allowance	-	80
Accrued unfunded commitments	149	258
Organizational costs of holding company	17	27
Investment in subsidiary	53	42
Net unrealized loss on securities available for sale	<u>114</u>	<u>327</u>
Gross deferred tax assets	<u>3,077</u>	<u>5,104</u>
Deferred tax liabilities:		
Premises and equipment	<u>-</u>	<u>29</u>
Gross deferred tax liabilities	<u>-</u>	<u>29</u>
Net deferred tax assets	<u>\$ 3,077</u>	<u>\$ 5,075</u>

Realization of deferred tax assets is dependent upon the generation of future taxable income. A valuation allowance is recognized when it is considered more likely than not that some portion of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income, and projected future taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible. Based on its assessment, management determined that no valuation allowance is necessary. The Tax Cuts and Jobs Act, enacted on December 22, 2017, lowered the Federal corporate income tax rate from a maximum 35 percent to 21 percent, effective January 1, 2018. As a result, the carrying value of net deferred tax assets was reduced, which increased income tax expense by \$1,603,000.

The differences between income taxes expected at the federal statutory rate of 34 percent and the reported income tax expense relate to tax-exempt interest income on securities and tax-exempt earnings on the cash surrender value of life insurance as well as the reduction in the corporate income tax rate. The Bank's effective income tax rates for the years ended December 31, 2017 and 2016, were 57.1 percent and 29.5 percent, respectively.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Company recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Consolidated Statement of Income.

11. Transactions with Executive Officers, Directors, and Principal Shareholders

The Bank has had, and may be expected to have in the future, transactions in the ordinary course of business with its directors, their immediate families, and their affiliated banks (commonly referred to as related parties), on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with others. As of December 31, 2017, there were two letters of credit with related parties totaling \$37,000. There were no outstanding loans to related parties at December 31, 2017 and 2016.

12. Commitments and Contingent LiabilitiesCommitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the Consolidated Balance Sheet.

The following financial instruments whose contract amounts represent credit risk were outstanding at December 31 (in thousands):

	<u>2017</u>	<u>2016</u>
Commitments to grant loans	\$ 2,937	\$ 6,099
Unfunded commitments under lines of credit and construction agreements	76,969	75,340
Standby letters of credit	<u>2,296</u>	<u>2,203</u>
Total	<u>\$ 82,202</u>	<u>\$ 83,642</u>

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

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory, and equipment.

Stand-by letters of credit are conditional commitments by the Company to guarantee the performance of a customer to a third party. The majority of these stand-by letters of credit expire within 12 months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The amount of the liability for guarantees under standby letters of credit as of December 31, 2017 and 2016, is not material.

12. Commitments and Contingent Liabilities (Continued)

Contingent Liabilities

The Company is subject to legal proceedings, claims, and litigation arising in the ordinary course of business. The Company defends itself vigorously against any such claims. Although the outcome of these matters is currently not determinable, management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on its consolidated financial position, results of operations, or cash flows.

13. Employee Benefit Plans

In 2016, the Company amended the 401(k) plan to match employee contributions at the rate of 100 percent for the first 4.0 percent of employee contributions and 50 percent on the next 4.0 percent. There were no changes to the 401(k) plan in 2017. The Company had a total expense of \$532,000 and \$475,000 for the years ended December 31, 2017 and 2016, respectively.

The Company maintains an arrangement for supplemental compensation (the Supplemental Plan) for certain of its executive officers (Executives). The Supplemental Plan provides that the Company and the Executives share in the rights to the death benefits of bank-owned split-dollar life insurance policies (BOLI Policies). The amount of the BOLI Policies has been calculated so that the projected increases in their cash surrender value will partially offset the Company's expense related to the Supplemental Plan. The Supplemental Plan is designed to provide certain Executives, upon attaining the normal retirement age, as defined within the Supplemental Plan, with projected annual distributions.

