

GLEN BURNIE BANCORP
Form 10-Q
May 15, 2018
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarterly period ended March 31, 2018

OR

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

Commission file number 0-24047

GLEN BURNIE BANCORP

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
incorporation or organization)

52-1782444
(I.R.S. Employer
Identification No.)

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101 Crain Highway, S.E.
Glen Burnie, Maryland 21061
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (410) 766-3300

Inapplicable

(Former name, former address and former fiscal year if changed from last report.)

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 for 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 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 No

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

| | | |
|-------------------------|---|--|
| Large accelerated filer | | Accelerated filer |
| Non-Accelerated Filer | (Do not check if a smaller reporting company) | Smaller Reporting Company Emerging growth company |

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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 Exchange Act). Yes
No

The number of shares of the registrant's common stock outstanding as of May 6, 2018 was 2,807,819.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

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PART I – FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(dollars in thousands)

| | March 31, 2018 (unaudited) | December 31, 2017 (audited) |
|---|----------------------------------|-----------------------------------|
| ASSETS | | |
| Cash and due from banks | \$ 2,449 | \$ 2,610 |
| Interest-bearing deposits in other financial institutions | 6,079 | 9,995 |
| Cash and Cash Equivalents | 8,528 | 12,605 |
| Investment securities available for sale, at fair value | 90,329 | 89,349 |
| Restricted equity securities, at cost | 1,231 | 1,232 |
| Loans, net of deferred fees and costs | 275,716 | 271,612 |
| Allowance for loan losses | (2,899) | (2,589) |
| Loans, net | 272,817 | 269,023 |
| Real estate acquired through foreclosure | 114 | 114 |
| Premises and equipment, net | 3,271 | 3,371 |
| Bank owned life insurance | 8,290 | 8,713 |
| Deferred tax assets, net | 2,759 | 2,429 |
| Accrued interest receivable | 1,182 | 1,133 |
| Accrued taxes receivable | — | 465 |
| Prepaid expenses | 554 | 433 |
| Other assets | 1,295 | 583 |
| Total Assets | \$ 390,370 | \$ 389,450 |
| LIABILITIES | | |
| Noninterest-bearing deposits | \$ 107,073 | \$ 104,017 |
| Interest-bearing deposits | 229,097 | 230,221 |
| Total Deposits | 336,170 | 334,238 |
| Short-term borrowings | 20,000 | 20,000 |
| Defined pension liability | 341 | 335 |
| Accrued Taxes Payable | 134 | — |
| Accrued expenses and other liabilities | 538 | 835 |
| Total Liabilities | 357,183 | 355,408 |

STOCKHOLDERS' EQUITY

Common stock, par value \$1, authorized 15,000,000 shares, issued and outstanding 2,804,456 and 2,801,149 shares as of March 31, 2018 and December 31, 2017, respectively.

| | | |
|--|------------|------------|
| | 2,804 | 2,801 |
| Additional paid-in capital | 10,301 | 10,267 |
| Retained earnings | 21,581 | 21,605 |
| Accumulated other comprehensive loss | (1,499) | (631) |
| Total Stockholders' Equity | 33,187 | 34,042 |
| | | |
| Total Liabilities and Stockholders' Equity | \$ 390,370 | \$ 389,450 |

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)

(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|----------|
| | 2018 | 2017 |
| INTEREST INCOME | | |
| Interest and fees on loans | \$ 2,872 | \$ 2,774 |
| Interest and dividends on securities | 524 | 518 |
| Interest on deposits with banks and federal funds sold | 48 | 31 |
| Total Interest Income | 3,444 | 3,323 |
| INTEREST EXPENSE | | |
| Interest on deposits | 309 | 333 |
| Interest on short-term borrowings | 143 | 82 |
| Interest on long-term borrowings | — | 76 |
| Total Interest Expense | 452 | 491 |
| Net Interest Income | 2,992 | 2,832 |
| Provision for loan losses | 360 | 195 |
| Net interest income after provision for loan losses | 2,632 | 2,637 |
| NONINTEREST INCOME | | |
| Service charges on deposit accounts | 67 | 67 |
| Other fees and commissions | 168 | 161 |
| Gains on redemption of BOLI policies | 207 | — |
| Income on life insurance | 44 | 49 |
| Other income | — | 2 |
| Total Noninterest Income | 486 | 279 |
| NONINTEREST EXPENSE | | |
| Salary and benefits | 1,721 | 1,421 |
| Occupancy and equipment expenses | 305 | 298 |
| Legal, accounting and other professional fees | 232 | 206 |
| Data processing and item processing services | 132 | 168 |
| FDIC insurance costs | 58 | 60 |
| Advertising and marketing related expenses | 17 | 31 |
| Loan collection costs | 41 | 18 |

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| | | |
|--|---------|---------|
| Telephone costs | 57 | 55 |
| Other expenses | 272 | 314 |
| Total Noninterest Expenses | 2,835 | 2,571 |
| Income before income taxes | 283 | 345 |
| Income tax expense | 28 | 29 |
| NET INCOME | \$ 255 | \$ 316 |
| Basic and diluted net income per share of common stock | \$ 0.09 | \$ 0.11 |

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(dollars in thousands)

(unaudited)

| | Three Months Ended March 31, | |
|--|---------------------------------|--------|
| | 2018 | 2017 |
| Net income | \$ 255 | \$ 316 |
| Other comprehensive (loss) income: | | |
| Net unrealized (loss) gain on securities available for sale: | | |
| Net unrealized (loss) gain on securities during the period | (1,596) | 69 |
| Income tax benefit (loss) relating to item above | 439 | (27) |
| Reclassification adjustment for gain on sales of securities included in net income | — | — |
| Net effect on other comprehensive (loss) income | (1,157) | 42 |
| Net unrealized gain on interest rate swap: | | |
| Net unrealized gain on interest rate swap during the period | 398 | — |
| Income tax expense relating to item above | (109) | — |
| Net effect on other comprehensive income | 289 | — |
| Other comprehensive (loss) income | (868) | 42 |
| Comprehensive (loss) income | \$ (613) | \$ 358 |

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)

(unaudited)

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Total |
|---|-----------------|----------------------------------|----------------------|---|-----------|
| Balance, December 31, 2016 | \$ 2,787 | \$ 10,130 | \$ 21,707 | \$ (810) | \$ 33,814 |
| Net income | — | — | 316 | — | 316 |
| Cash dividends, \$0.10 per share | — | — | (278) | — | (278) |
| Dividends reinvested under dividend reinvestment plan | 3 | 34 | — | — | 37 |
| Other comprehensive income | — | — | — | 42 | 42 |
| Balance, March 31, 2017 | 2,790 | 10,164 | 21,745 | (768) | 33,931 |

| | Common Stock | Additional Paid-in Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Total |
|---|-----------------|----------------------------------|----------------------|---|-----------|
| Balance, December 31, 2017 | \$ 2,801 | \$ 10,267 | \$ 21,605 | \$ (631) | \$ 34,042 |
| Net income | — | — | 255 | — | 255 |
| Cash dividends, \$0.10 per share | — | — | (279) | — | (279) |
| Dividends reinvested under dividend reinvestment plan | 3 | 34 | — | — | 37 |
| Other comprehensive loss | — | — | — | (868) | (868) |
| Balance, March 31, 2018 | \$ 2,804 | \$ 10,301 | \$ 21,581 | \$ (1,499) | \$ 33,187 |

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)

(unaudited)

| | Three Months Ended March 31, | |
|---|---------------------------------|----------|
| | 2018 | 2017 |
| Cash flows from operating activities: | | |
| Net income | \$ 255 | \$ 316 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation, amortization, and accretion of premises and equipment | 319 | 267 |
| Provision for loan losses | 360 | 195 |
| Deferred income taxes, net | — | (42) |
| Gain on life insurance | (207) | — |
| Decrease (increase) in cash surrender value of bank owned life insurance | 424 | (49) |
| Decrease in ground rents | 3 | 5 |
| (Increase) decrease in accrued interest receivable | (49) | 19 |
| Net (increase) decrease in other assets | 234 | 611 |
| Net decrease in accrued expenses and other liabilities | (175) | (371) |
| Net cash provided by operating activities | 1,164 | 951 |
| Cash flows from investing activities: | | |
| Redemptions and maturities of investment securities available for sale | 2,663 | 4,779 |
| Purchases of investment securities available for sale | (5,440) | (1,310) |
| Net purchase of Federal Home Loan Bank stock | 2 | 2 |
| Net increase in loans | (4,138) | (4,726) |
| Purchases of premises and equipment | (19) | (89) |
| Net cash used in investing activities | (6,932) | (1,344) |
| Cash flows from financing activities: | | |
| Net increase in deposits | 1,932 | 7,341 |
| Increase in short term borrowings | — | 20,000 |
| Decrease in long term borrowings | — | (20,000) |
| Cash dividends paid | (279) | (278) |
| Common stock dividends reinvested | 38 | 38 |
| Net cash provided by financing activities | 1,691 | 7,101 |
| Net (decrease) increase in cash and cash equivalents | (4,077) | 6,708 |
| Cash and cash equivalents at beginning of year | 12,605 | 10,622 |

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| | | |
|---|----------|-----------|
| Cash and cash equivalents at end of year | \$ 8,528 | \$ 17,330 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Interest paid on deposits and borrowings | \$ 441 | \$ 494 |
| Income taxes refunded | (583) | — |
| Net (increase) decrease in unrealized depreciation on available for sale securities | (1,198) | 69 |

See accompanying notes to unaudited consolidated financial statements.

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GLEN BURNIE BANCORP AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 – ORGANIZATIONAL

Nature of Business

Glen Burnie Bancorp (the “Company”) is a bank holding company organized in 1990 under the laws of the State of Maryland. The Company owns all the outstanding shares of capital stock of The Bank of Glen Burnie (the “Bank”), a commercial bank organized in 1949 under the laws of the State of Maryland (the “State”). The Bank provides financial services to individuals and corporate customers located in Anne Arundel County and surrounding areas of Central Maryland, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities.

NOTE 2 – BASIS OF PRESENTATION

In management’s opinion, the accompanying unaudited consolidated financial statements, which have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim period reporting, reflect all adjustments, consisting of only normal recurring adjustments, necessary for a fair presentation of the financial position at March 31, 2018 and December 31, 2017, the results of operations for the three-month periods ended March 31, 2018 and 2017, and the statements of cash flows for the three-month periods ended March 31, 2018 and 2017. The operating results for the three-month period ended March 31, 2018 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2018 or any future interim period. The consolidated balance sheet at December 31, 2017 has been derived from the audited financial statements included in the Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission (the “SEC”) on April 2, 2018. The unaudited consolidated financial statements for March 31, 2018 and 2017, the consolidated balance sheet at December 31, 2017, and accompanying notes should be read in conjunction with the Company’s audited consolidated financial statements and the accompanying notes thereto that are included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, The Bank of Glen Burnie and GBB Properties. Consolidation resulted in the elimination of all intercompany accounts and transactions.

