FIRST UNITED CORP/MD/
Form 10-K
March 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2017

Commission file number 0-14237

FIRST UNITED CORPORATION
(Exact name of registrant as specified in its charter)

Maryland	**52-1380770**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification Number)*

19 South Second Street, Oakland, Maryland	**21550-0009**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(800) 470-4356**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class:	Name of Each Exchange on Which Registered:
Common Stock, par value $.01 per share	**NASDAQ Global Select Market**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark if disclosures of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "accelerated filer", "large accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act). (check one):

Large accelerated filer ¨	Accelerated filer þ	Non-accelerated filer ¨	Smaller reporting company ¨
Emerging growth company ¨			

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).Yes ¨ No þ

The aggregate market value of the registrant's outstanding voting and non-voting common equity held by non-affiliates as of June 30, 2017: **$85,358,102.**

The number of shares of the registrant's common stock outstanding as of February 28, 2018: **7,067,425.**

Documents Incorporated by Reference

Portions of the registrant's definitive proxy statement for the 2018 Annual Meeting of Shareholders to be filed with the SEC pursuant to Regulation 14A are incorporated by reference into Part III of this Annual Report on Form 10-K.

First United Corporation

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Explanatory Note

First United Corporation (the "Corporation" and "we", "our" or "us" on a consolidated basis) has determined that, as of December 31, 2017, it is an "accelerated filer" as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As of December 31, 2016, the Corporation was a "smaller reporting company" as defined by Rule 12b-2. In accordance with Item 10(f)(2)(i) of Regulation S-K, the Corporation has chosen to provide the scaled disclosures permitted for a smaller reporting company in this Annual Report on Form 10-K for the year ended December 31, 2017 and will provide non-scaled larger reporting company disclosure beginning with its Quarterly Report on Form 10-Q for the quarter ending March 31, 2018.

Forward-Looking Statements

This Annual Report on Form 10-K of the Corporation contains forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Such statements include projections, predictions, expectations or statements as to beliefs or future events or results or refer to other matters that are not historical facts. Forward-looking statements are subject to known and unknown risks, uncertainties and other factors that could cause the actual results to differ materially from those contemplated by the statements. The forward-looking statements contained in this annual report are based on various factors and were derived using numerous assumptions. In some cases, you can identify these forward-looking statements by words like "may", "will", "should", "expect", "plan", "anticipate", "intend", "believe", "estimate", "predict", "potential", or "continue" or the negative of those words and other comparable word You should be aware that those statements reflect only our predictions. If known or unknown risks or uncertainties should materialize, or if underlying assumptions should prove inaccurate, actual results could differ materially from past results and those anticipated, estimated or projected. You should bear this in mind when reading this annual report and not place undue reliance on these forward-looking statements. Factors that might cause such differences include, but are not limited to:

- changes in market rates and prices may adversely impact the value of securities, loans, deposits and other financial instruments and the interest rate sensitivity of our balance sheet;
- our liquidity requirements could be adversely affected by changes in our assets and liabilities;
- the effect of legislative or regulatory developments, including changes in laws concerning taxes, banking, securities, insurance and other aspects of the financial services industry;
- competitive factors among financial services organizations, including product and pricing pressures and our ability to attract, develop and retain qualified banking professionals;

- the effect of changes in accounting policies and practices, as may be adopted by the Financial Accounting Standards Board (the “FASB”), the Securities and Exchange Commission (the “SEC”), and other regulatory agencies; and

- the effect of fiscal and governmental policies of the United States federal government.

You should also consider carefully the risk factors discussed in Item 1A of Part I of this annual report, which address additional factors that could cause our actual results to differ from those set forth in the forward-looking statements and could materially and adversely affect our business, operating results and financial condition. The risks discussed in this annual report are factors that, individually or in the aggregate, management believes could cause our actual results to differ materially from expected and historical results. You should understand that it is not possible to predict or identify all such factors. Consequently, you should not consider such disclosures to be a complete discussion of all potential risks or uncertainties.

The forward-looking statements speak only as of the date on which they are made, and, except to the extent required by federal securities laws, we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which the statement is made or to reflect the occurrence of unanticipated events. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

ITEM 1. BUSINESS

General

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered with the Board of Governors of the Federal Reserve System (the “Federal Reserve”) under the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Corporation’s primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company with commercial banking powers (the “Bank”), First United Statutory Trust I, a Connecticut statutory business trust (“Trust I”), First United Statutory Trust II, a Connecticut statutory business trust (“Trust II” and together with Trust I, the “Trusts”), and First United Statutory Trust III, a Delaware statutory business trust (“Trust III”). Trust I, Trust II and Trust III were formed for the purpose of selling trust preferred securities that qualified as Tier 1 capital.

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The Bank has four wholly-owned subsidiaries: OakFirst Loan Center, Inc., a West Virginia finance company; OakFirst Loan Center, LLC, a Maryland finance company (collectively, the “OakFirst Loan Centers”); First OREO Trust, a Maryland statutory trust; and FUBT OREO I, LLC, a Maryland limited liability company. The OakFirst Loan Centers are consumer financial companies, and First OREO Trust and FUBT OREO I, LLC were formed for the purpose of holding, servicing and disposing of the real estate that the Bank acquires through foreclosure or by deed in lieu of foreclosure. The Bank also owns 99.9% of the limited partnership interests in Liberty Mews Limited Partnership, a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing units in Garrett County, Maryland.

At December 31, 2017, we had total assets of $1.3 billion, net loans of $882.5 million, and deposits of $1.0 billion. Shareholders’ equity at December 31, 2017 was $108.4 million.

The Corporation maintains an Internet website at www.mybank.com on which it makes available, free of charge, its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and all amendments to the foregoing as soon as reasonably practicable after these reports are electronically filed with, or furnished to, the SEC.

Banking Products and Services

The Bank operates 24 banking offices, one customer care center and 26 Automated Teller Machines (“ATMs”) in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Mineral County, Berkeley County Monongalia County and Harrison County in West Virginia. The Bank is an independent community bank providing a complete range of retail and commercial banking services to businesses and individuals in its market areas. Services offered are essentially the same as those offered by the regional institutions that compete with the Bank and include checking, savings, money market deposit accounts, and certificates of deposit, business loans, personal loans, mortgage loans, lines of credit, and consumer-oriented retirement accounts including individual retirement accounts (“IRAs”) and employee benefit accounts. In addition, the Bank provides full brokerage services through a networking arrangement with Cetera Investment Services, LLC., a full service broker-dealer. The Bank also provides safe deposit and night depository facilities, insurance products and trust services. The Bank’s deposits are insured by the Federal Deposit Insurance Corporation (the “FDIC”).

Lending Activities

Our lending activities are conducted through the Bank. Since 2010, the Bank has not originated any new loans through the OakFirst Loan Centers and their sole activity is servicing existing loans.

The Bank's commercial loans are primarily secured by real estate, commercial equipment, vehicles or other assets of the borrower. Repayment is often dependent on the successful business operations of the borrower and may be affected by adverse conditions in the local economy or real estate market. The financial condition and cash flow of commercial borrowers is therefore carefully analyzed during the loan approval process, and continues to be monitored throughout the duration of the loan by obtaining business financial statements, personal financial statements and income tax returns. The frequency of this ongoing analysis depends upon the size and complexity of the credit and collateral that secures the loan. It is also the Bank's general policy to obtain personal guarantees from the principals of the commercial loan borrowers.

Commercial real estate ("CRE") loans are primarily those secured by land for residential and commercial development, agricultural purpose properties, service industry buildings such as restaurants and motels, retail buildings and general purpose business space. The Bank attempts to mitigate the risks associated with these loans through low loan to value ratio standards, thorough financial analyses, and management's knowledge of the local economy in which the Bank lends.

The risk of loss associated with CRE construction lending is controlled through conservative underwriting procedures such as loan to value ratios of 80% or less, obtaining additional collateral when prudent, analysis of cash flows, and closely monitoring construction projects to control disbursement of funds on loans.

The Bank's residential mortgage portfolio is distributed between variable and fixed rate loans. Some loans are booked at fixed rates in order to meet the Bank's requirements under the federal Community Reinvestment Act (the "CRA") or to complement our asset liability mix. Other fixed rate residential mortgage loans are originated in a brokering capacity on behalf of other financial institutions, for which the Bank receives a fee. As with any consumer loan, repayment is dependent on the borrower's continuing financial stability, which can be adversely impacted by factors such as job loss, divorce, illness, or personal bankruptcy. Residential mortgage loans exceeding an internal loan-to-value ratio require private mortgage insurance. Title insurance protecting the Bank's lien priority, as well as fire and casualty insurance, is also required.

Home equity lines of credit, included within the residential mortgage portfolio, are secured by the borrower's home and can be drawn on at the discretion of the borrower. These lines of credit are at variable interest rates.

The Bank also provides residential real estate construction loans to builders and individuals for single family dwellings. Residential construction loans are usually granted based upon "as completed" appraisals and are secured by the property under construction. Site inspections are performed to determine pre-specified stages of completion before loan proceeds are disbursed. These loans typically have maturities of six to twelve months and may have a fixed or variable rate. Permanent financing for individuals offered by the Bank includes fixed and variable rate loans with five, seven or ten-year adjustable rate mortgages.

A variety of other consumer loans are also offered to customers, including indirect and direct auto loans, and other secured and unsecured lines of credit and term loans. Careful analysis of an applicant's creditworthiness is performed before granting credit, and on-going monitoring of loans outstanding is performed in an effort to minimize risk of loss by identifying problem loans early.

An allowance for loan losses is maintained to provide for probable losses from our lending activities. A complete discussion of the factors considered in determination of the allowance for loan losses is included in Item 7 of Part II of this report.

Deposit Activities

The Bank offers a full array of deposit products including checking, savings and money market accounts, regular and IRA certificates of deposit, Christmas Savings accounts, College Savings accounts, and Health Savings accounts. The Bank also offers the Certificate of Deposit Account Registry Service®, or CDARS®, program to municipalities, businesses, and consumers through which the Bank provides access to multi-million-dollar certificates of deposit and the Insured Cash Sweep®, or ICS®, program to municipalities, businesses, and consumers through which the Bank provides access to multi-million-dollar savings and demand deposits. Both programs are FDIC-insured. In addition, we offer our commercial customers packages which include Treasury Management, Cash Sweep and various checking opportunities.

Information about our income from and assets related to our banking business may be found in the Consolidated Statements of Financial Condition and the Consolidated Statements of Income and the related notes thereto included in Item 8 of Part II of this annual report.

Wealth Management

The Bank's Trust Department offers a full range of trust services, including personal trust, investment agency accounts, charitable trusts, retirement accounts including IRA roll-overs, 401(k) accounts and defined benefit plans, estate administration and estate planning.

At December 31, 2017 and 2016, the total market value of assets under the supervision of the Bank's Trust Department was approximately $824 million and $740 million, respectively. Trust Department revenues for these years may be found in the Consolidated Statements of Income under the heading "Other operating income", which is contained in Item 8 of Part II of this annual report.

COMPETITION

The banking business, in all of its phases, is highly competitive. Within our market areas, we compete with commercial banks, (including local banks and branches or affiliates of other larger banks), savings and loan associations and credit unions for loans and deposits, with consumer finance companies for loans, and with other financial institutions for various types of products and services, including trust services. There is also competition for commercial and retail banking business from banks and financial institutions located outside our market areas and on the internet.

The primary factors in competing for deposits are interest rates, personalized services, the quality and range of financial services, convenience of office locations and office hours. The primary factors in competing for loans are interest rates, loan origination fees, the quality and range of lending services and personalized services.

To compete with other financial services providers, we rely principally upon local promotional activities, personal relationships established by officers, directors and employees with customers, and specialized services tailored to meet customers' needs. In those instances in which we are unable to accommodate a customer's needs, we attempt to arrange for those services to be provided by other financial services providers with which we have a relationship.

The following table sets forth deposit data for the Maryland and West Virginia Counties in which the Bank maintains offices as of June 30, 2017, the most recent date for which comparative information is available.

	Offices (in Market)	Deposits (in thousands)	Market Share
Allegany County, Maryland:			
Branch Banking and Trust Company	7	$315,219	43.95 %
Manufacturers & Traders Trust Company	6	163,666	22.82 %
First United Bank & Trust	3	134,084	18.69 %
Standard Bank, PaSB	2	58,999	8.23 %
PNC Bank NA	1	45,287	6.31 %

Source: FDIC Deposit Market Share Report

Frederick County, Maryland:			
PNC Bank NA	16	$1,225,933	26.81 %
Branch Banking & Trust Co.	12	762,685	16.68 %
Bank Of America NA	5	475,921	10.41 %
Frederick County Bank	5	348,262	7.62 %
Capital One NA	4	307,085	6.72 %
Manufacturers & Traders Trust Company	6	306,088	6.70 %
Woodsboro Bank	7	205,746	4.50 %
Middletown Valley Bank	4	171,502	3.75 %
First United Bank & Trust	4	165,362	3.62 %
Sandy Spring Bank	4	147,389	3.22 %
Revere Bank	1	144,700	3.17 %
SunTrust Bank	2	131,174	2.87 %
Wells Fargo Bank NA	1	70,434	1.54 %
The Columbia Bank	2	43,952	0.96 %
Damascus Community Bank	2	32,650	0.71 %
SONABANK	1	32,096	0.70 %
Woodforest National Bank	1	1,064	0.02 %

Source: FDIC Deposit Market Share Report

Garrett County, Maryland:			
First United Bank & Trust	5	$332,518	57.91 %
Manufacturers & Traders Trust Company	3	90,440	15.75 %
Branch Banking and Trust Company	2	82,184	14.31 %
Clear Mountain Bank	1	50,811	8.85 %
Somerset Trust Company	1	12,160	2.12 %
Miners & Merchants Bank	1	6,075	1.06 %

Source: FDIC Deposit Market Share Report

Washington County, Maryland:			
Branch Banking & Trust Company	12	$634,922	28.78 %
The Columbia Bank	9	510,959	23.16 %
Manufacturers & Traders Trust Company	10	427,998	19.40 %
PNC Bank NA	4	222,524	10.09 %
Middletown Valley Bank	2	111,998	5.08 %
First United Bank & Trust	3	89,058	4.04 %
United Bank	2	84,072	3.81 %
CNB Bank, Inc.	3	61,811	2.80 %
Orrstown Bank	1	33,764	1.53 %
Bank of Charles Town	1	20,522	0.93 %
Jefferson Security Bank	1	8,249	0.38 %

Source: FDIC Deposit Market Share Report

Berkeley County, West Virginia:			
Branch Banking & Trust Company	5	$367,733	27.28 %
United Bank	4	258,350	19.17 %
MVB Bank Inc.	4	204,666	15.18 %
City National Bank of West Virginia	4	154,960	11.50 %
First United Bank & Trust	3	125,131	9.28 %
Jefferson Security Bank	2	82,152	6.09 %
Bank of Charles Town	2	74,099	5.50 %
CNB Bank, Inc.	3	65,845	4.88 %
Summit Community Bank	1	13,846	1.03 %
Woodforest National Bank	1	1,275	0.09 %

Source: FDIC Deposit Market Share Report

Mineral County, West Virginia:			
First United Bank & Trust	2	$94,702	37.47 %
Branch Banking & Trust Company	2	70,877	28.05 %
Manufacturers & Traders Trust Company	2	48,632	19.24 %
Grant County Bank	1	30,957	12.25 %
FNB Bank, Inc.	1	7,553	2.99 %

Source: FDIC Deposit Market Share Report

Monongalia County, West Virginia:			
United Bank	6	$872,638	34.71 %
Branch Banking & Trust Company	4	484,600	19.28 %
Huntington National Bank	7	416,297	16.56 %
Clear Mountain Bank	6	218,178	8.68 %
Wesbanco Bank, Inc.	5	154,454	6.14 %
MVB Bank, Inc.	2	134,977	5.37 %
First United Bank & Trust	3	100,332	3.99 %
PNC Bank NA	4	82,781	3.29 %
First Exchange Bank	1	26,250	1.05 %
Citizens Bank of Morgantown, Inc.	1	23,466	0.93 %

Source: FDIC Deposit Market Share Report

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For further information about competition in our market areas, see the Risk Factor entitled "**We operate in a competitive environment, and our inability to effectively compete could adversely and materially impact our financial condition and results of operations**" in Item 1A of Part I of this annual report.

SUPERVISION AND REGULATION

The following is a summary of the material regulations and policies applicable to the Corporation and its subsidiaries and is not intended to be a comprehensive discussion. Changes in applicable laws and regulations may have a material effect on our business.

General

The Corporation is registered with the Federal Reserve as a bank holding company under the BHC Act and, as such, is subject to the supervision, examination and reporting requirements of the BHC Act and the regulations of the Federal Reserve. As a publicly-traded company whose common stock is registered under Section 12(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and listed on The NASDAQ Global Select Market, the Corporation is also subject to regulation and supervision by the SEC and The NASDAQ Stock Market, LLC ("NASDAQ").

The Bank is a Maryland trust company subject to the banking laws of Maryland and to regulation by the Commissioner of Financial Regulation of Maryland (the "Maryland Commissioner"), who is required by statute to make at least one examination in each calendar year (or at 18-month intervals if the Maryland Commissioner determines that an examination is unnecessary in a particular calendar year). The Bank also has offices in West Virginia, and the operations of these offices are subject to West Virginia laws and to supervision and examination by the West Virginia Division of Banking. As a member of the FDIC, the Bank is also subject to certain provisions of federal laws and regulations regarding deposit insurance and activities of insured state-chartered banks, including those that require examination by the FDIC. In addition to the foregoing, there are a myriad of other federal and state laws and regulations that affect, or govern the business of banking, including consumer lending, deposit-taking, and trust operations.

All non-bank subsidiaries of the Corporation are subject to examination by the Federal Reserve, and, as affiliates of the Bank, are subject to examination by the FDIC and the Maryland Commissioner. In addition, OakFirst Loan Center, Inc. is subject to licensing and regulation by the West Virginia Division of Banking, and OakFirst Loan Center, LLC is subject to licensing and regulation by the Maryland Commissioner.

Regulatory Reforms

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), which was enacted in July 2010, significantly restructured the financial regulatory regime in the United States. Although the Dodd-Frank Act’s provisions that have received the most public attention generally have been those applying to or more likely to affect larger institutions such as banks and bank holding companies with total consolidated assets of $50 billion or more, it contains numerous other provisions that affect all financial institutions, including the Bank. The Dodd-Frank Act established the Consumer Financial Protection Bureau (the”CFPB”), discussed below, and contains a wide variety of provisions (many of which are not yet effective) affecting the regulation of depository institutions, including fair lending, fair debt collection practices, mortgage loan origination and servicing obligations, bankruptcy, military service member protections, use of credit reports, privacy matters, and disclosure of credit terms and correction of billing errors. Local, state and national regulatory and enforcement agencies continue efforts to address perceived problems within the mortgage lending and credit card industries through broad or targeted legislative or regulatory initiatives aimed at lenders’ operations in consumer lending markets. There continues to be a significant amount of legislative and regulatory activity, nationally, locally and at the state level, designed to limit certain lending practices while mandating certain servicing procedures. Federal bankruptcy and state debtor relief and collection laws, as well as the Servicemembers Civil Relief Act affect the ability of banks, including the Bank, to collect outstanding balances.

Moreover, the Dodd-Frank Act permits states to adopt stricter consumer protection laws and states’ attorneys general may enforce consumer protection rules issued by the CFPB. Recently, U.S. financial regulatory agencies have increasingly used a general consumer protection statute to address unethical or otherwise bad business practices that may not necessarily fall directly under the purview of a specific banking or consumer finance law. Prior to the Dodd-Frank Act, there was little formal guidance to provide insight to the parameters for compliance with the “unfair or deceptive acts or practices” (“UDAP”) law. However, the UDAP provisions have been expanded under the Dodd-Frank Act to apply to “unfair, deceptive or abusive acts or practices”, which has been delegated to the CFPB for supervision.

The implementation of several of the Dodd-Frank Act’s provisions is subject to final rulemaking by the U.S. financial regulatory agencies, and the Dodd-Frank Act’s impact on our business will depend to a large extent on how and when such rules are adopted and implemented by the primary U.S. financial regulatory agencies. We continue to analyze the impact of rules adopted under the Dodd-Frank Act on our business, but the full impact will not be known until the rules and related regulatory initiatives are finalized and their combined impact can be understood. The Dodd-Frank Act has increased, and will likely continue to increase, our regulatory compliance burdens and costs and may restrict the financial products and services that we offer to our customers in the future. In particular, the Dodd-Frank Act will require us to invest significant management attention and resources so that we can evaluate the impact of and ensure compliance with this law and its rules.

Regulation of Bank Holding Companies

The Corporation and its affiliates are subject to the provisions of Section 23A and Section 23B of the Federal Reserve Act. Section 23A limits the amount of loans or extensions of credit to, and investments in, the Corporation and its non-bank affiliates by the Bank. Section 23B requires that transactions between the Bank and the Corporation and its non-bank affiliates be on terms and under circumstances that are substantially the same as with non-affiliates.

Under Federal Reserve policy, the Corporation is expected to act as a source of strength to the Bank, and the Federal Reserve may charge the Corporation with engaging in unsafe and unsound practices for failure to commit resources to a subsidiary bank when required. This support may be required at times when the bank holding company may not have the resources to provide the support. Under the prompt corrective action provisions, if a controlled bank is undercapitalized, then the regulators could require the bank holding company to guarantee the bank's capital restoration plan. In addition, if the Federal Reserve believes that a bank holding company's activities, assets or affiliates represent a significant risk to the financial safety, soundness or stability of a controlled bank, then the Federal Reserve could require the bank holding company to terminate the activities, liquidate the assets or divest the affiliates. The regulators may require these and other actions in support of controlled banks even if such actions are not in the best interests of the bank holding company or its stockholders. Because the Corporation is a bank holding company, it is viewed as a source of financial and managerial strength for any controlled depository institutions, like the Bank.

In addition, under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), depository institutions insured by the FDIC can be held liable for any losses incurred by, or reasonably anticipated to be incurred by, the FDIC in connection with (i) the default of a commonly controlled FDIC-insured depository institution or (ii) any assistance provided by the FDIC to a commonly controlled FDIC-insured depository institution in danger of default. Accordingly, in the event that any insured subsidiary of the Corporation causes a loss to the FDIC, other insured subsidiaries of the Corporation could be required to compensate the FDIC by reimbursing it for the estimated amount of such loss. Such cross guaranty liabilities generally are superior in priority to obligations of a financial institution to its shareholders and obligations to other affiliates.

Federal Banking Regulation

Federal banking regulators, such as the Federal Reserve and the FDIC, may prohibit the institutions over which they have supervisory authority from engaging in activities or investments that the agencies believe are unsafe or unsound banking practices. Federal banking regulators have extensive enforcement authority over the institutions they regulate to prohibit or correct activities that violate law, regulation or a regulatory agreement or which are deemed to be unsafe or unsound practices. Enforcement actions may include the appointment of a conservator or receiver, the issuance of a cease and desist order, the termination of deposit insurance, the imposition of civil money penalties on the institution, its directors, officers, employees and institution-affiliated parties, the issuance of directives to increase capital, the issuance of formal and informal agreements, the removal of or restrictions on directors, officers, employees and institution-affiliated parties, and the enforcement of any such mechanisms through restraining orders or other court actions.

The Bank is subject to certain restrictions on extensions of credit to executive officers, directors, and principal shareholders or any related interest of such persons, which generally require that such credit extensions be made on substantially the same terms as those available to persons who are not related to the Bank and not involve more than the normal risk of repayment. Other laws tie the maximum amount that may be loaned to any one customer and its related interests to capital levels.

As part of the Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”), each federal banking regulator adopted non-capital safety and soundness standards for institutions under its authority. These standards include internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate exposure, asset growth, and compensation, fees and benefits. An institution that fails to meet those standards may be required by the agency to develop a plan acceptable to meet the standards. Failure to submit or implement such a plan may subject the institution to regulatory sanctions. We believe that the Bank meets substantially all standards that have been adopted. FDICIA also imposes capital standards on insured depository institutions.

The CRA requires the FDIC, in connection with its examination of financial institutions within its jurisdiction, to evaluate the record of those financial institutions in meeting the credit needs of their communities, including low and moderate income neighborhoods, consistent with principles of safe and sound banking practices. These factors are also considered by all regulatory agencies in evaluating mergers, acquisitions and applications to open a branch or facility. As of the date of its most recent examination report, the Bank had a CRA rating of “Satisfactory”.

The Bank is also subject to a variety of other laws and regulations with respect to the operation of its business, including, but not limited to, the Truth in Lending Act, the Truth in Savings Act, the Equal Credit Opportunity Act, the Electronic Funds Transfer Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, Expedited Funds Availability (Regulation CC), Reserve Requirements (Regulation D), Privacy of Consumer Information (Regulation P), Margin Stock Loans (Regulation U), the Right To Financial Privacy Act, the Flood Disaster Protection Act, the Homeowners Protection Act, the Servicemembers Civil Relief Act, the Real Estate Settlement Procedures Act, the Telephone Consumer Protection Act, the CAN-SPAM Act, the Children's Online Privacy Protection Act, and the John Warner National Defense Authorization Act.

Capital Requirements

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdrawal demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not adequate to fund our capital requirements, we can rely on the funding sources identified below under the heading "Liquidity Management". At December 31, 2017, the Bank had $75.0 million available through unsecured lines of credit with correspondent banks, $7.0 million available through a secured line of credit with the Fed Discount Window and approximately $86.2 million available through the Federal Home Loan Bank of Atlanta ("FHLB"). Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

In addition to operational requirements, the Bank and the Corporation are subject to risk-based capital regulations, which were adopted and are monitored by federal banking regulators. These regulations are used to evaluate capital adequacy and require an analysis of an institution's asset risk profile and off-balance sheet exposures, such as unused loan commitments and stand-by letters of credit.

On July 2, 2013, the Federal Reserve approved final rules that substantially amended the regulatory risk-based capital rules applicable to First United Corporation. The FDIC subsequently approved the same rules. The final rules implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act and were implemented as of March 31, 2015.

The Basel III capital rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and which refine the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation under the final rules are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January

1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (a) a common equity Tier 1 capital ratio of 7.0%, (b) a Tier 1 capital ratio of 8.5% and (c) a total capital ratio of 10.5%. Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The Basel III capital final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that no longer qualify as Tier 1 capital, some of which will be phased out over time. Under the final rules, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations like the Corporation and the Bank that are not considered "advanced approaches" banking organizations may make a one-time permanent election to continue to exclude these items. The Corporation and the Bank made this election in their first quarter 2015 regulatory filings in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Corporation's available-for-sale securities portfolio. Additionally, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The Basel III capital rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital levels begin to show signs of weakness. These revisions were effective January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following capital level requirements in order to qualify as "well capitalized": (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The Basel III capital rules set forth certain changes for the calculation of risk-weighted assets. These changes include (i) an increased number of credit risk exposure categories and risk weights; (ii) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (iii) revisions to recognition of credit risk mitigation; (iv) rules for risk weighting of equity exposures and past due loans, and (v) revised capital treatment for derivatives and repo-style transactions.

Regulators may require higher capital ratios when warranted by the particular circumstances or risk profile of a given banking organization. In the current regulatory environment, banking organizations must stay well-capitalized in order to receive favorable regulatory treatment on acquisition and other expansion activities and favorable risk-based deposit insurance assessments. Our capital policy establishes guidelines meeting these regulatory requirements and takes into consideration current or anticipated risks as well as potential future growth opportunities.

As of December 31, 2017, we were in compliance with the applicable requirements.

In October 2017, the federal banking agencies proposed revisions that would simplify compliance with certain aspects of capital rules. A majority of the proposed simplifications would apply solely to banking organizations that are not subject to the advanced approaches capital rule. The proposed rules simplify application of regulatory capital treatment for mortgage servicing assets, certain deferred tax assets arising from temporary differences, investments in the capital of unconsolidated financial institutions, and capital issued by a consolidated subsidiary of a banking organization and held by third parties (minority interest), and; revisions to the treatment of certain acquisition, development, or construction exposures. In addition, the federal banking agencies have deferred the final phase-in and increased risk-weighting associated with CET1 deductions (discussed in the next section) indefinitely for non-advanced approaches banks.

Additional information about our capital ratios and requirements is contained in Item 7 of Part II of this annual report under the heading "Capital Resources".

Prompt Corrective Action

The Federal Deposit Insurance ("FDI") Act requires, among other things, the federal banking agencies to take "prompt corrective action" in respect of depository institutions that do not meet minimum capital requirements. The FDI Act includes the following five capital tiers: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A depository institution's capital tier will depend upon how its capital levels compare with various relevant capital measures and certain other factors, as established by regulation. The relevant capital measures are the total capital ratio, the Tier 1 capital ratio and the leverage ratio.

A bank will be (i) "well capitalized" if the institution has a total risk-based capital ratio of 10.0% or greater, a Tier 1 risk-based capital ratio of 6.0% or greater, and a leverage ratio of 5.0% or greater, and is not subject to any order or written directive by any such regulatory authority to meet and maintain a specific capital level for any capital measure, (ii) "adequately capitalized" if the institution has a total risk-based capital ratio of 8.0% or greater, a Tier 1 risk-based capital ratio of 4.0% or greater, and a leverage ratio of 4.0% or greater and is not "well capitalized", (iii) "undercapitalized" if the institution has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio of less than 4.0% or a leverage ratio of less than 4.0%, (iv) "significantly undercapitalized" if the institution has a total risk-based capital ratio of less than 6.0%, a Tier 1 risk-based capital ratio of less than 3.0% or a leverage ratio of less than 3.0%, and (v) "critically undercapitalized" if the institution's tangible equity is equal to or less than 2.0% of average quarterly tangible assets. An institution may be downgraded to, or deemed to be in, a capital category that is lower than indicated by its capital ratios if it is determined to be in an unsafe or unsound condition or if it receives an unsatisfactory examination rating with respect to certain matters. A bank's capital category is determined solely for the purpose of applying prompt corrective action regulations, and the capital category may not constitute an accurate representation of the bank's overall financial condition or prospects for other purposes.

Effective January 1, 2015, the Basel III capital rules revised the prompt corrective action requirements by (i) introducing the Common Equity Tier 1 ("CET1") ratio requirement at each level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status; (ii) increasing the minimum Tier 1 capital ratio requirement for each category (other than critically undercapitalized), with the minimum Tier 1 capital ratio for well-capitalized status being 8%; and (iii) eliminating the provision that permitted a bank with a composite supervisory rating of 1 but a leverage ratio of at least 3% to be deemed adequately capitalized. The Basel III Capital Rules did not change the total risk-based capital requirement for any prompt corrective action category.