The amount of the benefit obligation is increased or decreased each year based on the service cost, interest cost, and benefits paid by the Supplemental Plan. The expense associated with the Supplemental Plan was \$294,000 and \$330,000 for the years ended December 31, 2017 and 2016, respectively. The benefit obligation associated with the Supplemental Plan was \$3,672,000 and \$3,563,000 at December 31, 2017 and 2016, respectively, and is included in other liabilities in the Consolidated Balance Sheet.

14. Regulatory Matters

Effective January 1, 2015, the Company and the Bank became subject to the final rules issued by the Federal Reserve and the OCC and subsequently adopted by the FDIC, establishing a new comprehensive capital framework for banking organizations. The new capital framework substantially revised the risk-based capital requirements in comparison to the prior rules, which were in effect through December 31, 2014. The Basel III Capital Rules introduced a new capital measure, "Common Equity Tier 1"; increased the minimum requirements for Tier 1 Capital ratio as well as the minimum to be considered well capitalized under prompt corrective action; and introduce the "capital conservation buffer", which will be phased in over a four-year period. Failure to meet minimum capital requirements can initiate certain mandatory-and possibly additional discretionary-actions by regulators that, if undertaken, could have a direct material effect on the Company's 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 U.S. GAAP, regulatory reporting requirements, and regulatory capital standards. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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14. Regulatory Matters (Continued)

Quantitative measures established by regulatory capital standards to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total and Tier 1 capital to risk-weighted assets, common equity Tier 1 capital to total risk-weighted assets, and Tier 1 capital to average assets. Management believes, as of December 31, 2017, that the Bank meets all capital adequacy requirements, including the capital conservation buffer, to which it is subject.

As of December 31, 2017 and 2016, the Bank is categorized as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based capital, Tier 1 risk-based capital, common equity Tier 1 risk-based capital, and Tier 1 leverage ratios of at least 10 percent, 8 percent, 6.5 percent, and 5 percent, respectively.

The Bank's actual capital amounts and ratios at December 31 are presented below (dollars in thousands):

	2017		2016	
	Amount	Ratio	Amount	Ratio
<u>Total capital</u> <u>(to risk-weighted assets)</u>				
Actual	\$ 83,949	22.81 %	\$ 81,012	23.83 %
For capital adequacy purposes	29,455	8.00	27,191	8.00
To be well capitalized	36,818	10.00	33,989	10.00
<u>Tier 1 capital</u> <u>(to risk-weighted assets)</u>				
Actual	\$ 79,799	21.68 %	\$ 77,032	22.66 %
For capital adequacy purposes	22,091	6.00	20,393	6.00
To be well capitalized	29,455	8.00	27,191	8.00
<u>Common equity Tier 1 capital</u> <u>(to risk-weighted assets)</u>				
Actual	\$ 79,799	21.68 %	\$ 77,032	22.66 %
For capital adequacy purposes	16,568	4.50	15,295	4.50
To be well capitalized	23,932	6.50	22,093	6.50
<u>Tier 1 capital</u> <u>(to average assets)</u>				
Actual	\$ 79,799	12.51 %	\$ 77,032	12.61 %
For capital adequacy purposes	25,521	4.00	24,427	4.00
To be well capitalized	31,902	5.00	30,533	5.00

The Company's capital amounts and ratios are not significantly different than the Bank's capital amounts and ratios as of December 31, 2017.

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations, including maintaining the capital ratios referenced above.

15. Fair Value Measurements

Management uses its best judgment in estimating the fair value of the Company's financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts the Bank could have realized in a sales transaction on the dates indicated. The estimated fair value amounts have been measured as of their respective year-ends and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the estimated fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each year-end.

Fair value is defined as the price that would be received to sell the asset or transfer the liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. Additional guidance is provided in determining fair value when the volume and level of activity for the asset or liability has significantly decreased, including guidance on identifying circumstances when a transaction may not be considered orderly.