Cash Flow Presentation

In the statements of cash flows, cash and cash equivalents include cash on hand, amounts due from banks, Federal Home Loan Bank of Atlanta (“FHLB Atlanta”) overnight deposits, and federal funds sold. Generally, federal funds are sold for one-day periods.

Reclassifications

Certain items in the 2017 consolidated financial statements have been reclassified to conform to the 2018 classifications. The reclassifications had no effect on previously reported results of operations or retained earnings.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates. Material estimates that are particularly susceptible to significant change in the near term include the determination of the allowance for loan losses (the “allowance”); the fair value of financial instruments,

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such as loans and investment securities; benefit plan obligations and expenses; and the valuation of deferred tax assets and liabilities.

NOTE 3 – EARNINGS PER SHARE

Basic earnings per common share (“EPS”) is computed by dividing net income available to common shareholders by the weighted average common shares outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average common shares outstanding, plus the effect of common stock equivalents (for example, stock options computed using the treasury stock method).

| | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 2018 | 2017 |
| Basic and diluted earnings per share: | | |
| Net income | \$ 255,469 | \$ 315,786 |
| Weighted average common shares outstanding | 2,802,509 | 2,789,012 |
| Basic and dilutive net income per share | \$ 0.09 | \$ 0.11 |

Diluted earnings per share calculations were not required for the three-month periods ended March 31, 2018 and 2017, as there were no stock options outstanding.

NOTE 4 – INVESTMENT SECURITIES

Investment securities are accounted for according to their purpose and holding period. Trading securities are those that are bought and held principally for the purpose of selling them in the near term. The Company held no trading securities at March 31, 2018 or December 31, 2017. Available-for-sale investment securities, comprised of debt and mortgage-backed securities, are those that may be sold before maturity due to changes in the Company's interest rate risk profile or funding needs, and are reported at fair value with unrealized gains and losses, net of taxes, reported as a component of other comprehensive income. Held-to-maturity investment securities are those that management has the positive intent and ability to hold to maturity and are reported at amortized cost. The Company held no held-to-maturity securities at March 31, 2018 or December 31, 2017.

Realized gains and losses are recorded in noninterest income and are determined on a trade date basis using the specific identification method. Interest and dividends on investment securities are recognized in interest income on an accrual basis. Premiums and discounts are amortized or accreted into interest income using the interest method over

the expected lives of the individual securities.

The following table summarizes the amortized cost and estimated fair value of the Company's investment securities portfolio at March 31, 2018 and December 31, 2017:

| (dollars in thousands) | At March 31, 2018 | | | |
|--|-------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Residential mortgage-backed securities | \$ 49,081 | \$ 18 | \$ (1,857) | \$ 47,242 |
| State and municipal | 35,392 | 81 | (607) | 34,866 |
| U.S. Government agency | 6,870 | — | (135) | 6,735 |
| U.S. Treasury | 1,501 | — | (15) | 1,486 |
| Total securities available for sale | \$ 92,844 | \$ 99 | \$ (2,614) | \$ 90,329 |

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| (dollars in thousands) | At December 31, 2017 | | | |
|--|----------------------|------------------------------|-------------------------------|---------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
| Residential mortgage-backed securities | \$ 49,788 | \$ 24 | \$ (1,069) | \$ 48,743 |
| Municipal securities | 35,453 | 339 | (159) | 35,633 |
| U.S. Government agency securities | 3,526 | — | (46) | 3,480 |
| U.S. Treasury securities | 1,501 | — | (8) | 1,493 |
| Total securities available for sale | \$ 90,268 | \$ 363 | \$ (1,282) | \$ 89,349 |

The gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2018 and December 31, 2017 are as follows:

| March 31, 2018 Securities available for sale: | Less than 12 months | | 12 months or more | | Total Fair Value | Unrealized Loss |
|--|------------------------|--------------------|-------------------|--------------------|------------------------|--------------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | | |
| | (dollars in thousands) | | | | | |
| Residential mortgage-backed securities | \$ 14,707 | \$ (402) | \$ 31,610 | \$ (1,456) | \$ 46,317 | \$ (1,858) |
| Municipal securities | 17,903 | (336) | 6,079 | (271) | 23,982 | (607) |
| U.S. Government agency securities | 6,230 | (125) | 506 | (9) | 6,736 | (134) |
| U.S. Treasury securities | 1,486 | (15) | — | — | 1,486 | (15) |
| | \$ 40,326 | \$ (878) | \$ 38,195 | \$ (1,736) | \$ 78,521 | \$ (2,614) |

| December 31, 2017 Securities available for sale: | Less than 12 months | | 12 months or more | | Total Fair Value | Unrealized Loss |
|---|------------------------|--------------------|-------------------|--------------------|------------------------|--------------------|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | | |
| | (dollars in thousands) | | | | | |
| Residential mortgage-backed securities | \$ 13,333 | \$ (143) | \$ 33,896 | \$ (927) | \$ 47,229 | \$ (1,070) |
| Municipal securities | 2,396 | (11) | 6,230 | (148) | 8,626 | (159) |
| U.S. Government agency securities | 2,965 | (37) | 515 | (9) | 3,480 | (46) |

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| | | | | | | |
|--------------------------|-----------|----------|-----------|------------|-----------|------------|
| U.S. Treasury securities | 1,494 | (7) | — | — | 1,494 | (7) |
| | \$ 20,188 | \$ (198) | \$ 40,641 | \$ (1,084) | \$ 60,829 | \$ (1,282) |

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary-impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At March 31, 2018, the Company recorded unrealized losses in its portfolio of debt securities totaling \$2.6 million related to 152 securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

At December 31, 2017, the Company recorded unrealized losses in its portfolio of debt securities totaling \$1.3 million related to 114 securities, which resulted from increases in market interest rates, spread volatility, and other factors that management deems to be temporary. Management does not believe the securities are impaired due to reasons of credit quality. Since management believes that it is more likely than not that the Company will not be

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required to sell these securities prior to maturity or a full recovery of the amortized cost, the Company does not consider these securities to be other-than-temporarily impaired.

Contractual maturities of debt securities at March 31, 2018 are shown below. Actual maturities may differ from contractual maturities because borrowers have the right to call or prepay obligations with or without call or prepayment penalties.

| | At March 31, 2018 | | |
|---|-------------------|---------------|-------------------|
| (dollars in thousands) | Amortized Cost | Fair Value | Yield (1), (2) |
| Available for sale securities maturing: | | | |
| Within one year | \$ 1,197 | \$ 1,207 | 3.84 % |
| Over one to five years | 1,817 | 1,793 | 1.71 % |
| Over five to ten years | 18,097 | 17,582 | 2.23 % |
| Over ten years | 71,733 | 69,747 | 2.74 % |
| Total debt securities | \$ 92,844 | \$ 90,329 | |

(1) Yields are stated as book yields which are adjusted for amortization and accretion of purchase premiums and discounts, respectively.

(2) Yields on tax-exempt obligations have been computed on a tax-equivalent basis.

NOTE 5 – LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

The fundamental lending business of the Company is based on understanding, measuring, and controlling the credit risk inherent in the loan portfolio. The Company's loan portfolio is subject to varying degrees of credit risk. These risks entail both general risks, which are inherent in the lending process, and risks specific to individual borrowers. The Company's credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry or collateral type.

The Company currently manages its credit products and the respective exposure to loan losses by the following specific portfolio segments, which are levels at which the Company develops and documents its systematic methodology to determine the allowance for loan losses. The Company considers each loan type to be a portfolio segment having unique risk characteristics.

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| | March 31, 2018 | | December 31, 2017 | |
|-----------------------------|-------------------|-----|----------------------|-----|
| (dollars in thousands) | \$ | % | \$ | % |
| Consumer | \$ 15,730 | 5 | \$ 16,112 | 6 |
| Residential real estate | 82,151 | 30 | 81,926 | 30 |
| Indirect | 90,278 | 33 | 85,186 | 32 |
| Commercial | 11,176 | 4 | 11,257 | 4 |
| Construction | 4,385 | 2 | 3,536 | 1 |
| Commercial real estate | 71,996 | 26 | 73,595 | 27 |
| Total Loans | 275,716 | 100 | 271,612 | 100 |
| Allowance for credit losses | (2,899) | | (2,589) | |
| Net Loans | \$ 272,817 | | \$ 269,023 | |

The Bank's net loans totaled \$272.8 million at March 31, 2018, compared to \$269.0 million at December 31, 2017, an increase of \$3.8 million (1.41%). Indirect loans increased from \$85.2 million to \$90.3 million (\$5.1 million or

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5.98%). Construction loans increased from \$3.5 million to \$4.4 million (\$0.9 million or 24.03%). Commercial real estate loans decreased from \$73.6 million to \$72.0 million (\$1.6 or 2.17%) as loan payoffs outpaced loan originations.

Credit Risk and Allowance for Credit Losses. Credit risk is the risk of loss arising from the inability of a borrower to meet his or her obligations and entails both general risks, which are inherent in the process of lending, and risks specific to individual borrowers. Credit risk is mitigated through portfolio diversification, which limits exposure to any single customer, industry, or collateral type. Residential mortgage and home equity loans and lines generally have the lowest credit loss experience. Loans secured by personal property, such as auto loans, generally experience medium credit losses. Unsecured loan products, such as personal revolving credit, have the highest credit loss experience and for that reason, the Bank has chosen not to engage in a significant amount of this type of lending. Credit risk in commercial lending can vary significantly, as losses as a percentage of outstanding loans can shift widely during economic cycles and are particularly sensitive to changing economic conditions. Generally, improving economic conditions result in improved operating results on the part of commercial customers, enhancing their ability to meet their particular debt service requirements. Improvements, if any, in operating cash flows can be offset by the impact of rising interest rates that may occur during improved economic times. Inconsistent economic conditions may have an adverse effect on the operating results of commercial customers, reducing their ability to meet debt service obligations.

The allowance for credit losses is established through a provision for credit losses charged to expense. Loans are charged against the allowance for credit losses when management believes that the collectability of the principal is unlikely. The allowance, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on existing loans that may become uncollectible. The evaluations are performed for each class of loans and take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, value of collateral securing the loans and current economic conditions and trends that may affect the borrowers' ability to pay. For example, delinquencies in unsecured loans and indirect automobile installment loans will be reserved for at significantly higher ratios than loans secured by real estate. Based on that analysis, the Bank deems its allowance for credit losses in proportion to the total non-accrual loans and past due loans to be sufficient.