The FDI Act generally prohibits a depository institution from making any capital distributions (including payment of a dividend) or paying any management fee to its parent holding company if the depository institution would thereafter be "undercapitalized." "Undercapitalized" institutions are subject to growth limitations and are required to submit a capital restoration plan. The agencies may not accept such a plan without determining, among other things, that the plan is based on realistic assumptions and is likely to succeed in restoring the depository institution's capital. In addition, for a capital restoration plan to be acceptable, the depository institution's parent holding company must guarantee that the institution will comply with such capital restoration plan. The bank holding company must also provide appropriate assurances of performance. The aggregate liability of the parent holding company is limited to the lesser of (i) an amount equal to 5.0% of the depository institution's total assets at the time it became undercapitalized and (ii) the amount which is necessary (or would have been necessary) to bring the institution into compliance with all capital standards applicable with respect to such institution as of the time it fails to comply with the plan. If a depository institution fails to submit an acceptable plan, it is treated as if it is "significantly undercapitalized." Significantly undercapitalized" depository institutions may be subject to a number of requirements and restrictions, including orders to sell sufficient voting stock to become "adequately capitalized," requirements to reduce total assets, and cessation of receipt of deposits from correspondent banks. "Critically undercapitalized" institutions are subject to the appointment of a receiver or conservator.

The appropriate federal banking agency may, under certain circumstances, reclassify a well-capitalized insured depository institution as adequately capitalized. The FDI Act provides that an institution may be reclassified if the appropriate federal banking agency determines (after notice and opportunity for hearing) that the institution is in an unsafe or unsound condition or deems the institution to be engaging in an unsafe or unsound practice.

The appropriate agency is also permitted to require an adequately capitalized or undercapitalized institution to comply with the supervisory provisions as if the institution were in the next lower category (but not treat a significantly undercapitalized institution as critically undercapitalized) based on supervisory information other than the capital levels of the institution.

As of December 31, 2017, the Bank was "well capitalized" based on the aforementioned ratios.

Liquidity Requirements

Historically, the regulation and monitoring of bank liquidity has been addressed as a supervisory matter, without required formulaic measures. The Basel III liquidity framework requires banks to measure their liquidity against specific liquidity tests that, although similar in some respects to liquidity measures historically applied by banks and regulators for management and supervisory purposes, going forward would be required by regulation. One test, referred to as the liquidity coverage ratio ("LCR"), is designed to ensure that the banking entity maintains an adequate level of unencumbered high-quality liquid assets equal to the entity's expected net cash outflow for a 30-day time horizon (or, if greater, 25% of its expected total cash outflow) under an acute liquidity stress scenario. The other test, referred to as the net stable funding ratio ("NSFR"), is designed to promote more medium- and long-term funding of the assets and activities of banking entities over a one-year time horizon. These requirements will incent banking entities to increase their holdings of U.S. Treasury securities and other sovereign debt as a component of assets and increase the use of long-term debt as a funding source. In October 2013, the federal banking agencies proposed rules implementing the LCR for advanced approaches banking organizations and a modified version of the LCR for bank holding companies with at least $50 billion in total consolidated assets that are not advanced approach banking organizations, neither of which would apply to the Corporation. In the second quarter of 2016, the federal banking regulators issued a proposed rule that would implement the NSFR for certain U.S. banking organizations to ensure that they have access to table funding over a one-year time horizon. The proposed rule would not apply to a U.S. banking organization with less than $50 billion in total consolidated assets, such as the Bank.

Deposit Insurance

The Bank is a member of the FDIC and pays an insurance premium to the FDIC based upon its assessable deposits on a quarterly basis. Deposits are insured up to applicable limits by the FDIC and such insurance is backed by the full faith and credit of the United States Government.

Under the Dodd-Frank Act, a permanent increase in deposit insurance was authorized to $250,000. The coverage limit is per depositor, per insured depository institution for each account ownership category.

The Dodd-Frank Act also set a new minimum DIF reserve ratio at 1.35% of estimated insured deposits. The FDIC is required to attain this ratio by September 30, 2020. The Dodd-Frank Act required the FDIC to redefine the deposit insurance assessment base for an insured depository institution. Prior to the Dodd-Frank Act, an institution's assessment base has historically been its domestic deposits, with some adjustments. As redefined pursuant to the Dodd-Frank Act, an institution's assessment base is now an amount equal to the institution's average consolidated total assets during the assessment period minus average tangible equity. Institutions with $1.0 billion or more in assets at the end of a fiscal quarter, like the Bank, must report their average consolidated total assets on a daily basis and report their average tangible equity on an end-of-month balance basis.

The Federal Deposit Insurance Reform Act of 2005, which created the DIF, gave the FDIC greater latitude in setting the assessment rates for insured depository institutions which could be used to impose minimum assessments. The FDIC has the flexibility to adopt actual rates that are higher or lower than the total base assessment rates adopted without notice and comment, if certain conditions are met.

DIF-insured institutions pay a Financing Corporation ("FICO") assessment in order to fund the interest on bonds issued in the 1980s in connection with the failures in the thrift industry. These assessments will continue until the bonds mature in 2019.

The FDIC is authorized to conduct examinations of and require reporting by FDIC-insured institutions. It is also authorized to terminate a depository bank's deposit insurance upon a finding by the FDIC that the bank's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices or has violated any applicable rule, regulation, order or condition enacted or imposed by the bank's regulatory agency. The termination of deposit insurance for our bank subsidiary would have a material adverse effect on our earnings, operations and financial condition.

Bank Secrecy Act/Anti-Money Laundering

The Bank Secrecy Act ("BSA"), which is intended to require financial institutions to develop policies, procedures, and practices to prevent and deter money laundering, mandates that every national bank have a written, board-approved program that is reasonably designed to assure and monitor compliance with the BSA.

The program must, at a minimum: (i) provide for a system of internal controls to assure ongoing compliance; (ii) provide for independent testing for compliance; (iii) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (iv) provide training for appropriate personnel. In addition, state-chartered banks are required to adopt a customer identification program as part of its BSA compliance program. State-chartered banks are also required to file Suspicious Activity Reports when they detect certain known or suspected violations of federal law or suspicious transactions related to a money laundering activity or a violation of the BSA.

In addition to complying with the BSA, the Bank is subject to the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "USA Patriot Act"). The USA Patriot Act is designed to deny terrorists and criminals the ability to obtain access to the United States' financial system and has significant implications for depository institutions, brokers, dealers, and other businesses involved in the transfer of money. The USA Patriot Act mandates that financial service companies implement additional policies and procedures and take heightened measures designed to address any or all of the following matters: customer identification programs, money laundering, terrorist financing, identifying and reporting suspicious activities and currency transactions, currency crimes, and cooperation between financial institutions and law enforcement authorities.

Mortgage Lending and Servicing

In January 2013, the CFPB issued eight final regulations governing mainly consumer mortgage lending. These regulations became effective in January 2014.

One of these rules, effective on January 10, 2014, requires mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. This rule also defines "qualified mortgages." In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or a term exceeding 30 years, where the lender determines that the borrower has the ability to repay, and where the borrower's points and fees do not exceed 3% of the total loan amount. Qualified mortgages that that are not "higher-priced" are afforded a safe harbor presumption of compliance with the ability to repay rules. Qualified mortgages that are “higher-priced” garner a rebuttable presumption of compliance with the ability to repay rules.

The CFPB regulations also: (i) require that “higher-priced” mortgages must have escrow accounts for taxes and insurance and similar recurring expenses; (ii) expand the scope of the high-rate, high-cost mortgage provisions by, among other provisions, lowering the rates and fees that lead to coverage and including home equity lines of credit; (iii) revise rules for mortgage loan originator compensation; (iv) add prohibitions against mandatory arbitration provisions and financing single premium credit insurances; and (v) impose a broader requirement for providing borrowers with copies of all appraisals on first-lien dwelling secured loans.

Effective January 10, 2014, the CFPB’s final Truth-in-Lending Act rules relating to mortgage servicing impose new obligations to credit payments and provide payoff statements within certain time periods and provide new notices prior to interest rate and payment adjustments. Effective on that same date, the CFPB’s final Real Estate Settlement Procedures Act rules add new obligations on the servicer when a mortgage loan is default.

On November 20, 2013, the CFPB issued a final rule on integrated mortgage disclosures under the Truth-in-Lending Act and the Real Estate Settlement Procedures Act, for which compliance was required by October 3, 2015. As of December 31, 2017, we believe that we are in compliance.

Consumer Lending – Military Lending Act

The Military Lending Act (the “MLA”), which was initially implemented in 2007, was amended and its coverage significantly expanded in 2015. The Department of Defense (the “DOD”) issued a final rule under the MLA that took effect on October 15, 2015, but financial institutions were not required to take action until October 3, 2016. The types of credit covered under the MLA were expanded to include virtually all consumer loan and credit card products (except for loans secured by residential real property and certain purchase-money motor vehicle/personal property secured transactions). Lenders must now provide specific written and oral disclosures concerning the protections of the MLA to active duty members of the military and dependents of active duty members of the military (“covered borrowers”). The rule imposes a 36% “Military Annual Percentage Rate” cap that includes costs associated with credit insurance premiums, fees for ancillary products, finance charges associated with the transactions, and application and participation charges. In addition, loan terms cannot include (i) a mandatory arbitration provision, (ii) a waiver of consumer protection laws, (iii) mandatory allotments from military benefits, or (iv) a prepayment penalty. The revised rule also prohibits “roll-over” or refinances of the same loan unless the new loan provides more favorable terms for the covered borrower. Lenders may verify covered borrower status using a DOD database or information provided by credit bureaus. We believe that we are in compliance with the revised rule.

Cybersecurity

We rely on electronic communications and information systems to conduct our operations and store sensitive data. We employ an in-depth approach that leverages people, processes, and technology to manage and maintain cybersecurity controls. In addition, we employ a variety of preventative and detective tools to monitor, block, and provide alerts regarding suspicious activity, as well as to report on any suspected advanced persistent threats. Notwithstanding the strength of our defensive measures, the threat from cyber-attacks is severe, attacks are sophisticated and increasing in volume, and attackers respond rapidly to changes in defensive measures.

The federal banking regulators have adopted guidelines for establishing information security standards and cybersecurity programs for implementing safeguards under the supervision of a financial institution’s board of directors. These guidelines, along with related regulatory materials, increasingly focus on risk management and processes related to information technology and the use of third parties in the provision of financial products and services. The federal banking regulators expect financial institutions to establish lines of defense and to ensure that their risk management processes address the risk posed by compromised customer credentials, and also expect financial institutions to maintain sufficient business continuity planning processes to ensure rapid recovery, resumption and maintenance of the institution's operations after a cyberattack. If we fail to meet the expectations set forth in this regulatory guidance, then we could be subject to various regulatory actions and we may be required to devote significant resources to any required remediation efforts.

Federal Securities Laws and NASDAQ Rules

The shares of the Corporation’s common stock are registered with the SEC under Section 12(b) of the Exchange and listed on the NASDAQ Global Select Market. The Corporation is subject to information reporting requirements, proxy solicitation requirements, insider trading restrictions and other requirements of the Exchange Act, including the requirements imposed under the federal Sarbanes-Oxley Act of 2002, and rules adopted by NASDAQ. Among other things, loans to and other transactions with insiders are subject to restrictions and heightened disclosure, directors and certain committees of the Board must satisfy certain independence requirements, the Corporation must comply with certain enhanced corporate governance requirements, and various issuances of securities by the Corporation require shareholder approval.

Governmental Monetary and Credit Policies and Economic Controls

The earnings and growth of the banking industry and ultimately of the Bank are affected by the monetary and credit policies of governmental authorities, including the Federal Reserve. An important function of the Federal Reserve is to regulate the national supply of bank credit in order to control recessionary and inflationary pressures. Among the instruments of monetary policy used by the Federal Reserve to implement these objectives are open market operations in U.S. Government securities, changes in the federal funds rate, changes in the discount rate of member bank borrowings, and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth of bank loans, investments and deposits and may also affect interest rates charged on loans or paid on deposits. The monetary policies of the Federal Reserve authorities have had a significant effect on the operating results of commercial banks in the past and are expected to continue to have such an effect in the future. In view of changing conditions in the national economy and in the money markets, as well as the effect of actions by monetary and fiscal authorities, including the Federal Reserve, no prediction can be made as to possible future changes in interest rates, deposit levels, loan demand or their effect on our businesses and earnings.

SEASONALITY

Management does not believe that our business activities are seasonal in nature. Deposit and loan demand may vary depending on local and national economic conditions, but management believes that any variation will not have a material impact on our planning or policy-making strategies.

EMPLOYEES

At December 31, 2017, we employed 363 individuals, of whom 308 were full-time employees.

ITEM 1A. RISK FACTORS

The significant risks and uncertainties related to us, our business and our securities of which we are aware are discussed below. Investors and shareholders should carefully consider these risks and uncertainties before making investment decisions with respect to the Corporation’s securities. Any of these factors could materially and adversely affect our business, financial condition, operating results and prospects and could negatively impact the market price of the Corporation’s securities. If any of these risks materialize, the holders of the Corporation’s securities could lose all or part of their investments in the Corporation. Additional risks and uncertainties that we do not yet know of, or that we currently think are immaterial, may also impair our business operations. Investors and shareholders should also consider the other information contained in this annual report, including our financial statements and the related notes, before making investment decisions with respect to the Corporation’s securities.

Risks Relating to First United Corporation and its Affiliates

First United Corporation’s future success depends on the successful growth of its subsidiaries.

The Corporation’s primary business activity for the foreseeable future will be to act as the holding company of the Bank and its other direct and indirect subsidiaries. Therefore, the Corporation’s future profitability will depend on the success and growth of these subsidiaries. In the future, part of our growth may come from buying other banks and buying or establishing other companies. Such entities may not be profitable after they are purchased or established, and they may lose money, particularly at first. A new bank or company may bring with it unexpected liabilities, bad loans, or bad employee relations, or the new bank or company may lose customers.

Interest rates and other economic conditions will impact our results of operations.

Our net income depends primarily upon our net interest income. Net interest income is the difference between interest income earned on loans, investments and other interest-earning assets and the interest expense incurred on deposits and borrowed funds. The level of net interest income is primarily a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities, and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are impacted by such external factors as the local economy, competition for loans and deposits, the monetary policy of the Federal Open Market Committee of the Federal Reserve Board of Governors, and market interest rates.

Different types of assets and liabilities may react differently, and at different times, to changes in market interest rates. We expect that we will periodically experience gaps in the interest rate sensitivities of our assets and liabilities. That means either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. When interest-bearing liabilities mature or re-price more quickly than interest-earning assets, an increase in market rates of interest could reduce our net interest income. Likewise, when interest-earning assets mature or re-price more quickly than interest-bearing liabilities, falling interest rates could reduce our net interest income. We are unable to predict changes in market interest rates, which are affected by many factors beyond our control, including inflation, deflation, recession, unemployment, money supply, domestic and international events and changes in the United States and other financial markets.

We also attempt to manage risk from changes in market interest rates, in part, by controlling the mix of interest rate sensitive assets and interest rate sensitive liabilities. However, interest rate risk management techniques are not exact. A rapid increase or decrease in interest rates could adversely affect our results of operations and financial performance.

The majority of our business is concentrated in Maryland and West Virginia, much of which involves real estate lending, so a decline in the real estate and credit markets could materially and adversely impact our financial condition and results of operations.

Most of the Bank’s loans are made to borrowers located in Western Maryland and Northeastern West Virginia, and many of these loans, including construction and land development loans, are secured by real estate. At December 31, 2017, approximately 12%, or $110.5 million, of our total loans were real estate acquisition, construction and development loans that were secured by real estate. Accordingly, a decline in local economic conditions would likely have an adverse impact on our financial condition and results of operations, and the impact on us would likely be greater than the impact felt by larger financial institutions whose loan portfolios are geographically diverse. We cannot guarantee that any risk management practices we implement to address our geographic and loan concentrations will be effective to prevent losses relating to our loan portfolio.

The Bank’s concentrations of commercial real estate loans could subject it to increased regulatory scrutiny and directives, which could force us to preserve or raise capital and/or limit future commercial lending activities.

The Federal Reserve, the FDIC, and the other federal banking regulators issued guidance in December 2006 entitled “Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices” directed at institutions who have particularly high concentrations of CRE loans within their lending portfolios. This guidance suggests that these institutions face a heightened risk of financial difficulties in the event of adverse changes in the economy and CRE markets. Accordingly, the guidance suggests that institutions whose concentrations exceed certain percentages of capital should implement heightened risk management practices appropriate to their concentration risk. The guidance provides that banking regulators may require such institutions to reduce their concentrations and/or maintain higher capital ratios than institutions with lower concentrations in CRE. At December 31, 2017, our CRE concentrations were below the heightened risk management thresholds set forth in this guidance.

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The Bank may experience loan losses in excess of its allowance, which would reduce our earnings.

The risk of credit losses on loans varies with, among other things, general economic conditions, the type of loans being made, the creditworthiness of the borrowers over the term of the loans and, in the case of collateralized loans, the value and marketability of the collateral for the loans. Management of the Bank maintains an allowance for loan losses based upon, among other things, historical experience, an evaluation of economic conditions and regular reviews of delinquencies and loan portfolio quality. Based upon such factors, management makes various assumptions and judgments about the ultimate collectability of the loan portfolio and provides an allowance for loan losses based upon a percentage of the outstanding balances and for specific loans when their ultimate collectability is considered questionable. If management's assumptions and judgments prove to be incorrect and the allowance for loan losses is inadequate to absorb future losses, or if the bank regulatory authorities require us to increase the allowance for loan losses as a part of its examination process, our earnings and capital could be significantly and adversely affected. Although management continually monitors our loan portfolio and makes determinations with respect to the allowance for loan losses, future adjustments may be necessary if economic conditions differ substantially from the assumptions used or adverse developments arise with respect to our non-performing or performing loans. Material additions to the allowance for loan losses could result in a material decrease in our net income and capital, and could have a material adverse effect on our financial condition.

A new accounting standard will likely require us to increase our allowance for loan losses and may have a material adverse effect on our financial condition and results of operations.

The FASB has adopted a new accounting standard that will be effective for the Corporation and the Bank beginning with our first full fiscal year after December 15, 2019. This standard, referred to as Current Expected Credit Loss, or CECL, will require financial institutions to determine periodic estimates of lifetime expected credit losses on loans, and recognize the expected credit losses as allowances for loan losses. This standard will change the current method of providing allowances for loan losses that are probable, which would likely require us to increase our allowance for loan losses, and to greatly increase the types of data we would need to collect and review to determine the appropriate level of the allowance for loan losses. Any increase in our allowance for loan losses or expenses incurred to determine the appropriate level of the allowance for loan losses may have a material adverse effect on our financial condition and results of operations.

The market value of our investments could decline.

As of December 31, 2017, investment securities in our investment portfolio having a cost basis of $153.6 million and a market value of $146.5 million were classified as available-for-sale pursuant to FASB Accounting Standards Codification ("ASC") Topic 320, *Investments – Debt and Equity Securities*, relating to accounting for investments. Topic 320 requires that unrealized gains and losses in the estimated value of the available-for-sale portfolio be "marked to market" and reflected as a separate item in shareholders' equity (net of tax) as accumulated other comprehensive loss. There can be no assurance that future market performance of our investment portfolio will enable us to realize income from sales of securities. Shareholders' equity will continue to reflect the unrealized gains and losses (net of tax) of these investments. Moreover, there can be no assurance that the market value of our investment portfolio will not decline, causing a corresponding decline in shareholders' equity.

Management believes that several factors could affect the market value of our investment portfolio. These include, but are not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation and the slope of the interest rate yield curve (the yield curve refers to the differences between shorter-term and longer-term interest rates; a positively sloped yield curve means shorter-term rates are lower than longer-term rates). Also, the passage of time will affect the market values of our investment securities, in that the closer they are to maturing, the closer the market price should be to par value. These and other factors may impact specific categories of the portfolio differently, and management cannot predict the effect these factors may have on any specific category.

Impairment of investment securities, goodwill, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

In assessing whether the impairment of investment securities is other-than-temporary, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability to retain our investment in the security for a period of time sufficient to allow for any anticipated recovery in fair value in the near term. See the discussion under the heading "Estimates and Critical Accounting Policies – Other-Than-Temporary Impairment of Investment Securities" in Item 7 of Part II of this annual report for further information.

Under current accounting standards, goodwill is not amortized but, instead, is subject to impairment tests on at least an annual basis or more frequently if an event occurs or circumstances change that reduce the fair value of a reporting unit below its carrying amount. A decline in the price of the Corporation's common stock or occurrence of a triggering event following any of our quarterly earnings releases and prior to the filing of the periodic report for that period could, under certain circumstances, cause us to perform a goodwill impairment test and result in an impairment charge being recorded for that period which was not reflected in such earnings release. In the event that we conclude that all or a portion of our goodwill may be impaired, a non-cash charge for the amount of such impairment would be recorded to earnings. Such a charge would have no impact on tangible capital. At December 31, 2017, we had recorded goodwill of $11.0 million, representing approximately 11% of shareholders' equity. See the discussion under the heading "Estimates and Critical Accounting Policies – Goodwill" in Item 7 of Part II of this annual report for further information.

At December 31, 2017, our net deferred tax assets were valued at $9.3 million, which included $.8 million associated with a federal net operating loss carryforward which we expect to be substantially utilized in 2018. Also included in that total is $2.6 million of state net operating loss carryforwards associated with separate company tax filings of the Corporation, which we do not expect to use and, thus, we have established a $2.4 million valuation allowance. A deferred tax asset is reduced by a valuation allowance if, based on the weight of the evidence available, both negative and positive, including the recent trend of quarterly earnings, management believes that it is more likely than not that some portion or all of the total deferred tax asset will not be realized. Moreover, our ability to utilize our net operating loss carryforwards to offset future taxable income may be significantly limited if we experience an "ownership change," as determined under Section 382 of the Code. If an ownership change were to occur, the limitations imposed by Section 382 of the Code could result in a portion of our net operating loss carryforwards expiring unused, thereby impairing their value. Section 382's provisions are complex, and we cannot predict any circumstances surrounding the future ownership of the common stock. Accordingly, we cannot provide any assurance that we will not experience an ownership change in the future.

The impact of each of these impairment matters could have a material adverse effect on our business, results of operations, and financial condition.

We operate in a competitive environment, and our inability to effectively compete could adversely and materially impact our financial condition and results of operations.

We operate in a competitive environment, competing for loans, deposits, and customers with commercial banks, savings associations and other financial entities. Competition for deposits comes primarily from other commercial banks, savings associations, credit unions, money market and mutual funds and other investment alternatives. Competition for loans comes primarily from other commercial banks, savings associations, mortgage banking firms, credit unions and other financial intermediaries. Competition for other products, such as securities products, comes from other banks, securities and brokerage companies, and other non-bank financial service providers in our market area. Many of these competitors are much larger in terms of total assets and capitalization, have greater access to capital markets, and/or offer a broader range of financial services than those that we offer. In addition, banks with a larger capitalization and financial intermediaries not subject to bank regulatory restrictions have larger lending limits and are thereby able to serve the needs of larger customers.

In addition, changes to the banking laws over the last several years have facilitated interstate branching, merger and expanded activities by banks and holding companies. For example, the federal Gramm-Leach-Bliley Act (the "GLB Act") revised the BHC Act and repealed the affiliation provisions of the Glass-Steagall Act of 1933, which, taken together, limited the securities and other non-banking activities of any company that controls an FDIC insured financial institution. As a result, the ability of financial institutions to branch across state lines and the ability of these institutions to engage in previously-prohibited activities are now accepted elements of competition in the banking industry. These changes may bring us into competition with more and a wider array of institutions, which may reduce our ability to attract or retain customers. Management cannot predict the extent to which we will face such additional competition or the degree to which such competition will impact our financial conditions or results of operations.

The banking industry is heavily regulated; significant regulatory changes could adversely affect our operations.

Our operations will be impacted by current and future legislation and by the policies established from time to time by various federal and state regulatory authorities. The Corporation is subject to supervision by the Federal Reserve. The Bank is subject to supervision and periodic examination by the Maryland Commissioner of Financial Regulation, the West Virginia Division of Banking, and the FDIC. Banking regulations, designed primarily for the safety of depositors, may limit a financial institution's growth and the return to its investors by restricting such activities as the payment of dividends, mergers with or acquisitions by other institutions, investments, loans and interest rates, interest rates paid on deposits, expansion of branch offices, and the offering of securities or trust services. The Corporation and the Bank are also subject to capitalization guidelines established by federal law and could be subject to enforcement actions to the extent that either is found by regulatory examiners to be undercapitalized. It is not possible to predict what changes, if any, will be made to existing federal and state legislation and regulations or the effect that such changes may have on our future business and earnings prospects. Management also cannot predict the nature or the extent of the effect on our business and earnings of future fiscal or monetary policies, economic controls, or new federal or state legislation. Further, the cost of compliance with regulatory requirements may adversely affect our ability to operate profitably.

The full impact of the Dodd-Frank Act is unknown because some rule making efforts are still required to fully implement all of its requirements and the implementation of some enforcement efforts is just beginning. We anticipate continued increases in regulatory expenses as a result of the Dodd-Frank Act.

The Dodd-Frank Act represents a comprehensive overhaul of the financial services industry within the United States and affects the lending, investment, trading and operating activities of all financial institutions. Based on the text of the Dodd-Frank Act and the implementing regulations, it is anticipated that the costs to banks may increase or fee income may decrease significantly, which could adversely affect our results of operations, financial condition and/or liquidity.

The Consumer Financial Protection Bureau may continue to reshape the consumer financial laws through rulemaking and enforcement of the prohibitions against unfair, deceptive and abusive business practices. Compliance with any such change may impact our business operations.

The CFPB has broad rulemaking authority to administer and carry out the provisions of the Dodd-Frank Act with respect to financial institutions that offer covered financial products and services to consumers. The CFPB has also been directed to adopt rules identifying practices or acts that are unfair, deceptive or abusive in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service. The concept of what may be considered to be an "abusive" practice is new under the law. The full scope of the impact of this authority has not yet been determined as the CFPB has not yet released significant supervisory guidance.

As discussed above, the CFPB issued several rules in 2013 relating to mortgage operations and servicing, including a rule requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms, or to originate "qualified mortgages" that meet specific requirements with respect to terms, pricing and fees. These new rules have required the Bank to dedicate significant personnel resources and could have a material adverse effect on our operations.

Bank regulators and other regulations, including the Basel III Capital Rules, may require higher capital levels, impacting our ability to pay dividends or repurchase our stock.

The capital standards to which we are subject, including the standards created by the Basel III Capital Rules, may materially limit our ability to use our capital resources and/or could require us to raise additional capital by issuing common stock. The issuance of additional shares of common stock could dilute existing stockholders.

A material weakness or significant deficiency in our disclosure or internal controls could have an adverse effect on us.

The Corporation is required by the Sarbanes-Oxley Act of 2002 to establish and maintain disclosure controls and procedures and internal control over financial reporting. These control systems are intended to provide reasonable assurance that material information relating to the Corporation is made known to our management and reported as required by the Exchange Act, to provide reasonable assurance regarding the reliability and preparation of our financial statements, and to provide reasonable assurance that fraud and other unauthorized uses of our assets are detected and prevented. We may not be able to maintain controls and procedures that are effective at the reasonable assurance level. If that were to happen, our ability to provide timely and accurate information about the Corporation, including financial information, to investors could be compromised and our results of operations could be harmed. Moreover, if the Corporation or its independent registered public accounting firm were to identify a material weakness or significant deficiency in any of those control systems, our reputation could be harmed and investors could lose confidence in us, which could cause the market price of the Corporation's stock to decline and/or limit the trading market for the common stock.

The Bank's funding sources may prove insufficient to replace deposits and support our future growth.

The Bank relies on customer deposits, advances from the FHLB, lines of credit at other financial institutions and brokered funds to fund our operations. Although the Bank has historically been able to replace maturing deposits and advances if desired, no assurance can be given that the Bank would be able to replace such funds in the future if our financial condition or the financial condition of the FHLB or market conditions were to change. Our financial flexibility will be severely constrained and/or our cost of funds will increase if we are unable to maintain our access to funding or if financing necessary to accommodate future growth is not available at favorable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In that case, our profitability would be adversely affected.

The loss of key personnel could disrupt our operations and result in reduced earnings.

Our growth and profitability will depend upon our ability to attract and retain skilled managerial, marketing and technical personnel. Competition for qualified personnel in the financial services industry is intense, and there can be no assurance that we will be successful in attracting and retaining such personnel. Our current executive officers provide valuable services based on their many years of experience and in-depth knowledge of the banking industry and the market areas we serve. Due to the intense competition for financial professionals, these key personnel would be difficult to replace and an unexpected loss of their services could result in a disruption to the continuity of operations and a possible reduction in earnings.

The Bank’s lending activities subject the Bank to the risk of environmental liabilities.

A significant portion of the Bank’s loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property’s value or limit the Bank’s ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank’s exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our financial condition and results of operations.

We are a community bank and our ability to maintain our reputation is critical to the success of our business.

We are a community banking institution, and our reputation is one of the most valuable components of our business. A key component of our business strategy is to rely on our reputation for customer service and knowledge of local markets to expand our presence by capturing new business opportunities from existing and prospective customers in our current market and contiguous areas. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected by the actions of our employees, by our inability to conduct our operations in a manner that is appealing to current or prospective customers, or otherwise, our business and, therefore, our operating results may be materially adversely affected.

We may be subject to claims and the costs of defensive actions, and such claims and costs could materially and adversely impact our financial condition and results of operations.

Our customers may sue us for losses due to alleged breaches of fiduciary duties, errors and omissions of employees, officers and agents, incomplete documentation, our failure to comply with applicable laws and regulations, or many other reasons. Also, our employees may knowingly or unknowingly violate laws and regulations. Management may not be aware of any violations until after their occurrence. This lack of knowledge may not insulate us from liability. Claims and legal actions will result in legal expenses and could subject us to liabilities that may reduce our profitability and hurt our financial condition.

We may not be able to keep pace with developments in technology.

We use various technologies in conducting our businesses, including telecommunication, data processing, computers, automation, internet-based banking, and debit cards. Technology changes rapidly. Our ability to compete successfully with other financial institutions may depend on whether we can exploit technological changes. We may not be able to exploit technological changes, and any investment we do make may not make us more profitable.

Our information systems may experience an interruption or a breach in security, including due to cyber-attacks.