A reporting entity should determine whether there has been a significant decrease in the volume and level of activity for the asset or liability in relation to normal market activity for the asset or liability. When the reporting entity concludes there has been a significant decrease in the volume and level of activity for the asset or liability, further analysis of the information from that market is needed and significant adjustments to the related prices may be necessary to estimate fair value.

A reporting entity must determine if the decrease in the volume and level of activity for the asset or liability, suggest the transactions may not be orderly. In those situations, the entity must evaluate the weight of the evidence to determine whether the transaction is orderly, considering the circumstances that indicate that a transaction is not orderly. A transaction price that is not associated with an orderly transaction is given little, if any, weight when estimating fair value.

The guidance establishes a fair value hierarchy that prioritizes the inputs to valuation methods used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level I measurements) and the lowest priority to unobservable inputs (Level III measurements). The three levels of the fair value hierarchy are as follows:

Level I: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level II: Quoted prices in markets that are not active, or inputs that are observable either directly or indirectly, for substantially the full term of the asset or liability.

Level III: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported with little or no market activity).

An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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15. Fair Value Measurements (Continued)

For financial assets and liabilities measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used at December 31 are as follows (in thousands):

	2017			
	Level I	Level II	Level III	Total
Assets measured at fair value on a recurring basis:				
Mortgage-backed securities:				
U.S. government-sponsored enterprises residential	\$ -	\$ 65,350	\$ -	\$ 65,350
Private-label residential	-	5	-	5
U.S. agency securities	-	9,069	-	9,069
Corporate securities	-	3,569	-	3,569
Total	<u>\$ -</u>	<u>\$ 77,993</u>	<u>\$ -</u>	<u>\$ 77,993</u>

	2016			
	Level I	Level II	Level III	Total
Assets measured at fair value on a recurring basis:				
Mortgage-backed securities:				
U.S. government-sponsored enterprises residential	\$ -	\$ 63,239	\$ -	\$ 63,239
Private-label residential	-	23	-	23
U.S. agency securities	-	9,813	-	9,813
Corporate securities	-	1,503	-	1,503
Total	<u>\$ -</u>	<u>\$ 74,578</u>	<u>\$ -</u>	<u>\$ 74,578</u>

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31 are as follows (in thousands):

	2017			
	Level I	Level II	Level III	Total
Assets measured at fair value on a nonrecurring basis:				
Impaired loans	\$ -	\$ -	\$ 1,678	\$ 1,678

	2016			
	Level I	Level II	Level III	Total
Assets measured at fair value on a nonrecurring basis:				
Impaired loans	\$ -	\$ -	\$ 1,343	\$ 1,343
Foreclosed real estate	-	-	489	489

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15. Fair Value Measurements (Continued)

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis which the Company has utilized Level III inputs to determine the fair value at December 31 (in thousands):

2017					
Quantitative Information About Level III Fair Value Measurements					
	Estimate	Valuation Techniques	Unobservable Inputs	Range	Weighted Average
Impaired loans	\$ 1,678	Appraisal of collateral (1)	Appraisal adjustments (2)	10% - 65%	40%
Foreclosed real estate	\$ -	Appraisal of collateral (1)	Appraisal adjustments (2)	100% - 100%	100%
2016					
Quantitative Information About Level III Fair Value Measurements					
	Estimate	Valuation Techniques	Unobservable Inputs	Range	Weighted Average
Impaired loans	\$ 1,343	Appraisal of collateral (1)	Appraisal adjustments (2)	46% - 67%	56%
Foreclosed real estate	\$ 489	Appraisal of collateral (1)	Appraisal adjustments (2)	16% - 100%	49%

(1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level III inputs, which are not identifiable.

(2) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated liquidation expenses. The range of liquidation expenses and other appraisal adjustments are presented as a percent of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Bank's financial instruments at December 31, 2017 and 2016:

Cash and Cash Equivalents (Carried at Cost)

The carrying amounts reported in the Consolidated Balance Sheet for cash and short-term instruments approximate those assets' fair values.

