

**PREMARA FINANCIAL, INC. AND SUBSIDIARY**

***Report on Consolidated Financial Statements***

***Years Ended December 31, 2016 and 2015***

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# Premara Financial, Inc. and Subsidiary

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## INDEPENDENT AUDITOR'S REPORT

The Board of Directors  
Premara Financial, Inc. and Subsidiary

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Premara Financial, Inc. and Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, the related consolidated statements of income (loss), comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the "financial statements").

### Management's Responsibility for the Financial Statements

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

### Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Premara Financial, Inc. and Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Elliott Davis Decosimo, PLLC".

Charlotte, North Carolina  
March 27, 2017

**Premara Financial, Inc. and Subsidiary**  
**Consolidated Balance Sheets**  
**As of December 31, 2016 and 2015**

	2016	2015
<b>Assets:</b>		
Cash and cash equivalents:		
Cash and due from banks	\$ 3,222,428	\$ 2,993,233
Interest-bearing bank deposits	5,792,212	16,998,026
Total cash and cash equivalents	9,014,640	19,991,259
Time deposits with financial institutions	500,000	500,000
Securities available-for-sale	31,460,193	37,447,613
Securities held-to-maturity	1,250,000	1,250,000
Nonmarketable equity securities	1,744,493	1,255,367
Loans	200,782,266	176,719,915
Allowance for loan and lease losses	(2,138,155)	(2,292,862)
Loans, net	198,644,111	174,427,053
Premises and equipment, net	1,255,529	1,767,151
Deferred tax asset	2,857,861	2,728,301
Other real estate owned	-	54,119
Intangible assets	610,208	671,586
Bank owned life insurance	5,530,975	2,777,196
Accrued interest receivable	910,168	862,162
Other assets	1,262,532	773,057
Total assets	<b>\$ 255,040,710</b>	<b>\$ 244,504,864</b>
<b>Liabilities:</b>		
Deposits:		
Demand:		
Noninterest-bearing	\$ 48,181,492	\$ 49,035,819
Interest-bearing	20,413,683	20,129,000
Savings and money market	75,868,981	73,663,432
Time deposits, under \$250,000	57,468,248	58,825,372
Time deposits, \$250,000 and over	2,715,049	3,302,158
Total deposits	204,647,453	204,955,781
Federal Home Loan Bank advances	25,000,000	14,000,000
Accrued interest payable	53,073	43,517
Other liabilities	830,168	1,348,331
Total liabilities	230,530,694	220,347,629
Commitments and contingencies - Notes 18, 20 and 25		
<b>Stockholders' equity:</b>		
Preferred stock, \$0.01 par value; authorized 1,000,000 shares; no shares issued and outstanding	-	-
Common stock, \$0.01 par value; authorized 25,000,000 shares; 3,160,268 shares issued and outstanding	31,603	31,603
Additional paid in capital	23,556,468	23,537,438
Retained earnings	1,064,157	475,821
Accumulated other comprehensive income (loss)	(142,212)	112,373
Total stockholders' equity	24,510,016	24,157,235
Total liabilities and stockholders' equity	<b>\$ 255,040,710</b>	<b>\$ 244,504,864</b>

**See Notes to Consolidated Financial Statements**

**Premara Financial, Inc. and Subsidiary**  
**Consolidated Statements of Income (Loss)**  
**Years Ended December 31, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
<b>Interest income:</b>		
Loans, including fees	\$ 8,683,537	\$ 8,594,113
Securities	991,662	954,203
Other interest and dividend income	172,469	220,125
Total interest income	<u>9,847,668</u>	<u>9,768,441</u>
<b>Interest expense:</b>		
Time deposits, \$250,000 and over	29,941	35,151
Other deposits	1,178,476	985,717
Other borrowings	199,791	229,525
Total interest expense	<u>1,408,208</u>	<u>1,250,393</u>
Net interest income	8,439,460	8,518,048
Provision for loan losses	125,000	300,000
Net interest income after provision for loan losses	<u>8,314,460</u>	<u>8,218,048</u>
<b>Noninterest income:</b>		
Debit and ATM income	190,300	153,825
Bank owned life insurance	153,778	143,493
Mortgage broker fees	-	25,219
Mortgage banking income	-	32,688
Gain on sale of available-for-sale securities	15,371	-
Gain (loss) on sale of other real estate owned	(4,707)	324,854
Service charges and other income	588,792	328,190
Total noninterest income	<u>943,534</u>	<u>1,008,269</u>
<b>Noninterest expense:</b>		
Compensation and employee benefits	4,380,906	4,595,790
Occupancy	1,069,334	1,211,557
Furniture and equipment	357,148	449,838
Professional services	517,522	629,547
Data processing	573,420	593,317
Office supplies and printing	62,999	79,425
Software	210,474	206,295
Loss on sales and writedown of premises and equipment	87,903	363,408
Advertising and marketing	85,484	62,769
FDIC insurance premiums	205,587	204,500
Telecommunications	151,298	168,028
Debit and ATM fees	159,082	164,803
Other operating	777,434	1,502,856
Total noninterest expense	<u>8,638,591</u>	<u>10,232,133</u>
Income (loss) before income taxes	619,403	(1,005,816)
Income tax expense (benefit)	31,067	(589,645)
<b>Net income (loss)</b>	<b>588,336</b>	<b>(416,171)</b>
Preferred stock dividends	-	(59,608)
Net income (loss) available to common stockholders	<u>\$ 588,336</u>	<u>\$ (475,779)</u>
<b>Net income available per common share</b>		
Basic	\$ 0.19	\$ (0.21)
Diluted	<u>\$ 0.19</u>	<u>\$ (0.21)</u>
<b>Average common shares outstanding</b>		
Basic	<u>3,160,268</u>	<u>2,262,300</u>
Diluted	<u>3,170,898</u>	<u>2,264,760</u>

See Notes to Consolidated Financial Statements

**Premara Financial, Inc. and Subsidiary**  
**Consolidated Statements of Comprehensive Income (Loss)**  
**Years Ended December 31, 2016 and 2015**

	<b>2016</b>	<b>2015</b>
<b>Net income (loss)</b>	<u>\$ 588,336</u>	<u>\$ (416,171)</u>
<b>Other comprehensive income (loss):</b>		
Investment securities available-for-sale:		
Unrealized holding gains (losses)	(497,008)	112,688
Tax effect	185,495	(37,107)
Reclassification of gains recognized in net income	(15,371)	-
Tax effect	5,530	-
Net of tax amount	<u>(321,354)</u>	<u>75,581</u>
Hedging activities:		
Hedge effectiveness	105,380	(108,689)
Tax effect	(38,611)	37,813
Net of tax amount	<u>66,769</u>	<u>(70,876)</u>
<b>Other comprehensive income (loss), net of tax</b>	<u>(254,585)</u>	<u>4,705</u>
<b>Comprehensive income (loss)</b>	<u><u>\$ 333,752</u></u>	<u><u>\$ (411,466)</u></u>

*See Notes to Consolidated Financial Statements*

**Premara Financial, Inc. and Subsidiary**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**Years Ended December 31, 2016 and 2015**

	Preferred Stock		Common Stock		Additional paid-in Capital	Retained Earnings	Accumulated other comprehensive income (loss)	Total stockholders' equity
	Shares	Amount	Shares	Amount				
<b>Balance at December 31, 2014</b>	6,238	\$ 6,238,000	1,945,983	\$ 19,460	\$15,538,348	\$ 967,194	\$ 107,668	\$ 22,870,670
Common equity capital raise (net)	-	-	1,214,285	12,143	7,980,060	-	-	7,992,203
Redemption of preferred stock	(6,238)	(6,238,000)	-	-	-	-	-	(6,238,000)
Stock compensation expense	-	-	-	-	19,030	-	-	19,030
Dividend on preferred stock	-	-	-	-	-	(75,202)	-	(75,202)
Net loss	-	-	-	-	-	(416,171)	-	(416,171)
Other comprehensive income	-	-	-	-	-	-	4,705	4,705
<b>Balance at December 31, 2015</b>	-	-	3,160,268	31,603	23,537,438	475,821	112,373	24,157,235
Stock compensation expense	-	-	-	-	19,030	-	-	19,030
Net income	-	-	-	-	-	588,336	-	588,336
Other comprehensive loss	-	-	-	-	-	-	(254,585)	(254,585)
<b>Balance at December 31, 2016</b>	-	\$ -	3,160,268	\$ 31,603	\$ 23,556,468	\$ 1,064,157	\$ (142,212)	\$ 24,510,016