For purposes of determining the allowance for credit losses, the Bank has segmented the loan portfolio into the following classifications:

- Consumer
- Residential Real Estate
- Indirect
- Commercial
- Construction
- Commercial Real Estate

Each of these segments are reviewed and analyzed quarterly using the average historical charge-offs over a four year period for their respective segments as well as the following qualitative factors:

- Changes in asset quality metrics including past due (30-89 days) loans, nonaccrual loans, classified assets, watch list loans all in relation to total loans. Also policy exceptions in relationship to loan volume.
- Changes in the rate and direction of the loan volume by portfolio segment.
- Concentration of credit including the concentration percentages, changes in concentration and concentrations relative to goals.
- Changes in macro-economic factors including the rates and direction of unemployment, median income and population.
- Changes in internal factors including external loan review required reserve changes, internal review penetration, internal required reserve changes, and weighted required reserve trends.
- Changes in rate and direction of charge offs and recoveries.

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Transactions in the allowance for credit losses for the three months ended March 31, 2018 and the year ended December 31, 2017 were as follows:

| March 31, 2018 (dollars in thousands) | Residential | | | Commercial | | | Unallocated | Total |
|--|-------------|----------------|----------|------------|--------------|----------------|-------------|----------|
| | Consumer | Real Estate | Indirect | Commercial | Construction | Real Estate | | |
| Balance, beginning of year | \$ 214 | \$ 1,061 | \$ 774 | \$ 237 | \$ 12 | \$ 291 | \$ — | \$ 2,589 |
| Charge-offs | (62) | — | (39) | — | — | — | — | (101) |
| Recoveries | 5 | 2 | 44 | — | — | — | — | 51 |
| Provision for loan losses | 56 | (3) | 14 | 8 | (8) | 293 | — | 360 |
| Balance, end of year | \$ 213 | \$ 1,060 | \$ 793 | \$ 245 | \$ 4 | \$ 584 | \$ — | \$ 2,899 |
| Individually evaluated for impairment: | | | | | | | | |
| Balance in allowance | \$ 29 | \$ 513 | \$ — | \$ 214 | \$ — | \$ 305 | \$ — | \$ 1,061 |
| Related loan balance | 99 | 2,323 | — | 214 | — | 3,146 | — | 5,782 |
| Collectively evaluated for impairment: | | | | | | | | |
| Balance in allowance | \$ 184 | \$ 547 | \$ 793 | \$ 31 | \$ 4 | \$ 279 | \$ — | \$ 1,838 |
| Related loan balance | 15,631 | 79,828 | 90,278 | 10,962 | 4,385 | 68,850 | — | 269,934 |
| December 31, 2017 (dollars in thousands) | | | | | | | | |
| Balance, beginning of year | \$ 182 | \$ 1,042 | \$ 693 | \$ 284 | \$ 10 | \$ 259 | \$ 14 | \$ 2,484 |

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| | | | | | | | | |
|--|--------|----------|--------|--------|-------|--------|------|----------|
| Charge-offs | (96) | (3) | (458) | (9) | — | — | — | (566) |
| Recoveries | 8 | 27 | 286 | — | — | 14 | — | 335 |
| Provision for loan losses | 120 | (5) | 253 | (38) | 2 | 18 | (14) | 336 |
| Balance, end of year | \$ 214 | \$ 1,061 | \$ 774 | \$ 237 | \$ 12 | \$ 291 | \$ — | \$ 2,589 |
| Individually evaluated for impairment: | | | | | | | | |
| Balance in allowance | \$ 52 | \$ 513 | \$ — | \$ 217 | \$ — | \$ — | \$ — | \$ 782 |
| Related loan balance | 160 | 2,345 | — | 217 | — | 1,176 | — | 3,898 |
| Collectively evaluated for impairment: | | | | | | | | |
| Balance in allowance | \$ 162 | \$ 548 | \$ 774 | \$ 20 | \$ 12 | \$ 291 | \$ — | \$ 1,807 |
| Related loan balance | 15,952 | 79,580 | 85,186 | 11,040 | 3,536 | 72,420 | — | 267,714 |

Management believes the allowance for credit losses is at an appropriate level to absorb inherent probable losses in the portfolio.

| (dollars in thousands) | March 31, 2018 | March 31, 2017 |
|---|-------------------|-------------------|
| Average loans | \$ 273,964 | \$ 267,494 |
| Net charge offs to average loans (annualized) | 0.07 % | 0.12 % |

During the first quarter of 2018, loans to 7 borrowers and related entities totaling approximately \$101,000 were determined to be uncollectible and were charged off. During the first quarter of 2017, loans to 11 borrowers and related entities totaling approximately \$170,000 were determined to be uncollectible and were charged off.

Reserve for Unfunded Commitments. Loan commitments and unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. The Bank generally requires collateral to support financial instruments with credit risk on the same basis as it does for on-balance sheet instruments. The collateral requirement is based on management's credit evaluation of the counter party. Commitments generally

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have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. Each customer's creditworthiness is evaluated on a case-by-case basis.

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

As of March 31, 2018 and 2017, the Bank had outstanding commitments totaling \$24.7 million and \$26.5 million, respectively. These outstanding commitments consisted of letters of credit, undrawn lines of credit, and other loan commitments. The following table shows the Bank's reserve for unfunded commitments arising from these transactions:

| (dollars in thousands) | Three Months Ended March 31, | |
|----------------------------------|---------------------------------|-------|
| | 2018 | 2017 |
| Beginning balance | \$ 24 | \$ 25 |
| Reduction of unfunded reserve | (18) | — |
| Provisions charged to operations | 6 | 17 |
| Ending balance | \$ 12 | \$ 42 |

Contractual Obligations and Commitments. No material changes, outside the normal course of business, have been made during the first quarter of 2018.

Asset Quality. The following tables set forth the amount of the Bank's current, past due, and non-accrual loans by categories of loans and restructured loans, at the dates indicated.

| At March 31, 2018 (dollars in thousands) | 90 Days or More and Still Accruing | | | Nonaccrual | Total |
|---|--|------------------------|------|------------|-----------|
| | Current | 30-89 Days Past Due | | | |
| Consumer | \$ 15,469 | \$ 110 | \$ — | \$ 151 | \$ 15,730 |
| Residential Real Estate | 79,767 | 94 | — | 2,290 | 82,151 |
| Indirect | 89,557 | 577 | — | 144 | 90,278 |
| Commercial | 11,122 | — | 6 | 48 | 11,176 |

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| | | | | | |
|------------------------|------------|----------|-------|----------|------------|
| Construction | 4,014 | — | 53 | 318 | 4,385 |
| Commercial Real Estate | 67,506 | 2,000 | — | 2,490 | 71,996 |
| | \$ 267,435 | \$ 2,781 | \$ 59 | \$ 5,441 | \$ 275,716 |

At December 31, 2017
(dollars in thousands)

| | Current | 30-89 Days Past Due | 90 Days or More and Still Accruing | Nonaccrual | Total |
|-------------------------|------------|------------------------|--|------------|------------|
| Consumer | \$ 15,823 | \$ 80 | \$ 24 | \$ 185 | \$ 16,112 |
| Residential Real Estate | 79,205 | 597 | — | 2,124 | 81,926 |
| Indirect | 83,932 | 1,166 | — | 88 | 85,186 |
| Commercial | 11,203 | — | 6 | 48 | 11,257 |
| Construction | 3,188 | — | 30 | 318 | 3,536 |
| Commercial Real Estate | 73,088 | — | — | 507 | 73,595 |
| | \$ 266,439 | \$ 1,843 | \$ 60 | \$ 3,270 | \$ 271,612 |

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The balances in the above charts have not been reduced by the allowance for loan loss. For the period ending March 31, 2018, the allowance for loan loss is \$2.9 million. For the period ending December 31, 2017, the allowance for loan loss is \$2.6 million.

At March 31, 2018, there was \$1.0 million in loans outstanding, that were in an accrual status, but known information about possible credit problems of borrowers caused management to have doubts as to the ability of such borrowers to comply with present loan repayment terms. Such loans consist of loans which were not 90 days or more past due but where the borrower is in bankruptcy or has a history of delinquency, or the loan to value ratio is considered excessive due to deterioration of the collateral or other factors. The three loans outstanding, totaling \$1.0 million are as follows: \$667,000 Residential Real Estate loan where the guarantor is in bankruptcy and the loan has an accelerated payoff since we have an assignment of rents from the property which has a very long-term national tenant; \$160,000 Home Equity Line of Credit which is paying as agreed, however the borrower has defaulted on other commercial loans which have been satisfied; and a \$214,000 Commercial Real Estate loan with a loan to value ratio which has deteriorated, which has a complete specific reserve of \$214,000. All three of these loans are classified with a risk rating of Substandard.

Non-accrual loans with specific reserves at March 31, 2018 are comprised of:

Consumer loans – Two loans to two borrowers in the amount of \$99,500 with specific reserves of \$29,278 established for the loans.

Residential Real Estate – One loan to one borrower in the amount of \$1.3 million, secured by residential property with a specific reserve of \$513,000 established for the loan.

Commercial loans – One loan to one borrower in the amount of \$214,000 with specific reserves of \$214,000 established for the loan.

Commercial Real Estate – One loan to one borrower in the amount of \$2.0 million with specific reserves of \$305,000 established for the loan.

Below is a summary of the recorded investment amount and related allowance for losses of the Bank's impaired loans at March 31, 2018 and December 31, 2017.

| March 31, 2018 (dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Interest Income Recognized | Specific Reserve | Average Recorded Investment |
|---|------------------------|--------------------------------|----------------------------------|---------------------|-----------------------------------|
| Impaired loans with specific reserves: | | | | | |
| Consumer | \$ 100 | \$ 100 | \$ — | \$ 29 | \$ 137 |
| Residential Real Estate | 1,294 | 1,294 | — | 513 | 1,306 |
| Commercial | 214 | 214 | 3 | 214 | 215 |
| Commercial Real Estate | 2,000 | 2,000 | 14 | 305 | 3,103 |
| Total impaired loans with specific reserves | 3,608 | 3,608 | 17 | 1,061 | 4,761 |
| Impaired loans with no specific reserve: | | | | | |
| Residential Real Estate | \$ 977 | \$ 1,403 | \$ 2 | \$ — | \$ 1,566 |

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| | | | | | |
|---|----------|----------|-------|---|----------|
| Indirect | 144 | 144 | — | — | — |
| Construction | 236 | 236 | — | — | 236 |
| Commercial Real Estate | 1,238 | 1,548 | 9 | — | 1,666 |
| Total impaired loans with no specific reserve | \$ 2,595 | \$ 3,331 | \$ 11 | — | \$ 3,468 |

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| December 31, 2017 (dollars in thousands) | Recorded Investment | Unpaid Principal Balance | Interest Income Recognized | Specific Reserve | Average Recorded Investment |
|---|------------------------|--------------------------------|----------------------------------|---------------------|-----------------------------------|
| Impaired loans with specific reserves: | | | | | |
| Consumer | \$ 160 | \$ 160 | \$ 5 | \$ 52 | \$ 205 |
| Residential Real Estate | 1,294 | 1,322 | — | 513 | 1,312 |
| Commercial | 217 | 217 | — | 217 | 223 |
| Total impaired loans with specific reserves | 1,671 | 1,699 | 5 | 782 | 1,740 |
| Impaired loans with no specific reserve: | | | | | |
| Consumer | \$ 49 | \$ 49 | \$ — | — | \$ — |
| Residential Real Estate | 992 | 1,760 | 11 | — | 1,572 |
| Indirect | 88 | 88 | — | — | — |
| Commercial | 2 | 2 | — | — | 2 |
| Construction | 318 | 318 | — | — | 322 |
| Commercial Real Estate | 1,194 | 1,194 | 39 | — | 1,632 |
| Total impaired loans with no specific reserve | \$ 2,643 | \$ 3,411 | \$ 50 | — | \$ 3,528 |

| (dollars in thousands) | March 31, 2018 | December 31, 2017 |
|--|-------------------|----------------------|
| Troubled debt restructured loans | \$ 260 | \$ 263 |
| Non-accrual and 90+ days past due and still accruing loans to gross loans | 2.09 % | 1.32 % |
| Allowance for loan losses to nonaccrual & 90+ days past due and still accruing loans | 52.70 % | 77.70 % |

At March 31, 2018, there were two troubled debt restructured loans consisting of a commercial loan of \$214,000 and a consumer loan of \$46,000. The consumer loan is in a nonaccrual status.