15. Fair Value Measurements (Continued)

Securities

The fair value of securities available for sale (carried at fair value) and held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level I), or matrix pricing (Level II), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark-quoted prices.

Loans Receivable (Carried at Cost)

The fair values of loans are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments, and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Generally Carried at Fair Value)

Impaired loans are those that are accounted for under FASB ASC 310-10-35, in which the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level III fair values, based upon the lowest level of input that is significant to the fair value measurements. At December 31, 2017, the fair value consists of the loan balances of \$2,010,000, net of valuation allowances of \$332,000. At December 31, 2016, the fair value consists of the loan balances of 1,779,000, net of valuation allowances of \$436,000.

Restricted Investment in Regulatory Bank Stock (Carried at Cost)

The carrying amount of restricted investment in regulatory bank stock approximates fair value, and considers the limited marketability of such securities.

Accrued Interest Receivable and Payable (Carried at Cost)

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

Cash Surrender Value of Life Insurance

The carrying amount of cash surrender value of life insurance approximates fair value and represents the cash surrender value of bank-owned life insurance policies.

Foreclosed Real Estate (Generally Carried at Lower of Cost or Fair Value)

Foreclosed real estate is adjusted to fair value less costs to dispose upon transfer of a loan to foreclosed real estate. Subsequently, foreclosed real estate is carried at the lower of carrying value or fair value less costs to dispose. Fair value is generally based on current appraisals, comparable sales, and other estimates of value principally obtained from third parties. However, management considers other recent developments that could result in adjustments to collateral value and, as such, are classified as Level III within the fair value hierarchy.

15. Fair Value Measurements (Continued)

Deposit Liabilities (Carried at Cost)

The fair values disclosed for noninterest-bearing demand deposits (including escrow accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on time deposits to a schedule of aggregated expected monthly maturities on time deposits.

Federal Funds Purchased (Carried at Cost)

The carrying amounts of federal funds purchased approximate their fair values.

Federal Home Loan Bank Advances (Carried at Cost)

Fair values of long-term borrowings are estimated using discounted cash flow analysis, based on rates currently available to the Bank for advances from the FHLB with similar terms and remaining maturities.

Off-Balance Sheet Financial Instruments (Disclosed at Cost)

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

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15. Fair Value Measurements (Continued)

The estimated fair values of the Company's financial instruments were as follows at December 31 (in thousands):

	2017				
	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	\$ 240,133	240,133	\$ 240,133	\$ -	\$ -
Investment securities:					
Available for sale	77,993	77,993	-	77,993	-
Held to maturity	11,871	11,784	-	11,784	-
Loans, less allowance for loan losses	272,079	271,212	-	-	271,212
Cash surrender value of life insurance	21,161	21,161	21,161	-	-
Accrued interest receivable	1,075	1,075	1,075	-	-
Restricted investment in regulatory bank stock	3,458	3,458	3,458	-	-
Financial liabilities:					
Noninterest-bearing					
demand deposits	\$ 247,435	\$ 247,435	\$ 247,435	\$ -	\$ -
Money market deposits	9,515	9,515	9,515	-	-
Time deposits	127,493	126,561	-	-	126,561
Escrow accounts	5,436	5,436	5,436	-	-
Federal funds purchased	87,247	87,247	87,247	-	-
Federal Home Loan Bank advances	69,938	68,954	-	-	68,954
Accrued interest payable	204	204	204	-	-
2016					
	Carrying Value	Fair Value	Level I	Level II	Level III
Financial assets:					
Cash and cash equivalents	\$ 243,689	\$ 243,689	\$ 243,689	\$ -	\$ -
Investment securities:					
Available for sale	74,578	74,578	-	74,578	-
Held to maturity	13,923	13,729	-	13,729	-
Loans, less allowance for loan losses	243,040	244,064	-	-	244,064
Cash surrender value of life insurance	20,664	20,664	20,664	-	-
Accrued interest receivable	938	938	938	-	-
Restricted investment in regulatory bank stock	2,691	2,691	2,691	-	-
Financial liabilities:					
Noninterest-bearing					
demand deposits	\$ 249,291	\$ 249,291	\$ 249,291	\$ -	\$ -
Money market deposits	9,972	9,972	9,972	-	-
Time deposits	88,940	89,080	-	-	89,080
Escrow accounts	21,348	21,348	21,348	-	-
Federal funds purchased	103,939	103,939	103,939	-	-
Federal Home Loan Bank advances	50,892	50,292	-	-	50,292
Accrued interest payable	85	85	85	-	-