In the ordinary course of business, we collect and store sensitive data, including proprietary business information and personally identifiable information of our customers and employees in systems and on networks. The secure processing, maintenance, and use of this information is critical to our operations and business strategy. In addition, we rely heavily on communications and information systems to conduct our business. Any failure, interruption, or breach in security or operational integrity of these systems could result in failures or disruptions in our customer relationship management, general ledger, deposit, loan, and other systems. Although we have invested in various technologies and continually review processes and practices that are designed to protect our networks, computers, and data from damage or unauthorized access, our computer systems and infrastructure may nevertheless be vulnerable to attacks by hackers or breached due to employee error, malfeasance, or other disruptions. Further, cyber-attacks can originate from a variety of sources and the techniques used are increasingly sophisticated. A breach of any kind could compromise our systems, and the information stored there could be accessed, damaged, or disclosed. A breach in security or other failure could result in legal claims, regulatory penalties, disruptions in operations, increased expenses, loss of customers and business partners, and damage to our reputation, which could in turn adversely affect our business, financial condition and/or results of operations. Furthermore, as cyber threats continue to evolve and increase, we may be required to expend significant additional financial and operational resources to modify or enhance our protective measures, or to investigate and remediate any identified information security vulnerabilities.

Safeguarding our business and customer information increases our cost of operations. To the extent that we, or our third-party vendors, are unable to prevent the theft of or unauthorized access to this information, our operations may become disrupted, we may be subject to claims, and our net income may be adversely affected.

Our business depends heavily on the use of computer systems, the Internet and other means of electronic communication and recordkeeping. Accordingly, we must protect our computer systems and network from break-ins, security breaches, and other risks that could disrupt our operations or jeopardize the security of our business and customer information. Moreover, we use third party vendors to provide products and services necessary to conduct our day-to-day operations, which exposes us to risk that these vendors will not perform in accordance with the service arrangements, including by failing to protect the confidential information we entrust to them. Any security measures that we or our vendors implement, including encryption and authentication technology that we use to effect secure transmissions of confidential information, may not be effective to prevent the loss or theft of our information or to prevent risks associated with the Internet, such as cyber-fraud. Advances in computer capabilities, new discoveries in the field of cryptography, or other developments could permit unauthorized persons to gain access to our confidential information in spite of the use of security measures that we believe are adequate. Any compromise of our security measures or of the security measures employed by our vendors of our third party could disrupt our business and/or could subject us to claims from our customers, either of which could have a material adverse effect on our business, financial condition and results of operations.

Risks Relating to First United Corporation's Securities

The shares of common stock are not insured.

The shares of the Corporation's common stock are not deposits and are not insured against loss by the FDIC or any other governmental or private agency.

The common stock is not heavily traded.

The Corporation's common stock is listed on the NASDAQ Global Select Market, but shares of the common stock are not heavily traded. Securities that are not heavily traded can be more volatile than stock trading in an active public market. Factors such as our financial results, the introduction of new products and services by us or our competitors, and various factors affecting the banking industry generally may have a significant impact on the market price of the shares the common stock. Management cannot predict the extent to which an active public market for the common stock will develop or be sustained in the future. Accordingly, shareholders may not be able to sell their shares at the volumes, prices, or times that they desire.

Significant sales of the common stock, or the perception that significant sales may occur in the future, could adversely affect the market price for the common stock.

The sale of a substantial number of shares amounts of the Corporation's common stock could adversely affect the market price of the common stock. The availability of shares for future sale could adversely affect the prevailing market price of the common stock and could cause the market price of the common stock to remain low for a substantial amount of time. In addition, the Corporation may grant equity awards under its equity compensation plans from time to time in effect, including fully-vested shares of common stock. It is possible that if a significant percentage of such available shares were attempted to be sold within a short period of time, the market for the shares would be adversely affected. Management cannot predict whether the market for the common stock could absorb a large number of attempted sales in a short period of time, regardless of the price at which they might be offered. Even if a substantial number of sales do not occur within a short period of time, the mere existence of this "market overhang" could have a negative impact on the market for the common stock and our ability to raise capital in the future.

The common stock's inclusion in The NASDAQ Stock Market's "Tick Size Pilot Program" may limit your ability to sell your shares at the volumes, prices or times that you desire.

Effective October 31, 2016, the Corporation's common stock was randomly selected by The NASDAQ Stock Market for inclusion in "Test Group 3" of its "Tick Size Pilot Program". The program will last for two years and imposes wider minimum quoting and/or trading increments, or "tick sizes", for certain securities with small market capitalization. Specifically, subject to certain exceptions, the minimum quotation price and minimum trading price for securities in Test Group 3, like the common stock, have been widened to $0.05 per share, which means that the common stock must now be quoted in $0.05 minimum increments and must now trade at $0.05 minimum increments. In addition, securities in Test Group 3 are subject to a "trade-at" requirement that prevents price matching by a trading center that is not displaying a protected bid or protected offer, subject to certain exceptions. As a result, brokerage firms are now required to ensure that your orders with respect to shares of the common stock are priced in nickel increments. This means that the "limit" or "stop" prices that you may place on your order can no longer be in pennies and instead must be in increments of $0.05. We cannot predict the impact, if any, of the common stock's inclusion in this Tick Size Pilot Program. This program could adversely affect the market for the Corporation's common stock and could limit your ability to sell your shares at the prices, times and/or volumes that you desire.

The Corporation’s ability to pay dividends on the common stock is subject to the terms of the outstanding TPS Debentures, which prohibit the Corporation from paying dividends during an interest deferral period.

In March 2004, the Corporation issued approximately $30.9 million, in the aggregate, of junior subordinated debentures (“TPS Debentures”) to the Trusts in connection with the Trusts’ sales to third party investors of $30.0, in the aggregate, in mandatorily redeemable preferred capital securities. The terms of the TPS Debentures require the Corporation to make quarterly payments of interest to the Trusts, as the holders of the TPS Debentures, although the Corporation has the right to defer payments of interest for up to 20 consecutive quarterly periods. An election to defer interest payments does not constitute an event of default under the terms of the TPS Debentures. The terms of the TPS Debentures prohibit the Corporation from declaring or paying any dividends or making other distributions on, or from repurchasing, redeeming or otherwise acquiring, any shares of its capital securities, including the common stock, if the Corporation elects to defer quarterly interest payments under the TPS Debentures. In addition, a deferral election will require the Trusts to likewise defer the payment of quarterly dividends on their related trust preferred securities.

Applicable banking and Maryland laws impose additional restrictions on the ability of the Corporation and the Bank to pay dividends and make other distributions on their capital securities, and, in any event, the payment of dividends is at the discretion of the boards of directors of the Corporation and the Bank.

In the past, the Corporation has funded dividends on its capital securities using cash received from the Bank, and this will likely be the case for the foreseeable future. No assurance can be given that the Bank will be able to pay dividends to the Corporation for these purposes at times and/or in amounts requested by the Corporation. Both federal and state laws impose restrictions on the ability of the Bank to pay dividends. Under Maryland law, a state-chartered commercial bank may pay dividends only out of undivided profits or, with the prior approval of the Maryland Commissioner, from surplus in excess of 100% of required capital stock. If, however, the surplus of a Maryland bank is less than 100% of its required capital stock, cash dividends may not be paid in excess of 90% of net earnings. In addition to these specific restrictions, bank regulatory agencies have the ability to prohibit proposed dividends by a financial institution which would otherwise be permitted under applicable regulations if the regulatory body determines that such distribution would constitute an unsafe or unsound practice. Banks that are considered “troubled institution” are prohibited by federal law from paying dividends altogether. Notwithstanding the foregoing, shareholders must understand that the declaration and payment of dividends and the amounts thereof are at the discretion of the Corporation’s Board of Directors. Thus, even at times when the Corporation is not prohibited from paying cash dividends on its capital securities, neither the payment of such dividends nor the amounts thereof can be guaranteed.

The Corporation’s Articles of Incorporation and Bylaws and Maryland law may discourage a corporate takeover.

The Corporation's Amended and Restated Articles of Incorporation (the "Charter") and its Amended and Restated Bylaws, as amended (the "Bylaws"), contain certain provisions designed to enhance the ability of the Corporation's Board of Directors to deal with attempts to acquire control of the Corporation. First, the Board of Directors is classified into three classes. Directors of each class serve for staggered three-year periods, and no director may be removed except for cause, and then only by the affirmative vote of either a majority of the entire Board of Directors or a majority of the outstanding voting stock. Second, the board has the authority to classify and reclassify unissued shares of stock of any class or series of stock by setting, fixing, eliminating, or altering in any one or more respects the preferences, rights, voting powers, restrictions and qualifications of, dividends on, and redemption, conversion, exchange, and other rights of, such securities. The board could use this authority, along with its authority to authorize the issuance of securities of any class or series, to issue shares having terms favorable to management to a person or persons affiliated with or otherwise friendly to management. In addition, the Bylaws require any shareholder who desires to nominate a director to abide by strict notice requirements.

Maryland law also contains anti-takeover provisions that apply to the Corporation. The Maryland Business Combination Act generally prohibits, subject to certain limited exceptions, corporations from being involved in any "business combination" (defined as a variety of transactions, including a merger, consolidation, share exchange, asset transfer or issuance or reclassification of equity securities) with any "interested shareholder" for a period of five years following the most recent date on which the interested shareholder became an interested shareholder. An interested shareholder is defined generally as a person who is the beneficial owner of 10% or more of the voting power of the outstanding voting stock of the corporation after the date on which the corporation had 100 or more beneficial owners of its stock or who is an affiliate or associate of the corporation and was the beneficial owner, directly or indirectly, of 10% percent or more of the voting power of the then outstanding stock of the corporation at any time within the two-year period immediately prior to the date in question and after the date on which the corporation had 100 or more beneficial owners of its stock. The Maryland Control Share Acquisition Act applies to acquisitions of "control shares", which, subject to certain exceptions, are shares the acquisition of which entitle the holder, directly or indirectly, to exercise or direct the exercise of the voting power of shares of stock of the corporation in the election of directors within any of the following ranges of voting power: one-tenth or more, but less than one-third of all voting power; one-third or more, but less than a majority of all voting power or a majority or more of all voting power. Control shares have limited voting rights.

Although these provisions do not preclude a takeover, they may have the effect of discouraging, delaying or deferring a tender offer or takeover attempt that a shareholder might consider in his or her best interest, including those attempts that might result in a premium over the market price for the common stock. Such provisions will also render the removal of the Board of Directors and of management more difficult and, therefore, may serve to perpetuate current management. These provisions could potentially adversely affect the market prices of the Corporation's securities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The headquarters of the Corporation and the Bank occupies approximately 29,000 square feet at 19 South Second Street, Oakland, Maryland, and a 30,000 square feet operations center located at 12892 Garrett Highway, Oakland Maryland. These premises are owned by the Corporation. The Bank owns 19 of its banking offices and leases five. The Bank also leases one office that is used for disaster recovery purposes. Total rent expense on the leased offices and properties was $.5 million in 2017.

ITEM 3. LEGAL PROCEEDINGS

We are at times, in the ordinary course of business, subject to legal actions. Management, upon the advice of counsel, believes that losses, if any, resulting from current legal actions will not have a material adverse effect on our financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Shares of the Corporation's common stock are listed on the NASDAQ Global Select Market under the symbol "FUNC". As of February 28, 2018, the Corporation had 1,423 shareholders of record. The table below sets forth the high and low sales prices for the shares of the Corporation's common stock for each quarterly period of 2017 and 2016, as reported on the NASDAQ Global Select Market. On March 7, 2018, the closing sales price of the common stock as reported on the NASDAQ Global Select Market was $19.75 per share. The Corporation did not declare any dividends on its common stock during 2017 or 2016.

	High	Low
2017		
1st Quarter	$15.80	$13.00
2nd Quarter	15.80	13.80
3rd Quarter	16.65	14.55
4th Quarter	18.30	15.75
2016		
1st Quarter	$11.70	$8.82
2nd Quarter	11.34	9.65
3rd Quarter	12.38	9.58
4th Quarter	16.95	11.06

The ability of the Corporation to declare dividends is limited by federal banking laws and Maryland corporation laws. Subject to these and the terms of its other securities, including the TPS Debentures, the payment of dividends on the shares of common stock and the amounts thereof are at the discretion of the Corporation's board of directors. In November 2010, the Corporation's board of directors suspended the declaration and payment of cash dividends. Prior to that suspension, cash dividends were typically declared on a quarterly basis. When paid, dividends to shareholders have historically been dependent on the ability of the Corporation's subsidiaries, especially the Bank, to declare dividends to the Corporation. Like the Corporation, the Bank's ability to declare and pay dividends is subject to limitations imposed by federal and Maryland banking and Maryland corporation laws. A complete discussion of these and other dividend restrictions is contained in Item 1A of Part I of this annual report under the heading "***Risks Relating to First United Corporation's Securities***" and in Note 21 to the Consolidated Financial Statements, both of which are incorporated herein by reference. Accordingly, there can be no assurance that dividends will be declared on the shares of common stock in any future fiscal quarter.

The Corporation's Board of Directors periodically evaluates the Corporation's dividend policy, both internally and in consultation with the Federal Reserve.

Issuer Repurchases

Neither the Corporation nor any of its affiliates (as defined by Exchange Act Rule 10b-18) repurchased any shares of the Corporation's common stock during 2017.

Equity Compensation Plan Information

Pursuant to the SEC's Regulation S-K Compliance and Disclosure Interpretation 106.01, the information regarding the Corporation's equity compensation plans required by this Item pursuant to Item 201(d) of Regulation S-K is located in Item 12 of Part III of this annual report and is incorporated herein by reference.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth certain selected financial data for each of the last five calendar years and is qualified in its entirety by the detailed information and financial statements, including notes thereto, included elsewhere or incorporated by reference in this annual report.

(Dollars in thousands, except for share data)	2017	2016	2015	2014	2013
Balance Sheet Data					
Total Assets	$1,340,839	$1,318,190	$1,323,458	$1,332,296	$1,334,046
Net Loans	882,546	882,008	867,101	827,926	796,646
Investment Securities	240,102	237,169	275,792	330,566	340,489
Deposits	1,039,390	1,014,229	998,794	981,323	977,403
Long-term Borrowings	120,929	131,737	147,537	182,606	182,672
Shareholders' Equity	108,390	113,698	120,771	108,999	101,883
Operating Data					
Interest Income	$46,949	$45,863	$45,032	$46,386	$49,914
Interest Expense	7,371	8,223	9,407	10,870	11,732
Net Interest Income	39,578	37,640	35,625	35,516	38,182
Provision for Loan Losses	2,534	3,122	1,054	2,513	380
Other Operating Income	14,259	14,127	24,992	12,907	13,137
Net Gains	29	526	1,016	1,053	229
Other Operating Expense	39,118	39,107	41,115	40,095	42,471
Income Before Taxes	12,214	10,064	19,464	6,868	8,697
Income Tax expense(includes $3,226 from tax reform impact) [1]	6,945	2,783	6,473	1,271	2,222
Net Income	$5,269	$7,281	$12,991	$5,597	$6,475
Accumulated preferred stock dividends and discount accretion	(1,215)	(2,025)	(2,700)	(2,601)	(1,778)
Net income available to common shareholders	$4,054	$5,256	$10,291	$2,996	$4,697
Per Share Data					
Basic and diluted net income per common share	$0.58	$0.84	$1.65	$0.48	$0.76
Book Value	15.34	14.95	14.51	13.30	11.49
Significant Ratios					
Return on Average Assets	0.40 %	0.55 %	0.98 %	0.42 %	0.49 %
Return on Average Equity	4.52 %	6.38 %	11.40 %	5.07 %	6.48 %
Average Equity to Average Assets	8.82 %	8.62 %	8.69 %	8.26 %	7.52 %
Total Risk-based Capital Ratio	15.98 %	16.71 %	17.21 %	15.40 %	15.33 %
Tier I Capital to Risk Weighted Assets	14.97 %	14.76 %	15.24 %	14.23 %	13.71 %
Tier I Capital to Average Assets	11.00 %	10.95 %	11.64 %	11.29 %	11.02 %

Common Equity Tier I to Risk Weighted Assets	12.54 %	10.74 %	9.99 %

(1) Refer to Note 1 for more discussion of tax reform

[23]

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion and analysis should be read in conjunction with the Consolidated Financial Statements and notes thereto for the years ended December 31, 2017 and 2016, which are included in Item 8 of Part II of this annual report.

Overview

First United Corporation is a bank holding company that, through the Bank and its non-bank subsidiaries, provides an array of financial products and services primarily to customers in four Western Maryland counties and four Northeastern West Virginia counties. Its principal operating subsidiary is the Bank, which consists of a community banking network of 24 branch offices located throughout its market areas. Our primary sources of revenue are interest income earned from our loan and investment securities portfolios and fees earned from financial services provided to customers.

Consolidated net income available to common shareholders was $4.1 million for the year ended December 31, 2017, compared to $5.3 million for 2016. Basic and diluted net income per common share for the year ended December 31, 2017 were both $.58, compared to basic and diluted net income per common share of $.84 for 2016. The decrease in earnings for 2017 was primarily attributable to a $3.2 million, or $.49 per common share, increase in income tax expense on account of the enactment of the Tax Cuts and Jobs Act (the "Tax Act"), which required us to revalue our deferred tax assets and liabilities at December 31, 2017. When comparing 2017 to 2016, service charge income decreased, primarily due to a reduction in non-sufficient funds ("NSF") income, and Bank Owned Life Insurance ("BOLI") income decreased due to the receipt of one-time death benefits in the second quarter of 2016. These decreases were offset by increases in net interest income of $1.9 million, a $.6 million decrease in provision expense, a decrease of $.8 million in preferred stock dividends due to the redemption in March 2017 of $10.0 million and November 2017 of $10.0 million of the Corporation's Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the "Series A Preferred Stock") in both March 2017 and November 2017, and a decrease of $.3 million in FDIC premiums. The net interest margin for the year ended December 31, 2017, on a fully tax equivalent ("FTE") basis, increased to 3.37% from 3.19% for the year ended December 31, 2016.

The provision for loan losses decreased to $2.5 million for the year ended December 31, 2017 compared to $3.1 million for the year ended December 31, 2016. The decrease was driven by a reduction in net credit losses and reduced loan growth in 2017. Specific allocations have been made for impaired loans where management has determined that the collateral supporting the loans is not adequate to cover the loan balance, and the qualitative factors affecting the allowance for loan losses (the "ALL") have been adjusted based on the current economic environment and the characteristics of the loan portfolio.

Other operating income decreased $.4 million for the year ended December 31, 2017 when compared to 2016. This decrease was primarily attributable to a $.5 million decrease in the net gains on sales of investment securities due to reduced activity in the investment portfolio in 2017, a decrease in service charge income, primarily due to a reduction of NSF fees, a decrease in BOLI income due to the receipt of a one-time death claim in the second quarter of 2016, and a decrease in other miscellaneous income related to a one-time payment received in the third quarter of 2016 from the State of West Virginia for a right of way provision at one of our branch locations. These decreases were offset slightly by increased trust department and debit card income.

Operating expenses remained relatively consistent for the year ended December 31, 2017 when compared to the same period of 2016. Salaries and benefits increased $1.8 million due to new hires in late 2016 and annual merit increases as well as an increase in our life and health insurance expense that resulted from increased claims in 2017. We also saw an increase of $.5 million in data processing and equipment expense related to new services implemented in late 2016 and early 2017 and depreciation expense from the branch renovation projects related to the new branding efforts throughout the Bank. These increases were offset by a $.3 million decrease in FDIC premiums, a decrease of $.6 million in other real estate owned (“OREO”) expenses due to reductions in valuation write-downs on properties, and decreases in legal and professional expense, office supplies, trust department expense, miscellaneous loan fees, expenses related to fraud and other miscellaneous expenses due primarily to a $.3 million reserve for a litigation claim recorded in the first quarter of 2016.

Comparing December 31, 2017 to December 31, 2016, loans outstanding increased slightly by $.6 million (.07%). CRE loans decreased $14.8 million due primarily to charge-offs of $4.5 million on one large non-accrual loan, payoffs of $22.0 million on two large CRE loans offset by new production in the fourth quarter. Acquisition and development (“A&D”) loans increased $6.2 million and commercial and industrial (“C&I”) loans increased $4.4 million. Residential mortgage loans increased $5.2 million due to continued activity in the 1-4 family residential professional program, offset by payoffs and amortization of home equity balances. The consumer loan portfolio decreased slightly by $.4 million due to regularly scheduled payments. Approximately 28% of the commercial loan portfolio was collateralized by real estate at December 31, 2017 and 39% at December 31, 2016.

Interest income on loans increased by $.7 million (on a FTE basis) in 2017 when compared to 2016 due primarily to the rate increases by the Federal Reserve in 2017 as well as prepayment fees collected on early loan payoffs. Interest income on our investment securities increased slightly by $.1 million (on a FTE basis) in 2017 when compared to 2016. During 2017, we used the cashflow on the investment portfolio to fund loans and had minimal activity in new purchases. Additional information on the composition of interest income is available in Table 1 that appears on page 29 of this report.

Comparing December 31, 2017 to December 31, 2016, total deposits increased $25.2 million. During 2017, we continued to see increases in core deposits and reductions in certificates of deposit. Non-interest bearing deposits increased $30.4 million due to building new relationships with both consumer and commercial customers as well as increased balances on existing accounts. Traditional savings accounts increased $8.1 million as we continued to see growth in our Prime Saver product. Total demand deposits increased $2.6 million and total money market accounts decreased $9.1 million due to decreased balances in our ICS money market account relating to the re-allocation of cash in our trust accounts. Time deposits less than $100,000 declined $9.6 million and time deposits greater than $100,000 increased $2.6 million.

Interest expense decreased for the year ended December 31, 2017 when compared to the year ended December 31, 2016. This decrease was primarily due to the reduction of long-term borrowings from the payoff of a $15.0 million FHLB advance at its maturity in December 2016 and the March 2017 repayment of $10.8 million of TPS Debentures that were issued to Trust III, as well as the continued shift of higher cost certificates of deposit to lower cost core accounts. The effect on the average rate paid on total interest-bearing liabilities was a six basis point decrease from .84% for 2016 to .78% for 2017.

On December 22, 2017, the President of the United States signed the Tax Act into law, which, among other things, reduced the federal income tax rate for C Corporations from 35% to 21% effective January 1, 2018. The Tax Act required us to revalue, using the new 21% federal income tax rate, all of our deferred tax assets and deferred tax liabilities based on the rates at which they are schedule to reverse. This revaluation required us to recognize a one-time tax expense of $3.2 million in the fourth quarter of 2017. Our effective tax rate for 2017 was 56.8%, of which 26.4% related to the revaluation required by the Tax Act. For 2016, our effective tax rate was 27.6%.

Estimates and Critical Accounting Policies

This discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. (See Note 1 to the Consolidated Financial Statements.) On an on-going basis, management evaluates estimates and bases those estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Management believes the following critical accounting policies affect our more significant judgments and estimates used in the preparation of the Consolidated Financial Statements.

Allowance for Loan Losses

One of our most important accounting policies is that related to the monitoring of the loan portfolio. A variety of estimates impact the carrying value of the loan portfolio and resulting interest income, including the calculation of the ALL, the valuation of underlying collateral, and the timing of loan charge-offs. The ALL is established and maintained at a level that management believes is adequate to cover losses resulting from the inability of borrowers to make required payments on loans. Estimates for loan losses are arrived at by analyzing risks associated with specific loans and the loan portfolio, current and historical trends in delinquencies and charge-offs, and changes in the size and composition of the loan portfolio. The analysis also requires consideration of the economic climate and direction, changes in lending rates, political conditions, legislation impacting the banking industry and economic conditions specific to Western Maryland and Northeastern West Virginia. Because the calculation of the ALL relies on management's estimates and judgments relating to inherently uncertain events, actual results may differ from management's estimates.

The ALL is also discussed below in Item 7 under the heading "Allowance for Loan Losses" and in Note 7 to the Consolidated Financial Statements.

Goodwill

Accounting Standards Codification ("ASC") Topic 350, *Intangibles - Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. The $11.0 million in recorded goodwill at December 31, 2017 is related to the Bank's 2003 acquisition of Huntington National Bank branches and is not subject to periodic amortization.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of an entity's reporting units be compared to the carrying amount of its net assets, including goodwill. If the estimated current fair value of the reporting unit exceeds its carrying value, then no additional testing is required and an impairment loss is not recorded. Otherwise, additional testing is performed and, to the extent such additional testing results in a conclusion that the carrying value of goodwill exceeds its implied fair value, an impairment loss is recognized.

For evaluation purposes, the Corporation is considered to be a single reporting unit. Accordingly, our goodwill relates to value inherent in the banking business and the value is dependent upon our ability to provide quality, cost effective services in a highly competitive local market. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. ASC Topic 350 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments and estimates.

At December 31, 2017, the date of the Corporation's annual impairment test, the fair value of the Corporation as determined by the price of its common stock exceeded the carrying amount of the Corporation's common equity.

Based on the results of the evaluation, management concluded that the recorded value of goodwill at December 31, 2017 was not impaired. However, future changes in strategy and/or market conditions could significantly impact these judgments and require adjustments to recorded asset balances. Management will continue to evaluate goodwill for impairment on an annual basis and as events occur or circumstances change.

Accounting for Income Taxes

We account for income taxes in accordance with ASC Topic 740, "*Income Taxes*". Under this guidance, deferred taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates that will apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized as income or expense in the period that includes the enactment date.

We regularly review the carrying amount of our net deferred tax assets to determine if the establishment of a valuation allowance is necessary. If based on the available evidence, it is more likely than not that all or a portion of our net deferred tax assets will not be realized in future periods, then a deferred tax valuation allowance must be established. Consideration is given to various positive and negative factors that could affect the realization of the deferred tax assets. In evaluating this available evidence, management considers, among other things, historical performance, expectations of future earnings, the ability to carry back losses to recoup taxes previously paid, length of statutory carry forward periods, experience with utilization of operating loss and tax credit carry forwards not expiring, tax planning strategies and timing of reversals of temporary differences. Significant judgment is required in assessing future earnings trends and the timing of reversals of temporary differences. Our evaluation is based on current tax laws as well as management's expectations of future performance.

Management expects that the Corporation's adherence to the required accounting guidance may result in increased volatility in quarterly and annual effective income tax rates because of changes in judgment or measurement including changes in actual and forecasted income before taxes, tax laws and regulations, and tax planning strategies.

Additional information about income taxes is set forth below under the heading, "CONSOLIDATED STATEMENT OF INCOME REVIEW – Applicable Income Taxes" and in Note 17 to Consolidated Financial Statements presented in Item 8 of Part II of this annual report.

Other-Than-Temporary Impairment of Investment Securities

Management systematically evaluates the securities in our investment portfolio for impairment on a quarterly basis. Based upon the application of accounting guidance for subsequent measurement in ASC Topic 320 (Section 320-10-35), management assesses whether (i) we have the intent to sell a security being evaluated and (ii) it is more likely than not that we will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating other-than-temporary impairment ("OTTI") losses, management considers (a) the length of time and the extent to which the fair value has been less than cost, (b) adverse conditions specifically related to the security, an industry, or a geographic area, (c) the historic and implied volatility of the fair value of the security, (d) changes in the rating of the security by a rating agency, (e) recoveries or additional declines in fair value subsequent to the balance sheet date, (f) failure of the issuer of the security to make scheduled interest or principal payments, and (g) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35). This process is described more fully in the section of the Consolidated Balance Sheet Review entitled "Investment Securities".

Fair Value of Investments

We have determined the fair value of our investment securities in accordance with the requirements of ASC Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements required under other accounting pronouncements. We measure the fair market values of our investments based on the fair value hierarchy established in Topic 820. The determination of fair value of investments and other assets is discussed further in Note 23 to the Consolidated Financial Statements.

Pension Plan Assumptions

Our pension plan costs are calculated using actuarial concepts, as discussed within the requirements of ASC Topic 715, *Compensation – Retirement Benefits.* Pension expense and the determination of our projected pension liability are based upon two critical assumptions: the discount rate and the expected return on plan assets. We evaluate each of these critical assumptions annually. Other assumptions impact the determination of pension expense and the projected liability including the primary employee demographics, such as retirement patterns, employee turnover, mortality rates, and estimated employer compensation increases. These factors, along with the critical assumptions, are carefully reviewed by management each year in consultation with our pension plan consultants and actuaries. Further information about our pension plan assumptions, the plan’s funded status, and other plan information is included in Note 18 to the Consolidated Financial Statements.

Other than as discussed above, management does not believe that any material changes in our critical accounting policies have occurred since December 31, 2017.

Adoption of New Accounting Standards and Effects of New Accounting Pronouncements

Note 1 to the Consolidated Financial Statements discusses new accounting pronouncements that, when adopted, could affect our future consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME REVIEW

Net Interest Income

Net interest income is our largest source of operating revenue. Net interest income is the difference between the interest that we earn on our interest-earning assets and the interest expense we incur on our interest-bearing liabilities. For analytical and discussion purposes, net interest income is adjusted to a FTE basis to facilitate performance comparisons between taxable and tax-exempt assets by increasing tax-exempt income by an amount equal to the federal income taxes that would have been paid if this income were taxable at the statutorily applicable rate. This is a Non-GAAP disclosure and management believes it is not materially different than GAAP.

The table below summarizes net interest income (on a FTE basis) for 2017 and 2016.

(Dollars in thousands)	2017	2016
Interest income	$47,586	46,418
Interest expense	7,371	8,223
Net interest income	$40,215	$38,195
Net interest margin %	3.37 %	3.19 %

Net interest income on an FTE basis increased $2.0 million (5.5%) for the year ended December 31, 2017 when compared to 2016 due to a $1.2 million (2.7%) increase in interest income and a $.8 million (10.4%) decrease in interest expense. The increase in interest income was primarily due to an increase of $.7 million in loan interest and fee income and an increase of $.4 million in interest earned on federal funds sold due to excess cash invested with Federal Reserve at the increased rates. The decline in interest expense was due to the reduction of $23.0 million in average balances of long-term borrowings due to the payoff of a $15.0 million FHLB advance at its maturity in December 2016 and the repayment of $10.8 million of TPS Debentures held by Trust III in March 2017. The net interest margin for the year ended December 31, 2017 increased to 3.37% when compared to 3.19% for the year ended December 31, 2016.

When comparing the year ended December 31, 2017 to the year ended December 31, 2016, there was a decrease of $2.5 million in average interest-earning assets, driven primarily by a decrease of $11.3 million in average investment balances and a decrease of $9.6 million in average loan balances, offset by an increase of $19.3 million in federal funds sold related to the excess cash balances invested at the Federal Reserve.

Interest expense decreased for the year ended December 31, 2017 when compared to the year ended December 31, 2016. This decrease was primarily due to the reduction of long-term borrowings from the payoff of a $15.0 million FHLB advance at its maturity in December 2016 and the repayment of $10.8 million of TPS Debentures held by Trust III in March 2017 and the continued shift of higher cost certificates of deposit to lower cost core accounts. The effect on the average rate paid on total interest-bearing liabilities was a six-basis point decrease, from .84% for 2016 to .78% for 2017.