See Notes to Consolidated Financial Statements

# Premara Financial, Inc. and Subsidiary

## Consolidated Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 588,336	\$ (416,171)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	125,000	300,000
Depreciation and amortization	550,778	783,669
Discount accretion and premium amortization, net	172,226	135,233
Gain on sale of available-for-sale securities	(15,371)	-
Loss on sale and writedown of premises and equipment	87,903	363,408
Loss (gain) on sale of other real estate owned	4,707	(324,854)
Deferred income tax expense (benefit)	22,854	(593,214)
Intangible assets amortization	61,378	63,949
Stock compensation	19,030	19,030
Increase in bank owned life insurance	(153,779)	(143,493)
Originations of loans held for sale	-	(1,274,544)
Proceeds from the sale of loans held for sale	-	1,898,213
Gain on sale of loans held for sale	-	(32,688)
Increase in other assets	(489,475)	(348,311)
(Increase) decrease in accrued interest receivable	(48,006)	99,068
(Decrease) increase in other liabilities	(412,783)	207,116
Increase (decrease) in accrued interest payable	9,556	(838)
Net cash provided by operating activities	522,354	735,573
<b>Cash flows from investing activities:</b>		
Purchase of time deposits with financial institutions	-	(500,000)
Purchase of securities available-for-sale	(4,078,209)	(5,749,044)
Proceeds from sales, calls, prepayments and maturities of securities available-for-sale	9,396,395	1,141,325
Purchase of securities held-to-maturity	-	(1,250,000)
Purchase of nonmarketable equity securities	(842,200)	(50,000)
Sale of nonmarketable equity securities	353,074	102,121
Net decrease (increase) in loans	(24,342,058)	7,981,618
Purchase of premises and equipment	(132,559)	(53,624)
Proceeds from sale of premises and equipment	5,500	592,321
Proceeds from sale of other real estate owned	49,412	1,276,167
(Purchase) redemption of bank owned life insurance	(2,600,000)	2,675,197
Net cash provided by (used in) investing activities	(22,190,645)	6,166,081
<b>Cash flows from financing activities:</b>		
Net (decrease) increase in deposits	(308,328)	766,697
Federal Home Loan Bank advances , net	11,000,000	-
Common stock issued	-	7,992,203
Redemption of preferred stock	-	(6,238,000)
Dividend on preferred stock, net	-	(75,202)
Net cash provided by financing activities	10,691,672	2,445,698
Net increase (decrease) in cash and cash equivalents	(10,976,619)	9,347,352
Cash and cash equivalents, beginning of year	19,991,259	10,643,907
Cash and cash equivalents, end of year	\$ 9,014,640	\$ 19,991,259

See Notes to Consolidated Financial Statements



**Premara Financial, Inc. and Subsidiary**  
**Consolidated Statements of Cash Flows, continued**  
**Years Ended December 31, 2016 and 2015**

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	<b>2016</b>	<b>2015</b>
<b><i>Supplemental disclosures of cash flow information</i></b>		
Cash paid during the year for interest	\$ 1,398,652	\$ 1,251,231
Cash paid during the year for income taxes	\$ 7,000	\$ 21,200
<b><i>Supplemental schedule of noncash investing and financing activity</i></b>		
Change in unrealized loss on securities available-for-sale	\$ (512,379)	\$ 112,688
Change in hedge effectiveness	\$ (105,380)	\$ 108,689
Loans transferred to other real estate owned	\$ -	\$ 951,313

**See Notes to Consolidated Financial Statements**

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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

*Organization:*

Carolina Premier Bank (the “Bank”) was incorporated in North Carolina to serve as a state chartered commercial bank to provide banking services to customers located primarily in Charlotte, North Carolina and the surrounding areas. Carolina Premier Bank commenced business on August 29, 2007, and its deposits are insured by the Federal Deposit Insurance Corporation (FDIC). As a state chartered commercial bank, the Bank is subject to regulation by the Office of the North Carolina Commissioner of Banks and the Federal Deposit Insurance Corporation.

On May 10, 2011, the shareholders of Carolina Premier Bank approved a plan of corporate reorganization under which the Bank became a wholly-owned subsidiary of Premara Financial, Inc. (the “Company”), which was organized for that purpose by the Bank’s Board of Directors. The authorized common stock of Premara Financial, Inc. is 25,000,000 shares with \$.01 par value. Pursuant to the reorganization, the Company issued all shares of its common stock in exchange for all of the outstanding common shares of the Bank on May 24, 2011. The consolidated financial statements include the accounts of the parent company and its wholly owned subsidiary after elimination of all significant intercompany balances and transactions.

During 2015, the Company closed a secondary common stock offering in which it issued an additional 1,214,285 shares of common stock at a price of \$7.00 per share. The proceeds of the stock issuance amounted to \$8,499,995. Stock issuance costs totaling \$507,792 were netted from additional paid in capital. Net proceeds of \$6,238,000 were utilized to redeem 6,238 shares of preferred stock, previously issued to the Secretary of the Treasury (the “Treasury”) under the Small Business Lending Fund (SBLF).

On December 18, 2015, the Company closed the full service branch located in the Blakeney area of Charlotte. The branch was located in close proximity to the Company’s primary location and headquarters in the Ballantyne area. The closure of the branch will lower operating costs without limiting access to the financial and banking services needed by customers. The Company will continue to use the space for bank operations until the lease expires in early 2017.

As part of a strategic repositioning and a refocus on the Carolinas, the Company closed its Washington, D.C. branch on December 31, 2015. The fixed assets of the branch were sold and the facility was subleased to another financial institution with a strong market presence in the greater Washington, D.C. area. The expiration of the new sublease coincides with the expiration of the primary lease on the facility. Losses associated with the transaction of approximately \$474,000 were recognized during 2015.

Effective March 30, 2017, the Company will close the branch located in, and associated with, the Urban League of the Central Carolinas. As a result of the decision to close the branch, a write down of \$90,000 on the fixed assets was recognized as of December 31, 2016.

*Management’s estimates:*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Management's estimates (continued):*

A material estimate that is particularly susceptible to significant change is the determination of the allowance for losses on loans, including valuation allowances for impaired loans. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

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

*Concentrations of credit risk:*

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

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

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g., principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. For example, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully amortized (i.e., balloon payment loans). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

The Company's investment portfolio consists of obligations of the United States, its agencies or its corporations, municipalities and other revenue entities. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Generally however, excess balances are placed on deposit with the Federal Reserve, via a pass through relationship with the correspondent. Management believes credit risk associated with correspondent accounts is not significant.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Cash and cash equivalents:*

For purposes of reporting cash flows in the consolidated financial statements, the Company considers certain highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, interest-bearing bank deposits, deposits held on behalf of the Federal Reserve, and federal funds sold. Generally, federal funds are sold for one-day periods.

*Securities available-for-sale:*

Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in stockholders' equity net of deferred income taxes. Management does not actively trade securities classified as available-for-sale but intends to hold these securities for an indefinite period of time and may sell them prior to maturity to achieve certain objectives. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of securities available-for-sale is determined by specific identification and is used in computing the gain or loss from a sales transaction.

*Securities held-to-maturity:*

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Premiums and discounts are amortized using the interest method over the securities' contractual lives.

Declines in the fair value of individual securities classified as either held-to-maturity or available-for-sale below their amortized cost that are determined to be other-than-temporary result in write-downs of the individual securities to their fair value with the resulting write-downs included in operations as realized losses. In estimating other-than-temporary impairment, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Bank to retain its investment in the issuer for a period of time sufficient to allow for an anticipated recovery in fair value.

*Nonmarketable equity securities:*

Nonmarketable equity securities consist of restricted securities, which are carried at cost. Management periodically evaluates these securities for impairment, with any appropriate downward valuation adjustments being made when necessary.

*Derivatives and financial instruments:*

A derivative is a financial instrument that derives its cash flows, and therefore its value, by reference to an underlying instrument, index or referenced interest rate. The Company uses derivatives primarily to manage interest rate risk in the investment portfolio as it relates to earnings and market value. The fair value of derivatives in a gain or loss position is included in other assets or liabilities, respectively, on the consolidated balance sheets. The Company classifies its derivative financial instruments as a hedge of an exposure to changes in the fair value of a recorded asset or liability. The Company has master netting agreements with the derivatives dealers with which it does business, but reflects gross gains and losses on the consolidated statements of income.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Derivatives and financial instruments (continued):*

The Company uses the long-haul method to assess hedge effectiveness. The Company documents, both at inception and over the life of the hedge, at least quarterly, its analysis of actual and expected hedge effectiveness. This analysis is performed using a regression analysis to demonstrate that the hedge has been, and is expected to be, highly effective in off-setting corresponding changes in the fair value of the hedged item. For a qualifying fair value hedge, changes in the value of the derivatives that have been highly effective as hedges are recognized in current period earnings along with the corresponding changes in the fair value of the designated hedged item attributable to the risk being hedged.