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16. Accumulated Other Comprehensive Income (Loss)

The following table presents the changes in accumulated other comprehensive income (loss) by component net of tax for years ended December 31, 2017 and 2016 (in thousands):

	Unrealized Gains on Available-for-Sale Securities
Balance as of December 31, 2016	\$ (568)
Other comprehensive income	267
Reclassification for the change in corporate tax rate	(59)
Balance as of December 31, 2017	<u>\$ (360)</u>
	Unrealized Gains on Available-for-Sale Securities
Balance as of December 31, 2015	\$ 96
Other comprehensive loss	(664)
Balance as of December 31, 2016	<u>\$ (568)</u>

There were no amounts reclassified out of accumulated other comprehensive income (loss) for the years ended December 31, 2017 and 2016.

Atlantic Community Bancshares, Inc. and Subsidiary

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17. ACBB-BITS, LLC Only Financial Information

The following represents ACBB-BITS, LLC condensed financial information as of the years ended December 31
(in thousands):

BALANCE SHEET

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and cash equivalents	\$ 868	\$ 1,225
Accounts receivable, net	454	543
Prepaid expenses	730	936
Inventories	499	482
Premises and equipment, net	<u>2,239</u>	<u>2,311</u>
TOTAL ASSETS	\$ <u>4,790</u>	\$ <u>5,497</u>
LIABILITIES AND MEMBERS' EQUITY		
LIABILITIES		
Capital lease obligations	\$ 2,126	\$ 2,427
Advances from the Bank	-	600
Other liabilities	<u>2,496</u>	<u>2,191</u>
TOTAL LIABILITIES	4,622	5,218
MEMBERS' EQUITY	<u>168</u>	<u>279</u>
TOTAL LIABILITIES AND MEMBERS' EQUITY	\$ <u>4,790</u>	\$ <u>5,497</u>

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17. ACBB-BITS, LLC Only Financial Information (Continued)

STATEMENT OF OPERATIONS AND MEMBERS' EQUITY

	<u>2017</u>	<u>2016</u>
INCOME		
Enhanced Communications Services revenue	\$ 17,472	\$ 16,557
Installation revenue	3,749	3,604
Contract termination	490	493
Direct costs of revenue	(12,345)	(11,867)
Gross profit	<u>9,366</u>	<u>8,787</u>
EXPENSES		
Salaries and employee benefits	6,328	5,927
Occupancy and equipment	1,014	1,435
Professional and subcontracted services	407	420
Interest expense on loans from the Bank	10	21
Interest expense on capital lease obligations	117	130
Loss on disposal of property and equipment	449	-
Other	761	610
Total expenses	<u>9,086</u>	<u>8,543</u>
Net income	280	244
Distributions to members	(323)	(578)
Contributions from members	64	21
Members' unit exercised	-	5
Members' unit repurchased	(132)	(50)
Members' equity, January 1	<u>279</u>	<u>637</u>
Members' equity	<u>\$ 168</u>	<u>\$ 279</u>

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17. ACBB-BITS, LLC Only Financial Information (Continued)