[27]

As shown below, the composition of total interest income between 2017 and 2016 remained relatively stable between interest and fees on loans and investment securities with a slight decrease in interest and fees on loans and a slight increase in other due to the excess cash balances invested at Fed.

	% of Total Interest Income			
	2017		2016	
Interest and fees on loans	84	%	85	%
Interest on investment securities	14	%	14	%
Other	2	%	1	%

[28]

Table 1 sets forth the average balances, net interest income and expense, and average yields and rates for our interest-earning assets and interest-bearing liabilities for 2017, 2016 and 2015. Table 2 sets forth an analysis of volume and rate changes in interest income and interest expense of our average interest-earning assets and average interest-bearing liabilities for 2017, 2016 and 2015. Table 2 distinguishes between the changes related to average outstanding balances (changes in volume created by holding the interest rate constant) and the changes related to average interest rates (changes in interest income or expense attributed to average rates created by holding the outstanding balance constant).

Distribution of Assets, Liabilities and Shareholders' Equity

Interest Rates and Interest Differential – Tax Equivalent Basis

Table 1

	For the Years Ended December 31								
	2017			2016			2015		
(Dollars in thousands)	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate	Average Balance	Interest	Average Yield/Rate
Assets									
Loans	$889,880	$ 39,670	4.46%	$899,516	$ 38,981	4.33%	$846,391	$ 37,201	4.40%
Investment Securities:									
Taxable	220,107	5,554	2.52	228,174	5,611	2.46	276,063	6,248	2.26
Non taxable	17,602	1,527	8.68	20,840	1,391	6.67	34,820	2,023	5.81
Total	237,709	7,081	3.01	249,014	7,002	2.81	310,883	8,271	2.66
Federal funds sold	59,275	574	0.97	40,011	161	0.40	27,411	49	0.18
Interest-bearing deposits with other banks	1,879	9	0.48	2,032	4	0.20	4,022	4	0.10
Other interest earning assets	5,206	252	4.84	5,855	270	4.61	6,641	302	4.55
Total earning assets	1,193,949	47,586	3.99%	1,196,428	46,418	3.88%	1,195,348	45,827	3.83%
Allowance for loan losses	(10,854)			(12,183)			(12,072)		
Non-earning assets	138,918			140,819			127,851		
Total Assets	$1,322,013			$1,325,064			$1,311,127		
Liabilities and Shareholders' Equity									
Interest-bearing demand deposits	$171,697	$ 113	0.07%	$176,049	$ 137	0.08%	$149,214	$ 104	0.07%
Interest-bearing money markets	221,325	467	0.21	234,075	349	0.15	210,109	477	0.23
Savings deposits	156,538	176	0.11	147,428	168	0.11	136,946	228	0.17

Time deposits:									
Less than $100k	114,503	1,123	0.98	124,129	1,245	1.00	142,188	1,471	1.03
$100k or more	120,190	1,412	1.17	120,253	1,251	1.04	132,579	1,625	1.23
Short-term borrowings	37,376	73	0.20	31,007	60	0.19	36,048	58	0.16
Long-term borrowings	123,356	4,007	3.25	146,315	5,013	3.43	164,693	5,444	3.31
Total interest-bearing liabilities	944,985	7,371	0.78%	979,256	8,223	0.84%	971,777	9,407	0.97%
Non-interest-bearing deposits	237,578			209,948			204,453		
Other liabilities	22,867			21,703			20,925		
Shareholders’ Equity	116,583			114,157			113,972		
Total Liabilities and Shareholders’ Equity	$1,322,013			$1,325,064			$1,311,127		
Net interest income and spread		$ 40,215	3.21%		$ 38,195	3.04%		$ 36,420	2.86%
Net interest margin			3.37%			3.19%			3.04%

Notes:

(1) The above table reflects the average rates earned or paid stated on a FTE basis assuming a tax rate of 35% for 2017, 2016 and 2015. Non-GAAP interest income on a fully taxable equivalent basis for the years ended December 31, 2017, 2016 and 2015 were $637, $555 and $795, respectively.

(2) The average balances of non-accrual loans for the years ended December 31, 2017, 2016 and 2015, which were reported in the average loan balances for these years, were $10,872, $14,953 and $11,952, respectively.

(3) Net interest margin is calculated as net interest income divided by average earning assets.

(4) The average yields on investments are based on amortized cost.

Interest Variance Analysis (1)

Table 2

(In thousands and tax equivalent basis)	2017 Compared to 2016 Volume	Rate	Net	2016 Compared to 2015 Volume	Rate	Net
Interest Income:						
Loans	$(418)	$1,107	$689	$2,337	$(557)	$1,780
Taxable Investments	(198)	141	(57)	(1,082)	445	(637)
Non-taxable Investments	(216)	352	136	(812)	180	(632)
Federal funds sold	78	335	413	23	89	112
Interest-bearing deposits	0	5	5	(2)	2	0
Other interest earning assets	(30)	12	(18)	(36)	4	(32)
Total interest income	(784)	1,952	1,168	428	163	591
Interest Expense:						
Interest-bearing demand deposits	(3)	(21)	(24)	19	14	33
Interest-bearing money markets	(19)	137	118	55	(183)	(128)
Savings deposits	10	(2)	8	18	(78)	(60)
Time deposits less than $100	(97)	(25)	(122)	(186)	(40)	(226)
Time deposits $100 or more	(1)	162	161	(152)	(222)	(374)
Short-term borrowings	12	1	13	(8)	10	2
Long-term borrowings	(787)	(219)	(1,006)	(608)	177	(431)
Total interest expense	(885)	33	(852)	(862)	(322)	(1,184)
Net interest income	$101	$1,919	$2,020	$1,290	$485	$1,775

Note:

(1) The change in interest income/expense due to both volume and rate has been allocated to volume and rate changes in proportion to the relationship of the absolute dollar amounts of the change in each.

Provision for Loan Losses

The provision for loan losses was $2.5 million for the year ended December 31, 2017 compared to $3.1 million for the year ended December 31, 2016. The decrease was driven by a reduction in net credit losses and reduced loan growth in 2017 (discussed below in the section entitled "FINANCIAL CONDITION, Allowance and Provision for Loan Losses"). Management believes that the ALL reflects a level commensurate with the risk inherent in our loan portfolio.

Other Operating Income

The following table shows the major components of other operating income for the past two years, exclusive of net gains, and the percentage changes during these years:

(Dollars in thousands)	2017	2016	% Change	
Service charges on deposit accounts	$2,308	$2,428	-4.94	%
Other service charge income	837	853	-1.88	%
Debit card income	2,337	2,112	10.65	%
Trust department income	6,246	5,837	7.01	%
Bank owned life insurance (BOLI) income	1,186	1,426	-16.83	%
Brokerage commissions	872	849	2.71	%
Other income	473	622	-23.95	%
Total other operating income	$14,259	$14,127	0.94	%

Other operating income, exclusive of net gains, increased slightly by $.1 million for the year ended December 31, 2017 when compared to 2016. As compared to 2016, the Company experienced increases in trust department earnings of $.4 million and debit card income of $.2 million, which were offset by a decrease in service charge income of $.1 million due primarily to a reduction in NSF fees, and a decrease in BOLI income of $.2 million due to the receipt of a one-time death benefit in the second quarter of 2016. Trust assets under management were $824 million at December 31, 2017 and $740 million at December 31, 2016.

Net gains of $29 thousand were reported through other income for the year ended December 31, 2017, compared to net gains of $.5 million for 2016. The reduction in gains realized in 2017 was due to reduced sale activity in 2017.

Other Operating Expense

The following table compares the major components of other operating expense for 2017 and 2016:

(Dollars in thousands)	2017	2016	% Change	
Salaries and employee benefits	$22,391	$20,595	8.72	%
Other expenses	5,127	6,309	-18.74	%
FDIC premiums	634	940	-32.55	%
Equipment	2,610	2,437	7.10	%
Occupancy	2,496	2,499	-0.12	%
Data processing	3,339	3,065	8.94	%
Professional services	985	1,127	-12.60	%
Other real estate owned expense	190	802	-76.31	%
Contract labor	683	718	-4.87	%
Line rentals	663	615	7.80	%
Total other operating expense	$39,118	$39,107	0.03	%

Operating expenses remained relatively consistent for the year ended December 31, 2017 when compared to the same period of 2016. Salaries and benefits increased $1.8 million due to new hires in late 2016 and annual merit increases as well as an increase in our life and health insurance expense due to increased claims in 2017. We also saw an increase of $.5 million in data processing and equipment expense related to new services implemented in late 2016 and early 2017 and depreciation expense from the branch renovation projects related to the new branding efforts throughout the Bank. These increases were offset by a $.3 million decrease in FDIC premiums, a decrease of $.6 million in OREO expenses due to reductions in valuation write-downs on properties, and decreases in legal and professional expense, office supplies, trust department expense, miscellaneous loan fees, expenses related to fraud and other miscellaneous expenses due primarily to a $.3 million reserve for a litigation claim recorded in the first quarter of 2016.

Applicable Income Taxes

We recognized a tax expense of $6.9 million in 2017, compared to a tax expense of $2.8 million in 2016. As noted above, $3.2 million of our tax expense recorded in 2017 resulted from the revaluation of our deferred tax assets and liabilities required by the Tax Act. See the discussion under “Income Taxes” in Note 17 to the Consolidated Financial

Statements presented elsewhere in this annual report for a detailed analysis of our deferred tax assets and liabilities. A valuation allowance has been provided for the $2.4 million in deferred tax assets associated with state tax loss carry forwards, which will expire commencing in 2030.

At December 31, 2017, the Corporation had federal net operating losses ("NOLs") of approximately $3.8 million and West Virginia NOLs of approximately $3.9 million for which deferred tax assets of $.8 million and $.2 million, respectively, have been recorded at December 31, 2017. The federal NOLs were created in 2014 and 2016 and will begin to expire in 2037. West Virginia NOLs were created in 2010, 2012, 2014 and 2016 and will begin to expire in 2031. Management has determined that a deferred tax valuation allowance for these NOLs is not required for 2017 because management believes it is more likely than not (defined a level of likelihood that is more than 50%) that these deferred tax assets will be realized prior to the expiration of their carry-forward periods.

At December 31, 2017, the Corporation had Maryland NOLs of $39.5 million for which a deferred tax asset of $2.4 million has been recorded. There has been and continues to be a full valuation allowance on these NOLs based on the fact that management's belief that it is more likely than not that these NOLs will not be realized prior to the expiration of their carry-forward periods because the Corporation files a separate Maryland income tax return, the Corporation has recurring tax losses, and management believes the Corporation will not generate sufficient taxable income in the future to fully utilize the NOLs. The valuation allowance of $2.4 million at December 31, 2017 reflects an increase of $.5 million from the level at December 31, 2016.

We have concluded that no valuation allowance is deemed necessary for our remaining federal and state deferred tax assets at December 31, 2017, as it is more likely than not that they will be realized based on the expected reversal of deferred tax liabilities, the generation of future income sufficient to realize the deferred tax assets as they reverse, and the ability to implement tax planning strategies to prevent the expiration of any carry-forward periods. In making this determination, management considered the following:

- the expected reversal of $.5 million of the total $3.3 million of deferred tax liabilities at December 31, 2017 in such a manner so as to substantially utilize the dollar for dollar impact against the deferred tax assets at December 31, 2017;
- for the remaining excess deferred tax assets that will not be utilized by the reversal of deferred tax liabilities, our expected future income will be sufficient to utilize the deferred tax assets as they reverse or before any net operating loss, would expire; and
- tax planning strategies that can provide both one-time increases to taxable income of up to approximately $9.0 million and recurring annual decreases in unfavorable permanent items.

CONSOLIDATED BALANCE SHEET REVIEW

Overview

Total assets at December 31, 2017 remained unchanged from the $1.3 billion recorded at December 31, 2016. Comparing 2017 to 2016, cash and interest-bearing deposits in other banks increased $20.4 million, the investment portfolio increased $2.9 million, and gross loans increased slightly by $.6 million. Net deferred tax assets decreased by $10.1 million largely due the use of NOLs in 2017, contributions to the pension plan, a recharacterization of Alternative Minimum Tax Credit Carryforwards to refundable income tax consistent with the Tax Act, and a revaluation of all our deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future. The latter resulted in a reduction of $3.2 million due to lower future tax rates under the Tax Act. OREO balances decreased $.8 million due to sales of properties in 2017. The balance of our BOLI investments increased $1.2 million due to earnings in 2017. Total liabilities increased by $28.0 million for the year ended December 31, 2017 when compared to 2016 due primarily to an increase of $25.2 million in deposits, and a $12.8 million increase in short-term borrowings related to increased balances in Treasury Management overnight investments, offset by a decrease of $10.8 million in long-term borrowings as a result of the repayment of $10.8 million in TPS Debentures held by Trust III in March 2017. Comparing December 31, 2017 to December 31, 2016, shareholders' equity decreased $5.3 million as a result of the Corporation's redemption of $20.0 million of outstanding shares of Series A Preferred Stock during 2017, offset by the $9.2 million, net of offering expenses, realized m the Corporation's common stock rights offering that was completed in March 2017 and the $4.1 million in net income recorded for 2017.

The total interest-earning asset mix remained relatively stable at December 31, 2017 and December 31, 2016. The mix for each year is illustrated below:

	Year End Percentage of Total Assets			
	2017		2016	
Cash and cash equivalents	6	%	5	%
Net loans	66	%	67	%
Investments	18	%	18	%

The year-end total liability mix has remained consistent during the two-year period as illustrated below.

	Year End Percentage of Total Liabilities			
	2017		2016	
Total deposits	84	%	84	%
Total borrowings	14	%	14	%

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Loan Portfolio

The Bank is actively engaged in originating loans to customers primarily in Allegany County, Frederick County, Garrett County, and Washington County in Maryland, and in Berkeley County, Mineral County, Monongalia County, and Harrison County in West Virginia; and the surrounding regions of West Virginia and Pennsylvania. We have policies and procedures designed to mitigate credit risk and to maintain the quality of our loan portfolio. These policies include underwriting standards for new credits as well as continuous monitoring and reporting policies for asset quality and the adequacy of the allowance for loan losses. These policies, coupled with ongoing training efforts, have provided effective checks and balances for the risk associated with the lending process. Lending authority is based on the type of the loan, and the experience of the lending officer.

Commercial loans are collateralized primarily by real estate and, to a lesser extent, equipment and vehicles. Unsecured commercial loans represent an insignificant portion of total commercial loans. Residential mortgage loans are collateralized by the related property. Generally, a residential mortgage loan exceeding a specified internal loan-to-value ratio requires private mortgage insurance. Installment loans are typically collateralized, with loan-to-value ratios which are established based on the financial condition of the borrower. We also have made unsecured consumer loans to qualified borrowers meeting our underwriting standards. Additional information about our loans and underwriting policies can be found in Item 1 of Part I of this annual report under the heading “Banking Products and Services”.

Table 3 sets forth the composition of our loan portfolio. Historically, our policy has been to make the majority of our loan commitments in our market areas. We had no foreign loans in our portfolio as of December 31 for any of the years presented.

Summary of Loan Portfolio

Table 3

The following table presents the composition of our loan portfolio as of December 31 for the past five years:

(In millions)	2017	2016	2015	2014	2013
Commercial real estate	$283.2	$298.0	$280.5	$256.1	$268.0
Acquisition and development	110.5	104.3	111.0	99.3	107.2

Commercial and industrial	76.7	72.3	73.9	93.3	59.8
Residential mortgage	398.6	393.4	388.7	367.6	350.9
Consumer	23.5	23.9	24.9	23.7	24.3
Total Loans	$892.5	$891.9	$879.0	$840.0	$810.2

Comparing December 31, 2017 to December 31, 2016, loans outstanding increased $.6 million. CRE loans decreased $14.8 million due primarily to charge-offs of $4.5 million on one large non-accrual loan, payoffs of $22.0 million on two large CRE loans offset by new production in the fourth quarter of 2017. A&D loans increased $6.2 million and C&I loans increased $4.4 million. Residential mortgage loans increased $5.2 million due to continued activity in the 1-4 family residential professional program, offset by payoffs and amortization of home equity balances. The consumer loan portfolio decreased slightly by $.4 million due to regularly scheduled payments. Approximately 28% and 39% respectively, of the commercial loan portfolio was collateralized by real estate at December 31, 2017 and December 31, 2016. Adjustable interest rate loans made up 58% of total loans at December 31, 2017 and 60% at December 31, 2016, with the balance being fixed–interest rate loans.

Comparing December 31, 2016 to December 31, 2015, loans outstanding increased $12.9 million (1.5%). CRE loans increased $17.5 million as a result of several new relationships booked during 2016. A&D loans decreased $6.7 million due to payoffs in the third quarter 2016. C&I loans decreased $1.6 million due to regularly scheduled amortization. Residential mortgage loans increased $4.7 million due to increased production primarily in our 5/1 and 7/1 ARM programs. The Bank continues to sell new, longer term, fixed-rate residential loan originations to Fannie Mae. The consumer loan portfolio decreased slightly by $1.0 million due to our decision to discontinue indirect auto lending.

The following table sets forth the maturities, based upon contractual dates, for selected loan categories as of December 31, 2017:

Maturities of Loan Portfolio at December 31, 2017

Table 4

(In thousands)	Maturing Within One Year	Maturing After One Year But Within Five Years	Maturing After Five Years	Total
Commercial Real Estate	$ 29,833	$ 97,591	$ 155,738	$283,162
Acquisition and Development	46,908	26,123	37,499	110,530
Commercial and Industrial	21,746	41,674	13,303	76,723
Residential Mortgage	6,069	11,768	380,811	398,648
Consumer	3,598	17,176	2,681	23,455
Total Loans	$ 108,154	$ 194,332	$ 590,032	$892,518
Classified by Sensitivity to Change in Interest Rates				
Fixed-Interest Rate Loans	62,944	154,748	158,366	376,058
Adjustable-Interest Rate Loans	45,210	39,584	431,666	516,460
Total Loans	$ 108,154	$ 194,332	$ 590,032	$892,518

Management monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a required payment is past due. A loan is considered to be past due when a scheduled payment has not been received for 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Our policy for recognizing interest income on impaired loans does not differ from our overall policy for interest recognition.

Table 5 sets forth the amounts of non-accrual, past-due and restructured loans for the past five years:

Risk Elements of Loan Portfolio

Table 5

	At December 31,				
(In thousands)	2017	2016	2015	2014	2013
Non-accrual loans:					
Commercial real estate	$4,453	$12,211	$11,282	$5,762	$7,433
Acquisition and development	211	45	1,817	3,609	5,632
Commercial and industrial	378	0	185	171	191
Residential mortgage	2,046	1,690	2,214	2,009	4,126
Consumer	30	0	0	0	14
Total non-accrual loans	$7,118	$13,946	$15,498	$11,551	$17,396
Accruing Loans Past Due 90 days or more:					
Commercial real estate	$0	$0	$0	$0	$65
Acquisition and development	144	0	0	1	282
Commercial and industrial	6	11	0	4	133
Residential mortgage	430	382	998	485	730
Consumer	15	27	27	39	24
Total accruing loans past due 90 days or more	$595	$420	$1,025	$529	$1,234
Total non-accrual and past due 90 days or more	$7,713	$14,366	$16,523	$12,080	$18,630
Restructured Loans (TDRs):					
Performing	$5,121	$7,336	$8,168	$7,621	$10,567
Non-accrual (included above)	834	1,987	5,851	6,063	7,380
Total TDRs	$5,955	$9,323	$14,019	$13,684	$17,947
Other Real Estate Owned	$10,141	$10,910	$6,883	$12,932	$17,031
Impaired loans without a valuation allowance	$12,317	$23,131	$20,940	$19,937	$24,296
Impaired loans with a valuation allowance	2,634	869	3,868	4,844	9,013
Total impaired loans	$14,951	$24,000	$24,808	$24,781	$33,309
Valuation allowance related to impaired loans	$362	$260	$1,157	$1,236	$2,283

Non-Accrual Loans as a % of Applicable Portfolio

	2017	2016	2015	2014	2013
Commercial real estate	1.6 %	4.1 %	4.0 %	2.3 %	2.8 %
Acquisition and development	0.2 %	0.1 %	1.6 %	3.6 %	5.3 %

Commercial and industrial	0.5 %	0.0 %	0.3 %	0.2 %	0.3 %
Residential mortgage	0.5 %	0.4 %	0.6 %	0.5 %	1.2 %
Consumer	0.1 %	0.0 %	0.0 %	0.0 %	0.1 %

We would have recognized $.6 million in interest income for the year ended December 31, 2017 had our non-accrual loans been current and performing in accordance with their terms. During 2017, we recognized, on a cash basis, $34 thousand of interest income on non-accrual loans that paid off.

Performing loans considered to be impaired (including performing troubled debt restructurings, or TDRs), as defined and identified by management, amounted to $7.8 million at December 31, 2017 and $10.3 million at December 31, 2016. Loans are identified as impaired when, based on current information and events, management determines that we will be unable to collect all amounts due according to contractual terms. These loans consist primarily of A&D loans and CRE loans. The fair values are generally determined based upon independent third party appraisals of the collateral or discounted cash flows based upon the expected proceeds. Specific allocations have been made where management believes there is insufficient collateral to repay the loan balance if liquidated and there is no secondary source of repayment available.

The level of performing impaired loans (other than performing TDRs) decreased $.2 million during the year ended December 31, 2017.

A troubled debt restructuring is the restructuring of a loan in which one or more concessions are granted to a borrower who is experiencing financial difficulties. A loan will be classified as a TDR if the Bank restructures the loan's terms (i.e., interest rate, payment amount, amortization period and/or maturity date) after determining that the borrower is experiencing financial difficulties. A modified loan is considered to be a TDR when the Bank has determined that the borrower is experiencing financial difficulties. The Bank evaluates the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations. The following table presents the details of TDRs by loan class at December 31, 2017 and December 31, 2016

(Dollars in thousands)	December 31, 2017 Number of Contracts	December 31, 2017 Recorded Investment	December 31, 2016 Number of Contracts	December 31, 2016 Recorded Investment
Performing				
Commercial real estate				
Non owner-occupied	3	$ 370	3	$ 385
All other CRE	2	2,685	3	3,044
Acquisition and development				
1-4 family residential construction	1	527	1	582
All other A&D	1	238	2	1,898
Commercial and industrial	0	0	0	0
Residential mortgage				
Residential mortgage – term	8	1,301	9	1,427
Residential mortgage – home equity	0	0	0	0
Consumer	0	0	0	0
Total performing	15	$ 5,121	18	$ 7,336
Non-accrual				
Commercial real estate				

Non owner-occupied	0	$ 0	0	$ 0
All other CRE	2	583	3	1,594
Acquisition and development				
1-4 family residential construction	0	0	0	0
All other A&D	0	0	0	0
Commercial and industrial	0	0	0	0
Residential mortgage				
Residential mortgage – term	2	251	3	393
Residential mortgage – home equity	0	0	0	0
Consumer	0	0	0	0
Total non-accrual	4	834	6	1,987
Total TDRs	19	$ 5,955	24	$ 9,323

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The level of TDRs decreased $3.4 million during the year ended December 31, 2017. No new loans were added to TDRs and three loans already in performing TDRs were re-modified. During the year ended December 31, 2017, two non-accrual loans totaling $.6 million and three performing loans totaling $1.9 million paid off and net principal payments totaling $.9 million were received during the same time period.

At December 31, 2017, there were no additional funds committed to be advanced in connection with TDRs. Interest income not recognized due to rate modifications of TDRs was $.1 million and interest income recognized on all TDRs was $.4 million in 2017.

Allowance for Loan Losses

The ALL is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The ALL is also based on estimates, and actual losses will vary from current estimates. These estimates are reviewed quarterly, and as adjustments, either positive or negative, become necessary, a corresponding increase or decrease is made in the ALL. The methodology used to determine the adequacy of the ALL is consistent with prior years. An estimate for probable losses related to unfunded lending commitments, such as letters of credit and binding but unfunded loan commitments is also prepared. This estimate is computed in a manner similar to the methodology described above, adjusted for the probability of actually funding the commitment.

The ALL increased slightly to $10.0 million at December 31, 2017, compared to $9.9 million at December 31, 2016. The provision for loan losses for the year ended December 31, 2017 decreased to $2.5 million from $3.1 million for the year ended December 31, 2016. The decreased provision expense was primarily due to decreased net charge-offs of $2.5 million in 2017, compared to net charge-offs of $5.1 million in 2016. The ratio of the ALL to loans outstanding at December 31, 2017 was 1.12%, compared to 1.11% at December 31, 2016.

The ratio of net charge-offs to average loans for the year ended December 31, 2017 was .28%, compared to .57% for the year ended December 31, 2016. The CRE portfolio improved slightly to an annualized net charge-off rate of 1.43% as of December 31, 2017, compared to 1.80% as of December 31, 2016. The A&D loan portfolio had an annualized net recovery rate of .11% as of December 31, 2017 compared to .98% as of December 31, 2016. The reduction in 2017 when compared to 2016 was due primarily to obtaining new appraisals on properties that secure a large loan relationship in 2016. The annualized net recovery ratio for C&I loans was 2.21% as of December 31, 2017, compared to a net charge-off rate of 0.69% as of December 31, 2016. The recovery rate in 2017 was due to the receipt of $1.3 million on a previously charged- off loan on an ethanol plant. Residential mortgage loans had a net recovery ratio of 0.01% at December 31, 2017 compared to a net charge-off rate of 0.07% as of December 31, 2016, and the consumer loan charge-off ratios were .53% and .77% for December 31, 2017 and December 31, 2016, respectively.

Accruing loans past due 30 days or more improved slightly to .63% of the loan portfolio at December 31, 2017, compared to .67% at December 31, 2016. Non-accrual loans totaled $7.1 million at December 31, 2017, compared to $13.9 million at December 31, 2016. The decrease in non-accrual loans was primarily due to the charge-offs related to one large CRE loan relationship. Non-accrual loans which have been subject to partial charge-offs totaled $7.4 million at December 31, 2017, compared to $11.1 million at December 31, 2016.

Management believes that the ALL at December 31, 2017 is adequate to provide for probable losses inherent in our loan portfolio. Amounts that will be recorded for the provision for loan losses in future periods will depend upon trends in the loan balances, including the composition of the loan portfolio, changes in loan quality and loss experience trends, potential recoveries on previously charged-off loans and changes in other qualitative factors. Management also applies interest rate risk, collateral value and debt service sensitivity analyses to the CRE loan portfolio and obtains new appraisals on specific loans under defined parameters to assist in the determination of the periodic provision for loan losses.

The ALL decreased to $9.9 million at December 31, 2016, compared to $11.9 million at December 31, 2015. The provision for loan losses for the year ended December 31, 2016 increased to $3.1 million from $1.1 million for the year ended December 31, 2015. The increased provision expense was primarily due to increased net charge-offs of $5.1 million in 2016, compared to net charge-offs of $1.2 million in 2015. The ratio of the ALL to loans outstanding at December 31, 2016 was 1.11% compared to 1.36% at December 31, 2015.

Table 6 presents the activity in the allowance for loan losses by major loan category for the past five years.

Analysis of Activity in the Allowance for Loan Losses

Table 6

	For the Years Ended December 31,				
(In thousands)	2017	2016	2015	2014	2013
Balance, January 1	$9,918	$11,922	$12,065	$13,594	$16,047
Charge-offs:					
Commercial real estate	(4,605)	(5,301)	(420)	(485)	(233)
Acquisition and development	(133)	(248)	(1,261)	(2,673)	(2,200)
Commercial and industrial	(37)	(558)	(26)	(266)	(1,066)
Residential mortgage	(361)	(737)	(300)	(847)	(485)
Consumer	(336)	(333)	(307)	(512)	(590)
Total charge-offs	(5,472)	(7,177)	(2,314)	(4,783)	(4,574)
Recoveries:					
Commercial real estate	452	90	283	11	1,004
Acquisition and development	255	1,303	382	133	100
Commercial and industrial	1,683	52	26	26	79
Residential mortgage	392	461	217	229	199
Consumer	210	145	209	342	359
Total recoveries	2,992	2,051	1,117	741	1,741
Net credit losses	(2,480)	(5,126)	(1,197)	(4,042)	(2,833)
Provision for loan losses	2,534	3,122	1,054	2,513	380
Balance at end of period	$9,972	$9,918	$11,922	$12,065	$13,594
Allowance for loan losses to loans outstanding (as %)	1.12 %	1.11 %	1.36 %	1.44 %	1.68 %
Net charge-offs to average loans outstanding during the period (as %)	0.28 %	0.57 %	0.14 %	0.49 %	0.34 %

Table 7 presents management's allocation of the ALL by major loan category in comparison to that loan category's percentage of total loans. Changes in the allocation over time reflect changes in the composition of the loan portfolio risk profile and refinements to the methodology of determining the ALL. Specific allocations in any particular category may be reallocated in the future as needed to reflect current conditions. Accordingly, the entire ALL is considered available to absorb losses in any category.