For fair value hedges, the ineffectiveness may be recognized in noninterest income to the extent that changes in the value of the derivative instruments do not perfectly offset changes in the value of the hedged items attributable to the risk being hedged. If the hedge ceases to be highly effective, the Company discontinues hedge accounting and recognizes the changes in fair value in current period earnings. If a derivative that qualifies as a fair value hedge is terminated or the designation removed, the realized or then unrealized gain or loss is recognized into income over the original hedge period. Immediate recognition in earnings is required upon sale or extinguishment of the hedged item.

See Note 6 for additional information related to derivatives and financial instruments.

*Loans receivable:*

Loans are stated at their unpaid principal balance. Interest income is computed using the simple interest method and is recorded in the period earned. When serious doubt exists as to the collectability of a loan or when a loan becomes contractually 90 days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest, or other conditions exist that warrant the continued accrual of interest. When interest accruals are discontinued, income earned but not collected is reversed and interest accrued in prior years is charged to the allowance for loan losses.

Impairment of a loan is measured either by the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral securing loan. If a loan is deemed to be collateral dependent, then the fair value of the collateral method is always used. When management determines that a loan is impaired, the difference between the Company's investment in the related loan and the present value of the expected future cash flows or the fair value of the collateral, is provisioned for in the allowance for loan losses. The accrual of interest is generally discontinued on an impaired loan when management determines that the borrower is unable to meet payments as they become due.

The Company identifies impaired loans through its normal internal loan review processes. Loans on the Company's classified loan list are considered potential problem loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected. Accrued interest through the date of impairment is reversed. Subsequent interest earned is recognized only to the point that cash payments are received. All payments are applied to principal if the entire amount of principal is not expected to be collected.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Loans receivable (continued):*

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized as an adjustment of the related loan yields. Generally, these amounts are amortized over the contractual life of the related loans or commitments.

*Allowance for loan losses:*

An allowance for loan losses is maintained at a level deemed appropriate by management, and in accordance with generally accepted accounting principles (GAAP), to provide adequately for known and inherent losses in the loan portfolio. Loans or portions of loans that are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries of loans previously charged off are added to the allowance.

Loans are required to be presented at the lower of cost or market value if it is probable that the lender will be unable to collect all amounts due according to the terms of the loan agreement. Fair value may be determined based upon the present value of expected cash flows, market price of the loan, if available, or value of the underlying collateral. Expected cash flows are required to be discounted at the loan's effective interest rate.

When the ultimate collectability of an impaired loan's principal is in doubt, wholly or partially, cash receipts are applied to principal. Once the reported principal balance has been reduced to the loan's estimated net realized value, future cash receipts may be applied to interest income, to the extent that any interest has been foregone. Further cash receipts are recorded as recoveries of any amounts previously charged off. When this doubt does not exist, cash receipts are applied under the contractual terms of the loan agreement first to interest income then to principal.

A loan is also considered impaired if its terms are modified in a troubled debt restructuring. For these accruing impaired loans, cash receipts are typically applied to principal and interest receivable in accordance with the terms of the restructured loan agreement. Interest income is recognized on these loans using the accrual method of accounting.

*Premises and equipment:*

Premises and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 15 to 39 years, furniture and equipment of 3 to 10 years, and software of 3 years. Leasehold improvements are amortized over the life of the respective lease. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the statement of income when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized.

*Other real estate owned:*

Real estate properties acquired through or in lieu of loan foreclosure are initially recorded at the fair value less estimated selling cost at the date of foreclosure. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management, and any subsequent write-downs are recorded as a charge to operations, if necessary, to reduce the carrying value of a property to the lower of its cost or fair value less cost to sell. Costs of significant property improvements are capitalized, whereas costs relating to holding property are expensed.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Intangible assets:*

Intangible assets include goodwill and core deposit intangibles. Goodwill represents the cost in excess of fair value of net assets acquired (including identifiable intangibles) in purchase transactions. Core deposit intangibles represent premiums paid for acquisitions of core deposits. Core deposit intangibles are being amortized over a 10-year period based on amortization schedules prepared by an outside consultant. Goodwill and identifiable intangible assets are reviewed for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. The Company's evaluation considers various components, to include economic conditions, industry considerations, financial performance as well as other information. No impairment losses have been recorded as a result of the Company's analysis during the year ended December 31, 2016.

*Bank owned life insurance:*

Bank owned life insurance represents the cash surrender value of policies on certain officers and directors of the Company.

*Income taxes:*

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

The Company's accounting policy relative to uncertain tax positions is to recognize a liability when likelihood of an uncertain tax position being sustained upon examination by the taxing authorities is less than 50 percent.

*Advertising expense:*

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent. Advertising and public relations costs of \$85,484 and \$62,769 were included in the Company's results of operations for 2016 and 2015, respectively.

*Per share data:*

Basic income per share is computed by dividing net income by the weighted-average number of shares outstanding for the period excluding the effects of any dilutive potential common shares. Diluted income per share is similar to the computation of basic income per share except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Comprehensive income:*

Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. In addition, a separate Statement of Comprehensive Income is presented.

*Off-balance-sheet financial instruments:*

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

*Risks and uncertainties:*

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

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

*Recent accounting pronouncements:*

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

In May 2014, the Financial Accounting Standards Board (FASB) issued guidance to change the recognition of revenue from contracts with customers. The core principle of the new guidance is that an entity should recognize revenue to reflect the transfer of goods and services to customers in an amount equal to the consideration the entity receives or expects to receive. In August 2015, the FASB deferred the effective date of ASU 2014-09, Revenue from Contracts with Customers. As a result of the deferral, the guidance in ASU 2014-09 will be effective for the Company for reporting periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Company will apply the guidance using a modified retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.



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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 1. Summary of Significant Accounting Policies, Continued**

*Recent accounting pronouncements (continued):*

In January 2016, the FASB amended the Financial Instruments topic of the Accounting Standards Codification to address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. The amendments will be effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. The Company will apply the guidance by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. The amendments related to equity securities without readily determinable fair values will be applied prospectively to equity investments that exist as of the date of adoption of the amendments. The Company does not expect these amendments to have a material effect on its financial statements.

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

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

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

In November 2016, the FASB amended the Statement of Cash Flows topic of the Accounting Standards Codification to clarify how restricted cash is presented and classified in the statement of cash flows. The amendments will be effective for the Company for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In December 2016, the FASB issued technical corrections and improvements to the Revenue from Contracts with Customers Topic. These corrections make a limited number of revisions to several pieces of the revenue recognition standard issued in 2014. The effective date and transition requirements for the technical corrections will be effective for the Company for annual periods beginning after December 15, 2018, and interim periods within annual reporting periods beginning after December 15, 2019. The Company will apply the guidance using a full retrospective approach. The Company does not expect these amendments to have a material effect on its financial statements.

**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 1. Summary of Significant Accounting Policies, Continued**

Reclassifications:

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

**Note 2. Accumulated Other Comprehensive Income**

Comprehensive income includes net income and all other changes to the Company's equity, with the exception of transactions with stockholders. The Company's other comprehensive income and accumulated other comprehensive income are comprised of unrealized gains and losses on certain investments in debt securities and hedging activities. The accumulated balances related to each component of other comprehensive income (loss) are as follows:

	Unrealized Gain/(Loss) on Available- for-Sale Securities	Hedging Activities	Total
<b>Balance as of December 31, 2014</b>	\$ 241,338	\$ (133,670)	\$ 107,668
Other comprehensive income before reclassifications	75,581	(70,876)	4,705
Net current period other comprehensive income	75,581	(70,876)	4,705
<b>Balance as of December 31, 2015</b>	<b>\$ 316,919</b>	<b>\$ (204,546)</b>	<b>\$ 112,373</b>
<b>Balance as of December 31, 2015</b>	\$ 316,919	\$ (204,546)	\$ 112,373
Other comprehensive income before reclassifications	(311,513)	66,769	(244,744)
Amounts reclassified from accumulated other comprehensive income	(9,841)	-	(9,841)
Net current period other comprehensive income	(321,354)	66,769	(254,585)
<b>Balance as of December 31, 2016</b>	<b>\$ (4,435)</b>	<b>\$ (137,777)</b>	<b>\$ (142,212)</b>

**Note 3. Restrictions on Cash and Due from Banks**

The Company is required by regulation to maintain an average cash reserve balance based on a percentage of deposits. The average amount of the required cash reserve balances at December 31, 2016 and 2015 was approximately \$1,524,000 and \$1,620,000, respectively.