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Following is a table showing activity for non-accrual loans for the quarters ended March 31, 2017 and 2018.

| (dollars in thousands) | Consumer | Residential Real Estate | Indirect | Commercial | Construction | Commercial Real Estate | Totals |
|-------------------------------------|----------|----------------------------|----------|------------|--------------|---------------------------|--------|
| December 31, 2016 | 403 | 2,508 | 193 | — | — | 647 | 3,751 |
| Transfers into nonaccrual | 4 | — | 229 | — | 170 | 48 | 451 |
| Loans paid down/payoffs | (12) | (31) | (42) | — | — | (10) | (95) |
| Loans returned to accrual status | — | (132) | (33) | — | — | — | (165) |
| Loans charged off | — | (3) | (167) | — | — | — | (170) |
| March 31, 2017 | 395 | 2,342 | 180 | — | 170 | 685 | 3,772 |
| December 31, 2017 | 185 | 2,124 | 88 | 48 | 318 | 507 | 3,270 |
| Transfers into nonaccrual | 38 | 183 | 160 | — | — | 2,000 | 2,381 |
| Loans paid down/payoffs | (9) | (17) | (33) | — | — | (17) | (76) |
| Loans returned to accrual status | — | — | (37) | — | — | — | (37) |
| Loans charged off | (63) | — | (34) | — | — | — | (97) |
| March 31, 2018 | 151 | 2,290 | 144 | 48 | 318 | 2,490 | 5,441 |

Other Real Estate Owned. At March 31, 2018, the Company had \$114,000 in real estate acquired in partial or total satisfaction of debt, unchanged from \$114,000 at December 31, 2017. All such properties are initially recorded at the lower of cost or fair value (net realizable value) at the date acquired and carried on the balance sheet as other real estate owned. Losses arising at the date of acquisition are charged against the allowance for credit losses. Subsequent write-downs that may be required and expense of operation are included in noninterest expense. Gains and losses realized from the sale of other real estate owned are included in noninterest expense.

Credit Quality Information

In addition to monitoring the performance status of the loan portfolio, the Company utilizes a risk rating scale (1-8) to evaluate loan asset quality for all loans. Loans that are rated 1-4 are classified as pass credits. For the pass rated loans, management believes there is a low risk of loss related to these loans and, as necessary, credit may be strengthened through improved borrower performance and/or additional collateral.

The Bank's internal risk ratings are as follows:

- 1 Superior – minimal risk. (normally supported by pledged deposits, United States government securities, etc.)
- 2 Above Average - low risk. (all of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
- 3 Average – moderately low risk. (most of the risks associated with this credit based on each of the bank's creditworthiness criteria are minimal)
- 4 Acceptable – moderate risk. (the weighted overall risk associated with this credit based on each of the bank's creditworthiness criteria is acceptable)
- 5 Other Assets Especially Mentioned – moderately high risk. (possesses deficiencies which corrective action by the bank would remedy; potential watch list)
- 6 Substandard – (the bank is inadequately protected and there exists the distinct possibility of sustaining some loss if not corrected)

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7 Doubtful – (weaknesses make collection or liquidation in full, based on currently existing facts, improbable)

8 Loss – (of little value; not warranted as a bankable asset)

The following table provides information with respect to the Company's credit quality indicators by class of the loan portfolio at March 31, 2018:

| March 31, 2018 (dollars in thousands) | Consumer | Residential Real Estate | Indirect | Commercial | Commercial Construction | Commercial Real Estate | Total |
|---|-----------|----------------------------|-----------|------------|----------------------------|---------------------------|------------|
| Pass | \$ 15,574 | \$ 81,612 | \$ 89,345 | \$ 11,175 | \$ 4,385 | \$ 71,672 | \$ 273,763 |
| Special mention | 97 | 217 | 561 | 1 | — | 324 | 1,200 |
| Substandard | 14 | 322 | 321 | — | — | — | 657 |
| Doubtful | 45 | — | 51 | — | — | — | 96 |
| Loss | — | — | — | — | — | — | — |
| | \$ 15,730 | \$ 82,151 | \$ 90,278 | \$ 11,176 | \$ 4,385 | \$ 71,996 | \$ 275,716 |
| Nonaccrual | 151 | 2,290 | 144 | 48 | 318 | 2,490 | 5,441 |
| Troubled debt restructures | 46 | — | — | 214 | — | — | 260 |
| Number of TDRs accounts | 1 | — | — | 1 | — | — | 2 |
| Non-performing TDRs | 46 | — | — | — | — | — | 46 |
| Number of non-performing TDR accounts | 1 | — | — | — | — | — | 1 |

| December 31, 2017 (dollars in thousands) | Consumer | Residential Real Estate | Indirect | Commercial | Commercial Construction | Commercial Real Estate | Total |
|---|-----------|----------------------------|-----------|------------|----------------------------|---------------------------|------------|
| Pass | \$ 16,008 | \$ 81,346 | \$ 83,803 | \$ 11,256 | \$ 3,536 | \$ 73,268 | \$ 269,217 |
| Special mention | 77 | 344 | 1,027 | 1 | — | 327 | 1,776 |
| Substandard | 3 | 236 | 315 | — | — | — | 554 |
| Doubtful | 24 | — | 41 | — | — | — | 65 |
| Loss | — | — | — | — | — | — | — |
| | \$ 16,112 | \$ 81,926 | \$ 85,186 | \$ 11,257 | \$ 3,536 | \$ 73,595 | \$ 271,612 |
| Nonaccrual | 185 | 2,124 | 88 | 48 | 318 | 507 | 3,270 |
| Troubled debt restructures | 46 | — | — | 217 | — | — | 263 |
| Number of TDRs accounts | 1 | — | — | 1 | — | — | 2 |
| | 46 | — | — | — | — | — | 46 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Non-performing TDRs Number of non-performing TDR accounts | 1 | — | — | — | — | — | 1 |
|---|---|---|---|---|---|---|---|

NOTE 6 – FAIR VALUE

ASC Topic 820 provides a framework for measuring and disclosing fair value under GAAP. ASC 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or a nonrecurring basis (for example, impaired loans).

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ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Fair Value Hierarchy

ASC 820 10 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. In accordance with ASC 820 10, these inputs are summarized in the three broad levels listed below:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.
- Level 2 – Other significant observable inputs (including quoted prices in active markets for similar securities)
- Level 3 – Significant unobservable inputs (including the Company's own assumptions in determining the fair value of investments)

The following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

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

The Bank may be required, from time to time, to measure certain other financial and non-financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP.

Loans. At March 31, 2018, these assets include 21 loans, excluding \$464,000 of consumer and indirect loans, classified as impaired, which include nonaccrual, past due 90 days or more and still accruing, and a homogeneous pool of indirect loans all considered to be impaired loans, which are valued under Level 3 inputs. Loans which are deemed to be impaired (\$5.8 million of loans with \$832,000 of specific reserves as of March 31, 2018) and foreclosed real estate assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Company is predominantly a cash flow lender with real estate serving as collateral on a majority of loans (\$2.1 million of the total impaired loans as of March 31, 2018). On a quarterly basis, the Company determines such fair values through a variety of data points and mostly rely on appraisals from independent appraisers. We obtain an appraisal on properties when they become impaired and have new appraisals at least every year. Typically, these appraisals do not include an inside inspection of the property as our loan documents do not require the borrower to allow access to the property. Therefore the most significant unobservable inputs is the details of the amenities included within the property and the condition of the property. Further, we cannot always accurately assess the amount of time it takes to gain ownership of our collateral through the foreclosure process and the damage, as well as potential looting, of the property further decreasing our value. Thus, in determining the fair values we discount the current independent appraisals, with a range from 0% to 16%, based on individual circumstances. The remaining impaired loans (\$3.5 million with \$1.1 million of specific reserves as of March 31, 2018) include mobile homes, commercial, consumer, and indirect auto loans, which are valued based on the value of the underlying collateral.

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The changes in the assets subject to fair value measurements are summarized below by level:

| (dollars in thousands) | Level 1 | Level 2 | Level 3 | Fair Value |
|-------------------------------|---------|-----------|----------|------------|
| March 31, 2018 | | | | |
| Recurring: | | | | |
| Securities available for sale | | | | |
| U.S. Treasury | \$ — | \$ 1,486 | \$ — | \$ 1,486 |
| State and Municipal | — | 34,866 | — | 34,866 |
| Mortgaged-backed | — | 53,977 | — | 53,977 |
| Interest rate swap | — | 447 | — | 447 |
| Non-recurring: | | | | |
| Maryland Financial Bank stock | — | — | 30 | 30 |
| Impaired loans | — | — | 5,142 | 5,142 |
| OREO | — | 114 | — | 114 |
| | \$ — | \$ 90,890 | \$ 5,172 | \$ 96,062 |
| December 31, 2017 | | | | |
| Recurring: | | | | |
| Securities available for sale | | | | |
| U.S. Treasury | \$ — | \$ 1,493 | \$ — | \$ 1,493 |
| State and Municipal | — | 35,633 | — | 35,633 |
| Mortgaged-backed | — | 52,223 | — | 52,223 |
| Interest rate swap | — | 49 | — | 49 |
| Non-recurring: | | | | |
| Maryland Financial Bank stock | — | — | 30 | 30 |
| Impaired loans | — | — | 3,532 | 3,532 |
| OREO | — | 114 | — | 114 |
| | \$ — | \$ 89,512 | \$ 3,562 | \$ 93,074 |