Allocation of the Allowance for Loan Losses

Table 7

	For the Years Ended December 31,														
(In thousands)	2017	% of Total Loans		2016	% of Total Loans		2015	% of Total Loans		2014	% of Total Loans		2013	% of Total Loans	
Commercial real estate	$ 3,699	32	%	$ 3,913	33	%	$ 2,580	32	%	$ 2,424	30	%	$ 4,052	33	%
Acquisition and development	1,249	12	%	871	12	%	4,129	13	%	3,912	12	%	4,172	13	%
Commercial and industrial	869	8	%	858	8	%	722	8	%	1,680	11	%	766	8	%
Residential mortgage	3,452	45	%	3,588	44	%	3,785	44	%	3,862	44	%	4,320	43	%
Consumer	203	3	%	188	3	%	206	3	%	187	3	%	284	3	%
Unallocated	500	0	%	500	0	%	500	0	%	0	0	%	0	0	%
Total	$ 9,972	100	%	$ 9,918	100	%	$ 11,922	100	%	$ 12,065	100	%	$ 13,594	100	%

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Investment Securities

The following table sets forth the composition of our securities portfolio by major category as of the indicated dates:

Table 8

(In thousands)	At December 31, 2017 Amortized Cost	Fair Value (FV)	FV As % of Total	2016 Amortized Cost	Fair Value (FV)	FV As % of Total	2015 Amortized Cost	Fair Value (FV)	FV AS % of Total
Securities Available-for-Sale:									
U.S. government agencies	$30,000	$ 29,256	20 %	$25,000	$ 24,253	17 %	$34,079	$ 33,964	20 %
Residential mortgage-backed agencies	0	0	0 %	0	0	0 %	14,285	14,170	8 %
Commercial mortgage-backed agencies	41,771	40,891	28 %	52,978	52,222	37 %	43,780	43,636	26 %
Collateralized mortgage obligations	41,298	40,384	28 %	19,953	19,567	14 %	9,690	9,610	6 %
Obligations of states and political subdivisions	20,772	21,019	14 %	23,700	23,704	17 %	45,949	46,641	27 %
Collateralized debt obligations	19,711	14,920	10 %	27,930	20,254	15 %	29,287	22,211	13 %
Total available for sale	$153,552	$ 146,470	100 %	$149,561	$ 140,000	100 %	$177,070	$ 170,232	100 %
Securities Held to Maturity:									
U.S. government agencies	$15,876	$ 16,323	17 %	$15,738	$ 16,250	17 %	$24,704	$ 25,338	24 %
Residential mortgage-backed agencies	47,771	47,442	50 %	50,384	50,265	51 %	53,734	53,912	51 %
Commercial mortgage-backed agencies	17,288	17,518	18 %	17,584	17,832	18 %	18,078	18,232	17 %
	4,187	4,118	4 %	4,833	4,684	5 %	6,419	6,297	6 %

Collateralized mortgage obligations									
Obligations of states and political subdivisions	8,510	9,945	11 %	8,630	8,950	9 %	2,625	2,963	2 %
Total held to maturity	$93,632	$ 95,346	100 %	$97,169	$ 97,981	100 %	$105,560	$ 106,742	100 %

Total fair value of investment securities available-for-sale at December 31, 2017 increased $6.5 million when compared to December 31, 2016. At December 31, 2017, the securities classified as available-for-sale included a net unrealized loss of $7.1 million, compared to $9.6 million at December 31, 2016, which represents the difference between the fair value and amortized cost of securities in the portfolio and was primarily attributable to the collateralized debt obligations (“CDOs”) in our investment portfolio. On June 1, 2014, management reclassified an amortized cost basis of $107.6 million of available-for-sale securities to held to maturity. The unrealized loss of approximately $4.0 million, at the date of transfer, will continue to be reported in a separate component of shareholders’ equity as accumulated other comprehensive income and will be amortized over the remaining life of the securities as an adjustment of yield in a manner consistent with the amortization of any premium or discount.

As discussed in Note 23 to the Consolidated Financial Statements, we measure fair market values based on the fair value hierarchy established in ASC Topic 820, *Fair Value Measurements and Disclosures*. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). Level 3 prices or valuation techniques require inputs that are both significant to the valuation assumptions and are not readily observable in the market (i.e. supported with little or no market activity). These Level 3 instruments are valued based on both observable and unobservable inputs derived from the best available data, some of which is internally developed, and considers risk premiums that a market participant would require.

Approximately $131.6 million of the available-for-sale portfolio was valued using Level 2 pricing and had net unrealized losses of $2.3 million at December 31, 2017. The remaining $14.9 million of the securities available-for-sale represents the entire CDO portfolio, which was valued using significant unobservable inputs, or Level 3 pricing. The $4.8 million in net unrealized losses associated with the CDO portfolio relates to 10 pooled trust preferred securities. Unrealized losses of $3.4 million represent non-credit related OTTI charges on eight of the securities, while $1.4 million of unrealized losses relates to two securities which have no credit related OTTI. The unrealized losses on these securities are primarily attributable to continued depression in the marketability and liquidity associated with CDOs.

The following table provides a summary of the trust preferred securities in the CDO portfolio and the credit status of the securities as of December 31, 2017.

Level 3 Investment Securities Available for Sale

(Dollars in Thousands)

Investment Description		First United Level 3 Investments				Security Credit Status					
Deal	Class	Amortized Cost	Fair Market Value	Unrealized Gain/(Loss)	Lowest Credit Rating	Original Collateral	Deferrals/ Defaults as % of Original Collateral	Performing Collateral	Collateral Support	**Collateral Support as % of Performing Collateral**	Number of Performing Issuers/Total Issuers
Preferred Term Security XI*	B-1	1,352	996	(356)	C	635,775	13.61%	369,625	(14,688)	-3.97%	42 / 51
Preferred Term Security XVIII*	C	1,953	1,264	(689)	C	676,565	14.83%	310,546	(1,312)	-0.42%	44 / 60
Preferred Term Security XVIII	C	2,799	1,896	(903)	C	676,565	14.83%	310,546	(1,312)	-0.42%	44 / 60
Preferred Term Security XIX*	C	1,801	1,529	(272)	C	700,535	5.71%	500,006	13,337	2.67%	52 / 59
Preferred Term Security XIX*	C	1,072	917	(155)	C	700,535	5.71%	500,006	13,337	2.67%	52 / 59
Preferred Term Security XIX*	C	2,472	2,141	(331)	C	700,535	5.71%	500,006	13,337	2.67%	52 / 59
Preferred Term Security XIX*	C	1,074	917	(157)	C	700,535	5.71%	500,006	13,337	2.67%	52 / 59
Preferred Term	C-1	1,521	1,173	(348)	C	1,386,600	11.97%	914,324	48,292	5.28%	64 / 78

Security XXII*												
Preferred Term Security XXII*	C-1	3,800	2,933	(867)	C	1,386,600	11.97	%	914,324	48,292	5.28 %	64 / 78
Preferred Term Security XXIII	C-1	1,867	1,154	(713)	C	1,467,000	15.47	%	860,717	61,326	7.12 %	84 / 99
Total Level 3 Securities Available for Sale		19,711	14,920	(4,791)								

* Security has been deemed other-than-temporarily impaired and loss has been recognized in accordance with ASC Section 320-10-35.

The terms of the debentures underlying trust preferred securities allow the issuer of the debentures to defer interest payments for up to 20 quarters, and, in such case, the terms of the related trust preferred securities require their issuers to contemporaneously defer dividend payments. The issuers of the trust preferred securities in our investment portfolio have defaulted and/or deferred payments, ranging from 5.71% to 15.47% of the total collateral balances underlying the securities. The securities were designed to include structural features that provide investors with credit enhancement or support to provide default protection by subordinated tranches. These features include over-collateralization of the notes or subordination, excess interest or spread which will redirect funds in situations where collateral is insufficient, and a specified order of principal payments. There are securities in our portfolio that are under-collateralized, which does represent additional stress on our tranche. However, in these cases, the terms of the securities require excess interest to be redirected from subordinate tranches as credit support, which provides additional support to our investment.

Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of ASC Topic 320 (Section 320-10-35), management must assess whether (i) we have the intent to sell the security and (ii) it is more likely than not that we will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair value of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses. The other losses are recognized in other comprehensive income. In estimating OTTI charges, management considers (a) the length of time and the extent to which the fair value has been less than cost, (b) adverse conditions specifically related to the security, an industry, or a geographic area, (c) the historic and implied volatility of the security, (d) changes in the rating of a security by a rating agency, (e) recoveries or additional declines in fair value subsequent to the balance sheet date, (f) failure of the issuer of the security to make scheduled interest payments, and (g) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Due to the duration and the significant market value decline in the pooled trust preferred securities held in our portfolio, we performed more extensive testing on these securities for purposes of evaluating whether or not an OTTI has occurred.

The market for these securities as of December 31, 2017 is not active and markets for similar securities are also not active. The inactivity was evidenced first by a significant widening of the bid-ask spread in the brokered markets in which these securities trade and then by a significant decrease in the volume of trades relative to historical levels. The new issue market is also inactive, as no new CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities, or any securities other than those issued or guaranteed by the U.S. Department of the Treasury (the "Treasury"), are very depressed relative to historical levels. Therefore, in the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (i) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at December 31, 2017, (ii) an income valuation approach technique (i.e. present value) that maximizes the use of relevant unobservable inputs and minimizes the use of observable inputs will be equally or more representative of fair value than a market approach, and (iii) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management utilizes an independent third party to prepare both the evaluations of OTTI and the fair value determinations for the CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between December 31, 2016 and December 31, 2017.

The approach used by the third party to determine fair value involved several steps, which included detailed credit and structural evaluation of each piece of collateral in each bond, projection of default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities, with a limited market for highly-rated CDO securities that are more senior in the capital structure than the securities in the CDO portfolio. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that no additional credit-related OTTI was required during 2017.

On December 10, 2013, to implement Section 619 of the Dodd-Frank Act, the Treasury, the federal banking regulators including FDIC, and the SEC adopted the Volcker Rule. The Volcker Rule prohibits a banking institution from acquiring or retaining an “ownership interest” in a “covered fund”. A “covered fund” is (a) an entity that would be an investment company under the Investment Company Act of 1940, as amended, but for the exemptions contained in Section 3(c)(1) or Section 3(c)(7) of that Act, (b) a commodity pool with certain characteristics, and/or (c) a non-US entity with certain characteristics that is sponsored or owned by a banking entity located or organized in the US. The term “ownership interest” is defined as “any equity, partnership, or other similar interest.”

On January 14, 2014, the federal banking agencies adopted a final interim rule that exempts CDOs from the scope of the Volcker Rule if they were issued in offerings in which, among other things, the proceeds were used primarily to purchase securities issued by depository institutions and their affiliates. In connection with that final interim rule, the agencies published a non-exclusive list of exempt offerings. All of the CDOs held at December 31, 2017 are exempt.

During the first quarter of 2014 and following the promulgation of the Volcker Rule, the fair value of the CDO portfolio improved significantly. The improvement was due to several factors including improved financial condition of the issuers, improved cash flows and a lower discount rate. As the issuers resumed payments of previously deferred interest during the quarter, cash flow projections for the securities increased. In addition, the discount rate utilized in the cash flow models was reduced as the base line current market yield for comparable corporate and structured products improved and the projected credit performance of the CDOs improved with favorable market conditions. The resulting increase in cash flow projections over the remaining life of the securities yielded a higher fair market value.

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Table 9 sets forth the contractual or estimated maturities of the components of our securities portfolio as of December 31, 2017 and the weighted average yields on a tax-equivalent basis.

Investment Security Maturities, Yields, and Fair Values at December 31, 2017

Table 9

(In thousands)	Within 1 Year	1 Year To 5 Years	5 Years To 10 Years	Over 10 Years	Total Fair Value
Securities Available-for-Sale:					
U.S. government agencies	$ 0	$ 14,758	$ 14,498	$ 0	$ 29,256
Commercial mortgage-backed agencies	0	40,891	0	0	40,891
Collateralized mortgage obligations	551	25,203	14,630	0	40,384
Obligations of states and political subdivisions	452	2,757	7,765	10,045	21,019
Collateralized debt obligations	0	0	0	14,920	14,920
Total available for sale	$ 1,003	$ 83,609	$ 36,893	$ 24,965	$ 146,470
Percentage of total	0.68 %	57.08 %	25.19 %	17.05 %	100.00 %
Weighted average yield	3.27 %	2.36 %	2.58 %	4.49 %	2.79 %
Held to Maturity:					
U.S. government agencies	$ 0	$ 8,503	$ 7,820	$ 0	$ 16,323
Residential mortgage-backed agencies	1,586	14,840	13,434	17,582	47,442
Commercial mortgage-backed agencies	0	10,886	6,632	0	17,518
Collateralized mortgage obligations	0	0	0	4,118	4,118
Obligations of states and political subdivisions	0	0	0	9,945	9,945
Total held to maturity	$ 1,586	$ 34,229	$ 27,886	$ 31,645	$ 95,346
Percentage of total	1.66 %	35.90 %	29.25 %	33.19 %	100.00 %
Weighted average yield	-0.76 %	1.70 %	3.09 %	3.60 %	2.69 %

The weighted average yield was calculated using historical cost balances and does not give effect to changes in fair value. The negative weighted average yield was due to increased paydowns on mortgage-backed securities which impacted their factors and three-month conditional prepayment rate (“CPR”). At December 31, 2017, we did not hold any securities in the name of any one issuer exceeding 10% of shareholders’ equity.

Deposits

Table 10 sets forth the actual and average deposit balances by major category for 2017, 2016 and 2015:

Deposit Balances

Table 10

(In thousands)	Actual Balance	2017 Average Balance	Average Yield	Actual Balance	2016 Average Balance	Average Yield	Actual Balance	2015 Average Balance	Average Y
Non-interest-bearing demand deposits	$249,593	$ 237,578	0.00%	$219,158	$ 209,948	0.00%	$204,569	$ 204,453	0.00%
Interest-bearing deposits:									
Demand	174,714	171,697	0.07%	172,071	176,049	0.08%	176,084	149,214	0.07%
Money Market:									
Retail	156,159	160,923	0.21%	161,812	163,021	0.15%	160,597	203,214	0.23%
Brokered/ICS	67,014	60,402	0.21%	70,425	71,054	0.15%	62,197	6,895	0.20%
Savings deposits	157,783	156,538	0.11%	149,653	147,428	0.11%	140,772	136,946	0.16%
Time deposits less than $100K:									
Retail	107,238	114,078	0.98%	116,651	123,751	1.00%	129,324	141,738	1.22%
Brokered/CDARS	358	425	0.28%	520	378	0.10%	434	450	0.16%
Time deposits $100K or more:									
Retail	124,488	117,460	1.17%	120,341	117,641	1.04%	122,123	128,928	1.22%
Brokered/CDARS	2,043	2,730	0.64%	3,598	2,612	0.15%	2,694	3,651	0.16%
Total Deposits	$1,039,390	$ 1,021,831		$1,014,229	$ 1,011,882		$998,794	$ 975,489	

Total deposits increased $25.2 million at December 31, 2017 when compared to December 31, 2016. During 2017, we continued to see increases in core deposits and reductions in certificates of deposit. Non-interest bearing deposits increased $30.4 million due to building new relationships with both consumer and commercial customers as well as increased balances on existing accounts. Traditional savings accounts increased $8.1 million as we continued to see growth in our Prime Saver product. Total demand deposits increased $2.6 million and total money market accounts decreased $9.1 million due to decreased balances in our ICS money market account relating to the re-allocation of cash in our trust accounts. Time deposits less than $100,000 declined $9.6 million and time deposits greater than $100,000 increased $2.6 million.

The following table sets forth the maturities of time deposits of $100,000 or more:

Maturity of Time Deposits of $100,000 or More

Table 11

(In thousands)	**December 31, 2017**
Maturities	
3 Months or Less	$ 15,936
3-6 Months	22,518
6-12 Months	17,042
Over 1 Year	71,035
Total	$ 126,531

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Borrowed Funds

The following shows the composition of our borrowings at December 31:

(In thousands)	2017	2016	2015
Securities sold under agreements to repurchase	$48,845	$36,000	$35,828
Total short-term borrowings	$48,845	$36,000	$35,828
Long-term FHLB advances	$90,000	$90,007	$105,807
Junior subordinated debentures	30,929	41,730	41,730
Total long-term borrowings	$120,929	$131,737	$147,537
Total borrowings	$169,774	$167,737	$183,365
Average balance (from Table 1)	$160,732	$177,322	$200,741

The following is a summary of short-term borrowings at December 31 with original maturities of less than one year:

(Dollars in thousands)	2017	2016	2015
Securities sold under agreements to repurchase:			
Outstanding at end of year	$48,845	$36,000	$35,828
Weighted average interest rate at year end	0.15 %	0.16 %	0.16 %
Maximum amount outstanding as of any month end	$58,438	$39,456	$47,131
Average amount outstanding	37,326	30,899	35,908
Approximate weighted average rate during the year	0.19 %	0.19 %	0.16 %

Total borrowings increased slightly by $2.0 million, or 8.2%, in 2017 when compared to 2016, while the average balance of borrowings decreased by $16.6 million during the same period. The increase in borrowings was due to a $12.8 million increase in the balances of municipal accounts established through our Treasury Management product, offset by a decrease in long-term borrowings of $10.8 due to the repayment of $10.8 million in TPS Debentures held by Trust III in March 2017.

Total borrowings decreased by $15.6 million, or 8.5%, in 2016 when compared to 2015, and the average balance of borrowings decreased by $23.4 million during the same period. These decreases resulted from a $15.8 million decrease in long-term borrowings due primarily to the repayment of a $15.0 million FHLB advance in December 2016. Short-term borrowings increased $.2 million due to a slight increase in our Treasury Management product.

Management will continue to closely monitor interest rates within the context of its overall asset-liability management process. See the discussion under the heading “Interest Rate Sensitivity” in this Item 7 for further information on this topic.

As of December 31, 2017, we had additional borrowing capacity with the FHLB totaling $86.2 million, an additional $75.0 million of unused lines of credit with various financial institutions, $7.0 million of an unused secured line of credit with the Federal Reserve Bank and approximately $103.9 million available through wholesale money market funds. See Note 12 to the Consolidated Financial Statements presented elsewhere in this annual report for further details about our borrowings and additional borrowing capacity, which is incorporated herein by reference.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, lines of credit, and standby letters of credit. Our exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of the instruments. The credit risks inherent in loan commitments and letters of credit are essentially the same as those involved in extending loans to customers, and these arrangements are subject to our normal credit policies. We use the same credit policies in making commitments and conditional obligations as we do for on-balance sheet instruments. We generally require collateral or other security to support the financial instruments with credit risk. The amount of collateral or other security is determined based on management’s credit evaluation of the counterparty. We evaluate each customer’s creditworthiness on a case-by-case basis.

Loan commitments and letters of credit totaled $126.7 million and $2.6 million, respectively, at December 31, 2017. Management does not believe that any of the foregoing arrangements have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. We are not a party to any other off-balance sheet arrangements. See Note 22 to the Consolidated Financial Statements presented elsewhere in this annual report for additional information on these arrangements.

Capital Resources

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdraw demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not adequate to fund our capital requirements, we can rely on the funding sources identified below under the heading "Liquidity Management". At December 31, 2017, the Bank had $75.0 million available through unsecured lines of credit with correspondent banks, $7.0 million available through a secured line of credit with the Fed Discount Window and approximately $86.2 million available through the FHLB. Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

In addition to operational requirements, the Bank and the Corporation are subject to risk-based capital regulations, which were adopted and are monitored by federal banking regulators. These regulations are used to evaluate capital adequacy and require an analysis of an institution's asset risk profile and off-balance sheet exposures, such as unused loan commitments and stand-by letters of credit.

On July 2, 2013, the Federal Reserve approved final rules that substantially amended the regulatory risk-based capital rules applicable to the Corporation. The FDIC subsequently approved the same rules which apply to the Bank. The final rules implement the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act and were implemented as of March 31, 2015.

The Basel III capital rules include new risk-based capital and leverage ratios, which will be phased in from 2015 to 2019, and which refine the definition of what constitutes "capital" for purposes of calculating those ratios. The new minimum capital level requirements applicable to the Corporation under the final rules are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The final rules also establish a "capital conservation buffer" above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer will be phased-in over four years beginning on January 1, 2016, as follows: the maximum buffer will be 0.625% of risk-weighted assets for 2016, 1.25% for 2017, 1.875% for 2018, and 2.5% for 2019 and thereafter. This will result in the following minimum ratios beginning in 2019: (a) a common equity Tier 1 capital ratio of 7.0%, (b) a Tier 1 capital ratio of 8.5%, and (c) a total capital ratio of 10.5%.

Under the final rules, institutions are subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations establish a maximum percentage of eligible retained income that could be utilized for such actions.

The Basel III capital final rules also implement revisions and clarifications consistent with Basel III regarding the various components of Tier 1 capital, including common equity, unrealized gains and losses, as well as certain instruments that no longer qualify as Tier 1 capital, some of which will be phased out over time. Under the final rules, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations like the Corporation and the Bank that are not considered “advanced approaches” banking organizations may make a one-time permanent election to continue to exclude these items. The Corporation and the Bank made this election in their first quarter 2015 regulatory filings in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Corporation’s available-for-sale securities portfolio. Additionally, the final rules provide that small depository institution holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Corporation) will be able to permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 (such as the Corporation’s TPS Debentures) in additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

The Basel III capital rules also contain revisions to the prompt corrective action framework, which is designed to place restrictions on insured depository institutions if their capital levels begin to show signs of weakness. These revisions were effective January 1, 2015. Under the prompt corrective action requirements, which are designed to complement the capital conservation buffer, insured depository institutions are required to meet the following capital level requirements in order to qualify as “well capitalized”: (i) a new common equity Tier 1 capital ratio of 6.5%; (ii) a Tier 1 capital ratio of 8% (increased from 6%); (iii) a total capital ratio of 10% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 5% (increased from 4%).

The Basel III capital rules set forth certain changes for the calculation of risk-weighted assets. These changes include (i) an increased number of credit risk exposure categories and risk weights; (ii) an alternative standard of creditworthiness consistent with Section 939A of the Dodd-Frank Act; (iii) revisions to recognition of credit risk mitigation; (iv) rules for risk weighting of equity exposures and past due loans, and (v) revised capital treatment for derivatives and repo-style transactions.

Regulators may require higher capital ratios when warranted by the particular circumstances or risk profile of a given banking organization. In the current regulatory environment, banking organizations must stay well capitalized in order to receive favorable regulatory treatment on acquisition and other expansion activities and favorable risk-based deposit insurance assessments. Our capital policy establishes guidelines meeting these regulatory requirements and takes into consideration current or anticipated risks as well as potential future growth opportunities.

In October 2017, the federal banking agencies proposed revisions that would simplify compliance with certain aspects of capital rules. A majority of the proposed simplifications would apply solely to banking organizations that are not subject to the advanced approaches capital rule. The proposed rules simplify application of regulatory capital treatment for mortgage servicing assets, certain deferred tax assets arising from temporary differences, investments in the capital of unconsolidated financial institutions, and capital issued by a consolidated subsidiary of a banking organization and held by third parties (minority interest), and; revisions to the treatment of certain acquisition, development, or construction exposures. In addition, the federal banking agencies have deferred the final phase-in and increased risk-weighting associated with CET1 deductions indefinitely for non-advanced approaches banks.

At December 31, 2017, the Corporation’s total risk-based capital ratio was 15.98% and the Bank’s total risk-based capital ratio was 15.58%, both of which were well above the regulatory minimum of 8%. The total risk-based capital ratios of the Corporation and the Bank at December 31, 2016 were 16.71% and 16.70%, respectively. The decrease for the Corporation in 2017 was primarily due to the repayment of $20.0 million of Series A Preferred Stock, offset by the effect of current period net income.

At the Bank level, the ratios decreased from December 31, 2016 to December 31, 2017 because of the Bank’s dividends to the Holding Company for the repayment of the $10.8 million Trust III and the remaining $20.0 million of Series A Preferred Stock, offset by current period earnings for 2017.

As of December 31, 2017, the most recent notification from the regulators categorizes the Corporation and the Bank as “well capitalized” under the regulatory framework for prompt corrective action. See Note 4 to the Consolidated Financial Statements presented elsewhere in this annual report for additional information regarding regulatory capital ratios.

Liquidity Management

Liquidity is a financial institution’s capability to meet customer demands for deposit withdrawals while funding all credit-worthy loans. The factors that determine the institution’s liquidity are:

- Reliability and stability of core deposits;
- Cash flow structure and pledging status of investments; and
- Potential for unexpected loan demand.

We actively manage our liquidity position through meetings of a sub-committee of executive management, which looks forward 12 months at 30-day intervals. The measurement is based upon the projection of funds sold or purchased position, along with ratios and trends developed to measure dependence on purchased funds and core growth. Monthly reviews by management and quarterly reviews by the Asset and Liability Committee under prescribed policies and procedures are designed to ensure that we will maintain adequate levels of available funds.

It is our policy to manage our affairs so that liquidity needs are fully satisfied through normal Bank operations. That is, the Bank will manage its liquidity to minimize the need to make unplanned sales of assets or to borrow funds under emergency conditions. The Bank will use funding sources where the interest cost is relatively insensitive to market changes in the short run (periods of one year or less) to satisfy operating cash needs. The remaining normal funding will come from interest-sensitive liabilities, either deposits or borrowed funds. When the marginal cost of needed wholesale funding is lower than the cost of raising this funding in the retail markets, the Corporation may supplement retail funding with external funding sources such as:

- Unsecured Fed Funds lines of credit with upstream correspondent banks (M&T Bank, Atlantic Community Banker's Bank, Community Banker's Bank, PNC Financial Services ("PNC"), SunTrust and Zions Bancorp).
- Secured advances with the FHLB of Atlanta, which are collateralized by eligible one to four family residential mortgage loans, home equity lines of credit, commercial real estate loans. Cash and various securities may also be pledged as collateral.
- Secured line of credit with the Fed Discount Window for use in borrowing funds up to 90 days, using municipal securities as collateral.
- Brokered deposits, including CDs and money market funds, provide a method to generate deposits quickly. These deposits are strictly rate driven but often provide the most cost effective means of funding growth.
- One Way Buy CDARS/ICS funding – a form of brokered deposits that has become a viable supplement to brokered deposits obtained directly.

Management believes that we have adequate liquidity available to respond to current and anticipated liquidity demands and is not aware of any trends or demands, commitments, events or uncertainties that are likely to materially affect our ability to maintain liquidity at satisfactory levels.

Market Risk and Interest Sensitivity

Our primary market risk is interest rate fluctuation. Interest rate risk results primarily from the traditional banking activities that we engage in, such as gathering deposits and extending loans. Many factors, including economic and financial conditions, movements in interest rates and consumer preferences affect the difference between the interest earned on our assets and the interest paid on our liabilities. Interest rate sensitivity refers to the degree that earnings will be impacted by changes in the prevailing level of interest rates. Interest rate risk arises from mismatches in the repricing or maturity characteristics between interest-bearing assets and liabilities. Management seeks to minimize fluctuating net interest margins, and to enhance consistent growth of net interest income through periods of changing interest rates. Management uses interest sensitivity gap analysis and simulation models to measure and manage these risks. The interest rate sensitivity gap analysis assigns each interest-earning asset and interest-bearing liability to a time frame reflecting its next repricing or maturity date. The differences between total interest-sensitive assets and liabilities at each time interval represent the interest sensitivity gap for that interval. A positive gap generally indicates that rising interest rates during a given interval will increase net interest income, as more assets than liabilities will reprice. A negative gap position would benefit us during a period of declining interest rates.

As of December 31, 2017, we were asset sensitive.

Our interest rate risk management goals are:

- Ensure that the Board of Directors and senior management will provide effective oversight and ensure that risks are adequately identified, measured, monitored and controlled;
- Enable dynamic measurement and management of interest rate risk;
- Select strategies that optimize our ability to meet our long-range financial goals while maintaining interest rate risk within policy limits established by the Board of Directors;
- Use both income and market value oriented techniques to select strategies that optimize the relationship between risk and return; and
- Establish interest rate risk exposure limits for fluctuation in net interest income (“NII”), net income and economic value of equity.

In order to manage interest sensitivity risk, management formulates guidelines regarding asset generation and pricing, funding sources and pricing, and off-balance sheet commitments. These guidelines are based on management’s outlook regarding future interest rate movements, the state of the regional and national economy, and other financial and business risk factors. Management uses computer simulations to measure the effect on net interest income of various interest rate scenarios. Key assumptions used in the computer simulations include cash flows and maturities of interest rate sensitive assets and liabilities, changes in asset volumes and pricing, and management's capital plans. This modeling reflects interest rate changes and the related impact on net interest income over specified periods.

We evaluate the effect of a change in interest rates of +/-100 basis points to +/-400 basis points on both NII and Net Portfolio Value ("NPV") / Economic Value of Equity ("EVE"). We concentrate on NII rather than net income as long as NII remains the significant contributor to net income.

NII modeling allows management to view how changes in interest rates will affect the spread between the yield earned on assets and the cost of deposits and borrowed funds. Unlike traditional Gap modeling, NII modeling takes into account the different degree to which installments in the same repricing period will adjust to a change in interest rates. It also allows the use of different assumptions in a falling versus a rising rate environment. The period considered by the NII modeling is the next eight quarters.

NPV / EVE modeling focuses on the change in the market value of equity. NPV / EVE is defined as the market value of assets less the market value of liabilities plus/minus the market value of any off-balance sheet positions. By effectively looking at the present value of all future cash flows on or off the balance sheet, NPV / EVE modeling takes a longer-term view of interest rate risk. This complements the shorter-term view of the NII modeling.

Measures of NII at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. These measures are typically based upon a relatively brief period, usually one year. They do not necessarily indicate the long-term prospects or economic value of the institution.

Based on the simulation analysis performed at December 31, 2017 and 2016, management estimated the following changes in net interest income, assuming the indicated rate changes:

(Dollars in thousands)	2017	2016
+400 basis points	$(371)	$4,569
+300 basis points	$(30)	$3,617
+200 basis points	$261	$2,623
+100 basis points	$387	$1,501
-100 basis points	$(3,003)	$(3,175)

This estimate is based on assumptions that may be affected by unforeseeable changes in the general interest rate environment and any number of unforeseeable factors. Rates on different assets and liabilities within a single maturity category adjust to changes in interest rates to varying degrees and over varying periods of time. The relationships between lending rates and rates paid on purchased funds are not constant over time. Management can respond to current or anticipated market conditions by lengthening or shortening the Bank's sensitivity through loan repricings or changing its funding mix. The rate of growth in interest-free sources of funds will influence the level of interest-sensitive funding sources. In addition, the absolute level of interest rates will affect the volume of earning assets and funding sources. As a result of these limitations, the interest-sensitive gap is only one factor to be considered in estimating the net interest margin.

Impact of Inflation – Our assets and liabilities are primarily monetary in nature, and as such, future changes in prices do not affect the obligations to pay or receive fixed and determinable amounts of money. During inflationary periods, monetary assets lose value in terms of purchasing power and monetary liabilities have corresponding purchasing power gains. The concept of purchasing power is not an adequate indicator of the impact of inflation on financial institutions because it does not incorporate changes in our earnings.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information called for by this item is incorporated herein by reference to Item 7 of Part II of this annual report under the heading “Market Risk and Interest Sensitivity”.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders

First United Corporation

Oakland, Maryland

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated statement of financial condition of First United Corporation and Subsidiaries (the "Corporation") as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes (collectively referred to as the "consolidated financial statements"). We also have audited the Corporation's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as of December 31, 2017 and 2016, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control – Integrated Framework* (2013) issued by COSO.

Basis for Opinion

The Corporation's management is responsible for these consolidated financial statements, for maintaining effective control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assessment of Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Corporation's consolidated financial statements and an opinion on the Corporation's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Corporation in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Baker Tilly Virchow Krause, LLP

Pittsburgh, Pennsylvania

We have served as the Corporation's auditor since 2006.