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 4. Securities

The amortized cost and estimated fair values of securities available-for-sale at December 31, 2016 and 2015 were:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>2016</b>				
Collateralized mortgage obligations	\$ 560,937	\$ -	\$ 2,623	\$ 558,314
Mortgage-backed securities	7,188,775	702	122,632	7,066,845
Municipal bonds - nontaxable	16,178,268	129,351	76,089	16,231,530
Municipal bonds - taxable	4,524,437	89,420	32,599	4,581,258
Other securities	3,014,702	20,990	13,446	3,022,246
	<b>\$ 31,467,119</b>	<b>\$ 240,463</b>	<b>\$ 247,389</b>	<b>\$ 31,460,193</b>
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>2015</b>				
U.S. government agencies	\$ 1,000,000	\$ -	\$ 13,886	\$ 986,114
Collateralized mortgage obligations	746,368	-	10,981	735,387
Mortgage-backed securities	5,070,006	17,678	45,015	5,042,669
Municipal bonds - nontaxable	21,843,171	456,106	44,790	22,254,487
Municipal bonds - taxable	5,536,857	148,838	52,321	5,633,374
Other securities	2,745,759	52,027	2,204	2,795,582
	<b>\$ 36,942,161</b>	<b>\$ 674,649</b>	<b>\$ 169,197</b>	<b>\$ 37,447,613</b>

The amortized cost and estimated fair values of securities held-to-maturity as of December 31, 2016 and 2015 were:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>2016</b>				
Other securities	\$ 1,250,000	\$ 34,155	\$ -	\$ 1,284,155
	<b>\$ 1,250,000</b>	<b>\$ 34,155</b>	<b>\$ -</b>	<b>\$ 1,284,155</b>
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
<b>2015</b>				
Other securities	\$ 1,250,000	\$ 7,500	\$ -	\$ 1,257,500
	<b>\$ 1,250,000</b>	<b>\$ 7,500</b>	<b>\$ -</b>	<b>\$ 1,257,500</b>

The amortized costs and fair values of investment securities available-for-sale at December 31, 2016, by contractual maturity, are shown in the following chart. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 4. Securities, Continued

	Amortized Cost	Fair Value
Due one year or less	\$ 2,123,050	\$ 2,098,433
Due after one year through five years	7,677,916	7,690,967
Due after five years through ten years	15,644,383	15,621,988
Due after ten years	6,021,770	6,048,805
Total available-for-sale securities	<b>\$ 31,467,119</b>	<b>\$ 31,460,193</b>

The amortized costs and fair values of investment securities held-to-maturity at December 31, 2016, by contractual maturity, are shown in the following chart. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due one year or less	\$ -	\$ -
Due after one year through five years	-	-
Due after five years through ten years	1,250,000	1,284,155
Due after ten years	-	-
Total held-to-maturity securities	<b>\$ 1,250,000</b>	<b>\$ 1,284,155</b>

Proceeds from the sale of securities available-for-sale during 2016 were \$6,493,944. In 2016, gross gains were \$29,545 and gross losses were \$14,174. There was no sale of securities available-for-sale during 2015.

The following table presents available-for-sale securities, gross unrealized losses and related fair values, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position as of December 31, 2016 and 2015:

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2016</b>						
Collateralized mortgage obligations	\$ 558,314	\$ (2,623)	\$ -	\$ -	\$ 558,314	\$ (2,623)
Mortgage-backed securities	7,014,889	(122,632)	-	-	7,014,889	(122,632)
Municipal bonds-non-taxable	6,117,121	(76,089)	-	-	6,117,121	(76,089)
Municipal bonds-taxable	367,312	(3,034)	385,593	(29,565)	752,905	(32,599)
Other securities	2,261,994	(13,446)	-	-	2,261,994	(13,446)
<b>Total</b>	<b>\$ 16,319,630</b>	<b>\$ (217,824)</b>	<b>\$ 385,593</b>	<b>\$ (29,565)</b>	<b>\$ 16,705,223</b>	<b>\$ (247,389)</b>

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 4. Securities, Continued

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
<b>December 31, 2015</b>						
U.S. government agencies	\$ 986,114	\$ 13,886	\$ -	\$ -	\$ 986,114	\$ 13,886
Collateralized mortgage obligations	735,387	10,981	-	-	735,387	10,981
Mortgage-backed securities	4,309,047	45,015	-	-	4,309,047	45,015
Municipal bonds-non-taxable	1,685,619	10,422	1,635,863	34,368	3,321,482	44,790
Municipal bonds-taxable	1,785,216	32,054	396,603	20,267	2,181,819	52,321
Other securities	186,981	2,204	-	-	186,981	2,204
<b>Total</b>	<b>\$ 9,688,364</b>	<b>\$ 114,562</b>	<b>\$ 2,032,466</b>	<b>\$ 54,635</b>	<b>\$ 11,750,830</b>	<b>\$ 169,197</b>

There were no held-to-maturity securities in an unrealized loss position as of December 31, 2016.

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

The amortized cost of the investment securities pledged at December 31, 2016 and 2015 was \$3,072,908 and \$1,539,696, respectively, and fair values were \$3,115,445 and \$1,533,662, respectively.

#### Note 5. Nonmarketable Equity Securities

The Company, as a member of the Federal Home Loan Bank of Atlanta (FHLB), is required to own capital stock in this organization. The amount of FHLB stock owned is determined based on the Company's total assets and advances from the FHLB and totaled \$1,282,400 and \$847,400 at December 31, 2016 and 2015, respectively. No ready market exists for this stock and it has no quoted market value. However, redemption of this stock has historically been at par value, and as such the carrying amount is deemed to be a reasonable estimate of fair value.

The Company also had an investment in Plexus Fund II and Plexus Fund III; both are a Small Business Investment Company (SBIC), which had a combined investment total of \$462,093 and \$417,667 at December 31, 2016 and 2015, respectively. The purpose of the funds is to invest in small businesses to promote the growth, expansion and modernization of the sector, by working in partnership with the Small Business Administration (SBA) as a source of additional funding. This investment is carried at par, but is tested annually for impairment.

#### Note 6. Derivatives and Financial Instruments

The Company utilizes derivative financial instruments primarily to hedge its exposure to changes in interest rates. All derivative financial instruments are recorded on the balance sheet at their respective fair values. The Company does not use financial instruments or derivatives for any trading or other speculative purposes.

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 6. Derivatives and Financial Instruments, Continued

Accounting guidance requires an entity to recognize all derivatives as either assets or liabilities in the balance sheet, and measure those instruments at fair value. Changes in the fair value of those derivatives are reported in current earnings or other comprehensive income depending on the purpose for which the derivative is held and whether the derivative qualifies for hedge accounting.

During 2014, the Company entered into interest rate swap agreements for a portion of the municipal bond portfolio. The notional amount of the transaction was \$9,700,000, and the purpose was to mitigate the price volatility associated with carrying long term fixed rate investments.

The tables below provide data about the fair value of the Company's derivatives included in the consolidated balance sheets:

	<b>2016</b>	<b>2015</b>
Interest rate swap liability	\$ 208,748	\$ 318,969
	<b>2016</b>	<b>2015</b>
Effective portion recorded in Other Comprehensive Income, net of income taxes	\$ (137,777)	\$ (204,546)

#### Note 7. Loans Receivable

Major classifications of loans receivable are summarized as follows:

	<b>December 31,</b>	
	<b>2016</b>	<b>2015</b>
Residential real estate	\$ 62,935,278	\$ 58,782,704
Commercial real estate	89,211,374	77,046,974
Construction and land	19,456,283	14,370,544
Commercial and industrial	28,414,988	25,424,154
Consumer and other	672,064	868,360
Total gross loans	200,689,987	176,492,736
Less: deferred loan fees (costs)	(92,279)	(227,179)
Less: allowance for loan losses	2,138,155	2,292,862
Total loans, net	<b>\$ 198,644,111</b>	<b>\$ 174,427,053</b>

**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 7. Loans Receivable, Continued**

The following tables present activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2016 and 2015:

<b>December 31, 2016</b>	<b>Residential Real Estate</b>	<b>Commercial Real Estate</b>	<b>Construction and Land</b>	<b>Commercial and Industrial</b>	<b>Consumer and Other</b>	<b>Total</b>
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 714,231	\$ 831,678	\$ 128,988	\$ 569,003	\$ 48,962	\$ 2,292,862
Charge-offs	(56,632)	(1,744)	-	(318,323)	(13,210)	(389,909)
Recoveries	37,975	1,744	-	-	70,483	110,202
Provisions	(104,975)	176,422	9,918	128,872	(85,237)	125,000
Ending balance	<u>\$ 590,599</u>	<u>\$ 1,008,100</u>	<u>\$ 138,906</u>	<u>\$ 379,552</u>	<u>\$ 20,998</u>	<u>\$ 2,138,155</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ 51,171</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 48,988</u>	<u>\$ -</u>	<u>\$ 100,159</u>
Collectively evaluated for impairment	<u>\$ 539,428</u>	<u>\$ 1,008,100</u>	<u>\$ 138,906</u>	<u>\$ 330,564</u>	<u>\$ 20,998</u>	<u>\$ 2,037,996</u>
<b>Loans receivable:</b>						
Ending balance - total	<u>\$ 62,935,278</u>	<u>\$ 89,211,374</u>	<u>\$ 19,456,283</u>	<u>\$ 28,414,988</u>	<u>\$ 672,064</u>	<u>\$ 200,689,987</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ 1,685,664</u>	<u>\$ -</u>	<u>\$ 701,247</u>	<u>\$ 1,666,185</u>	<u>\$ -</u>	<u>\$ 4,053,096</u>
Collectively evaluated for impairment	<u>\$ 61,249,614</u>	<u>\$ 89,211,374</u>	<u>\$ 18,755,036</u>	<u>\$ 24,748,803</u>	<u>\$ 672,064</u>	<u>\$ 196,636,891</u>
<b>December 31, 2015</b>	<b>Residential Real Estate</b>	<b>Commercial Real Estate</b>	<b>Construction and Land</b>	<b>Commercial and Industrial</b>	<b>Consumer and Other</b>	<b>Total</b>
<b>Allowance for loan losses:</b>						
Beginning balance	\$ 769,399	\$ 1,148,864	\$ 152,134	\$ 224,097	\$ 7,278	\$ 2,301,772
Charge-offs	(34,902)	(251,579)	-	(25,610)	(235)	(312,326)
Recoveries	2,975	-	-	-	440	3,415
Provisions	(23,241)	(65,607)	(23,146)	370,516	41,479	300,001
Ending balance	<u>\$ 714,231</u>	<u>\$ 831,678</u>	<u>\$ 128,988</u>	<u>\$ 569,003</u>	<u>\$ 48,962</u>	<u>\$ 2,292,862</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ 230,345</u>	<u>\$ 67,472</u>	<u>\$ -</u>	<u>\$ 372,527</u>	<u>\$ -</u>	<u>\$ 670,344</u>
Collectively evaluated for impairment	<u>\$ 483,886</u>	<u>\$ 764,206</u>	<u>\$ 128,988</u>	<u>\$ 196,476</u>	<u>\$ 48,962</u>	<u>\$ 1,622,518</u>
<b>Loans receivable:</b>						
Ending balance - total	<u>\$ 58,782,704</u>	<u>\$ 77,046,974</u>	<u>\$ 14,370,544</u>	<u>\$ 25,424,154</u>	<u>\$ 868,360</u>	<u>\$ 176,492,736</u>
Ending balances:						
Individually evaluated for impairment	<u>\$ 1,817,952</u>	<u>\$ 1,670,333</u>	<u>\$ 1,738,305</u>	<u>\$ 737,511</u>	<u>\$ -</u>	<u>\$ 5,964,101</u>
Collectively evaluated for impairment	<u>\$ 56,964,752</u>	<u>\$ 75,376,641</u>	<u>\$ 12,632,239</u>	<u>\$ 24,686,643</u>	<u>\$ 868,360</u>	<u>\$ 170,528,635</u>

The credit quality indicators presented for all classes within the loan portfolio is a widely used and standard system representing the degree of risk of nonpayment. The risk-grade categories presented in the following table are:

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

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 7. Loans Receivable, Continued

**Special mention** – These credit facilities have potential developing weaknesses that deserve extra attention from the loan officer, and other management personnel. If the loan officer cannot correct or mitigate the developing weakness, there may be deterioration in the ability of the borrower to repay the bank's debt in the future. Loan officers should not assign this grade to loans that bear certain peculiar risks normally associated with the types of financing involved, unless circumstances have caused the risk to increase to a level higher than would have been acceptable when the credit was originally approved. Loan officers should generally grade loans where actual, not potential, weaknesses or problems are clearly evident and significant in one of the categories below.

**Substandard** – This category includes loans possessing weaknesses that jeopardize the ultimate collection of principal and interest outstanding. These loans are inadequately protected by the sound worth and paying capacity of the borrower or of the pledged collateral, if any. The weaknesses require close supervision by bank management. Loss may not be evident; however, current financials or pledged collateral inadequately protect the loan. Borrowers in this category have well-defined weaknesses that jeopardize the proper liquidation of the debt. They may also have adverse trends, unless improved, that will likely result in repayment over an excessive period of time, or possibly not at all. Weaknesses that exist may indicate the indebtedness may not be current or may not in the future be repaid according to previously agreed upon terms. If loans are current, future performance may be in question. All non-accrual loans shall be graded substandard or doubtful.

**Doubtful** – Loans or portions of loans in this category have one or more weaknesses, which, on the basis of currently existing facts, conditions, and values, make ultimate collection of all principal highly questionable. The possibility of loss is extremely high, and management should make specific loan loss reserve allocations. However, management does not know the amount with certainty of eventual loss because of specific pending factors. Pending factors include: litigation, proposed merger or acquisition or liquidation in progress, injection of new capital in progress or refinancing plans in progress, and pending factors still pending after 18 months must be disregarded and the loan downgraded appropriately.

The following tables present loan balances by credit quality indicator as of December 31, 2016 and 2015:

December 31, 2016	Residential Real Estate	Commercial Real Estate	Construction and Land	Commercial and Industrial	Consumer and Other	Total
Grade:						
Pass	\$61,026,702	\$88,038,763	\$19,456,283	\$ 23,281,579	\$ 672,064	\$ 192,475,391
Special Mention	385,093	1,172,611	-	2,541,207	-	4,098,911
Substandard	1,523,483	-	-	2,592,202	-	4,115,685
Doubtful	-	-	-	-	-	-
Ending balance	<u>\$62,935,278</u>	<u>\$89,211,374</u>	<u>\$19,456,283</u>	<u>\$ 28,414,988</u>	<u>\$ 672,064</u>	<u>\$ 200,689,987</u>

  

December 31, 2015	Residential Real Estate	Commercial Real Estate	Construction and Land	Commercial and Industrial	Consumer and Other	Total
Grade:						
Pass	\$57,307,642	\$73,036,597	\$13,342,680	\$ 21,040,880	\$ 868,360	\$ 165,596,159
Special Mention	758,114	2,340,045	-	2,623,706	-	5,721,865
Substandard	716,948	1,670,332	1,027,864	1,759,568	-	5,174,712
Doubtful	-	-	-	-	-	-
Ending balance	<u>\$58,782,704</u>	<u>\$77,046,974</u>	<u>\$14,370,544</u>	<u>\$ 25,424,154</u>	<u>\$ 868,360</u>	<u>\$ 176,492,736</u>



**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 7. Loans Receivable, Continued**

The following tables present an aging analysis of loans as of December 31, 2016 and 2015:

<b>December 31, 2016</b>	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>Greater Than 90 Days</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Loans Receivable</b>	<b>Recorded Investments 90 Days and Accruing</b>
Residential real estate	\$ 121,678	\$ -	\$ 964,051	\$ 1,085,729	\$ 61,849,549	\$ 62,935,278	\$ 47,416
Commercial real estate	275,668	183,955	988,656	1,448,279	87,763,095	89,211,374	988,656
Construction and land	-	-	-	-	19,456,283	19,456,283	-
Commercial and industrial	1,154,375	1,345,853	268,066	2,768,294	25,646,694	28,414,988	-
Consumer and other	708	-	25,000	25,708	646,356	672,064	25,000
<b>Total</b>	<b>\$ 1,552,429</b>	<b>\$ 1,529,808</b>	<b>\$ 2,245,773</b>	<b>\$ 5,328,010</b>	<b>\$ 195,361,977</b>	<b>\$200,689,987</b>	<b>\$ 1,061,072</b>

  