The estimated fair values of the Company's financial instruments at March 31, 2018 and December 31, 2017 are summarized below. The fair values of a significant portion of these financial instruments are estimates derived using present value techniques and may not be indicative of the net realizable or liquidation values. Also, the calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

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| (dollars in thousands) | March 31, 2018 | | December 31, 2017 | |
|---|-----------------|------------|-------------------|------------|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and due from banks | \$ 2,449 | \$ 2,449 | \$ 2,610 | \$ 2,610 |
| Interest-bearing deposits in other financial institutions | 5,896 | 5,896 | 9,846 | 9,846 |
| Federal funds sold | 183 | 183 | 149 | 149 |
| Investment securities available for sale | 90,329 | 90,329 | 89,349 | 89,349 |
| Investments in restricted stock | 1,231 | 1,231 | 1,232 | 1,232 |
| Ground rents | 150 | 150 | 153 | 153 |
| Loans, less allowance for credit losses | 272,817 | 271,053 | 269,023 | 275,819 |
| Accrued interest receivable | 1,182 | 1,182 | 1,133 | 1,133 |
| Cash value of life insurance | 8,290 | 8,290 | 8,713 | 8,713 |
| Financial liabilities: | | | | |
| Deposits | 336,170 | 315,964 | 334,238 | 324,512 |
| Long-term borrowings | — | — | — | — |
| Short-term borrowings | 20,000 | 20,781 | 20,000 | 20,739 |
| Accrued interest payable | 112 | 112 | 101 | 101 |
| Unrecognized financial instruments: | | | | |
| Commitments to extend credit | 22,210 | 22,210 | 19,109 | 19,109 |
| Standby letters of credit | 84 | 84 | 71 | 71 |

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments.

| (dollars in thousands) | Carrying Amount | Fair Value | Level 1 | Level 2 | Level 3 |
|-------------------------------------|-----------------|------------|----------|---------|---------|
| March 31, 2018 | | | | | |
| Financial instruments - Assets | | | | | |
| Cash and cash equivalents | \$ 8,528 | \$ 8,528 | \$ 8,528 | — | \$ — |
| Loans receivable, net | 272,817 | 271,053 | — | — | 271,053 |
| Cash value of life insurance | 8,290 | 8,290 | — | 8,290 | — |
| Financial instruments - Liabilities | | | | | |
| Deposits | 336,170 | 315,964 | 224,098 | 91,866 | — |
| Short-term debt | 20,000 | 20,781 | — | 20,781 | — |

Fair values are based on quoted market prices for similar instruments or estimated using discounted cash flows. The discounts used are estimated using comparable market rates for similar types of instruments adjusted to be commensurate with the credit risk, overhead costs and optionality of such instruments.

The fair value of cash and due from banks, federal funds sold, investments in restricted stocks and accrued interest receivable are equal to the carrying amounts. The fair values of investment securities are determined using market quotations. The fair value of loans receivable is estimated using discounted cash flow analysis.

The fair value of non-interest bearing deposits, interest-bearing checking, savings, and money market deposit accounts, securities sold under agreements to repurchase, and accrued interest payable are equal to the carrying amounts. The fair value of fixed-maturity time deposits is estimated using discounted cash flow analysis.

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NOTE 7 – RECENT ACCOUNTING PRONOUNCEMENTS

The FASB has issued several exposure drafts which, if adopted, would significantly alter the Company’s (and all other financial institutions’) method of accounting for, and reporting, its financial assets and some liabilities from a historical cost method to a fair value method of accounting as well as the reported amount of net interest income. The Company has not determined the extent of the possible changes at this time. The exposure drafts are in different stages of review, approval and possible adoption.

ASU 2014 09, “Revenue from Contracts with Customers (Topic 606).” ASU 2014 09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014 09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014 09 was effective for the Company on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2016 1, “No. 2016 01, Financial Instruments – Overall (Subtopic 825 10): Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU 2016-01 is intended to improve the recognition and measurement of financial instruments by requiring equity investments to be measured at fair value with changes in fair value recognized in net income; requiring public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured and amortized at cost on the balance sheet; and requiring a reporting organization 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 organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. ASU 2016-01 is effective for annual periods and interim periods within those annual periods, beginning after December 15, 2017. The amendments should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values (including disclosure requirements) should be applied prospectively to equity investments that exist as of the date of adoption. The Company adopted ASU 2016-01 on January 1, 2018 and it did not have a material impact on the consolidated financial statement. The Bank’s equity securities are membership stocks in the Federal Home Loan Bank and Maryland Financial Bank and thereby excluded from fair value pricing. For exit pricing on loans, the Company used data on recent originations which captured expectations of the credit risk “premium” and an analysis of prepayments which captures the Company’s historical prepayment experience.

ASU 2016 02 “Leases (Topic 842).” ASU 2016 02 will, among other things, require lessees to recognize a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016 02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and ASC Topic 606, “Revenue from Contracts with Customers.” ASU 2016 2 will be effective for us on January 1, 2019 and will require transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the potential impact of ASU 2016 02 on our financial statements.

ASU 2016-05 “Derivatives and Hedging (Topic 815) Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships.” ASU 2016-05 clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under ASC Topic 815 does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 was effective for us on January 1, 2017 and did not have a significant impact on our financial statements.

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ASU 2016 09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.” Under ASU 2016 09 all excess tax benefits and tax deficiencies related to share-based payment awards should be recognized as income tax expense or benefit in the income statement during the period in which they occur. Previously, such amounts were recorded in the pool of excess tax benefits included in additional paid-in capital, if such pool was available. Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share should exclude the amount of excess tax benefits that would have previously been recognized in additional paid-in capital. Additionally, excess tax benefits should be classified along with other income tax cash flows as an operating activity rather than a financing activity, as was previously the case. ASU 2016 09 also provides that an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur. ASU 2016 09 changes the threshold to qualify for equity classification (rather than as a liability) to permit withholding up to the maximum statutory tax rates (rather than the minimum as was previously the case) in the applicable jurisdictions. ASU 016 09 was effective on January 1, 2017 and did not have a significant impact on our financial statements.

ASU No. 2016 13, “Financial Instruments—Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments” which updated guidance intended to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The updated guidance replaces the current incurred loss impairment methodology with a methodology that reflects expected credit losses and requires the consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The updated guidance is effective for interim and annual reporting periods beginning after December 15, 2019, with early adoption permitted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

ASU 2016 15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016 15”). This Accounting Standards Update addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; 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; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. ASU 2016 15 is effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early application is permitted, including adoption in an interim period. The Company’s adoption of this guidance did not have a material effect on the Company’s consolidated financial statements.

ASU 2016 18, “Statement of Cash Flows (Topic 230) - Restricted Cash.” ASU 2016 18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016 18 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017 01, “Business Combinations (Topic 805) - Clarifying the Definition of a Business.” ASU 2017 01 clarifies the definition and provides a more robust framework to use in determining when a set of assets and activities constitutes a business. ASU 2017 01 is intended to provide guidance when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017 01 was effective for us on January 1, 2018 and did not have a significant impact on our financial statements.

ASU 2017-08, "Premium Amortization on Purchased Callable Debt Securities." This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early

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adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

ASU No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This standard better aligns 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. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedge instruments and the hedged item in the financial statements. Adoption for this ASU is required for fiscal years and interim periods beginning after December 15, 2018 and early adoption is permitted. The Company is currently assessing the impact of the new guidance on its condensed consolidated financial statements.

ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The ASU does not have any impact on the underlying ASC 740 guidance that requires the effect of a change in tax law be included in income from continuing operations. The amendments in this ASU are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company adopted the guidance in the ASU in its December 31, 2017 consolidated financial statements resulting in a reclassification of \$0.1 million of stranded tax effects related to net unrealized losses on investment securities. The impact was not material.

ITEM 2.MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

When used in this discussion and elsewhere in this Form 10 Q, the words or phrases “will likely result,” “are expected to,” “will continue,” “is anticipated,” “estimate,” “project” or similar expressions are intended to identify “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made, and readers are advised that various factors could affect the Company’s financial performance and could cause the Company’s actual results for future periods to differ materially from those anticipated or projected. While it is impossible to identify all such factors, such factors include, but are not limited to, those risks identified in the Company’s periodic reports filed with the Securities and Exchange Commission, including its most recent Annual Report on Form 10 K.

The Company does not undertake and specifically disclaims any obligation to update any forward-looking statements to reflect occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

OVERVIEW

Glen Burnie Bancorp, a Maryland corporation (the “Company”), through its subsidiary, The Bank of Glen Burnie, a Maryland banking corporation (the “Bank”), operates a commercial bank with eight offices in Anne Arundel County Maryland. The Bank’s loan portfolio grew by \$3.8 million or 1.4% in the first three months of 2018. Overall deposits increased by \$1.9 million or 0.58%. The Company has a very strong capital position and capacity for future growth with estimated total regulatory capital to risk weighted assets of 13.85% as of March 31, 2018. At March 31, 2018, the Bank remained above all “well-capitalized” regulatory requirement levels. The Bank’s estimated tier 1 risk-

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based capital ratio was 12.73% at March 31, 2018 compared to 12.83% at December 31, 2017. Our liquidity position remained strong due to available cash and cash equivalents, borrowing lines with the FHLB of Atlanta and correspondent banks, and the size and composition of the investment portfolio. Net income available to common stockholders for the three-month period ended March 31, 2018 was \$255,000, or \$0.09 per basic and diluted share compared to \$316,000, or \$0.11 per basic and diluted share for the same period of 2017. The results recorded for the first three-month period of 2018 were lower than the same period of 2017 resulting from a larger provision for loan losses related to the deteriorated credit quality of a single participated loan and, in management's view, are not indicative of poor credit quality of the overall loan portfolio. For the three-month period ended March 31, 2018, noninterest expense was \$2.8 million compared to \$2.6 million for the same period of 2017. The primary contributor to the increase when compared to the three-month period ended March 31, 2017 was an increase in salaries and employee benefits, legal, accounting and other professional fees and loan collection costs, offset by decreases in data processing and item processing services.

RESULTS OF OPERATIONS

Net Interest Income. The Company's net interest income for the three-month period ended March 31, 2018 was \$3.0 million, compared to \$2.8 million for the same period in 2017, an increase of \$160,000, or 5.65%.

Interest income for the first quarter increased \$120,000 from \$3.3 million in 2017 to \$3.4 million in 2018, a 3.61% increase. The primary reason for the increase in interest income for the 2018 period when compared to the 2017 period was a \$98,000 increase in loan income and an \$17,000 increase in interest on deposits with banks and federal funds sold.

Interest expense for the first quarter 2018 decreased \$39,000 from \$491,000 for the same period in 2017 to \$452,000 in 2018, a 7.94% decrease. Interest expense for the first quarter of 2018 was lower than the comparable period of 2017 primarily due to a decrease in the cost of deposits, changes in the mix from interest bearing accounts to non-interest bearing deposits and lower cost of borrowings.