March 9, 2018

First United Corporation and Subsidiaries

Consolidated Statement of Financial Condition

(In thousands, except per share amounts)

	December 31, 2017	December 31, 2016
Assets		
Cash and due from banks	$82,273	$60,707
Interest bearing deposits in banks	1,479	2,603
Cash and cash equivalents	83,752	63,310
Investment securities – available-for-sale (at fair value)	146,470	140,000
Investment securities – held to maturity (fair value of $95,346 at December 31, 2017 and $97,981 at December 31, 2016)	93,632	97,169
Restricted investment in bank stock, at cost	5,204	5,209
Loans	892,518	891,926
Allowance for loan losses	(9,972)	(9,918)
Net loans	882,546	882,008
Premises and equipment, net	30,881	27,160
Goodwill	11,004	11,004
Bank owned life insurance	42,155	40,968
Deferred tax assets	9,252	19,337
Other real estate owned	10,141	10,910
Accrued interest receivable and other assets	25,802	21,115
Total Assets	$1,340,839	$1,318,190
Liabilities and Shareholders' Equity		
Liabilities:		
Non-interest bearing deposits	$249,593	$219,158
Interest bearing deposits	789,797	795,071
Total deposits	1,039,390	1,014,229
Short-term borrowings	48,845	36,000
Long-term borrowings	120,929	131,737
Accrued interest payable and other liabilities	23,285	22,526
Total Liabilities	1,232,449	1,204,492
Shareholders' Equity:		
Preferred stock – no par value; Authorized 2,000,000 shares of which 30,000 shares of Series A, $1,000 per share liquidation preference, 9% cumulative; issued and outstanding 0 shares at December 31, 2017 and 20,000 shares at December 31, 2016	0	20,000
Common Stock – par value $.01 per share; Authorized 25,000,000 shares; issued and outstanding 7,067,425 shares at December 31, 2017 and 6,269,004 shares at December 31,	71	63

2016		
Surplus	31,553	22,178
Retained earnings	101,359	92,922
Accumulated other comprehensive loss	(24,593)	(21,465)
Total Shareholders' Equity	108,390	113,698
Total Liabilities and Shareholders' Equity	$1,340,839	$1,318,190

See notes to consolidated financial statements

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First United Corporation and Subsidiaries

Consolidated Statement of Income

(In thousands, except per share data)

	Year ended December 31,	
	2017	2016
Interest income		
Interest and fees on loans	$ 39,635	$ 38,948
Interest on investment securities		
Taxable	5,554	5,611
Exempt from federal income tax	925	869
Total investment income	6,479	6,480
Other	835	435
Total interest income	46,949	45,863
Interest expense		
Interest on deposits	3,291	3,150
Interest on short-term borrowings	73	60
Interest on long-term borrowings	4,007	5,013
Total interest expense	7,371	8,223
Net interest income	39,578	37,640
Provision for loan losses	2,534	3,122
Net interest income after provision for loan losses	37,044	34,518
Other operating income		
Net gains	29	526
Service charges	3,145	3,281
Trust department	6,246	5,837
Debit card income	2,337	2,112
Bank owned life insurance	1,187	1,426
Brokerage commissions	872	849
Other	472	622
Total other income	14,259	14,127
Total other operating income	14,288	14,653
Other operating expenses		
Salaries and employee benefits	22,391	20,595
FDIC premiums	634	940
Equipment	2,610	2,437
Occupancy	2,496	2,499
Data processing	3,339	3,065
Professional services	985	1,127
Other real estate owned expenses	190	802
Contract labor	683	718
Line rentals	663	615
Other	5,127	6,309

Total other operating expenses	39,118	39,107
Income before income tax expense	12,214	10,064
Provision for income tax expense (includes $3,226 from tax reform impact)	6,945	2,783
Net Income	5,269	7,281
Accumulated preferred stock dividends	(1,215)	(2,025)
Net Income Available to Common Shareholders	$ 4,054	$ 5,256
Basic and diluted net income per common share	$ 0.58	$ 0.84
Weighted average number of basic and diluted shares outstanding	6,932	6,264

See notes to consolidated financial statements

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First United Corporation and Subsidiaries

Consolidated Statement of Comprehensive Income

(In thousands)

	Year Ended December 31,	
Comprehensive Income	2017	2016
Net Income	$5,269	$7,281
Other comprehensive (loss)/income, net of tax and reclassification adjustments:		
Net unrealized losses on investments with OTTI	(90)	(426)
Net unrealized gains/(losses) on all other AFS securities	674	(1,194)
Net unrealized gains on HTM securities	253	617
Net unrealized gains on cash flow hedges	59	461
Net unrealized gains/(losses) on pension plan liability	336	(1,569)
Net unrealized gains/(losses) on SERP liability	23	(410)
Other comprehensive income/(loss), net of tax	1,255	(2,521)
Comprehensive Income	$6,524	$4,760

See notes to consolidated financial statements

First United Corporation and Subsidiaries

Consolidated Statement of Changes in Shareholders' Equity

(In thousands)

	Preferred Stock	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Loss, net of tax	Total Shareholders' Equity
Balance at January 1, 2016	$30,000	$ 63	$21,986	$87,666	$ (18,944)	$ 120,771
Net income				7,281		7,281
Other comprehensive loss, net of tax					(2,521)	(2,521)
Stock based compensation			192			192
Preferred stock redemption	(10,000)					(10,000)
Preferred stock dividends paid				(2,025)		(2,025)
Balance at December 31, 2016	20,000	63	22,178	92,922	(21,465)	113,698
Net income				5,269		5,269
Other comprehensive income, net of tax					1,255	1,255
Stock based compensation			192			192
Common Stock Issued		8	9,183			9,191
Preferred stock redemption	(20,000)					(20,000)
Reclassification of certain tax effects				4,383	(4,383)	0
Preferred stock dividends paid				(1,215)		(1,215)
Balance at December 31, 2017	$0	$ 71	$31,553	$101,359	$ (24,593)	$ 108,390

See notes to consolidated financial statements

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First United Corporation and Subsidiaries

Consolidated Statement of Cash Flows

(In thousands)

	Year ended December 31,	
	2017	2016
Operating activities		
Net income	$ 5,269	$ 7,281
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,534	3,122
Depreciation	1,898	1,693
Stock compensation	192	192
Gain on sales of other real estate owned	(645)	(189)
Write-downs of other real estate owned	398	486
Origination of loans held for sale	(10,049)	(9,024)
Proceeds from sales of loans held for sale	9,973	8,838
Gain on sales of loans held for sale	(75)	(95)
(Gain)/loss on disposal of fixed assets	(3)	9
Net amortization of investment securities discounts and premiums- AFS	148	365
Net amortization of investment securities discounts and premiums- HTM	111	142
Net loss/(gain) on sales of investment securities – available-for-sale	49	(440)
Amortization of deferred loan fees	(622)	(494)
Increase in accrued interest receivable and other assets	(7,848)	(5,472)
Deferred tax expense	9,257	2,117
Increase in accrued interest payable and other liabilities	3,524	4,388
Earnings on bank owned life insurance	(1,187)	(1,426)
Net cash provided by operating activities	12,924	11,493
Investing activities		
Proceeds from maturities/calls of investment securities available-for-sale	17,878	38,387
Proceeds from maturities/calls of investment securities held-to-maturity	7,614	19,334
Proceeds from sales of investment securities available-for-sale	18,530	43,782
Purchases of investment securities available-for-sale	(40,596)	(54,585)
Purchases of investment securities held-to-maturity	(4,188)	(11,085)
Proceeds from sales of other real estate owned	3,076	2,614
Proceeds from disposal of fixed assets	945	260
Proceeds from BOLI death benefit	0	608
Net decrease in FHLB stock	5	695
Net increase in loans	(4,359)	(24,192)
Purchases of premises and equipment	(6,561)	(3,924)
Net cash (used in)/provided by investing activities	(7,656)	11,894
Financing activities		

Net increase in deposits	25,161	15,435
Preferred stock dividends paid	(1,215)	(2,025)
Preferred stock redemption	(20,000)	(10,000)
Proceeds from issuance of common stock	9,191	0
Net increase in short-term borrowings	12,845	172
Payments on long-term borrowings	(10,808)	(15,800)
Net cash provided by/(used in) financing activities	15,174	(12,218)
Increase in cash and cash equivalents	20,442	11,169
Cash and cash equivalents at beginning of the year	63,310	52,141
Cash and cash equivalents at end of period	$ 83,752	$ 63,310
Supplemental information		
Interest paid	$ 7,298	$ 8,321
Taxes paid	$ 175	$ 540
Non-cash investing activities:		
Transfers from loans to other real estate owned	$ 2,060	$ 6,938

See notes to consolidated financial statements

First United Corporation and Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business

First United Corporation is a Maryland corporation chartered in 1985 and a bank holding company registered under the federal Bank Holding Company Act of 1956, as amended. First United Corporation's primary business is serving as the parent company of First United Bank & Trust, a Maryland trust company with commercial banking powers (the "Bank"), First United Statutory Trust I, a Connecticut statutory business trust ("Trust I"), First United Statutory Trust II, a Connecticut statutory business trust ("Trust II" and together with Trust I, the "Trusts"), and First United Statutory Trust III, a Delaware statutory business trust ("Trust III"). Trust I, Trust II and Trust III were formed for the purpose of selling trust preferred securities that qualified as Tier 1 capital. The Bank has four wholly-owned subsidiaries: OakFirst Loan Center, Inc., a West Virginia finance company; OakFirst Loan Center, LLC, a Maryland finance company (collectively, the "OakFirst Loan Centers"); First OREO Trust, a Maryland statutory trust; and FUBT OREO I, LLC, a Maryland limited liability company. The OakFirst Loan Centers are engaged in the consumer finance business, and First OREO Trust and FUBT OREO I, LLC were formed for the purposes of holding, servicing and disposing of the real estate that the Bank acquires through foreclosure or by deed in lieu of foreclosure. The Bank also owns 99.9% of the limited partnership interests in Liberty Mews Limited Partnership, a Maryland limited partnership formed for the purpose of acquiring, developing and operating low-income housing units in Garrett County, Maryland ("Liberty Mews").

First United Corporation and its subsidiaries operate principally in four counties in Western Maryland and four counties in West Virginia.

As used in these Notes, the terms "the Corporation", "we", "us", and "our" mean First United Corporation and, unless the context clearly suggests otherwise, its consolidated subsidiaries.

Basis of Presentation

The accompanying consolidated financial statements of the Corporation have been prepared in accordance with United States generally accepted accounting principles ("GAAP") as required by the Financial Accounting Standards

Board ("FASB") Accounting Standards Codification ("ASC") that require management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the financial statements as well as the reported amount of revenues and expenses during the reporting period. Actual results could differ from these 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 assessment of other-than-temporary impairment ("OTTI") pertaining to investment securities, potential impairment of goodwill, and the valuation of deferred tax assets. For purposes of comparability, certain prior period amounts have been reclassified to conform to the 2016 presentation. Such reclassifications had no impact on net income or equity.

The Corporation has evaluated events and transactions occurring subsequent to the statement of financial condition date of December 31, 2017 for items that should potentially be recognized or disclosed in these financial statements as prescribed by ASC Topic 855, *Subsequent Events*.

Principles of Consolidation

The consolidated financial statements of the Corporation include the accounts of First United Corporation, the Bank, the OakFirst Loan Centers, First OREO Trust and FUBT OREO I, LLC. All significant inter-company accounts and transactions have been eliminated.

First United Corporation determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity ("VIE") in accordance with GAAP. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make financial and operating decisions. The Corporation consolidates voting interest entities in which it has 100%, or at least a majority, of the voting interest. As defined in applicable accounting standards, a VIE is an entity that either (i) does not have equity investors with voting rights or (ii) has equity investors that do not provide sufficient financial resources for the entity to support its activities. A controlling financial interest in an entity exists when an enterprise has a variable interest, or a combination of variable interests that will absorb a majority of an entity's expected losses, receive a majority of an entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE.

The Corporation accounts for its investment in Liberty Mews utilizing the effective yield method under guidance that applies specifically to investments in limited partnerships that operate qualified affordable housing projects. Under the effective yield method, the investor recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the investor. The effective yield is the internal rate of return on the investment, based on the cost of the investment and the guaranteed tax credits allocated to the investor. The tax credit allocated, net of the amortization of the investment in the limited partnership, is recognized in the income statement as a component of income taxes attributable to continuing operations.

Significant Concentrations of Credit Risk

Most of the Corporation's relationships are with customers located in Western Maryland and Northeastern West Virginia. At December 31, 2017, approximately 12%, or $110.5 million, of total loans were secured by real estate acquisition, construction and development projects, with $109.5 million performing according to their contractual terms and $1.0 million considered to be impaired based on management's concerns about the borrowers' ability to comply with present repayment terms. Of the $1.0 million in impaired loans, $.8 million were classified as troubled debt restructurings ("TDRs") performing in accordance with their modified terms, and $.2 million were classified as non-performing loans at December 31, 2017. Additionally, loans collateralized by commercial rental properties represented 19% of the total loan portfolio as of December 31, 2017. Note 6 discusses the types of securities in which the Corporation invests and Note 7 discusses the Corporation's lending activities.

Investments

The investment portfolio is classified and accounted for based on the guidance of ASC Topic 320, *Investments – Debt and Equity Securities*. Securities bought and held principally for the purpose of selling them in the near term are classified as trading account securities and reported at fair value with unrealized gains and losses included in net gains/losses in other operating income. Securities purchased with the intent and ability to hold the securities to maturity are classified as held-to-maturity securities and are recorded at amortized cost. All other investment securities are classified as available-for-sale. These securities are held for an indefinite period of time and may be sold in response to changing market and interest rate conditions or for liquidity purposes as part of our overall asset/liability management strategy. Available-for-sale securities are reported at market value, with unrealized gains and losses excluded from earnings and reported as a separate component of other comprehensive income included in consolidated statement of comprehensive income, net of applicable income taxes.

The amortized cost of debt securities is adjusted for the amortization of premiums to the first call date, if applicable, or to maturity, and for the accretion of discounts to maturity, or, in the case of mortgage-backed securities, over the estimated life of the security. Such amortization and accretion is included in interest income from investments.

Interest and dividends are included in interest income from investments. Gains and losses on the sale of securities are recorded using the specific identification method.

Restricted Investment in Bank Stock

Restricted stock, which represents required investments in the common stock of the Federal Home Loan Bank ("FHLB") of Atlanta, Atlantic Community Bankers Bank ("ACBB") and Community Bankers Bank ("CBB"), is carried at cost and is considered a long-term investment.

Management evaluates the restricted stock for impairment in accordance with ASC Industry Topic 942, *Financial Services – Depository and Lending*, (942-325-35). Management's evaluation of potential impairment is based on its assessment of the ultimate recoverability of the cost of the restricted stock rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability is influenced by criteria such as (i) the significance of the decline in net assets of the issuing bank as compared to the capital stock amount for that bank and the length of time this situation has persisted, (ii) commitments by the issuing bank to make payments required by law or regulation and the level of such payments in relation to the operating performance of that bank, and (iii) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuing bank. Management has evaluated the restricted stock for impairment and believes that no impairment charge is necessary as of December 31, 2017 or 2016.

The Corporation recognizes dividends on a cash basis. For the years ended December 31, 2017 and December 31, 2016, dividends of $251,709 and $269,694 respectively, were recorded in other operating income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or full repayment by the borrower are reported at their unpaid principal balance outstanding, adjusted for any deferred fees or costs pertaining to origination. Loans that management has the intent to sell are reported at the lower of cost or fair value determined on an individual basis.

The segments of the Bank’s loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The commercial real estate (“CRE”) loan segment is further disaggregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The acquisition and development (“A&D”) loan segment is further disaggregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. These loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the A&D loan. The commercial and industrial (“C&I”) loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is further disaggregated into two classes: amortizing term loans, which are primarily first liens, and home equity lines of credit, which are generally second liens. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

Interest and Fees on Loans

Interest on loans (other than those on non-accrual status) is recognized based upon the principal amount outstanding. Loan fees in excess of the costs incurred to originate the loan are recognized as income over the life of the loan utilizing either the interest method or the straight-line method, depending on the type of loan. Generally, fees on loans with a specified maturity date, such as residential mortgages, are recognized using the interest method. Loan fees for lines of credit are recognized using the straight-line method.

A loan is considered to be past due when a payment has not been received for 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation’s policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

Generally, consumer installment loans are not placed on non-accrual status, but are charged off after they are 120 days contractually past due. Loans other than consumer loans are charged-off based on an evaluation of the facts and circumstances of each individual loan.

Allowance for Loan Losses

An allowance for loan losses ("ALL") is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Corporation's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank's ALL.

The Corporation maintains an ALL on unfunded commercial lending commitments and letters of credit to provide for the risk of loss inherent in these arrangements. The allowance is determined utilizing a methodology that is similar to that used to determine the ALL, modified to take into account the probability of a draw down on the commitment. This allowance is reported as a liability on the balance sheet within accrued interest payable and other liabilities. The balance in the liability account was $64,688 at December 31, 2017 and $61,174 at December 31, 2016.

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation. The provision for depreciation for financial reporting has been made by using the straight-line method based on the estimated useful lives of the assets, which range from 10 to 31.6 years for buildings and three to 20 years for furniture and equipment. Accelerated depreciation methods are used for income tax purposes.

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired in business combinations. In accordance with ASC Topic 350, *Intangibles - Goodwill and Other*, goodwill is not amortized but is subject to an annual impairment test.

Bank-Owned Life Insurance ("BOLI")

BOLI policies are recorded at their cash surrender values. Changes in the cash surrender values are recorded as other operating income.

Other Real Estate Owned ("OREO")

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less the cost to sell at the date of foreclosure, with any losses charged to the ALL, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Changes in the valuation allowance, sales gains and losses, and revenue and expenses from holding and operating properties are all included in net expenses from other real estate owned.

Income Taxes

First United Corporation and its subsidiaries file a consolidated federal income tax return. Income taxes are accounted for using the asset and liability method. Under the asset and liability method, the deferred tax liability or asset is determined based on the difference between the financial statement and tax bases of assets and liabilities (temporary differences) and is measured at the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is determined by the change in the net liability or asset for deferred taxes adjusted for changes in any deferred tax asset valuation allowance.

ASC Topic 740, *Taxes,* provides clarification on accounting for uncertainty in income taxes recognized in an enterprise's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We have not identified any income tax uncertainties.

State corporate income tax returns are filed annually. Federal and state returns may be selected for examination by the Internal Revenue Service and the states where we file, subject to statutes of limitations. At any given point in time, the Corporation may have several years of filed tax returns that may be selected for examination or review by taxing authorities.

Interest and penalties on income taxes are recognized as a component of income tax expense.

Defined Benefit Plans

The defined benefit pension plan and supplemental executive retirement plan are accounted for in accordance with ASC Topic 715, *Compensation – Retirement Benefits*. Under the provisions of Topic 715, the defined benefit pension plan and the supplemental executive retirement plan are recognized as liabilities in the Consolidated Statement of Financial Condition, and unrecognized net actuarial losses, prior service costs and a net transition asset are recognized as a separate component of other comprehensive loss, net of tax. Actuarial gains and losses in excess of 10 percent of the greater of plan assets or the pension benefit obligation are amortized over a blend of future service of active employees and life expectancy of inactive participants. Refer to Note 18 for a further discussion of the pension plan and supplemental executive retirement plan obligations.

Statement of Cash Flows

Cash and cash equivalents are defined as cash and due from banks and interest-bearing deposits in banks in the Consolidated Statement of Cash Flows.

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Trust Assets and Income

Assets held in an agency or fiduciary capacity are not the Bank’s assets and, accordingly, are not included in the Consolidated Statement of Financial Condition. Income from the Bank’s trust department represents fees charged to customers.

Business Segments

The Corporation operates in one segment, community banking, as defined by ASC Topic 280, *Segment Reporting*. The Corporation in its entirety is managed and evaluated on an ongoing basis by First United Corporation’s Board of Directors and executive management, with no division or subsidiary receiving separate analysis regarding performance or resource allocation.

Equity Compensation Plan

At the 2007 Annual Meeting of Shareholders, First United Corporation’s shareholders approved the First United Corporation Omnibus Equity Compensation Plan (the “Omnibus Plan”), which authorized the issuance of up to 185,000 shares of common stock pursuant to the grant of stock options, stock appreciation rights, stock awards, stock units, performance units, dividend equivalents, and other stock-based awards to employees or directors. The Omnibus Plan expired by its terms in the second quarter of 2017.

The Corporation applies the provisions of ASC Topic 718, *Compensation-Stock Compensation*, in measuring and disclosing stock compensation cost. The measurement objective in ASC Paragraph 718-10-30-6 requires public companies to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. The cost is recognized in expense over the period in which an employee is required to provide service in exchange for the award (the vesting period).

Stock-based awards were made to non-employee directors in the second quarter of 2017 pursuant to First United Corporation’s director compensation policy. Each director received an annual retainer of 1,000 shares of First United Corporation common stock, plus $10,000 that was paid, at the director’s election, in cash or additional shares of common stock. In 2017 and 2016, a total of 14,795 and 14,384, respectively, fully-vested shares of common stock were issued to directors, which had a fair market value of $14.48 and $10.34 per share, respectively. Director stock compensation expense was $192,398 for the year ended December 31, 2017 and $147,006 for the year ended

December 31, 2016.

In January 2015, a one-time stock grant was awarded to one executive officer in the amount of 4,845 shares at a fair market value of $8.63. In February 2015, a one-time stock grant was awarded to one executive officer in the amount of 5,387 shares at a fair market value of $8.76. These shares had a two-year vesting period. Executive stock compensation expense related to these awards was $45,527 for the year ended December 31, 2016. There was no executive stock compensation expense remaining at December 31, 2016.

Stock Repurchases

Under the Maryland General Corporation Law, shares of capital stock that are repurchased are cancelled and treated as authorized but unissued shares. When a share of capital stock is repurchased, the payment of the repurchase price reduces stated capital by the par value of that share (currently, $0.01 for common stock and $0.00 for preferred stock), and any excess over par value reduces capital surplus. There were no stock repurchases in 2017 and 2016.

Adoption of New Accounting Standards and Effects of New Accounting Pronouncements

In February 2018, the FASB issued Accounting Standards Update ("ASU") 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220)*. ASU 2018-02 is an amendment to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. ASU 2018-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. Early adoption of the amendment in this update is permitted, including adoption in any interim period. The Corporation elected to early adopt the standard effective December 31, 2017. Deferred tax assets within Accumulated Other Comprehensive Loss ("AOCL") of $4.4 million were reclassified to retained earnings within the consolidated statement of changes in shareholders' equity in 2017.

In January 2018, the FASB issued Accounting Standards Update ("ASU") 2018-01, *Leases (Topic 842).* This update is to provide improvements of transparency and comparability by recognizing lease assets and liabilities on the balance sheet and disclosing key information about leasing transactions. This update also provides an optional practical expedient that affects entities with land easements that existed or expired before an entity's adoption of Topic 842, provided that the entity does not account for those land easements as leases under Topic 840. ASU 2018-01 amendments affect the amendments in ASU 2016-02, which are not yet effective. The effective date and transition requirements for the amendments are the same as the effective date and transition requirements in ASU 2016-02. The Corporation is evaluating the provisions of ASU 2018-01 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In September 2017, the FASB issued Accounting Standards Update ("ASU") 2017-13, Revenue Recognition *(Topic 605), Revenue from Contracts with Customers (Topic 606), Leases (Topic 840), and Leases (Topic 842).* ASU 2017-13 amends guidance on ASU 2014-09, *Revenue from Contracts with Customers.* ASU 2017-13 is effective for public business entities that are SEC filers for annual periods beginning after December 15, 2017, and interim periods within those annual periods, and for all other entities for annual periods beginning after December 15, 2018 and interim reporting periods within annual reporting periods within annual reporting periods beginning after December 15, 2019. The Corporation is evaluating the provisions of ASU 2017-13 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging *(Topic 815): Targeted Improvements to Accounting for Hedging Activities.* ASU 2017-12 amendments better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. For public business entities, AU 2017-12 is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Corporation is evaluating the provisions of ASU 2017-12 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In March 2017, the FASB issued ASU 2017-08, *Receivables- Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchases Callable Debt Securities.* ASU 2017-08 amends guidance on the amortization period of premiums on certain purchases callable debt securities. The amendments shorten the amortization period of premiums on certain purchases callable debt securities to the earliest call date. ASU 2017-08 is effective for public business entities that are SEC filers for annual periods beginning after December 15, 2018, and interim periods within those annual periods, for public entities that are not SEC filers for annual periods beginning after December 15, 2019 and for all other entities for annual periods beginning after December 15, 2020 with early adoption permitted. The Corporation amortizes to the call date and therefore the adoption will not have any impact on the Corporation's financial condition or results of operations.

In March 2017, the FASB issued ASU 2017-07, *Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*. ASU 2017-07 requires an entity to present net periodic pension cost and net periodic postretirement benefit cost as a net amount that may be capitalized as part of an asset when appropriate. ASU 2017-07 is effective for public business entities that are SEC filers for annual periods beginning after December 15, 2017, and interim periods within those annual periods, for public entities that are not SEC filers for annual periods beginning after December 15, 2018 and for all other entities for annual periods beginning after December 15, 2019 with early adoption permitted. The Corporation is evaluating the provisions of ASU 2017-07 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In January 2017, the FASB issued ASU 2017-04, *Intangibles- Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.* ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating step 2 from the goodwill impairment test. Instead, if "the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit." The ASU does not change the qualitative assessment, however, it removes the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform step 2 of the goodwill impairment test. ASU 2017-04 is effective for public business entities that are SEC filers for annual periods beginning after December 15, 2019, and interim periods within those annual periods, for public entities that are not SEC filers for annual periods beginning after December 15, 2020 and for all other entities for annual periods beginning after December 15, 2021 with early adoption permitted. The Corporation is evaluating the provisions of ASU 2017-04 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 addresses the following eight specific cash flow issues: (a) debt prepayment or debt extinguishment costs; (b) settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; (c) contingent consideration payments made after a business combination; (d) proceeds from the settlement of insurance claims; (e) proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); (f) distributions received from equity method investees; (g) beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The amendments in this Update apply to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230. ASU 2016-15 is effective for public business entities for annual periods beginning after December 15, 2017, and interim periods within those annual periods, and for all other entities for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019 with early adoption permitted. The Corporation is evaluating the provisions of ASU 2016-15 but believes that its adoption will not have a material impact on the Corporation's financial condition or results of operations.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments- Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 introduces an approach based on expected losses to estimate credit losses on certain types of financial instruments. It also modifies the impairment model for available-for-sale debt securities and provides for a simplified accounting model for purchases financial assets with credit deterioration since their origination. The new model referred to as current expected credit losses model, will apply to: (a) financial assets subject to credit losses and measured at amortized cost, and (b) certain off-balance sheet credit exposures. This includes loans, held to maturity debt securities, loan commitments, financial guarantees and net investments in leases as well as reinsurance and trade receivables. The estimate of expected credit losses should consider historical information, current information, and supportable forecasts, including estimates of prepayments. ASU 2016-13 is effective for public business entities for annual periods beginning after December 15, 2019, and interim periods within those annual periods, and for all other entities for annual periods beginning after December 15, 2020 and interim periods within annual periods beginning after December 15, 2018 with early adoption permitted. Management currently intends to adopt the guidance on January 1, 2020 and is assessing the impact of this guidance on the Corporation’s financial condition and results of operations. Management has formed a focus group consisting of multiple members from areas including credit, finance, and information systems. The focus group is evaluating the requirements of the new standard and the impact it will have on our processes. The Corporation is in the process of determining the impact on the Corporation’s financial condition or results of operations.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. ASU 2016-02 is intended to improve financial reporting about leasing transactions by requiring organizations that lease assets – referred to as “lessees” – to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. Under the new guidance, a lessee will be required to recognize assets and liabilities related to certain operating leases on the balance sheet. The amendments will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. ASU 2016-02 applies to all public business entities for annual and interim periods after December 15, 2018, and for all other entities for annual periods beginning after December 15, 2019 and interim periods beginning after December 15, 2020 with early adoption permitted. Management is currently assessing the impact of the new guidance but expects to report higher assets and liabilities as a result of including additional leases on the consolidated statement of financial condition.

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10)*. The update requires all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The update also requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition, the update eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement for to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measure at amortized cost on the balance sheet for public entities. For public business entities, the amendments are effective for annual periods beginning after December 15, 2017, including interim periods within the annual period, and for all other entities, effective for annual periods beginning after December 15, 2018 and interim periods within annual periods beginning after December 15, 2019. Early application is permitted. The Corporation is evaluating the provisions of ASU 2016-01, but believes that its adoption will not have a material impact on the Corporation’s financial condition or results of operations.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers,* which establishes a comprehensive revenue recognition standard for virtually all industries under U.S. GAAP, including those that previously followed industry-specific guidance such as the real estate, construction and software industries. ASU 2014-09 specifies that an entity shall recognize revenue when, or as, the entity satisfies a performance obligation by transferring a promised good or service (i.e. an asset) to a customer. An asset is transferred when, or as, the customer obtains control of the asset. Entities are required to disclose qualitative and quantitative information on the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The guidance is effective for us on January 1, 2018. We have elected to implement using the modified retrospective application, with the cumulative effect recorded as an adjustment to opening retained earnings at January 1, 2018. Financial instruments which are the sources of the majority of our operating revenue are excluded from the scope of this amended guidance, which includes interest income and securities gains/losses. The following revenue streams were identified to be in scope of ASC 606: Wealth Management, includes trust and brokerage services, service charges on deposit accounts, and interchange fee income – debit card income. The Company adopted ASU 2014-09 on January 1, 2018 and did not identify any significant changes in the timing of revenue recognition when considering the amended accounting guidance. The Company will have additional disclosures beginning in the first quarter of 2018 as required by the guidance.

2. Earnings Per Common Share

Basic earnings per common share is derived by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is derived by dividing net income available to common shareholders by the weighted-average number of shares outstanding, adjusted for the dilutive effect of outstanding common stock equivalents. There were no common stock equivalents at December 31, 2017 or December 31, 2016.