<b>December 31, 2015</b>	<b>30-59 Days Past Due</b>	<b>60-89 Days Past Due</b>	<b>Greater Than 90 Days</b>	<b>Total Past Due</b>	<b>Current</b>	<b>Total Loans Receivable</b>	<b>Recorded Investments 90 Days and Accruing</b>
Residential real estate	\$ 684,002	\$ 49,837	\$ 334,232	\$ 1,068,071	\$ 57,714,633	\$ 58,782,704	\$ -
Commercial real estate	-	-	796,660	796,660	76,250,314	77,046,974	-
Construction and land	-	-	-	-	14,370,544	14,370,544	-
Commercial and industrial	1,094,032	1,303,829	703,968	3,101,829	22,322,325	25,424,154	-
Consumer and other	-	-	-	-	868,360	868,360	-
<b>Total</b>	<b>\$ 1,778,034</b>	<b>\$ 1,353,666</b>	<b>\$ 1,834,860</b>	<b>\$ 4,966,560</b>	<b>\$ 171,526,176</b>	<b>\$176,492,736</b>	<b>\$ -</b>

The following tables present information on impaired loans as of December 31, 2016 and 2015:

<b>December 31, 2016</b>	<b>Recorded Investment</b>	<b>Unpaid Principal Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>
With no related allowance recorded:					
Residential real estate	\$ 963,293	\$ 1,148,104	\$ -	\$ 876,353	\$ 12,058
Commercial real estate	-	1,843	-	791,725	-
Construction and land	701,247	701,247	-	1,347,372	43,154
Commercial and industrial	797,669	890,691	-	902,464	35,199
Consumer and other	-	-	-	-	-
	<u>2,462,209</u>	<u>2,741,885</u>	<u>-</u>	<u>3,917,914</u>	<u>90,411</u>
With related allowance recorded:					
Residential real estate	722,371	874,885	51,171	771,171	-
Commercial real estate	-	-	-	100,655	-
Construction and land	-	-	-	-	-
Commercial and industrial	868,516	895,252	48,988	690,288	34,257
Consumer and other	-	-	-	-	-
	<u>1,590,887</u>	<u>1,770,137</u>	<u>100,159</u>	<u>1,562,114</u>	<u>34,257</u>
Total:					
Residential real estate	1,685,664	2,022,989	51,171	1,647,524	12,058
Commercial real estate	-	1,843	-	892,380	-
Construction and land	701,247	701,247	-	1,347,372	43,154
Commercial and industrial	1,666,185	1,785,933	48,988	1,592,752	69,456
Consumer and other	-	-	-	-	-
	<u>\$ 4,053,096</u>	<u>\$ 4,512,022</u>	<u>\$ 100,159</u>	<u>\$ 5,480,028</u>	<u>\$ 124,668</u>

**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 7. Loans Receivable, Continued**

December 31, 2015	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential real estate	\$ 815,493	\$ 1,114,936	\$ -	\$ 780,709	\$ 23,938
Commercial real estate	1,400,445	1,408,404	-	762,368	-
Construction and land	1,738,305	1,738,305	-	1,106,822	29,200
Commercial and industrial	-	-	-	360,628	-
Consumer and other	-	-	-	-	-
	<u>3,954,243</u>	<u>4,261,645</u>	<u>-</u>	<u>3,010,527</u>	<u>53,138</u>
With related allowance recorded:					
Residential real estate	1,002,459	1,002,459	230,345	910,247	28,821
Commercial real estate	269,888	269,888	67,472	102,040	-
Construction and land	-	-	-	-	-
Commercial and industrial	737,511	739,953	372,527	305,257	-
Consumer and other	-	-	-	-	-
	<u>2,009,858</u>	<u>2,012,300</u>	<u>670,344</u>	<u>1,317,544</u>	<u>28,821</u>
Total:					
Residential real estate	1,817,952	2,117,395	230,345	1,690,956	52,759
Commercial real estate	1,670,333	1,678,292	67,472	864,408	-
Construction and land	1,738,305	1,738,305	-	1,106,822	29,200
Commercial and industrial	737,511	739,953	372,527	665,885	-
Consumer and other	-	-	-	-	-
	<u>\$ 5,964,101</u>	<u>\$ 6,273,945</u>	<u>\$ 670,344</u>	<u>\$ 4,328,071</u>	<u>\$ 81,959</u>

The following table presents loans on nonaccrual status by loan class at December 31, 2016 and 2015:

	2016	2015
Residential real estate	\$ 1,523,483	\$ 716,948
Commercial real estate	-	1,670,332
Construction and land	-	1,027,864
Commercial and industrial	436,829	737,511
Consumer and other	-	-
Total	<u>\$ 1,960,312</u>	<u>\$ 4,152,655</u>

Troubled debt restructurings:

During the year ended December 31, 2016 there were no loans modified that were considered to be a troubled debt restructuring. During 2016 and 2015 there were no loans that went into default which had previously been restructured.

In the determination of the allowance for loan losses, management considers troubled debt restructurings, and subsequent defaults in these restructurings by evaluating the potential for impairment under ASC 310, and if appropriate, a specific reserve is allocated.

**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 8. Property and Equipment**

Property and equipment consisted of the following at December 31, 2016 and 2015:

	<b>2016</b>	<b>2015</b>
Leasehold improvements	\$ 1,947,370	\$ 1,942,635
Building	322,158	322,158
Land	91,221	91,221
Furniture and equipment	1,536,578	1,621,121
Computer equipment	936,032	849,509
Software	243,945	243,946
Vehicles	58,196	74,530
Construction in progress	49,345	13,500
Total	5,184,845	5,158,620
Less: accumulated depreciation	3,929,316	3,391,469
Premises and equipment, net	<b>\$ 1,255,529</b>	<b>\$ 1,767,151</b>

Depreciation expense totaled \$550,778 and \$783,669 in 2016 and 2015, respectively. During 2016 the Company incurred a writedown of \$90,000 on property and equipment, related to closure of its branch located in, and associated with, the Urban League of the Central Carolinas.

**Note 9. Other Real Estate Owned**

The following summarizes the activity in other real estate owned:

	<b>2016</b>	<b>2015</b>
Balance, beginning of year	\$ 54,119	\$ 54,119
Additions	-	951,313
Sales proceeds	49,412	1,276,167
Gain (loss) on sale	(4,707)	324,854
Write-downs	-	-
Balance, end of year	<b>\$ -</b>	<b>\$ 54,119</b>

**Note 10. Intangible Assets**

The following table presents information about the Company's intangible assets at December 31, 2016 and 2015:

	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
<b>December 31, 2016</b>		
Indefinite lived intangible asset: Goodwill	\$ 325,335	\$ -
Finite lived intangible asset: Core deposit intangibles	\$ 613,784	\$ 328,911
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
<b>December 31, 2015</b>		
Indefinite lived intangible asset: Goodwill	\$ 325,335	\$ -
Finite lived intangible asset: Core deposit intangibles	\$ 613,784	\$ 267,533

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**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

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**Note 10. Intangible Assets, Continued**

Based on the core deposit intangibles as of December 31, 2016, the following table presents the aggregate amortization expense for each of the four succeeding years ending December 31:

<u>Year:</u>	<u>Amount</u>
2017	\$ 61,378
2018	61,378
2019	61,378
2020	61,378
2021 and thereafter	39,361
Total	<u>\$ 284,873</u>

Amortization expense of \$61,378 and \$63,948 related to the core deposit intangibles was recognized in 2016 and 2015, respectively.

Goodwill is reviewed for impairment annually in accordance with generally accepted accounting principles. As of December 31, 2016, management determined that no impairment existed on the goodwill.

**Note 11. Deposits**

The Company had brokered certificates of deposit of \$22,602,000 and \$24,450,000 at December 31, 2016 and 2015, respectively. Time deposits that met or exceeded the FDIC insurance limit of \$250,000 at December 31, 2016 and 2015 were \$2,715,049 and \$3,302,158, respectively.

At December 31, 2016, the scheduled maturities of time deposits were as follows:

<u>Maturing In:</u>	<u>Amount</u>
2017	\$ 35,288,334
2018	10,402,853
2019	7,437,819
2020	4,432,454
2021 and thereafter	2,621,837
Total	<u>\$ 60,183,297</u>

**Note 12. Federal Home Loan Bank Advances**

FHLB advances represent borrowings from the FHLB of Atlanta by the Company pursuant to a line of credit collateralized by a blanket lien on qualifying loans secured by first mortgages on 1-4 family residences, home equity lines of credit, multi-family real estate, and commercial real estate. Advances may have various maturity dates, terms and repayment schedules with fixed or variable rates of interest, payable monthly on maturities of one year or less and payable quarterly on maturities over one year. In addition to qualified loans being used as collateral, certain securities including US government agencies and mortgage-backed securities may also be pledged.