Net interest margins for the three-month period ended March 31, 2018 was 3.22% compared to 3.07% for the three-month period ended March 31, 2017. The increase in the net interest margin for the first quarter 2018 as compared to the same period in 2017 was primarily due an overall increase in total interest earning assets and a reduction in the cost of funds. The yield on interest earning assets increased by 0.10% from 3.60% for the 2017 period to 3.71% for the 2018 period. While the cost of funds decreased 0.05% from 0.56% for the 2017 period to 0.51% for the 2018 period.

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The following tables sets forth, for the periods indicated, information regarding the average balances of interest earning assets and interest bearing liabilities, the amount of interest income and interest expense and the resulting yields on average interest earning assets and rates paid on average interest bearing liabilities.

| (dollars in thousands) | Three Months Ended March 31, | | | 2017 | | |
|--|------------------------------|----------|----------------|--------------------|----------|----------------|
| | 2018 Average Balance | Interest | Yield/ Cost | Average Balance | Interest | Yield/ Cost |
| ASSETS: | | | | | | |
| Interest-earning assets: | | | | | | |
| Interest-bearing deposits w/ banks & fed funds | \$ 8,654 | \$ 33 | 1.53 % | \$ 11,032 | \$ 18 | 0.67 % |
| Investment securities available for sale | 92,449 | 524 | 2.30 | 94,062 | 518 | 2.23 |
| Restricted equity securities | 1,339 | 15 | 4.50 | 1,246 | 13 | 4.14 |
| Total interest bearing deposits/investments | 102,442 | 572 | 2.27 | 106,340 | 549 | 2.09 |
| Loans: | | | | | | |
| Commercial & industrial | 11,167 | 164 | 5.97 | 12,392 | 164 | 5.38 |
| Commercial real estate | 73,388 | 881 | 4.87 | 68,666 | 806 | 4.76 |
| Residential real estate | 81,996 | 914 | 4.52 | 89,657 | 1,016 | 4.59 |
| Indirect automobile | 87,575 | 606 | 2.80 | 75,812 | 486 | 2.60 |
| Construction | 4,154 | 62 | 6.08 | 5,933 | 79 | 5.43 |
| Consumer & other | 15,684 | 245 | 6.33 | 15,034 | 223 | 6.01 |
| Total loans | 273,964 | 2,872 | 4.25 | 267,494 | 2,774 | 4.21 |
| Total interest-earning assets | 376,406 | 3,444 | 3.71 | 373,834 | 3,323 | 3.60 |
| Cash | 2,673 | | | 3,098 | | |
| Allowance for loan losses | (2,622) | | | (2,566) | | |
| Market valuation | (1,780) | | | (1,326) | | |
| Other assets | 17,156 | | | 18,428 | | |
| Total non-earning assets | 15,427 | | | 17,634 | | |
| Total assets | \$ 391,833 | | | \$ 391,468 | | |
| LIABILITIES AND STOCKHOLDER'S EQUITY: | | | | | | |
| Interest-bearing deposits: | | | | | | |
| Interest-bearing checking and savings | \$ 116,030 | 16 | 0.05 % | \$ 110,575 | 15 | 0.05 % |
| Money market | 20,488 | 3 | 0.05 | 19,388 | 2 | 0.05 |
| Certificates of deposit | 94,610 | 290 | 1.24 | 104,388 | 316 | 1.23 |
| Total interest-bearing deposits | 231,128 | 309 | 0.54 | 234,351 | 333 | 0.58 |
| Borrowed Funds: | | | | | | |
| Federal Funds Purchased | — | — | — | 32 | — | — |

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| | | | | | | |
|--|------------|----------|--------|------------|----------|--------|
| FHLB advances | 22,752 | 143 | 2.55 | 20,387 | 158 | 3.14 |
| Total borrowed funds | 22,752 | 143 | 2.55 | 20,419 | 158 | 3.14 |
| Total interest-bearing liabilities | 253,880 | 452 | 0.72 | 254,770 | 491 | 0.78 |
| Non-interest-bearing deposits | 103,364 | | | 102,094 | | |
| Total cost of funds | 357,244 | 452 | 0.51 | 356,864 | 491 | 0.56 |
| Other liabilities and accrued expenses | 893 | | | 1,048 | | |
| Total liabilities | 358,137 | | | 357,912 | | |
| Stockholder's equity | 33,696 | | | 33,556 | | |
| Total liabilities and equity | \$ 391,833 | | | \$ 391,468 | | |
| Net interest income | | \$ 2,992 | | | \$ 2,832 | |
| Yield on earning assets | | | 3.71 % | | | 3.60 % |
| Cost of interest-bearing liabilities | | | 0.72 % | | | 0.78 % |
| Net interest spread | | | 2.99 % | | | 2.82 % |
| Net interest margin | | | 3.22 % | | | 3.07 % |

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Provision for Credit Losses. The Company made a provision for credit losses of \$360,000 for the three-month period ending March 31, 2018 and \$195,000 during the three-month period ending March 31, 2017. The increase in provision for credit losses in the 2018 period was the result of the deteriorated credit quality of a single participated loan. As of March 31, 2018, the allowance for credit losses equaled 52.7% of non-accrual and past due loans compared to 68.3% at March 31, 2017. During the three-month period ended March 31, 2018, the Company recorded net charge-offs of \$50,000 compared to net charge-offs of \$77,000 during the corresponding period of the prior year.

Noninterest Income. Noninterest income increased to \$486,000 for the three-month period ended March 31, 2018, from \$279,000 for the corresponding 2017 period, a \$207,000, or 13.09% increase. The increase is due to a gain on the redemption of a bank-owned life insurance policy.

Noninterest Expenses. Noninterest expenses increased from \$2.6 million for the three-month period ended March 31, 2017, to \$2.8 million for the corresponding 2018 period, a \$264,000, or 10.15% increase. The increase for the three-month period was due to higher salaries and benefit expenses that resulted from the hiring of personnel to fill key positions in the Bank, legal, accounting and other professional fees and loan collection costs, offset by lower data processing and item processing services.

Income Taxes. During the three-month period ended March 31, 2018, the Company recorded income tax expenses of \$28,000 compared to \$29,000 for the same respective period in 2017. The Company's effective tax rate for the three-month period in 2018 was 9.89% compared to 8.41% for the prior year period.

Comprehensive Income (Loss). In accordance with regulatory requirements, the Company reports comprehensive income (loss) in its financial statements. Comprehensive income (loss) consists of the Company's net income, adjusted for unrealized gains and losses on the Bank's portfolio of investment securities and interest rate swap contracts. For the first quarter of 2018, comprehensive loss, net of tax, totaled \$613,000, compared to income of \$358,000 for the same period in 2017. The decrease for the three-month period was due to a net unrealized loss on available for sale securities driven by rising interest rates.

FINANCIAL CONDITION

General. The Company's assets increased to \$390.4 million at March 31, 2018 from \$389.5 million at December 31, 2017, primarily due to an increase in investment securities and loans, offset by a decrease in cash and cash due from banks. The Bank's net loans totaled \$272.8 million at March 31, 2018, compared to \$269.0 million at December 31, 2017, an increase of \$3.8 million, or 1.41%, primarily attributable to an increase in indirect, residential real estate and construction loans, partially offset by decreases in commercial real estate and consumer loans.

The Company's investment securities available for sale totaled \$90.3 million at March 31, 2018, a \$980,000, or 1.10% increase from \$89.3 million at December 31, 2017, primarily due to the purchase of new investment securities offset by principle and interest payments received on existing securities and increases in unrealized losses due to rising interest rates. The Bank's cash and due from banks (cash due from banks, interest-bearing deposits in other financial institutions, and federal funds sold), as of March 31, 2018, totaled \$8.5 million, a decrease of \$4.1 million, or 32.34% from the December 31, 2017 total of \$12.6 million.

Loans, net, increased by \$3.8 million, or 1.41%, to \$272.8 million at March 31, 2018 from \$269.0 million at December 31, 2017, primarily due to the loan originations of indirect loans offset by repayments.

Loans are placed on nonaccrual status when they are past-due 90 days as to either principal or interest or when, in the opinion of management, the collection of all interest and/or principal is in doubt. Placing a loan on nonaccrual status means that we no longer accrue interest on such loan and reverse any interest previously accrued but not collected. Management may grant a waiver from nonaccrual status for a 90-day past-due loan that is both well secured and in the process of collection. A loan remains on nonaccrual status until the loan is current as to payment of both principal and interest and the borrower has demonstrated the ability to make payments in accordance with the terms of the loan and remain current.

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A loan is considered to be impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are measured based on the fair value of the collateral for collateral dependent loans and at the present value of expected future cash flows using the loans' effective interest rates for loans that are not collateral dependent.

At March 31, 2018, impaired loans totaled \$6.2 million. Included in the impaired loans total were \$5.4 million in loans classified as nonaccrual loans. At March 31, 2018, troubled debt restructurings included in impaired loans totaled \$260,000. Borrowers under all other restructured loans are paying in accordance with the terms of the modified loan agreement and have been placed on accrual status after a period of performance with the restructured terms.

The following table presents details of our nonperforming loans and nonperforming assets, as these asset quality metrics are evaluated by management, at the dates indicated:

| | March 31, 2018 | December 31, 2017 |
|---|-------------------|-------------------------|
| (dollars in thousands) | | |
| Nonaccrual loans | \$ 5,441 | \$ 3,270 |
| TDR loans excluding those in nonaccrual loans | 214 | 217 |
| Accruing loans past due 90+ days | 59 | 60 |
| Total nonperforming loans | 5,714 | 3,547 |
| Real estate acquired through foreclosure | 114 | 114 |
| Total nonperforming assets | \$ 5,828 | \$ 3,660 |
| Nonperforming assets to total assets | 1.49 % | 0.94 % |

Deposits as of March 31, 2018 totaled \$336.2 million, which is an increase of \$1.9 million, or 0.6% from \$334.2 million at December 31, 2017. Demand deposits as of March 31, 2018, totaled \$107.1 million, which is an increase of \$3.1 million, or 2.9% from \$104.0 million at December 31, 2017. Interest-bearing checking accounts as of March 31, 2018, totaled \$27.1 million, which is a decrease of \$1.7 million, or 5.9% from \$28.8 million at December 31, 2017. Savings accounts as of March 31, 2018 totaled \$87.1 million, an increase of \$1.2 million, or 1.4%, from \$85.9 million at December 31, 2017. Money market accounts as of March 31, 2018, totaled \$21.1 million, which is an increase of \$1.2 million, or 6.2%, from \$19.9 million at December 31, 2017. Time deposits under \$100,000 totaled \$51.1 million on March 31, 2018, which is a \$1.2 million, or 2.3% decrease from the \$52.3 million total at December 31, 2017. Time deposits over \$100,000 totaled \$42.7 million on March 31, 2018, which is a decrease of \$0.8 million, or 1.7% from \$43.5 million at December 31, 2017.