The following table sets forth the calculation of basic and diluted earnings per common share for the years ended December 31, 2017 and 2016:

	2017			2016		
(in thousands, except for per share amount)	Income	Average Shares	Per Share Amount	Income	Average Shares	Per Share Amount
Basic and Diluted Earnings Per Share:						
Net income	$5,269			$7,281		
Preferred stock dividends paid	(1,215)			(2,025)		
Net income available to common shareholders	$4,054	6,932	$ 0.58	$5,256	6,264	$ 0.84

3. Net Gains

The following table summarizes the gain/(loss) activity for the years ended December 31, 2017 and 2016:

(in thousands)	2017	2016
Net gains/(losses):		
Available-for-sale securities:		
Realized gains	$52	$688
Realized losses	(101)	(248)
Gain on sale of consumer loans	75	95
Gain/(loss) on disposal of fixed assets	3	(9)
Net gains	$29	$526

4. Regulatory Capital Requirements

We require capital to fund loans, satisfy our obligations under the Bank's letters of credit, meet the deposit withdrawal demands of the Bank's customers, and satisfy our other monetary obligations. To the extent that deposits are not adequate to fund our capital requirements, we can rely on a number of funding sources, including an unsecured Fed Funds lines of credit with upstream correspondent banks; secured advances with the FHLB of Atlanta, which are collateralized by eligible one to four family residential mortgage loans, home equity lines of credit, commercial real estate loans, and various securities. Cash may also be pledged as collateral. In addition, First United Corporation has a secured line of credit with the Fed Discount Window for use in borrowing funds up to 90 days, using municipal securities as collateral; brokered deposits, including CDs and money market funds; and One Way Buy CDARS/ ICS funding, which is a form of brokered deposits that has become a viable supplement to brokered deposits obtained directly. At December 31, 2017, the Bank had $75.0 million available through unsecured lines of credit with correspondent banks, $7.0 million through a secured line of credit with the Fed Discount Window and approximately $86.2 million at the FHLB. Management is not aware of any demands, commitments, events or uncertainties that are likely to materially affect our ability to meet our future capital requirements.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2017						
Total Capital (to risk-weighted assets)						
Consolidated	$158,108	15.98%	$ 78,954	8.00 %	$ 98,693	10.00 %
First United Bank & Trust	145,921	15.58%	74,739	8.00 %	93,424	10.00 %
Tier 1 Capital (to risk-weighted assets)						
Consolidated	148,072	14.97%	59,216	6.00 %	78,954	8.00 %
First United Bank & Trust	135,885	14.51%	56,054	6.00 %	74,739	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)						
Consolidated	124,064	12.54%	44,412	4.50 %	64,150	6.50 %
First United Bank & Trust	135,885	14.51%	42,041	4.50 %	60,726	6.50 %
Tier 1 Capital (to average assets)						
Consolidated	148,072	11.00%	53,646	4.00 %	67,058	5.00 %
First United Bank & Trust	135,885	10.21%	52,801	4.00 %	66,001	5.00 %

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2016						
Total Capital (to risk-weighted assets)						
Consolidated	$164,081	16.71%	$ 78,577	8.00 %	$ 98,221	10.00 %
First United Bank & Trust	155,992	16.70%	74,733	8.00 %	93,416	10.00 %
Tier 1 Capital (to risk-weighted assets)						
Consolidated	145,008	14.76%	58,933	6.00 %	78,577	8.00 %
First United Bank & Trust	146,013	15.63%	56,050	6.00 %	74,733	8.00 %
Common Equity Tier 1 Capital (to risk-weighted assets)						
Consolidated	105,523	10.74%	44,200	4.50 %	63,844	6.50 %
First United Bank & Trust	146,013	15.63%	42,037	4.50 %	60,721	6.50 %
Tier 1 Capital (to average assets)						
Consolidated	145,008	10.95%	53,124	4.00 %	66,404	5.00 %
First United Bank & Trust	146,013	11.11%	52,321	4.00 %	65,401	5.00 %

As of December 31, 2017 and 2016, the most recent notifications from the regulators categorized First United Corporation and the Bank as “well capitalized” under the regulatory framework for prompt corrective action. On a consolidated basis, there was a slight decline in the capital ratios when comparing December 31, 2017 to December 31, 2016, due primarily to the repayment of $20.0 million of its outstanding Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”) in 2017. The consolidated total risk-based capital ratios include $30.9 million of First United Corporation’s junior subordinated debentures (“TPS Debentures”) which qualified as Tier 1 capital at December 31, 2017 under guidance issued by the Board of Governors of the Federal Reserve System (the “Federal Reserve”).

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At the Bank level, the ratios also decreased when comparing December 31, 2017 to December 31, 2016 due to the dividend of $20.0 million from the Bank to the Holding Company for the repayment of the $20.0 million of Series A Preferred Stock. At December 31, 2017, we were in compliance with the requirements.

First United Corporation's Board of Directors suspended the payment of dividends on the common stock in December 2010.

5. Cash and Cash Equivalents

Cash and due from banks, which represents vault cash in the retail offices and invested cash balances at the Federal Reserve, is carried at fair value.

(in thousands)	December 31, 2017	December 31, 2016
Cash and due from banks, weighted average interest rate of 0.82% (at December 31, 2017)	$ 82,273	$ 60,707

Interest bearing deposits in banks, which represent funds invested at a correspondent bank, are carried at fair value and, as of December 31, 2017 and 2016, consisted of daily funds invested at the FHLB of Atlanta, and M&T Bank ("M&T").

(in thousands)	December 31, 2017	December 31, 2016
FHLB daily investments, interest rate of 1.24% (at December 31, 2017)	$ 464	$ 1,590
M&T daily investments, interest rate of 0.15% (at December 31, 2017)	1,015	1,013
	$ 1,479	$ 2,603

6. Investment Securities

The following table shows a comparison of amortized cost and fair values of investment securities at December 31, 2017 and 2016:

(in thousands)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	OTTI in AOCL
December 31, 2017					
Available for Sale:					
U.S. government agencies	$ 30,000	$ 0	744	$ 29,256	$ 0
Commercial mortgage-backed agencies	41,771	0	880	40,891	0
Collateralized mortgage obligations	41,298	2	916	40,384	0
Obligations of states and political subdivisions	20,772	365	118	21,019	0
Collateralized debt obligations	19,711	0	4,791	14,920	(3,389)
Total available for sale	$ 153,552	$ 367	$ 7,449	$ 146,470	$ (3,389)
Held to Maturity:					
U.S. government agencies	$ 15,876	$ 447	$ 0	$ 16,323	$ 0
Residential mortgage-backed agencies	47,771	94	423	47,442	0
Commercial mortgage-backed agencies	17,288	236	6	17,518	0
Collateralized mortgage obligations	4,187	0	69	4,118	0
Obligations of states and political subdivisions	8,510	1,443	8	9,945	0
Total held to maturity	$ 93,632	$ 2,220	$ 506	$ 95,346	$ 0
December 31, 2016					
Available for Sale:					
U.S. government agencies	$ 25,000	$ 0	$ 747	$ 24,253	$ 0
Commercial mortgage-backed agencies	52,978	1	757	52,222	0
Collateralized mortgage obligations	19,953	13	399	19,567	0
Obligations of states and political subdivisions	23,700	255	251	23,704	0
Collateralized debt obligations	27,930	0	7,676	20,254	(3,961)
Total available for sale	$ 149,561	$ 269	$ 9,830	$ 140,000	(3,961)
Held to Maturity:					
U.S. government agencies	$ 15,738	$ 512	$ 0	$ 16,250	$ 0
Residential mortgage-backed agencies	50,384	160	279	50,265	0
Commercial mortgage-backed agencies	17,584	248	0	17,832	0
Collateralized mortgage obligations	4,833	0	149	4,684	0
Obligations of states and political subdivisions	8,630	490	170	8,950	0
Total held to maturity	$ 97,169	$ 1,410	$ 598	$ 97,981	$ 0

Proceeds from sales of available-for-sale securities and the realized gains and losses for the years ended December 31, 2017 and 2016 are as follows:

(in thousands)	2017	2016
Proceeds	$ 18,530	$ 43,782
Realized gains	52	688
Realized losses	101	248

The following table shows the Corporation's securities with gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized position, at December 31, 2017 and 2016:

(in thousands)	Less than 12 months		12 months or more	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
December 31, 2017				
Available for Sale:				
U.S. government agencies	$ 4,931	$ 69	$ 24,325	$ 675
Commercial mortgage-backed agencies	12,593	169	28,298	711
Collateralized mortgage obligations	27,387	472	12,447	443
Obligations of states and political subdivisions	2,683	44	2,747	75
Collateralized debt obligations	0	0	14,920	4,791
Total available for sale	$ 47,594	$ 754	$ 82,737	$ 6,695
Held to Maturity:				
Residential mortgage-backed agencies	15,897	135	10,422	288
Commercial mortgage-backed agencies	9,028	6	0	0
Collateralized mortgage obligations	0	0	4,118	69
Obligations of states and political subdivisions	0	0	2,377	8
Total held to maturity	$ 24,925	$ 141	$ 16,917	$ 365
December 31, 2016				
Available for Sale:				
U.S. government agencies	$ 24,253	$ 747	$ 0	$ 0
Commercial mortgage-backed agencies	51,604	757	0	0
Collateralized mortgage obligations	14,706	399	0	0
Obligations of states and political subdivisions	8,079	160	2,934	91
Collateralized debt obligations	0	0	20,254	7,676
Total available for sale	$ 98,642	$ 2,063	$ 23,188	$ 7,767
Held to Maturity:				
Residential mortgage-backed agencies	20,899	279	0	0
Commercial mortgage-backed agencies	4,684	149	0	0
Obligations of states and political subdivisions	2,335	170	0	0

Total held to maturity	$ 27,918	$ 598	$ 0	$ 0

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Management systematically evaluates securities for impairment on a quarterly basis. Based upon application of accounting guidance for subsequent measurement in ASC Topic 320 (ASC Section 320-10-35), management assesses whether (i) the Corporation has the intent to sell a security being evaluated and (ii) it is more likely than not that the Corporation will be required to sell the security prior to its anticipated recovery. If neither applies, then declines in the fair values of securities below their cost that are considered other-than-temporary declines are split into two components. The first is the loss attributable to declining credit quality. Credit losses are recognized in earnings as realized losses in the period in which the impairment determination is made. The second component consists of all other losses, which are recognized in other comprehensive loss. In estimating OTTI losses, management considers (a) the length of time and the extent to which the fair value has been less than cost, (b) adverse conditions specifically related to the security, an industry, or a geographic area, (c) the historic and implied volatility of the fair value of the security, (d) changes in the rating of the security by a rating agency, (e) recoveries or additional declines in fair value subsequent to the balance sheet date, (f) failure of the issuer of the security to make scheduled interest or principal payments, and (g) the payment structure of the debt security and the likelihood of the issuer being able to make payments that increase in the future. Management also monitors cash flow projections for securities that are considered beneficial interests under the guidance of ASC Subtopic 325-40, *Investments – Other – Beneficial Interests in Securitized Financial Assets*, (ASC Section 325-40-35).

Management believes that the valuation of certain securities is a critical accounting policy that requires significant estimates in preparation of its consolidated financial statements. Management utilizes an independent third party to prepare both the impairment valuations and fair value determinations for its collateralized debt obligation (“CDO“) portfolio consisting of pooled trust preferred securities. Management performs due diligence on the third party processes and believes that it has an adequate understanding of the analysis, assumptions and methodology used by the third party to prepare the fair value determination and the OTTI evaluation. Management reviews the qualifications of the third party and believes they are qualified to provide the analysis and pricing determinations. Quarterly, management reviews the third party’s detailed assumptions and analyzes its projected discounted present value results for reasonableness and consistency with the trend of prior projections. Annually, management performs stress tests of the assumptions used in the third party models and performs back tests of the assumptions and prepayment projections to validate the impairment model results. As a result of its due diligence process, management believes that the fair value presented and the OTTI recognized are appropriate. A total of $3.2 million in impairment losses was realized during the time period 2009 through 2011 on the CDO portfolio remaining at December 31, 2017. Due to the prior credit impairment, the securities in this portfolio have continued to be evaluated to determine whether any additional OTTI has occurred. Based on management’s review of the third party evaluations, management believes that there were no material differences in the relative valuations between December 31, 2017 and December 31, 2016.

<u>U.S. Government Agencies – Available for Sal</u>e – There was one U.S. government agency in an unrealized loss position for less than 12 months as of December 31, 2017. There were four U.S. government agencies in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Commercial Mortgage-Backed Agencies – Available for Sale – There were two commercial mortgage-backed agencies in an unrealized loss position for less than 12 months as of December 31, 2017. There were six commercial mortgage-backed agency securities in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Collateralized Mortgage Obligations – Available for Sale – There were six collateralized mortgage obligations in an unrealized loss position for less than 12 months as of December 31, 2017. There were two collateralized mortgage obligations in an unrealized loss position for 12 months or more. The securities are of the highest investment grade and the Corporation does not intend to sell them, and it is not more likely than not that the Corporation will be required to sell them before recovery of the amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Obligations of State and Political Subdivisions – Available for Sale – There was one obligation of state and political subdivisions that has been in an unrealized loss position for less than 12 months at December 31, 2017. There were two securities that have been in an unrealized loss position for 12 months or more. These investments are of investment grade as determined by the major rating agencies and management reviews the ratings of the underlying issuers and performs an in-depth credit analysis on the securities. Management believes that this portfolio is well-diversified throughout the United States, and all bonds continue to perform according to their contractual terms. The Corporation does not intend to sell these investments and it is not more likely than not that the Corporation will be required to sell the investments before recovery of their amortized cost basis, which may be at maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Collateralized Debt Obligations – Available for Sale - The $4.8 million in unrealized losses greater than 12 months at December 31, 2017 relates to ten pooled trust preferred securities that are included in the CDO portfolio. See Note 23 for a discussion of the methodology used by management to determine the fair values of these securities. Based upon a review of credit quality and the cash flow tests performed by the independent third party, management determined that there were no securities that had credit-related non-cash OTTI charges during 2017. The unrealized losses on the remaining securities in the portfolio are primarily attributable to continued depression in market interest rates, marketability, liquidity and the current economic environment.

U.S. Government Agencies – Held to Maturity – There were no U.S. government agencies in an unrealized loss position as of December 31, 2017.

Residential Mortgage-Backed Agencies – Held to Maturity – There were eleven residential mortgage-backed agencies that have been in an unrealized loss position for less than 12 months as of December 31, 2017. There were eleven residential mortgage-backed agencies in an unrealized loss position for 12 months or more as of December 31, 2017. The securities are of the highest investment grade and the Corporation has the intent and ability to hold the investments to maturity. Accordingly, management does not consider these investments to be other-than-temporarily impaired at December 31, 2017.

Commercial Mortgage-Backed Agencies – Held to Maturity – There was one commercial mortgage-backed agency in an unrealized loss position for less than 12 months as of December 31, 2017. The security is of the highest investment grade and the Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at December 31, 2017. There were no commercial mortgage-backed agencies in an unrealized loss position for 12 months or more.

Collateralized Mortgage Obligations – Held to Maturity – There was one collateralized mortgage obligation in an unrealized loss position for 12 months or more as of December 31, 2017. The security is of the highest investment grade and the Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at December 31, 2017. There were no collateralized mortgage obligations in an unrealized loss position for less than 12 months.

Obligations of State and Political Subdivisions – Held to Maturity – There was one obligation of state and political subdivision in an unrealized loss position for less than 12 months as of December 31, 2017. This bond is a Tax Increment Fund (TIF) bond. Management performs an in-depth credit analysis on this security. The Corporation has the intent and ability to hold the investment to maturity. Accordingly, management does not consider this investment to be other-than-temporarily impaired at December 31, 2017. There were no obligations of state and political subdivisions in an unrealized loss position for greater than12 months.

Due to the duration and market value decline in the pooled trust preferred securities held in our portfolio, we performed more extensive testing on these securities for purposes of evaluating whether or not OTTI has occurred.

The market for these securities as of December 31, 2017 as well as the market for similar securities saw limited activity. The inactivity was evidenced by a decrease in the volume of trades relative to historical levels due to limited supply. In addition, the securities that traded were typically more senior in the capital structure. The new issue market is also inactive, as no new CDOs have been issued since 2007. There are currently very few market participants who are willing to effect transactions in these securities. The market values for these securities, or any securities other than those issued or guaranteed by the Treasury, are depressed relative to historical levels. In the current market, a low market price for a particular bond may only provide evidence of stress in the credit markets in general rather than being an indicator of credit problems with a particular issue. Given the conditions in the current debt markets and the absence of observable transactions in the secondary and new issue markets, management has determined that (i) the few observable transactions and market quotations that are available are not reliable for the purpose of obtaining fair value at either December 31, 2016 or 2017, (ii) an income valuation approach technique (i.e. present value) that maximizes the use of relevant unobservable inputs and minimizes the use of observable inputs will be equally or more representative of fair value than a market approach, and (iii) the CDO segment is appropriately classified within Level 3 of the valuation hierarchy because management determined that significant adjustments were required to determine fair value at the measurement date.

Management utilizes an independent third party to prepare both the evaluations of OTTI and the fair value determinations for the CDO portfolio. Management does not believe that there were any material differences in the OTTI evaluations and pricing between December 31, 2016 and December 31, 2017.

The approach used by the third party to determine fair value involved several steps, which included detailed credit and structural evaluation of each piece of collateral in each bond, projection of default, recovery and prepayment/amortization probabilities for each piece of collateral in the bond, and discounted cash flow modeling. The discount rate methodology used by the third party combines a baseline current market yield for comparable corporate and structured credit products with adjustments based on evaluations of the differences found in structure and risks associated with actual and projected credit performance of each CDO being valued. Currently, the only active and liquid trading market that exists is for stand-alone trust preferred securities, with a limited market for highly-rated CDO securities that are more senior in the capital structure than the securities in the CDO portfolio. Therefore, adjustments to the baseline discount rate are also made to reflect the additional leverage found in structured instruments.

On December 10, 2013, to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Treasury, the federal banking regulators including FDIC, and the SEC adopted the Volcker Rule. The Volcker Rule prohibits a banking institution from acquiring or retaining an “ownership interest” in a “covered fund”. A “covered fund” is (a) an entity that would be an investment company under the Investment Company Act of 1940, as amended, but for the exemptions contained in Section 3(c)(1) or Section 3(c)(7) of that Act, (b) a commodity pool with certain characteristics, and/or (c) a non-US entity with certain characteristics that is sponsored or owned by a banking entity located or organized in the US. The term “ownership interest” is defined as “any equity, partnership, or other similar interest.” On January 14, 2014, the federal banking agencies adopted a final interim rule that exempts CDOs from the scope of the Volcker Rule if they were issued in offerings in which, among other things, the proceeds were used primarily to purchase securities issued by depository institutions and their affiliates. In connection with that final interim rule, the agencies published a non-exclusive list of exempt offerings. All of the CDOs included in the Corporation’s investment portfolio at December 31, 2017 were exempt.

The following table presents a cumulative roll-forward of the amount of non-cash OTTI charges related to credit losses which have been recognized in earnings for the trust preferred securities in the CDO portfolio held and not intended to be sold for the years ended December 31, 2017 and 2016:

(in thousands)	2017	2016
Balance of credit-related OTTI at January 1	$3,124	$3,133
Decreases for previously recognized credit-related OTTI because there was an intent to sell	0	0
Additions for decreases in cash flows expected to be collected	0	0
Reduction for increases in cash flows expected to be collected	(166)	(9)
Balance of credit-related OTTI at December 31	$2,958	$3,124

The amortized cost and estimated fair value of securities by contractual maturity at December 31, 2017 are shown in the following table. Actual maturities will differ from contractual maturities because the issuers of the securities may have the right to call or prepay obligations with or without call or prepayment penalties.

(in thousands)	Amortized Cost	Fair Value
Contractual Maturity		
Available for sale:		
Due in one year or less	$ 447	$ 452
Due after one year through five years	17,739	17,515
Due after five years through ten years	22,761	22,263
Due after ten years	29,536	24,965
	70,483	65,195
Commercial mortgage-backed agencies	41,771	40,891
Collateralized mortgage obligations	41,298	40,384
Total available for sale	$ 153,552	$ 146,470
Held to Maturity:		
Due after one year through five years	$ 8,276	$ 8,503
Due after five years through ten years	7,600	$ 7,820
Due after ten years	8,510	9,945
	24,386	26,268
Residential mortgage-backed agencies	47,771	47,442
Commercial mortgage-backed agencies	17,288	17,518
Collateralized mortgage obligations	4,187	4,118
Total held to maturity	$ 93,632	$ 95,346

At December 31, 2017 and 2016, investment securities with a value of $125.0 million and $121.8 million, respectively, were pledged as permitted or required to secure public deposits, for securities sold under agreements to repurchase as required or permitted by law and as collateral for borrowing capacity.

7. Loans and Related Allowance for Loan Losses

The following table summarizes the primary segments of the loan portfolio as of December 31, 2017 and December 31, 2016:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Total
December 31, 2017						
	$ 9,076	$ 976	$ 668	$ 4,201	$ 30	$ 14,951

Individually evaluated for impairment						
Collectively evaluated for impairment	$ 274,086	$ 109,554	$ 76,055	$ 394,447	$ 23,425	$ 877,567
Total loans	$ 283,162	$ 110,530	$ 76,723	$ 398,648	$ 23,455	$ 892,518
December 31, 2016						
Individually evaluated for impairment	$ 17,210	$ 2,525	$ 290	$ 3,975	$ 0	$ 24,000
Collectively evaluated for impairment	$ 280,749	$ 101,757	$ 72,056	$ 389,441	$ 23,923	$ 867,926
Total loans	$ 297,959	$ 104,282	$ 72,346	$ 393,416	$ 23,923	$ 891,926

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The segments of the Bank's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. The CRE loan segment is further disaggregated into two classes. Non-owner occupied CRE loans, which include loans secured by non-owner occupied nonfarm nonresidential properties, generally have a greater risk profile than all other CRE loans, which include loans secured by farmland, multifamily structures and owner-occupied commercial structures. The A&D loan segment is further disaggregated into two classes. One-to-four family residential construction loans are generally made to individuals for the acquisition of and/or construction on a lot or lots on which a residential dwelling is to be built. All other A&D loans are generally made to developers or investors for the purpose of acquiring, developing and constructing residential or commercial structures. These loans have a higher risk profile because the ultimate buyer, once development is completed, is generally not known at the time of the A&D loan. The C&I loan segment consists of loans made for the purpose of financing the activities of commercial customers. The residential mortgage loan segment is further disaggregated into two classes: amortizing term loans, which are primarily first liens, and home equity lines of credit, which are generally second liens. The consumer loan segment consists primarily of installment loans (direct and indirect) and overdraft lines of credit connected with customer deposit accounts.

In the ordinary course of business, executive officers and directors of the Corporation, including their families and companies in which certain directors are principal owners, were loan customers of the Bank. Pursuant to the Bank's lending policies, such loans were made on the same terms, including collateral, as those prevailing at the time for comparable transactions with persons who are not related to the Corporation and do not involve more than the normal risk of collectability. Changes in the dollar amount of loans outstanding to officers, directors and their associates were as follows for the year ended December 31:

(in thousands)	2017
Balance at January 1	$10,292
Loans or advances	633
Repayments	(1,876)
Balance at December 31	$9,049

Management uses a 10-point internal risk rating system to monitor the credit quality of the overall loan portfolio. The first six categories are considered not criticized and are aggregated as "Pass" rated. The criticized rating categories utilized by management generally follow bank regulatory definitions. The Special Mention category includes assets that are currently protected but are potentially weak, resulting in an undue and unwarranted credit risk, but not to the point of justifying a Substandard classification. Loans in the Substandard category have well-defined weaknesses that jeopardize the liquidation of the debt, and have a distinct possibility that some loss will be sustained if the weaknesses are not corrected. All loans greater than 90 days past due are considered Substandard. Only the portion of a specific allocation of the allowance for loan losses that management believes is associated with a pending event that could trigger loss in the short term is classified in the Doubtful category. Any portion of a loan that has been charged off is placed in the Loss category. It is possible for a loan to be classified as Substandard in the internal risk rating system, but not considered impaired under GAAP, due to the broader reach of "well-defined weaknesses" in the application of the Substandard definition.

To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Bank has a structured loan rating process with several layers of internal and external oversight. Generally, consumer and residential mortgage loans are included in the Pass categories unless a specific action, such as bankruptcy, repossession, or death occurs to raise awareness of a possible credit event. The Bank's Commercial Loan Officers are responsible for the timely and accurate risk rating of the loans in the commercial segments at origination and on an ongoing basis. The Bank's experienced Credit Quality and Loan Review Department performs an annual review of all commercial relationships of $500,000 or greater. Confirmation of the appropriate risk grade is included as part of the review process on an ongoing basis. The Credit Quality and Loan Review Department continually reviews and assesses loans within the portfolio. In addition, the Bank engages an external consultant to conduct loan reviews on at least an annual basis. Generally, the external consultant reviews commercial relationships greater than $1,000,000 and/or criticized non-consumer loans greater than $500,000. Detailed reviews, including plans for resolution, are performed on loans classified as Substandard on a quarterly basis. Loans in the Special Mention and Substandard categories that are collectively evaluated for impairment are given separate consideration in the determination of the allowance.

The following table presents the classes of the loan portfolio summarized by the aggregate Pass and the criticized categories of Special Mention and Substandard. There were no loans classified as Doubtful within the internal risk rating system as of December 31, 2017 and 2016:

(in thousands)	Pass	Special Mention	Substandard	Total
December 31, 2017				
Commercial real estate				
Non owner-occupied	$133,725	$ 0	$ 5,843	$139,568
All other CRE	132,003	3,963	7,628	143,594
Acquisition and development				
1-4 family residential construction	17,719	0	0	17,719
All other A&D	84,345	7,294	1,172	92,811
Commercial and industrial	75,299	17	1,407	76,723
Residential mortgage				
Residential mortgage - term	319,059	0	5,326	324,385
Residential mortgage – home equity	73,059	148	1,056	74,263
Consumer	23,391	5	59	23,455
Total	$858,600	$ 11,427	$ 22,491	$892,518
December 31, 2016				
Commercial real estate				
Non owner-occupied	$137,181	$ 10,620	$ 9,357	$157,158
All other CRE	125,720	3,121	11,960	140,801
Acquisition and development				
1-4 family residential construction	15,845	0	0	15,845
All other A&D	87,135	65	1,237	88,437
Commercial and industrial	70,613	593	1,140	72,346
Residential mortgage				
Residential mortgage - term	308,734	113	7,618	316,465
Residential mortgage – home equity	75,710	0	1,241	76,951
Consumer	23,794	0	129	23,923
Total	$844,732	$ 14,512	$ 32,682	$891,926

Management further monitors the performance and credit quality of the loan portfolio by analyzing the age of the portfolio as determined by the length of time a recorded payment is past due. A loan is considered to be past due when a payment has not been received for 30 days past its contractual due date. For all loan segments, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. All non-accrual loans are considered to be impaired. Interest payments received on non-accrual loans are applied as a reduction of the loan principal balance. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. The Corporation's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition.

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The following table presents the classes of the loan portfolio at December 31, 2017 and December 31, 2016, summarized by the aging categories of performing loans and non-accrual loans:

(in thousands)	Current	30-59 Day Past Due	60-89 Days Past Due	90 Days+ Past Due	Total Past Due and still accruing	Non-Accrual	Total Loans
December 31, 2017							
Commercial real estate							
Non owner-occupied	$136,134	$ 186	$ 0	$ 0	$ 186	$ 3,248	$ 139,568
All other CRE	141,680	461	248	0	709	1,205	143,594
Acquisition and development							
1-4 family residential construction	17,719	0	0	0	0	0	17,719
All other A&D	92,291	0	165	144	309	211	92,811
Commercial and industrial	76,322	0	17	6	23	378	76,723
Residential mortgage							
Residential mortgage - term	319,633	322	2,534	430	3,286	1,466	324,385
Residential mortgage – home equity	72,683	600	400	0	1,000	580	74,263
Consumer	23,273	115	22	15	152	30	23,455
Total	$879,735	$ 1,684	$ 3,386	$ 595	$ 5,665	$ 7,118	$ 892,518
December 31, 2016							
Commercial real estate							
Non owner-occupied	$150,595	$ 182	$ 0	$ 0	$ 182	$ 6,381	$ 157,158
All other CRE	134,931	40	0	0	40	5,830	140,801
Acquisition and development							
1-4 family residential construction	15,845	0	0	0	0	0	15,845
All other A&D	88,353	0	39	0	39	45	88,437
Commercial and industrial	72,324	9	2	11	22	0	72,346
Residential mortgage							
Residential mortgage - term	310,721	517	3,376	312	4,205	1,539	316,465
Residential mortgage – home equity	75,558	974	198	70	1,242	151	76,951
Consumer	23,662	186	48	27	261	0	23,923
Total	$871,989	$ 1,908	$ 3,663	$ 420	$ 5,991	$ 13,946	$ 891,926

Non-accrual loans which have been subject to a partial charge-off totaled $7.4 million at December 31, 2017, compared to $11.1 million at December 31, 2016. The amount of loans secured by 1-4 family residential real estate properties in the process of foreclosure was $0.4 million at December 31, 2017 and $0.5 million at December 31, 2016.

The ALL is maintained to absorb losses from the loan portfolio. The ALL is based on management's continuing evaluation of the risk characteristics and credit quality of the loan portfolio, assessment of current economic conditions, diversification and size of the portfolio, adequacy of collateral, past and anticipated loss experience, and the amount of non-performing loans.

The Bank's methodology for determining the ALL is based on the requirements of ASC Section 310-10-35, *Receivables-Overall-Subsequent Measurement*, for loans individually evaluated for impairment and ASC Subtopic 450-20, *Contingencies-Loss Contingencies*, for loans collectively evaluated for impairment, as well as the Interagency Policy Statements on the Allowance for Loan and Lease Losses and other bank regulatory guidance. The total of the two components represents the Bank's ALL.

The following table summarizes the primary segments of the ALL, at December 31, 2017 and December 31, 2016, segregated into the amount required for loans individually evaluated for impairment and the amount required for loans collectively evaluated for impairment.

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
December 31, 2017							
Individually evaluated for impairment	$ 245	$ 40	$ 0	$ 65	$ 12	$ 0	$362
Collectively evaluated for impairment	$ 3,454	$ 1,217	$ 869	$ 3,379	$ 191	$ 500	$9,610
Total ALL	$ 3,699	$ 1,257	$ 869	$ 3,444	$ 203	$ 500	$9,972
December 31, 2016							
Individually evaluated for impairment	$ 177	$ 40	$ 0	$ 43	$ 0	$ 0	$260
Collectively evaluated for impairment	$ 3,736	$ 831	$ 858	$ 3,545	$ 188	$ 500	$9,658
Total ALL	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$9,918

Management evaluates individual loans in all of the commercial segments for possible impairment if the loan is greater than $500,000 or is part of a relationship that is greater than $750,000 and (i) is either in non-accrual status or (ii) is risk-rated Substandard and is greater than 60 days past due. Loans are considered to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in evaluating impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. The Bank does not separately evaluate individual consumer and residential mortgage loans for impairment, unless such loans are part of larger relationship that is impaired; otherwise loans in these segments are considered impaired when they are classified as non-accrual.