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 280	\$ 244
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	555	953
Amortization	896	725
Loss on disposition of property and equipment	449	-
Decrease in accounts receivable	73	103
Increase in prepaid expenses	(386)	(164)
Increase in other assets	(16)	(91)
Increase (decrease) in other liabilities	320	(49)
Net cash provided by operating activities	<u>2,171</u>	<u>1,721</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of premises and equipment	(24)	(6)
Net cash used for investing activities	<u>(24)</u>	<u>(6)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
(Decrease) increase in advances from the Bank	(600)	350
Member units exercised	-	5
Member units repurchased	(132)	(50)
Distributions to members	(323)	(578)
Contributions from members	64	21
Repayments on capital lease obligations	(1,513)	(1,195)
Net cash used for financing activities	<u>(2,504)</u>	<u>(1,447)</u>
(Decrease) increase in cash	(357)	268
CASH AT BEGINNING OF PERIOD	<u>1,225</u>	<u>957</u>
CASH AT END OF PERIOD	<u>\$ 868</u>	<u>\$ 1,225</u>
SUPPLEMENTARY CASH FLOWS INFORMATION		
Equipment acquired under capital leases	<u>\$ 1,213</u>	<u>\$ 1,456</u>

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

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18. Members' Equity and Voting Structure

As outlined in the BITS operating agreement, the membership interests in BITS consist of Class A, Class B, Class C, and Class D membership units.

The membership units and voting structure of BITS are as follows at December 31, 2017 and 2016:

2017	Number of Units		Ownership Percentage	Voting Rights
	Authorized	Issued		
Class A is for bankers banks and community banks	2,500,000	2,500,000	25.00 %	25.00 %
Classes B and C are for Bank and BITS employees, respectively	7,500,000	1,925,000	75.00	0.00
Class D (a special unit) is for the Bank	<u>1</u>	<u>1</u>	<u>0.00</u>	<u>75.00</u>
	<u>10,000,001</u>	<u>4,425,001</u>	<u>100.00 %</u>	<u>100.00 %</u>
2016	Number of Units		Ownership Percentage	Voting Rights
	Authorized	Issued		
Class A is for bankers banks and community banks	2,500,000	2,500,000	25.00 %	25.00 %
Classes B and C are for Bank and BITS employees, respectively	7,500,000	4,675,000	75.00	0.00
Class D (a special unit) is for the Bank	<u>1</u>	<u>1</u>	<u>0.00</u>	<u>75.00</u>
	<u>10,000,001</u>	<u>7,175,001</u>	<u>100.00 %</u>	<u>100.00 %</u>

All 2,500,000 Class A membership units were initially issued to the Bank. At December 31, 2017 and 2016, the Bank owned 2,380,000 of the membership units with the other membership units having been sold to bankers banks and community banks. The Bank sold none of its Class A membership units in 2017 and 2016. In 2017, there were no Class B membership unit options exercised, and in 2016, 25,000 Class B membership units were exercised, generating total profits of \$5,000. In 2017 and 2016, there were no Class C membership unit options exercised.

Atlantic Community Bancshares, Inc. and Subsidiary

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19. Stock Option Plans

In 2007, the Bank approved the ACBB-BITS, LLC Membership Unit Benefits Plan for Employees of ACBB (ACBB Plan) and the ACBB-BITS, LLC Membership Unit Benefits Plan for Employees of ACBB-BITS, LLC (BITS Plan). These plans were created to enable employees of the Bank and BITS to participate in the long-term success and growth of BITS. The chief executive officer of the Bank serves as the manager of both the ACBB Plan and the BITS Plan (Plan Manager).

Under the ACBB Plan, there were originally 2,500,000 Class B membership available for grant. All employees of the Bank are eligible, but not entitled, to receive options to purchase Class B membership units at a price per share as determined at the date of grant by the Plan Manager; however, this price shall not be less than fair value on the date the option is granted. Options granted under the ACBB Plan vest as determined by the Plan Manager coincident with each option grant and are exercisable as determined by the Plan Manager. For 2017 and 2016, the weighted-average grant-date fair value for the stock options granted was not material to the financial statements.