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Deposits for the three months ended March 31, 2018 and the year ended December 31, 2017 were as follows:

| (dollars in thousands) | March 31, 2018 | | December 31, 2017 | | 2018 vs 2017 | |
|--|----------------|------------|-------------------|------------|--------------|----------|
| | Amount | % of Total | Amount | % of Total | \$ Change | % Change |
| Noninterest-bearing deposits | \$ 107,073 | 31.9 % | \$ 104,017 | 31.1 % | \$ 3,056 | 2.9 % |
| Interest-bearing deposits: | | | | | | |
| Checking | 27,089 | 8.1 % | 28,774 | 8.6 % | (1,684) | (5.9) % |
| Savings | 87,096 | 25.8 % | 85,890 | 25.8 % | 1,205 | 1.4 % |
| Money market | 21,088 | 6.3 % | 19,855 | 5.9 % | 1,233 | 6.2 % |
| Total interest-bearing checking, savings and money market deposits | 135,273 | 40.2 % | 134,519 | 40.3 % | 754 | 0.6 % |
| Time deposits under \$100,000 | 51,125 | 15.2 % | 52,250 | 15.6 % | (1,125) | (2.2) % |
| Time deposits of \$100,00 or more | 42,699 | 12.7 % | 43,452 | 13.0 % | (753) | (1.7) % |
| Total time deposits | 93,824 | 27.9 % | 95,702 | 28.6 % | (1,878) | (2.0) % |
| Total interest-bearing deposits | 229,097 | 68.1 % | 230,221 | 68.9 % | (1,124) | (0.5) % |
| Total Deposits | \$ 336,170 | 100.0 % | \$ 334,238 | 100.0 % | \$ 1,932 | 0.6 % |

Pension and Profit Sharing Plans. The Bank has a defined contribution retirement plan qualifying under Section 401(k) of the Internal Revenue Code that is funded through a profit sharing agreement and voluntary employee contributions. The plan provides for discretionary employer matching contributions to be determined annually by the Board of Directors. The plan covers substantially all employees.

For the three months ended March 31, 2018, the Bank accrued \$93,000 for its 401(k) match contribution as well as other profit sharing benefits.

MARKET RISK AND INTEREST RATE SENSITIVITY

Our primary market risk is interest rate fluctuation. Interest rate risk results primarily from the traditional banking activities in which the Bank engages, 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 liabilities. Our interest rate risk represents the level of exposure we have to fluctuations in interest rates and is primarily measured as the change in earnings and the theoretical market value of equity that results from changes in interest rates. The ALCO oversees our management of interest rate risk. The objective of the management of interest rate risk is to maximize stockholder value, enhance profitability and increase capital, serve customer and community needs, and protect us from any material financial consequences associated with changes in interest rate risk.

Interest rate risk is that risk to earnings or capital arising from movement of interest rates. It arises from differences between the timing of rate changes and the timing of cash flows (repricing risk); from changing rate relationships

across yield curves that affect bank activities (basis risk); from changing rate relationships across the spectrum of maturities (yield curve risk); and from interest rate related options embedded in certain bank products (option risk). Changes in interest rates may also affect a bank's underlying economic value. The value of a bank's assets, liabilities, and interest-rate related, off-balance sheet contracts is affected by a change in rates because the present value of future cash flows, and in some cases the cash flows themselves, is changed.

We believe that accepting some level of interest rate risk is necessary in order to achieve realistic profit goals. Management and the Board have chosen an interest rate risk profile that is consistent with our strategic business plan.

The Company's board of directors has established a comprehensive interest rate risk management policy, which is administered by our ALCO. The policy establishes limits on risk, which are quantitative measures of the percentage

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change in net interest income (a measure of net interest income at risk) and the fair value of equity capital (a measure of economic value of equity or “EVE” at risk) resulting from a hypothetical change in U.S. Treasury interest rates. We measure the potential adverse impacts that changing interest rates may have on our short-term earnings, long-term value, and liquidity by employing simulation analysis through the use of computer modeling. The simulation model captures optionality factors such as call features and interest rate caps and floors imbedded in investment and loan portfolio contracts. As with any method of gauging interest rate risk, there are certain shortcomings inherent in the interest rate modeling methodology we employ. When interest rates change, actual movements in different categories of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model. Finally, the methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan customers’ ability to service their debts, or the impact of rate changes on demand for loan and deposit products.

We prepare a current base case and eight alternative simulations at least once a quarter and report the analysis to the board of directors. In addition, more frequent forecasts are produced when the direction or degree of change in interest rates are particularly uncertain to evaluate the impact of balance sheet strategies or when other business conditions so dictate.

The statement of condition is subject to quarterly testing for eight alternative interest rate shock possibilities to indicate the inherent interest rate risk. Average interest rates are shocked by +/- 100, 200, 300, and 400 basis points (“bp”), although we may elect not to use particular scenarios that we determine are impractical in the current rate environment. It is our goal to structure the balance sheet so that net interest-earnings at risk over a 12-month period and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels.

At March 31, 2018, the simulation analysis reflected that the Bank is in a neutral to slightly asset sensitive position. Management currently strives to manage higher costing fixed rate funding instruments, while seeking to increase assets that are more fluid in their repricing. An asset sensitive position, theoretically, is favorable in a rising rate environment since more assets than liabilities will re-price in a given time frame as interest rates rise. Similarly, a liability sensitive position, theoretically, is favorable in a declining interest rate environment since more liabilities than assets will re-price in a given time frame as interest rates decline. Management works to maintain a consistent spread between yields on assets and costs of deposits and borrowings, regardless of the direction of interest rates.

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The following table sets forth the Company's interest-rate sensitivity at March 31, 2018.

| | 0-3 Months (dollars in thousands) | Over 3 to 12 Months | Over 1 Through 5 Years | Over 5 Years | Total |
|---|--------------------------------------|------------------------|------------------------------|-------------------|-------------------|
| Assets: | | | | | |
| Cash and due from banks | \$ — | \$ — | \$ — | \$ — | \$ 2,449 |
| Federal funds and overnight deposits | 6,079 | — | — | — | 6,079 |
| Securities | — | 1,207 | 1,793 | 87,329 | 90,329 |
| Loans | 17,009 | 5,423 | 86,409 | 163,976 | 272,817 |
| Fixed assets | — | — | — | — | 3,271 |
| Other assets | — | — | — | — | 15,425 |
| Total assets | \$ 23,088 | \$ 6,630 | \$ 88,202 | \$ 251,305 | \$ 390,370 |
| Liabilities: | | | | | |
| Demand deposit accounts | \$ — | \$ — | \$ — | \$ — | \$ 107,073 |
| NOW accounts | 28,018 | — | — | — | 28,018 |
| Money market deposit accounts | 21,088 | — | — | — | 21,088 |
| Savings accounts | 86,362 | — | — | — | 86,362 |
| IRA accounts | 1,699 | 11,646 | 17,567 | 2,111 | 33,023 |
| Certificates of deposit | 6,162 | 26,933 | 25,908 | 1,603 | 60,606 |
| Long-term borrowings | — | — | — | — | — |
| Short-term borrowings | 10,000 | 10,000 | — | — | 20,000 |
| Other liabilities | — | — | — | — | 1,013 |
| Stockholders' equity: | — | — | — | — | 33,187 |
| Total liabilities and stockholders' equity | \$ 153,329 | \$ 48,579 | \$ 43,475 | \$ 3,714 | \$ 390,370 |
| GAP | \$ (130,241) | \$ (41,949) | \$ 44,727 | \$ 247,591 | |
| Cumulative GAP | \$ (130,241) | \$ (172,190) | \$ (127,463) | \$ 120,128 | |
| Cumulative GAP as a % of total assets | -33.36 % | -44.11 % | -32.65 % | 30.77 % | |

The foregoing analysis assumes that the Company's assets and liabilities move with rates at their earliest repricing opportunities based on final maturity. Mortgage backed securities are assumed to mature during the period in which they are estimated to prepay and it is assumed that loans and other securities are not called prior to maturity. Certificates of deposit and IRA accounts are presumed to reprice at maturity. NOW savings accounts are assumed to reprice at within six months although it is the Company's experience that such accounts may be less sensitive to changes in market rates.

In addition to GAP analysis, the Bank utilizes a simulation model to quantify the effect a hypothetical immediate plus or minus 200 basis point change in rates would have on net interest income and the economic value of equity. The model takes into consideration the effect of call features of investments as well as prepayments of loans in periods of declining rates. When actual changes in interest rates occur, the changes in interest earning assets and interest bearing liabilities may differ from the assumptions used in the model. As of March 31, 2018, the model produced the

following sensitivity profile for net interest income and the economic value of equity.

| | Static Balance Sheet/Immediate Change in Rates | | | |
|---|--|----------|----------|----------|
| | `-200 bp | `-100 bp | `+100 bp | `+200 bp |
| Estimated Changes in Net Interest Income Policy Limit | (4) % | (3) % | (3) % | (4) % |
| March 31, 2018 | (16) % | (7) % | 3 % | 5 % |
| March 31, 2017 | (17) % | (8) % | 5 % | 10 % |

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As shown above, measures of net interest income at risk were slightly more favorable at March 31, 2018 than at March 31, 2017 over a 12-month modeling period. All measures remained within prescribed policy limits. The primary contributor to the less favorable position was the less asset sensitive balance sheet.

The measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The difference between these discounted values of the assets and liabilities is the economic value of equity, which, in theory, approximates the fair value of the Company's net assets.

| Estimated Changes in Economic Value of Equity (EVE) | Static Balance Sheet/Immediate Change in Rates | | | |
|---|--|----------|----------|----------|
| | `-200 bp | `-100 bp | `+100 bp | `+200 bp |
| Policy Limit | (15)% | (10)% | (10)% | (15)% |
| March 31, 2018 | (3) % | (2) % | (7) % | (17)% |
| March 31, 2017 | (16)% | (2) % | 0 % | (8) % |

The EVE at risk declined slightly at March 31, 2018 when compared to March 31, 2017 in all interest rate shock levels. The Company's economic value of equity has a negative effect in both an increased and decreased interest rate environment because the liabilities reprice much slower than our assets, and our interest earning assets are much greater than our interest bearing liabilities. The Company's economic value of equity worsens in declining interest rate environments as the majority of our liabilities cannot continue to decrease from their current levels thus the economic value of our liabilities and our assets both worsen in a declining rate environment i.e., given the current rate environment, down shocks may not be meaningful as market rates can only be shocked down to zero.

Inasmuch as a large portion of the Company's deposits are non-interest bearing, in an increasing interest rate environment the Company's interest income increases at a proportionally greater rate than its total interest expense, thereby resulting in higher net interest income. Conversely, in a declining interest rate environment the decreases in the Company's interest income will be greater than decreases in its already low interest expense, thereby resulting in lower net interest income. In a rising interest rate environment, the Company is positioned to generate less economic value of equity as asset values fall faster than funding sources because the liabilities reprice much slower than our assets, especially considering our interest earning assets are much greater than our interest bearing liabilities. The Company's economic value of equity worsens in declining interest rate environments as the majority of our liabilities cannot continue to decrease much from their current low levels thus the economic value of liabilities and assets both worsen.