Once the determination has been made that a loan is impaired, the determination of whether a specific allocation of the allowance is necessary is measured by comparing the recorded investment in the loan to the fair value of the loan using one of three methods: (i) the present value of expected future cash flows discounted at the loan’s effective interest rate; (ii) the loan’s observable market price; or (iii) the fair value of the collateral less selling costs. The method is selected on a loan-by-loan basis, with management utilizing the fair value of collateral method for all of the analyses. If the fair value of the collateral less selling costs method is utilized for collateral securing loans in the commercial segments, then an updated external appraisal is ordered on the collateral supporting the loan if the loan balance is greater than $500,000 and the existing appraisal is greater than 18 months old. If the loan balance is less than $500,000, then the estimated fair value of the collateral is determined by adjusting the existing appraisal by the appropriate percentage from an internally prepared appraisal discount grid. This grid considers the age of a third-party appraisal and the geographic region where the collateral is located in order to discount an appraisal. The discount rates in the appraisal discount grid are updated at least annually to reflect the most current knowledge that management has available, including the results of current appraisals. If there is a delay in receiving an updated appraisal or if the appraisal is found to be deficient in our internal appraisal review process and re-ordered, the Bank continues to use a discount factor from the appraisal discount grid based on the collateral location and current appraisal age in order to determine the estimated fair value. If management believes that general market conditions in that geographic market have changed considerably, the property has deteriorated or perhaps lost an income stream, or a recent appraisal for a similar property indicates a significant change, then management may adjust the fair value indicated by the existing appraisal until a new appraisal is obtained. A specific allocation of the ALL is recorded if there is any deficiency in collateral value determined by comparing the estimated fair value to the recorded investment of the loan. When updated appraisals are received and reviewed, adjustments are made to the specific allocation as needed.

The evaluation of the need and amount of a specific allocation of the ALL and whether a loan can be removed from impairment status is made on a quarterly basis.

The following table presents impaired loans by class, at December 31, 2017 and December 31, 2016, segregated by those for which a specific allowance was required and those for which a specific allowance was not necessary:

	Impaired Loans with Specific Allowance		Impaired Loans with No Specific Allowance	Total Impaired Loans	
(in thousands)	Recorded Investment	Related Allowances	Recorded Investment	Recorded Investment	Unpaid Principal Balance
December 31, 2017					
Commercial real estate					
Non owner-occupied	$ 1,711	$ 245	$ 1,907	$ 3,618	$ 10,579
All other CRE	0	0	5,458	5,458	5,731
Acquisition and development					
1-4 family residential construction	0	0	527	527	527
All other A&D	295	40	154	449	722
Commercial and industrial	0	0	668	668	2,882
Residential mortgage					
Residential mortgage - term	598	65	3,023	3,621	3,919
Residential mortgage – home equity	0	0	580	580	593
Consumer	30	12	0	30	30
Total impaired loans	$ 2,634	$ 362	$ 12,317	$ 14,951	$ 24,983
December 31, 2016					
Commercial real estate					
Non owner-occupied	$ 131	$ 23	$ 6,635	$ 6,766	$ 9,372
All other CRE	432	154	10,012	10,444	11,057
Acquisition and development					
1-4 family residential construction	0	0	582	582	628
All other A&D	245	40	1,698	1,943	2,213
Commercial and industrial	0	0	290	290	2,504
Residential mortgage					
Residential mortgage - term	61	43	3,763	3,824	4,249
Residential mortgage – home equity	0	0	151	151	168
Consumer	0	0	0	0	0
Total impaired loans	$ 869	$ 260	$ 23,131	$ 24,000	$ 30,191

Loans that are collectively evaluated for impairment are analyzed with general allowances being made as appropriate. For general allowances, historical loss trends are used in the estimation of losses in the current portfolio. These historical loss amounts are modified by other qualitative factors.

The classes described above, which are based on the Federal call code assigned to each loan, provide the starting point for the ALL analysis. Management tracks the historical net charge-off activity (full and partial charge-offs, net of full and partial recoveries) at the call code level. A historical charge-off factor is calculated utilizing a defined number of consecutive historical quarters. Consumer pools currently utilize a rolling 12 quarters, while Commercial pools currently utilize a rolling eight quarters.

"Pass" rated credits are segregated from "Criticized" credits for the application of qualitative factors. The un-criticized ("pass") pools for commercial and residential real estate are further segmented based upon the geographic location of the underlying collateral. There are seven geographic regions utilized – six that represent the Bank's lending footprint and a seventh for all out-of-market credits. Different economic environments and resultant credit risks exist in each region that are acknowledged in the assignment of qualitative factors. Loans in the criticized pools, which possess certain qualities or characteristics that may lead to collection and loss issues, are closely monitored by management and subject to additional qualitative factors.

Management supplements the historical charge-off factor with a number of additional qualitative factors that are likely to cause estimated credit losses associated with the existing loan pools to differ from historical loss experience. The additional factors, which are evaluated quarterly and updated using information obtained from internal, regulatory, and governmental sources, are: (i) national and local economic trends and conditions; (ii) levels of and trends in delinquency rates and non-accrual loans; (iii) trends in volumes and terms of loans; (iv) effects of changes in lending policies; (v) experience, ability, and depth of lending staff; (vi) value of underlying collateral; and (vii) concentrations of credit from a loan type, industry and/or geographic standpoint.

Management reviews the loan portfolio on a quarterly basis using a defined, consistently applied process in order to make appropriate and timely adjustments to the ALL. When information confirms all or part of specific loans to be uncollectible, these amounts are promptly charged off against the ALL. Residential mortgage and consumer loans are charged off after they are 120 days contractually past due. All other loans are charged off based on an evaluation of the facts and circumstances of each individual loan. When the Bank believes that its ability to collect is solely dependent on the liquidation of the collateral, a full or partial charge-off is recorded promptly to bring the recorded investment to an amount that the Bank believes is supported by an ability to collect on the collateral. The circumstances that may impact the Bank's decision to charge-off all or a portion of a loan include default or non-payment by the borrower, scheduled foreclosure actions, and/or prioritization of the Bank's claim in bankruptcy. There may be circumstances where due to pending events, the Bank will place a specific allocation of the ALL on a loan for which a partial charge-off has been previously recognized. This specific allocation may be either charged-off or removed depending upon the outcome of the pending event. Full or partial charge-offs are not recovered until full principal and interest on the loan have been collected, even if a subsequent appraisal supports a higher value. In most cases, loans with partial charge-offs remain in non-accrual status. Both full and partial charge-offs reduce the recorded investment of the loan and the ALL and are considered to be charge-offs for purposes of all credit loss metrics and trends, including the historical rolling charge-off rates used in the determination of the ALL.

Activity in the ALL is presented for the years ended December 31, 2017 and December 31, 2016:

(in thousands)	Commercial Real Estate	Acquisition and Development	Commercial and Industrial	Residential Mortgage	Consumer	Unallocated	Total
ALL balance at January 1, 2017	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$ 9,918
Charge-offs	(4,605)	(133)	(37)	(361)	(336)	0	(5,472)
Recoveries	452	255	1,683	392	210	0	2,992
Provision	3,939	264	(1,635)	(175)	141	0	2,534
ALL balance at December 31, 2017	$ 3,699	$ 1,257	$ 869	$ 3,444	$ 203	$ 500	$ 9,972
ALL balance at January 1, 2016	$ 2,580	$ 4,129	$ 722	$ 3,785	$ 206	$ 500	$ 11,922
Charge-offs	(5,301)	(248)	(558)	(737)	(333)	0	(7,177)
Recoveries	90	1,303	52	461	145	0	2,051

Provision	6,544	(4,313)	642	79	170	0	3,122
ALL balance at December 31, 2016	$ 3,913	$ 871	$ 858	$ 3,588	$ 188	$ 500	$9,918

The ALL is based on estimates, and actual losses will vary from current estimates. Management believes that the granularity of the homogeneous pools and the related historical loss ratios and other qualitative factors, as well as the consistency in the application of assumptions, result in an ALL that is representative of the risk found in the components of the portfolio at any given date.

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The following table presents the average recorded investment in impaired loans and related interest income recognized for the years ended December 31, 2017 and 2016:

	2017			2016		
(in thousands)	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis	Average investment	Interest income recognized on an accrual basis	Interest income recognized on a cash basis
Commercial real estate						
Non owner-occupied	$5,727	$ 24	$ 30	$6,076	$ 131	$ 0
All other CRE	7,743	205	0	11,802	187	8
Acquisition and development						
1-4 family residential construction	571	24	0	629	27	0
All other A&D	1,571	85	0	2,735	95	0
Commercial and industrial	448	13	0	934	37	0
Residential mortgage						
Residential mortgage - term	3,792	131	8	4,580	163	16
Residential mortgage – home equity	305	0	0	272	0	0
Consumer	15	0	0	0	0	0
Total	$20,172	$ 482	$ 38	$27,028	$ 640	$ 24

In the normal course of business, the Bank modifies loan terms for various reasons. These reasons may include as a retention strategy to compete in the current interest rate environment, and to re-amortize or extend a loan term to better match the loan’s payment stream with the borrower’s cash flows. A modified loan is considered to be a TDR when the Bank has determined that the borrower is troubled (i.e. experiencing financial difficulties). The Bank evaluates the probability that the borrower will be in payment default on any of its debt in the foreseeable future without modification. To make this determination, the Bank performs a global financial review of the borrower and loan guarantors to assess their current ability to meet their financial obligations.

When the Bank restructures a loan to a troubled borrower, the loan terms (i.e. interest rate, payment, amortization period and/or maturity date) are modified in such a way to enable the borrower to cover the modified debt service payments based on current financials and cash flow adequacy. If a borrower’s hardship is thought to be temporary, then modified terms are only offered for that time period. Where possible, the Bank obtains additional collateral and/or secondary payment sources at the time of the restructure in order to put the Bank in the best possible position if the borrower is not able to meet the modified terms. To date, the Bank has not forgiven any principal as a restructuring concession. The Bank will not offer modified terms if it believes that modifying the loan terms will only delay an inevitable permanent default.

All loans designated as TDRs are considered impaired loans and may be in either accruing or non-accruing status. The Corporation's policy for recognizing interest income on impaired loans does not differ from its overall policy for interest recognition. Accordingly, the accrual of interest is discontinued when principal or interest is delinquent for 90 days or more unless the loan is well-secured and in the process of collection. If the loan was accruing at the time of the modification, then it continues to be in accruing status subsequent to the modification. Non-accrual TDRs may return to accruing status when there has been sufficient payment performance for a period of at least six months. TDRs are considered to be in payment default if, subsequent to modification, the loans are transferred to non-accrual status or to foreclosure. A loan may be removed from being reported as a TDR in the calendar year following the modification if the interest rate at the time of modification was consistent with the interest rate for a loan with comparable credit risk and the loan has performed according to its modified terms for at least six months. Further, a loan that has been removed from TDR reporting status and has been subsequently re-modified at standard market terms, may be removed from impaired status as well.

The volume, type and performance of TDR activity is considered in the assessment of the local economic trend qualitative factor used in the determination of the ALL for loans that are evaluated collectively for impairment.

There were 19 loans totaling $6.0 million and 24 loans totaling $9.3 million that were classified as TDRs at December 31, 2017 and December 31, 2016, respectively. The following table presents the volume and recorded investment at the time of modification of TDRs by class and type of modification that occurred during the periods indicated:

(Dollars in thousands)	Temporary Rate Modification		Extension of Maturity		Modification of Payment and Other Terms	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
For the year ended December 31, 2017						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	0	0	0	0
Acquisition and development						
1-4 family residential construction	0	0	0	0	0	0
All other A&D	0	0	1	244	0	0
Commercial and industrial	0	0	0	0	0	0
Residential mortgage						
Residential mortgage – term	0	0	2	698	0	0
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	0	$ 0	3	$ 942	0	$ 0
For the year ended December 31, 2016						
Commercial real estate						
Non owner-occupied	0	$ 0	0	$ 0	0	$ 0
All other CRE	0	0	1	203	0	0
Acquisition and development						
1-4 family residential construction	0	0	1	582	0	0
All other A&D	0	0	1	1,664	0	0
Commercial and industrial	0	0	1	482	1	486
Residential mortgage						
Residential mortgage – term	3	260	1	61	3	469
Residential mortgage – home equity	0	0	0	0	0	0
Consumer	0	0	0	0	0	0
Total	3	$ 260	5	$ 2,992	4	$ 955

During the year ended December 31, 2017, there were no new TDRs, but three existing TDRs that had reached their original modification maturity were re-modified. These re-modifications did not impact the ALL.

During the year ended December 31, 2017, there were no payment defaults. There were no additional funds committed to be advanced in connection with TDRs at December 31, 2017 or 2016.

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8. Other Real Estate Owned

The following table presents the components of OREO, net of related valuation allowance, as of December 31, 2017 and 2016:

(in thousands)	2017	2016
Commercial real estate	$3,605	$3,779
Acquisition and development	5,295	5,944
Commercial & Industrial	24	24
Residential mortgage	1,217	1,163
Total OREO	$10,141	$10,910

The following table presents the activity in the OREO valuation allowance for the years ended December 31, 2017 and 2016:

(in thousands)	2017	2016
Balance January 1	$3,535	$4,430
Fair value write-down	398	486
Sales of OREO	(1,193)	(1,381)
Balance December 31	$2,740	$3,535

The following table presents the components of OREO expenses, net, for the years ended December 31, 2017 and 2016:

(in thousands)	2017	2016
Gains on real estate, net	$(645)	$(189)
Fair value write-down	398	486
Expenses, net	616	603
Rental and other income	(179)	(98)
Total OREO expenses, net	$190	$802

9. Premises and Equipment

The following table presents the components of premises and equipment at December 31, 2017 and 2016:

(in thousands)	2017	2016
Land	$7,035	$7,383
Land Improvements	1,203	1,201
Premises	25,150	25,696
Furniture and Equipment	20,246	17,506
Capital Lease	534	534
	54,168	52,320
Less accumulated depreciation	(23,287)	(25,160)
Total	$30,881	$27,160

The Corporation recorded depreciation expense of $1.9 million in 2017 and $1.7 million in 2016.

Pursuant to the terms of non-cancelable operating lease agreements for banking and subsidiaries' offices and for data processing and telecommunications equipment in effect at December 31, 2017, future minimum rent commitments under these leases for future years are as follows: (i) $3.4 million for 2018; (ii) $3.1 million for 2019; (iii) $3.1 million for 2020; (iv) $3.0 million for 2021; (v) $3.0 million for 2022; and (vi) $6.0 million thereafter. The leases contain options to extend for periods from one to five years, which are not included in the aforementioned amounts.

Total building and land rental expense amounted to $.5 million in 2017 and 2016.

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10. Goodwill

ASC Topic 350, *Intangibles - Goodwill and Other*, establishes standards for the amortization of acquired intangible assets and impairment assessment of goodwill. The $11.0 million in recorded goodwill at December 31, 2017 is related to the Bank's 2003 acquisition of Huntington National Bank branches and is not subject to periodic amortization, but evaluated annually for impairment.

Goodwill arising from business combinations represents the value attributable to unidentifiable intangible elements in the business acquired. Goodwill is not amortized but is tested for impairment annually or more frequently if events or changes in circumstances indicate that the asset might be impaired. Impairment testing requires that the fair value of each of an entity's reporting units be compared to the carrying amount of its net assets, including goodwill. If the estimated current fair value of the reporting unit exceeds its carrying value, then no additional testing is required and an impairment loss is not recorded. Otherwise, additional testing is performed and, to the extent such additional testing results in a conclusion that the carrying value of goodwill exceeds its implied fair value, an impairment loss is recognized.

For evaluation purposes, the Corporation is considered to be a single reporting unit. Accordingly, our goodwill relates to value inherent in the banking business and the value is dependent upon our ability to provide quality, cost effective services in a highly competitive local market. This ability relies upon continuing investments in processing systems, the development of value-added service features and the ease of use of our services. As such, goodwill value is supported ultimately by revenue that is driven by the volume of business transacted. A decline in earnings as a result of a lack of growth or the inability to deliver cost effective services over sustained periods can lead to impairment of goodwill, which could adversely impact earnings in future periods. ASC Topic 350 requires an annual evaluation of goodwill for impairment. The determination of whether or not these assets are impaired involves significant judgments and estimates.

At December 31, 2017, the date of the Corporation's annual impairment evaluation, the estimated fair value of the Corporation, as determined by the price of its common stock, exceeded the carrying amount of the Corporation's common equity. Based on this analysis, management concluded that the recorded value of goodwill at December 31, 2017 was not impaired. However, future changes in strategy and/or market conditions could significantly impact this conclusion and require adjustments to recorded asset balances. Management will continue to evaluate goodwill for impairment on an annual basis and as events occur or circumstances change.

11. Deposits

The aggregate amount of time deposits in denomination of $250,000 or more was $66.9 million at December 31, 2017 and $45.6 million at December 31, 2016. The aggregate amount of time deposits with a minimum denomination of

$100,000 was $126.5 million and $123.9 million at December 31, 2017 and 2016, respectively. At December 31, 2017, $.2 million of deposit overdrafts were re-classified as loans.

The following is a summary of the scheduled maturities of all time deposits as of December 31, 2017 (in thousands):

2018	$97,039
2019	36,164
2020	33,238
2021	41,328
2022	26,358
Thereafter	0
Total	$234,127

In the ordinary course of business, executive officers and directors of the Corporation, including their families and companies in which certain directors are principal owners, were deposit customers of the Bank. Pursuant to the Bank's policies, such deposits are on the same terms as those prevailing at the time for comparable deposits with persons who are not related to the Corporation. At December 31, 2017, executive officers and directors had approximately $7.9 million in deposits with the Bank.

12. Borrowed Funds

The following is a summary of short-term borrowings at December 31, 2017 and 2016 with original maturities of less than one year:

(Dollars in thousands)	2017	2016
Securities sold under agreements to repurchase:		
Outstanding at end of year	$48,845	$36,000
Weighted average interest rate at year end	0.15 %	0.16 %
Maximum amount outstanding as of any month end	$58,438	$39,456
Average amount outstanding	$37,326	$30,899
Approximate weighted average rate during the year	0.19 %	0.19 %

At December 31, 2017, the repurchase agreements were secured by $60.5 million in investment securities.

The following is a summary of long-term borrowings at December 31, 2017 and 2016 with original maturities exceeding one year:

(In thousands)	2017	2016
FHLB advances, bearing fixed interest rates ranging from 1.54% to 3.69% at December 31, 2017	$90,000	$90,007
Junior subordinated debt, bearing variable interest rate of 3.74% at December 31, 2017	30,929	30,929
Junior subordinated debt, bearing fixed interest rate of 9.88% at December 31, 2016	0	10,801
Total long-term debt	$120,929	$131,737

At December 31, 2017, the long-term FHLB advances were secured by $176.2 million in loans.

The contractual maturities of long-term borrowings at December 31, 2017 and 2016 are as follows:

	2017			
	Fixed	Floating		2016
(in thousands)	Rate	Rate	Total	Total
Due in 2018	$20,000	$0	$20,000	$20,000
Due in 2019	20,000	0	20,000	20,000

Due in 2020	30,000	0	30,000	30,000
Due in 2021	20,000	0	20,000	20,000
Thereafter	0	30,929	30,929	41,737
Total long-term debt	$90,000	$30,929	$120,929	$131,737

The Bank has a borrowing capacity agreement with the FHLB in an amount equal to 30% of the Bank's assets. At December 31, 2017, the available line of credit equaled $395.9 million. This line of credit, which can be used for both short and long-term funding, can only be utilized to the extent of available collateral. The line is secured by certain qualified mortgage, commercial and home equity loans and investment securities as follows (in thousands):

1-4 family mortgage loans	$119,482
Commercial loans	26,069
Multi-family loans	3,422
Home equity loans	27,274
	$176,247

At December 31, 2017, $86.2 million was available for additional borrowings.

The Bank also has various unsecured lines of credit totaling $75.0 million with various financial institutions and a $7.0 million secured line with the Federal Reserve to meet daily liquidity requirements. As of December 31, 2017, there were no borrowings under these credit facilities. In addition, there was approximately $103.9 million of available funding through brokered money market funds at December 31, 2017.

Repurchase Agreements - The Bank has retail repurchase agreements with customers within its local market areas. Repurchase agreements generally have maturities of one to four days from the transaction date. These borrowings are collateralized with securities that we own and are held in safekeeping at independent correspondent banks.

FHLB Advances - The FHLB advances consist of various borrowings with maturities generally ranging from five to 10 years with initial fixed rate periods of one, two or three years. After the initial fixed rate period, the FHLB has one or more options to convert each advance to a LIBOR based, variable rate advance, but the Bank may repay the advance in whole or in part, without a penalty, if the FHLB exercises its option. At all other times, the Bank's early repayment of any advance could be subject to a prepayment penalty.

13. Junior Subordinated Debentures and Restrictions on Dividends

In March 2004, the Trusts issued preferred securities with an aggregate liquidation amount of $30.0 million to third-party investors and issued common equity with an aggregate liquidation amount of $.9 million to First United Corporation. The Trusts used the proceeds of these offerings to purchase an equal amount of TPS Debentures, as follows:

$20.6 million—floating rate payable quarterly based on three-month LIBOR plus 275 basis points (4.35% at December 31, 2017), maturing in 2034, became redeemable five years after issuance at First United Corporation's option.

$10.3 million—floating rate payable quarterly based on three-month LIBOR plus 275 basis points (4.35% at December 31, 2017) maturing in 2034, became redeemable five years after issuance at First United Corporation's option.

In December 2009, Trust III issued 9.875% fixed-rate preferred securities with an aggregate liquidation amount of approximately $7.0 million to private investors and issued common securities to First United Corporation with an aggregate liquidation amount of approximately $.2 million. Trust III used the proceeds of the offering to purchase approximately $7.2 million of 9.875% fixed-rate TPS Debentures. Interest on these TPS Debentures are payable quarterly, and the TPS Debentures mature in 2040 but are redeemable five years after issuance at First United Corporation's option.

In January 2010, Trust III issued an additional $3.5 million of 9.875% fixed-rate preferred securities to private investors and issued common securities to First United Corporation with an aggregate liquidation amount of $.1 million. Trust III used the proceeds of the offering to purchase $3.6 million of 9.875% fixed-rate TPS Debentures. Interest on these TPS Debentures are payable quarterly, and the TPS Debentures mature in 2040 but are redeemable five years after issuance at First United Corporation's option.

In March 2017, the Corporation repaid all of the outstanding TPS Debentures issued to and held by Trust III, and Trust III in turn redeemed all of its outstanding securities from its security holders. The $10.8 million repayment was consummated following the Corporation's common stock rights offering that closed on March 20, 2017.

The TPS Debentures issued to each of the Trusts represent the sole assets of that Trust, and payments of the TPS Debentures by First United Corporation are the only sources of cash flow for the Trust. First United Corporation has the right, without triggering a default, to defer interest on all of the TPS Debentures for up to 20 quarterly periods, in which case distributions on the preferred securities will also be deferred. Should this occur, the Corporation may not pay dividends or distributions on, or repurchase, redeem or acquire any shares of its capital stock. Refer to Note 4 for further details.

14. Preferred Stock

On January 30, 2009, pursuant to the Troubled Asset Relief program Capital Purchase Program adopted by the U.S. Department of the Treasury (the "Treasury"), First United Corporation issued to the Treasury 30,000 shares of its Series A Preferred Stock and a Warrant to purchase 326,323 shares of common stock at an exercise price of $13.79 per share, for an aggregate consideration of $30.0 million. The proceeds from this transaction qualified as Tier 1 capital and the Warrant qualified as tangible common equity.

On December 4, 2014, the Treasury sold all of its shares of Series A Preferred stock to third-party investors. On May 26, 2015, the Corporation repurchased the warrant from the Treasury for $120,786, which is included in other expense. The warrant was canceled and as a result of the repurchase, the Treasury has no remaining equity investment in the Corporation. First United Corporation redeemed all outstanding shares of Series A Preferred Stock as follows: (i) 10,000 shares, having an aggregate liquidation amount of $10.0 million, on February 14, 2016, (ii) 10,000 shares, having an aggregate liquidation amount of $10.0 million, on March 21, 2017; and (iii) 10,000 shares, having an aggregate liquidation amount of $10.0 million, on November 15, 2017.

The holders of the Series A Preferred Stock were entitled to receive, if and when declared by the Board of Directors, out of assets legally available for payment, cumulative cash dividends at a rate per annum of 5% per share on a liquidation amount of $1,000 per share of Series A Preferred Stock with respect to each dividend period from January 30, 2009 to, but excluding, February 15, 2014. From and after February 15, 2014, holders of Series A Preferred Stock were entitled to receive cumulative cash dividends at a rate per annum of 9% per share on a liquidation amount of $1,000 per share with respect to each dividend period thereafter.

15. Variable Interest Entities

As noted in Note 14, First United Corporation created the Trusts for the purposes of raising regulatory capital through the sale of mandatorily redeemable preferred capital securities to third party investors and common equity interests to First United Corporation. The Trusts are considered VIEs, but are not consolidated because First United Corporation is not the primary beneficiary of the Trusts. At December 31, 2017, the Corporation reported all of the $30.9 million of TPS Debentures issued in connection with these offerings as long-term borrowings, and it reported its $.9 million equity interest in the Trusts as “Other Assets”.

In November 2009, the Bank became a 99.99% limited partner in Liberty Mews. Liberty Mews was financed with a total of $10.6 million of funding, including a $6.1 million equity contribution from the Bank as the limited partner. Liberty Mews used the proceeds from these sources to purchase land and construct thereon a 36-unit low income housing rental complex at a total cost of $10.6 million. The total assets of Liberty Mews were $8.6 million at December 31, 2017 and $8.8 million at December 31, 2016.

Through December 31, 2017, the Bank had made contributions to Liberty Mews totaling $6.1 million. The project for which Liberty Mews was formed was completed in June 2011, and the Bank is entitled to $8.4 million in federal investment tax credits over a 10-year period as long as certain qualifying hurdles are maintained. The Bank will also receive the benefit of tax operating losses from Liberty Mews the extent of its capital contribution. The investment in Liberty Mews assists the Bank in achieving its community reinvestment initiatives.

Because Liberty Mews is considered to be a VIE, management performed an analysis to determine whether its involvement with Liberty Mews would lead it to determine that it must consolidate Liberty Mews. In performing its analysis, management evaluated the risks creating the variability in Liberty Mews and identified which activities most significantly impact the VIE’s economic performance. Finally, it examined each of the variable interest holders to determine which, if any, of the holders was the primary beneficiary based on their power to direct the most significant activities and their obligation to absorb potentially significant losses of Liberty Mews.

The Bank, as a limited partner, generally has no voting rights. The Bank is not in any way involved in the daily management of Liberty Mews and has no other rights that provide it with the power to direct the activities that most significantly impact Liberty Mews’ economic performance, which are to develop and operate the housing project in such a manner that complies with specific tax credit guidelines. As a limited partner, there is no recourse to the Bank by the creditors of Liberty Mews. The tax credits that result from the Bank’s investment in Liberty Mews are generally subject to recapture should the partnership fail to comply with the applicable government regulations. The Bank has not provided any financial or other support to Liberty Mews beyond its required capital contributions and does not anticipate providing such support in the future. Management currently believes that no material losses are probable as a result of the Bank’s investment in Liberty Mews.

On the basis of management’s analysis, the general partner is deemed to be the primary beneficiary of Liberty Mews. Because the Bank is not the primary beneficiary, Liberty Mews has not been included in the Corporation’s consolidated financial statements.

The Corporation accounts for the Bank’s investment in Liberty Mews utilizing the effective yield method under guidance that applies specifically to investments in limited partnerships that operate qualified affordable housing projects. Under the effective yield method, the investor recognizes tax credits as they are allocated and amortizes the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the investor. The effective yield is the internal rate of return on the investment, based on the cost of the investment and the guaranteed tax credits allocated to the investor. The tax credit allocated, net of the amortization of the investment in the limited partnership, is recognized in the income statement as a component of income taxes attributable to continuing operations.

The Corporation’s tax expense for the year ended December 31, 2017 was approximately $.8 million lower as a result of the impact of the tax credits and the tax losses relating to the partnership.

At December 31, 2017 and December 31, 2016, the Corporation included the Bank’s total investment in Liberty Mews in “Other Assets” in its Consolidated Statements of Financial Condition. As of December 31, 2017, the Corporation’s commitment in Liberty Mews is fully funded. The following table presents details of the Bank’s involvement with Liberty Mews at the dates indicated:

(In thousands)	**2017**	**2016**
Investment in LIHTC Partnership		
Carrying amount on Balance Sheet of:		
Investment (Other Assets)	$2,562	$3,223
Maximum exposure to loss	2,562	3,223

16. Accumulated Other Comprehensive Loss ("AOCL")

The following table presents the changes in each component of accumulated other comprehensive loss for the years ended December 31, 2017 and 2016:

(in thousands)	Investment securities- with OTTI AFS	Investment securities- all other AFS	Investment securities- HTM	Cash Flow Hedge	Pension Plan	SERP	Total
Accumulated OCL, net:							
Balance - January 1, 2016	$ (1,942)	$ (2,024)	$ (1,971)	$ (39)	$ (12,663)	$ (305)	$ (18,944)
Other comprehensive income/(loss) before reclassifications	(421)	(929)	0	461	(2,086)	(466)	(3,441)
Amounts reclassified from accumulated other comprehensive loss	(5)	(265)	617	0	517	56	920
Balance - December 31, 2016	$ (2,368)	$ (3,218)	$ (1,354)	$ 422	$ (14,232)	$ (715)	$ (21,465)
Other comprehensive income/(loss) before reclassifications	31	638	0	59	(445)	(82)	201
Amounts reclassified from accumulated other comprehensive loss	(121)	36	253	0	781	105	1,054
Reclassification of certain tax effects [1]	(481)	(435)	(246)	101	(3,170)	(152)	(4,383)
Balance - December 31, 2017	$ (2,939)	$ (2,979)	$ (1,347)	$ 582	$ (17,066)	$ (844)	$ (24,593)

(1) Refer to Note 1 for more discussion of tax reform

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The following tables present the components of other comprehensive income/(loss) for the years ended December 31, 2017 and 2016:

Components of Other Comprehensive Income (in thousands)	Before Tax Amount	Tax (Expense) Benefit	Net
For the year ended December 31, 2017			
Available for sale (AFS) securities with OTTI:			
Unrealized holding gains	$ 42	$ (11)	$31
Less: accretable yield recognized in income	166	(45)	121
Net unrealized losses on investments with OTTI	(124)	34	(90)
Available for sale securities – all other:			
Unrealized holding gains	874	(236)	638
Plus: losses recognized in income	(49)	13	(36)
Net unrealized gains on all other AFS securities	923	(249)	674
Held to maturity securities:			
Unrealized holding gains	0	0	0
Less: amortization recognized in income	(346)	93	(253)
Net unrealized gains on HTM securities	346	(93)	253
Cash flow hedges:			
Unrealized holding gains	81	(22)	59