The fair values were estimated using the Black-Scholes model. Information regarding the ACBB Plan is as follows:

	2017			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life	Aggregate Intrinsic Value
Outstanding at the beginning of the year	-	\$ -		\$ -
Granted	-	-		-
Exercised	-	-		-
Forfeited	-	-		-
Outstanding and exercisable at the end of the year	-	\$ -		\$ -
Options available for grant	<u>1,500,000</u>			

	2016			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life	Aggregate Intrinsic Value
Outstanding at the beginning of the year	-	\$ -		\$ -
Granted	25,000	0.20	10 years	-
Exercised	(25,000)	0.20		-
Forfeited	-	-		-
Outstanding and exercisable at the end of the year	-	\$ -		\$ -
Options available for grant	<u>1,500,000</u>			

Atlantic Community Bancshares, Inc. and Subsidiary

Notes to Consolidated Financial Statements

December 31, 2017 and 2016

19. Stock Option Plans (Continued)

Under the BITS Plan, there were originally 5,000,000 Class C membership available for grant. All employees of BITS are eligible, but not entitled, to receive options to purchase Class C membership units at a price per share as determined at the date of grant by the Plan Manager; however, this price will not be less than fair market value on the date the option is granted. Options granted under the BITS Plan vest as determined by the Plan Manager coincident with each option grant and are exercisable as determined by the Plan Manager. For 2017 and 2016, the weighted-average grant-date fair value for the stock options granted was not material to the financial statements. The fair values were estimated using the Black-Scholes model. Information regarding the BITS Plan is as follows:

	2017			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life	Aggregate Intrinsic Value
Outstanding at the beginning of the year	455,000	\$ 0.23	3.8 years	\$ -
Granted	240,000	0.21	5.0 years	-
Exercised	-	-		-
Expired	(15,000)	0.30		-
Forfeited	-	-		-
Outstanding and exercisable at the end of the year	<u>680,000</u>	0.23	3.0 years	-
Options available for grant	<u>3,395,000</u>			

	2016			
	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life	Aggregate Intrinsic Value
Outstanding at the beginning of the year	370,000	\$ 0.23	2.8 years	\$ -
Granted	240,000	0.20	5.0 years	-
Exercised	-	-		-
Expired	(155,000)	0.19		-
Forfeited	-	-		-
Outstanding and exercisable at the end of the year	<u>455,000</u>	0.23	3.8 years	-
Options available for grant	<u>870,000</u>			

20. Subsequent Events

On January 1, 2018, Atlantic Community Bancshares (ACBI) completed its acquisition of BBN Financial Corporation (BBNFC) and its wholly-owned subsidiary Bankers Bank Northeast (BBN) pursuant to a previously announced definitive merger agreement. BBNFC was merged with and into ACBI immediately followed by the merger of BBN with and into Atlantic Community Bankers Bank (ACBB).

20. Subsequent Events (Continued)

Under the terms of the merger agreement, ACBI acquired 100% of the stock of BBNFC and BBNFC shareholders received .2578 shares of ACBI's common stock in exchange for each share of BBNFC common stock they owned immediately prior to the merger and cash for any fractional shares based on per share consideration of \$7,081.87. ACBI issued approximately 2,404 shares its common stock in the merger and the aggregate merger consideration was approximately \$17.2 million.

BBN's principal office in Glastonbury, CT was retained as the regional office for ACBB's operations in New England and New York. As of December 31, 2017 BBNFC had total consolidated assets of \$166.3 million, total loans of \$43.4 million and total deposits of \$144.5 million.

Merger related costs were \$205,000 for the year ended December 31, 2017. These costs were primarily in professional fees and other on the consolidated statement of income. The systems integration of BBN into ACBB is scheduled for April 5, 2018. Management is still in the process of determining the fair value adjustments that will be applied as part of the business combination accounting.

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2017, for items that should potentially be recognized or disclosed in these financial statements. The evaluation was conducted through March 23, 2018, the date these financial statements were available to be issued.