**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 12. Federal Home Loan Bank Advances, Continued**

At December 31, 2016 and 2015, the Company had advances from the FHLB as follows:

<u>Maturity Date</u>	<u>Interest Rate</u>	<u>Terms</u>	<u>2016</u>	<u>2015</u>
May 20, 2016	2.24%	Fixed	\$ -	\$ 3,000,000
January 24, 2017	0.98%	Fixed	3,000,000	3,000,000
January 27, 2017	0.50%	Fixed	4,000,000	-
June 28, 2017	0.81%	Fixed	2,000,000	-
June 29, 2017	0.81%	Fixed	5,000,000	-
December 18, 2017	1.40%	Fixed	4,000,000	4,000,000
June 18, 2018	1.42%	Fixed	3,000,000	-
December 17, 2018	1.87%	Fixed	4,000,000	4,000,000
			<u>\$ 25,000,000</u>	<u>\$ 14,000,000</u>

At December 31, 2016, the Company had a total credit facility with the FHLB equal to 20 percent of the Company's total assets, limited to qualifying collateral. The total lendable value of qualifying loans and securities pledged by the Company to FHLB for advances at December 31, 2016 and 2015 were approximately \$29,819,704 and \$20,654,922, respectively.

**Note 13. Unused Lines of Credit**

At December 31, 2016, the Company had established unsecured lines of credit of approximately \$10,800,000 with correspondent banks to provide additional liquidity if, and as needed. At December 31, 2016, the Company had no outstanding borrowings on these lines.

The Company also has a line of credit to borrow funds from the Federal Home Loan Bank for up to approximately \$48,000,000 subject to the pledging of additional collateral, as of December 31, 2016. As of December 31, 2015, the Company had \$25,000,000 in outstanding borrowings on this line.

The Company has access to short term funds through the Federal Reserve Discount Window, under which approximately \$20,000,000 of additional liquidity was available as of December 31, 2016. Discount window advances are typically overnight and must be secured by collateral acceptable to the lending Federal Reserve Bank. As of December 31, 2016, the Company had no outstanding borrowings on this line.

**Note 14. Preferred Stock**

On September 22, 2011, the Company completed the sale of \$6,238,000 of Series A preferred stock to the Secretary of the Treasury (the "Treasury") under the Small Business Lending Fund (SBLF). The fund was established under the Small Business Jobs Act of 2010 that was created to encourage lending to small businesses by providing capital to qualified community banks with total assets less than \$10 billion.

Under the terms of the stock purchase agreement, the Treasury received 6,238 shares of \$0.01 par value, non-cumulative perpetual preferred stock with a liquidation value of \$1,000 per share in exchange for \$6,238,000.

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## Premara Financial, Inc. and Subsidiary

### *Notes to Consolidated Financial Statements*

*As of and for the Years Ended December 31, 2016 and 2015*

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#### **Note 14. Preferred Stock, Continued**

The Series A preferred stock qualifies as Tier 1 capital. The dividend rate can fluctuate on a quarterly basis during the first ten quarters the Series A preferred stock is outstanding, based upon changes in the level of qualified small business lending. The dividend rate is calculated based on the increase in the level of qualified small business lending over the baseline level calculated under the terms of the related purchase agreement and may range from 1 percent (1%) to 5 percent (5%) per annum for the first nine calendar quarters, beginning with the initial dividend period. The Company's dividend rate is fixed at one percent (1%) until March 21, 2016, and will convert to a fixed rate of nine percent (9%) thereafter.

On December 15, 2015, prior to the scheduled rate increase in 2016, the Company redeemed all of the outstanding shares of Series A preferred stock at the liquidation value of \$6,238,000, plus accrued dividends. The redemption of the stock was funded by the Company's secondary common stock offering in which it issued an additional 1,214,285 shares of common stock at a price of \$7.00 per share. The proceeds of the stock issuance amounted to \$8,499,995. Stock issuance costs totaling \$507,792 were netted from additional paid in capital.

#### **Note 15. Stock Warrants**

Each organizer of the Bank received stock warrants giving them the right to purchase up to 4,248 shares at a price of \$11 per share. As a result of the Company's 15% stock dividend in 2013, the warrants were adjusted to 4,885 shares at a purchase price of \$9.57 per share. The warrants vested immediately and expire on August 29, 2017. There were no organizer warrants issued, exercised or canceled during 2016 or 2015. During 2015, the expiration of the warrants for the five of the organizers still actively serving on the Board of Directors was extended to August 29, 2022. No expense was recognized as a result of the modification. At December 31, 2016, all of the warrants were exercisable.

#### **Note 16. Stock Compensation Plans**

The Company has a Long-Term Incentive Plan (the "Plan"), where 1,250,000 shares of the Company's common stock have been reserved for issuance pursuant to awards granted. Options granted under the Plan expire no more than 10 years from the date of grant. Option exercise price under the Plan shall be set by the Board of Directors at the date of grant, but shall not be less than 100 percent of the fair market value of the related stock at the date of the grant. Vesting under the Plan is determined at the date of grant.

During 2015 the company granted stock options of 49,000 shares being vested over a five years, with 20% being vested at issuance. The weighted average exercise price of the shares is \$7.00 per share, and they expire in ten (10) years. Compensation expense related to options granted was \$19,030 for the year ended December 31, 2015 and 2016. No options were exercised during 2016 and 2015.

The weighted average fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	<u>2015</u>
Expected volatility	37%
Expected dividend	0%
Expected term (years)	7
Risk free rate	1.87%

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 16. Stock Compensation Plans, Continued

There were no options exercised during the year ended December 31, 2016. Activity under each Plan during the year ended December 31, 2016 is summarized below:

	<u>Available for Grant</u>	<u>Granted</u>
<b>Balance December 31, 2014</b>	1,250,000	-
Granted	49,000	49,000
Exercised	<u>-</u>	<u>-</u>
<b>Balance December 31, 2015</b>	1,201,000	49,000
Granted	-	-
Exercised	<u>-</u>	<u>-</u>
<b>Balance December 31, 2016</b>	<u><b>1,201,000</b></u>	<u><b>49,000</b></u>

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

	<u>Options Outstanding</u>	<u>Weighted Average Exercise Price</u>	<u>Average Remaining Contractual Term</u>	<u>Aggregate Intrinsic Value <sup>(1)</sup></u>
Outstanding at December 31, 2015	49,000	\$ 7.00	9.92 years	\$ 36,750
Granted	-	-	-	-
Exercised	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Outstanding at December 31, 2016	<u><b>49,000</b></u>	<u><b>\$ 9.61</b></u>	<u><b>8.92 years</b></u>	<u><b>\$ 36,750</b></u>
Exercisable at December 31, 2016	<u><b>19,600</b></u>	<u><b>\$ 9.61</b></u>	<u><b>8.92 years</b></u>	<u><b>\$ 36,750</b></u>

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

Options vested during the twelve months ended December 31, 2016 totaled 19,600. Total unrecognized compensation expense related to outstanding non-vested stock options will be recognized over the following periods:

2017	\$ 19,091
2018	19,091
2019	<u>19,091</u>
Total	<u><b>\$ 57,273</b></u>

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 17. Income Taxes

The income tax effects of temporary differences in financial statement carrying values and the tax bases of assets and liabilities, as well as net operating loss carryforwards at December 31, 2016 and 2015 are as follows:

	December 31,	
	2016	2015
<b>Deferred tax assets</b>		
Net operating loss carryforwards	\$ 1,728,699	\$ 1,689,831
Allowance for loan losses	631,072	667,628
Unrealized loss on securities available-for-sale and hedge effectiveness	85,563	-
Non-qualified stock options/warrant expense	123,000	118,284
Amortization of intangibles	99,431	114,429
Deferred director compensation	-	150,129
Accrued expenses	24,124	20,451
Interest income on non-accrual loans	179,224	125,200
Lease up-fitting allowance	811	5,776
Alternative minimum tax carryforward	7,145	4,321
Depreciation	4,638	-
Other real estate owned	-	7,651
Valuations on purchased loans	76,700	29,270
Other	201,767	271,894
Total deferred tax assets before valuation allowance	3,162,174	3,204,864
Less valuation allowance	15,827	20,536
Total deferred tax assets	3,146,347	3,184,328
<b>Deferred tax liabilities</b>		
Depreciation	-	108,807
Unrealized gain on securities available-for-sale and hedge effectiveness	-	66,851
Prepaid expenses	15,542	22,842
Loan origination costs	272,944	257,527
Total deferred tax liabilities	288,486	456,027
Net deferred tax asset	<b>\$ 2,857,861</b>	<b>\$ 2,728,301</b>

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. The Company and the Bank file a consolidated federal income tax return and separate North Carolina state income tax returns. The Bank also files separate South Carolina and Washington, D.C. state income tax returns. The Company has recorded a valuation allowance with respect to state deferred tax assets as management has concluded that those assets are not more likely than not to be realized. Management has determined that it is more likely than not that all federal deferred tax assets and all Bank state deferred tax assets will be utilized in future years.