LIQUIDITY AND CAPITAL RESOURCES

The Company currently has no business other than that of the Bank and does not currently have any material funding commitments. The Company's principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank's principal sources of funds for investments and operations are net income, deposits from its primary market area, principal and interest payments on loans, interest received on investment securities and proceeds from maturing investment securities. Its principal funding commitments are for the origination or purchase of loans and the payment

of maturing deposits. Deposits are considered a primary source of funds supporting the Bank's lending and investment activities.

The Bank's most liquid assets are cash and cash equivalents, which are cash on hand, amounts due from financial institutions, federal funds sold, certificates of deposit with other financial institutions that have an original maturity of six months or less and money market mutual funds. The levels of such assets are dependent on the Bank's operating, financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows. The Bank's cash and cash equivalents (cash due from banks, interest-bearing deposits in other financial institutions, and federal funds sold), as of March 31, 2018, totaled \$8.5 million, a decrease of \$4.1 million, or 32.34% from the December 31, 2017 total of \$12.6 million.

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As of March 31, 2018, the Bank was permitted to draw on a \$97.4 million line of credit from the FHLB of Atlanta. Borrowings under the line are secured by a floating lien on the Bank's residential mortgage loans. At December 31, 2017, there was \$20.0 million in short-term borrowings from FHLB. As of March 31, 2018, there were \$20.0 million in short-term advances outstanding with various monthly and quarterly call features. In addition, the Bank has two unsecured federal funds lines of credit in the amount of \$5.0 million and \$6.0 million, of which nothing was outstanding as of March 31, 2018.

The Company's stockholders' equity decreased \$855,000, or 2.51% during the three-months ended March 31, 2018, due to a decrease in accumulated other comprehensive loss, net of taxes and an increase in additional paid-in capital and retained earnings. The Company's accumulated other comprehensive loss, net of taxes decreased by \$868,000, or 137.52% from (\$631,000) at December 31, 2017 to (\$1.5) million at March 31, 2018, as a result of an increase in the market value loss of securities classified as available for sale and increase in the fair value of interest rate swap contracts. Retained earnings decreased by \$24,000, or 0.11% as the result of the Company's net income for the three months, offset by dividends on common stock outstanding.

The Federal Reserve Board and the FDIC have established guidelines with respect to the maintenance of appropriate levels of capital by bank holding companies and state non-member banks, respectively. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on our financial condition. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

In July 2015, federal bank regulatory agencies issued final results to revise their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act ("Basel III"). Effective January 1, 2015, the final rules required the Company and the Bank to comply with the following minimum capital ratios: (i) a common equity Tier 1 capital ratio of 4.5% of risk-weighted assets; (ii) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (iii) a total capital ratio of 8.0% of risk-weighted assets; and (iv) a leverage ratio of 4.0% of total assets. These are the initial capital requirements, which will be phased in over a four-year period. When fully phased in on January 1, 2019, the rules will require the Company and the Bank to maintain (i) a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% common equity Tier 1 ratio as that buffer is phased in, effectively resulting in a minimum ratio of common equity Tier 1 to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the 2.5% capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of total capital to risk-weighted assets of at least 8.0%, plus the 2.5% capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation), and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average assets.

The regulations impose two sets of capital adequacy requirements: minimum leverage rules, which require bank holding companies and banks to maintain a specified minimum ratio of capital to total assets, and risk-based capital rules, which require the maintenance of specified minimum ratios of capital to "risk-weighted" assets. At March 31,

2018, the Bank was in full compliance with these guidelines with a Tier 1 leverage ratio of 8.40%, a Tier 1 risk-based

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capital ratio of 12.73%, a common equity Tier 1 risk-based capital ratio of 12.73%, and a total risk-based capital ratio of 13.85%. The Company's capital amounts and ratios at March 31, 2018 and December 31, 2017 were as follows:

| March 31, 2018 | Actual | | Minimum capital adequacy | | To be well capitalized | |
|--|------------------------|---------|--------------------------|--------|------------------------|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (dollars in thousands) | | | | | |
| Common equity tier 1 (to risk-weighted assets) | \$ 33,132 | 12.73 % | \$ 11,712 | 4.50 % | \$ 16,917 | 6.50 % |
| Total capital (to risk weighted assets) | \$ 36,042 | 13.85 % | \$ 20,822 | 8.00 % | \$ 26,027 | 10.00 % |
| Tier 1 capital (to risk weighted assets) | \$ 33,132 | 12.73 % | \$ 15,616 | 6.00 % | \$ 20,822 | 8.00 % |
| Tier 1 leverage (to average assets) | \$ 33,126 | 8.40 % | \$ 15,774 | 4.00 % | \$ 19,718 | 5.00 % |

| December 31, 2017 | Actual | | Minimum capital adequacy | | To be well capitalized | |
|--|------------------------|---------|--------------------------|--------|------------------------|---------|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| | (dollars in thousands) | | | | | |
| Common equity tier 1 (to risk-weighted assets) | \$ 32,946 | 12.83 % | \$ 11,553 | 4.50 % | \$ 16,687 | 6.50 % |
| Total capital (to risk weighted assets) | \$ 35,543 | 13.84 % | \$ 20,538 | 8.00 % | \$ 25,673 | 10.00 % |
| Tier 1 capital (to risk weighted assets) | \$ 32,946 | 12.83 % | \$ 15,404 | 6.00 % | \$ 20,538 | 8.00 % |
| Tier 1 leverage (to average assets) | \$ 32,928 | 8.43 % | \$ 15,617 | 4.00 % | \$ 19,521 | 5.00 % |

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company's accounting policies are more fully described in its Annual Report on Form 10 K for the fiscal year ended December 31, 2017 and are essential to understanding Management's Discussion and Analysis of Financial Condition and Results of Operations. As discussed there, the preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and accompanying notes. Since future events and their effects cannot be determined with absolute certainty, the determination of estimates requires the exercise of judgment. Management has used the best information available to make the estimations necessary to value the related assets and liabilities based on historical experience and on various assumptions which are believed to be reasonable under the circumstances. Actual results could differ from those estimates, and such differences may be material to the financial statements. The Company reevaluates these variables as facts and circumstances change. Historically, actual results have not differed significantly from the Company's estimates. The following is a summary of the more judgmental accounting estimates and principles involved in the preparation of the Company's financial statements, including the identification of the variables most important in the estimation process:

Allowance for Credit Losses. The Bank's allowance for credit losses is determined based upon estimates that can and do change when the actual events occur, including historical losses as an indicator of future losses, fair market value of collateral, and various general or industry or geographic specific economic events. The use of these estimates and values is inherently subjective and the actual losses could be greater or less than the estimates. For further information regarding the Bank's allowance for credit losses, see "Allowance for Credit Losses", above.

Valuation of the Securities Portfolio. Securities are evaluated periodically to determine whether a decline in their value is other than temporary. The term "other than temporary" is not intended to indicate a permanent decline in value. Rather, it means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of an investment. We review other criteria such as magnitude and duration of the decline, as well as the reasons for the decline, to predict whether the loss in value is other than temporary. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Accrued Taxes. Management estimates income tax expense based on the amount it expects to owe various tax authorities. Accrued taxes represent the net estimated amount due or to be received from taxing authorities. In

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estimating accrued taxes, management assesses the relative merits and risks of the appropriate tax treatment of transactions taking into account statutory, judicial and regulatory guidance in the context of the Company's tax position.

Deferred Income Taxes. Deferred income taxes are recognized for temporary differences between the financial reporting basis and income tax basis of assets and liabilities based on enacted tax rates expected to be in effect when such amounts are realized or settled. Deferred tax assets are recognized only to the extent that it is more likely than not that such amount will be realized based on consideration of available evidence.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. To the extent that current available evidence about the future raises doubt about the likelihood of a deferred tax asset being realized, a valuation allowance is established. We recognize a tax position as a benefit only if it "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination presumed to occur. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The judgment about the level of future taxable income is inherently subjective and is reviewed on a continual basis as regulatory and business factors change.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is a "smaller reporting company" and, as such, disclosure pursuant to this Item 3 is not required.

ITEM 4. CONTROLS AND PROCEDURES

The Company maintains a system of disclosure controls and procedures that is designed to provide reasonable assurance that information, which is required to be disclosed by the Company in the reports that it files or submits under the Securities and Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and is accumulated and communicated to management in a timely manner. The Company's Chief Executive Officer and Chief Financial Officer have evaluated this system of disclosure controls and procedures as of the end of the period covered by this quarterly report, and have concluded that the system is effective. There have been no changes in the Company's internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, we are party to litigation arising from the banking, financial, and other activities we conduct. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising from these matters will have a material effect on the Company's financial condition, operating results, or liquidity.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

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ITEM 6.EXHIBITS

Exhibit

- No.
- 3.1 Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Amendment No. 1 to the Registrant's Form 8 - A filed December 27, 1999, File No. 0 - 24047)
- 3.2 Articles of Amendment, dated October 8, 2003 (incorporated by reference to Exhibit 3.2 to the Registrant's Quarterly Report on Form 10 - Q for the Quarter ended March 31, 2003, File No. 0 - 24047)
- 3.3 Articles Supplementary, dated November 16, 1999 (incorporated by reference to Exhibit 3.3 to the Registrant's Current Report on Form 8 - K filed December 8, 1999, File No. 0 - 24047)
- 3.4 By-Laws (incorporated by reference to Exhibit 3.4 to the Registrant's Quarterly Report on Form 10 - Q for the Quarter ended March 31, 2003, File No. 0 - 24047)
- 10.1 Glen Burnie Bancorp Director Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to Post-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S - 8, File No.33 - 62280)
- 10.2 The Bank of Glen Burnie Employee Stock Purchase Plan (incorporated by reference to Exhibit 99.1 to Post-Effective Amendment No. 1 to the Registrant's Registration Statement on Form S - 8, File No. 333 - 46943)
- 10.3 Amended and Restated Change-in-Control Severance Plan (incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10 - K for the Fiscal Year Ended December 31, 2001, File No. 0 - 24047)
- 31.1 Rule 15d - 14(a) Certification of Chief Executive Officer (furnished herewith)
- 31.2 Rule 15d - 14(a) Certification of Chief Financial Officer (furnished herewith)
- 32 Section 1350 Certifications: Certification by the Principal Executive Officer and Principal Accounting Officer of the periodic financial reports, required by Section 906 of the Sarbanes-Oxley Act of 2002 - furnished herewith
- 101 Interactive Data Files pursuant to Rule 405 of Regulation S-T (filed herewith)