The Company has federal net operating losses for income tax purposes of \$5,037,858 as of December 31, 2016. These net operating losses expire in the years 2029 through 2037. The Bank has no North Carolina net economic losses for income tax purposes as of December 31, 2016.



**Premara Financial, Inc. and Subsidiary**  
**Notes to Consolidated Financial Statements**  
**As of and for the Years Ended December 31, 2016 and 2015**

**Note 17. Income Taxes, Continued**

The income tax expense for the years ended December 31, 2016 and 2015 are summarized as follows:

	<b>For the years ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
Current income tax expense (benefit) from current operations	\$ 8,213	\$ 3,569
Deferred income tax expense (benefit) from current operations	27,563	(596,175)
Change in valuation allowance from current operations	(4,709)	2,961
Income tax expense (benefit)	<b>\$ 31,067</b>	<b>\$ (589,645)</b>

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

	<b>For the years ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
Tax expense at statutory rate	\$ 210,597	\$ (341,977)
State income tax expense, net of federal expense	46,907	3,308
Increase (decrease) in taxes resulting from:		
Tax-exempt income	(230,571)	(275,950)
Change in valuation allowance from current operations	(4,709)	2,961
Other, net	8,843	22,013
Income tax expense (benefit)	<b>\$ 31,067</b>	<b>\$ (589,645)</b>

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with ASC Topic 740. With few exceptions, the Company is no longer subject to federal or state income tax examinations by tax authorities for years before 2013.

**Note 18. Leases**

The Bank entered into a ten year lease agreement for its Blakeney Park Drive banking facility on November 10, 2006. The Bank began leasing the facility in March 2007. Lease payments were \$9,375 per month and increased by three percent per year beginning with the third year of the lease. On December 18, 2015, the Company closed the branch. The Company will continue to use the space for bank operations until the lease expires in early 2017.

The Bank entered into a lease agreement for its Ballantyne Corporate Place banking facility on April 30, 2009. The agreement provided for a rent commencement date of December 1, 2009 and a termination date of November 30, 2019. Lease payments were \$22,900 per month for the first 12 months, and increased by four percent each year thereafter. The Bank has the option to renew the lease for two additional five-year periods at the conclusion of the original lease period.

The Bank entered into a lease agreement for its Rock Hill banking facility on July 1, 2012. The agreement provides for a termination date of September 30, 2024. Lease payments are \$4,600 per month.

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 18. Leases, Continued

The Bank entered into a lease agreement in 2012 for its Urban League location in uptown Charlotte. The agreement provided for a rent commencement date of November 1, 2012 and a termination date of October 31, 2017. During 2016, the Company made the decision to close the branch, effective March 30, 2017. As result of the decision to close the branch, a write down of \$90,000 on the fixed assets was recognized as of December 31, 2016. The exposure on the remaining term of the lease, which expires on October 31, 2017, if imposed by the landlord, is less than \$10,000.

The Bank entered into a lease agreement in 2013 for its Washington, D.C. branch located at 1299 Pennsylvania Avenue. The agreement provided for a rent commencement date of February 1, 2014 and a termination date of January 31, 2024. The lease payments were \$12,345 per month for the first 12 months, and increased at an annual rate of \$4 per square foot in the second and third years. The lease payment will increase by 2.5 percent each year thereafter.

The Bank entered into a lease agreement in 2013 for the branch located in Six Mile, South Carolina. The agreement provides for a variable monthly rent based on a percentage of branch profits at a rate of 10 percent of the monthly bank profits for the branch. The term of the lease is five years.

The Bank entered into a lease agreement adding extra square footage to its Ballantyne Corporate Place banking facility on October 1, 2016. The agreement provided for a rent commencement date of October 1, 2016 and a termination date of November 30, 2019. Lease payments are \$23,111 per month for the first 12 months, and will increase by four percent each year thereafter. The Bank has the option to renew the lease for two additional five-year periods at the conclusion of the original lease period.

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

2017	\$	660,070
2018		661,834
2019		639,294
2020		184,963
2021		189,586
Thereafter		410,151
	\$	<u>2,745,898</u>

As part of a strategic repositioning and a refocus on the Carolinas, the Company closed its Washington, D.C. branch on December 31, 2015. The fixed assets of the branch were sold and the facility was subleased to another financial institution. The expiration of the new sublease coincides with the expiration of the primary lease on the facility. Losses associated with the transaction of approximately \$474,000 were recognized during 2015.

Lease expense for the Company totaled \$757,242 and \$742,183 in 2016 and 2015, respectively.

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## **Premara Financial, Inc. and Subsidiary**

### ***Notes to Consolidated Financial Statements***

***As of and for the Years Ended December 31, 2016 and 2015***

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#### **Note 19. Related Party Transactions**

Certain related parties (principally certain directors and executive officers of the Bank, and their related interests) were loan customers of, and had other transactions in the normal course of business with, the Bank. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than normal risk of collectability. The aggregate dollar amount of loans to related parties was \$4,437,817 and \$4,810,894 at December 31, 2016 and 2015, respectively. During 2016, new loans to related parties were \$500,000 and repayments totaled \$837,077.

Deposits received from executive officers and directors and their related interests totaled \$4,131,245 and \$2,325,835 at December 31, 2016 and 2015, respectively. These deposit accounts have substantially the same terms, including interest rates, as those prevailing at the time for comparable transactions with other non-related depositors.

#### **Note 20. Commitments and Contingencies**

In the ordinary course of business, the Company may, from time to time, become a party to legal claims and disputes. At December 31, 2016, management is not aware of any pending or threatened litigation or un-asserted claims or assessments that could result in losses, if any, that would be material to the financial statements.

The Company has entered into employment agreements with certain of its key officers covering duties, salary, benefits, and provision for termination and Company obligations in the event of merger or acquisition.

#### **Note 21. Employee Benefit Plan**

Effective June 1, 2008, the Bank adopted a 401(k) plan which covers all eligible employees. Participants may contribute up to \$15,500 per year, and the Bank matches contributions equal to 100 percent of employee contributions up to 4 percent of eligible compensation. The Company's contributions to the plan were approximately \$111,000 and \$106,000 for the years ended December 31, 2016 and 2015, respectively.

In 2013 the Company added a supplemental executive retirement plan for certain officers. The benefits of the plan are funded primarily by life insurance policies on certain employees and directors with the Company designated as the beneficiary. Expenses related to the plan were \$0 and \$54,542 in 2016 and 2015, respectively. At December 31, 2016 other liabilities included \$133,060 for this supplement retirement plan.

In 2013 the Company added a deferred director compensation plan for certain directors. The benefits of the plan are funded primarily by life insurance policies on certain employees and directors with the Company designated as the beneficiary. Expenses related to the plan were \$0 and \$150,656 in 2016 and 2015, respectively. At December 31, 2015 other liabilities included \$395,187 for this deferred compensation plan.

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 22. Income (Loss) per Share

Basic income (loss) per share is computed by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding. Diluted income per share is computed by dividing net income available to common stockholders by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock warrants.

	<u>2016</u>	<u>2015</u>
Net income (loss) available to common shareholders	\$ 588,336	\$ (475,779)
Weighted average shares outstanding, basic	3,160,268	2,262,300
Effect of dilutive securities	-	2,460
Weighted average shares outstanding, diluted	<u>3,160,268</u>	<u>2,264,760</u>
Basic income (loss) per common share	\$ 0.19	\$ (0.21)
Dilutive income (loss) per common share	<u>\$ 0.19</u>	<u>\$ (0.21)</u>

#### Note 23. Capital Requirements

All bank holding companies and banks are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct adverse material effect on the Company's consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, bank holding companies and banks must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios set forth in the table below of Total and Tier 1 Capital, as defined in the regulations, to risk-weighted assets, as defined, and of Tier 1 Capital, as defined, to average assets, as defined. Management believes, as of December 31, 2016 that the Company and the Bank exceeded all capital adequacy minimum requirements.

As of the most recent regulatory examination, the Bank was deemed well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Company and the Bank must maintain total risk-based, Tier 1 risk-based, and Tier I leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's categories.

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 23. Capital Requirements, Continued

The following table summarizes the capital amounts (dollars in thousands) and ratios of the Company and the Bank and the regulatory minimum requirements at December 31, 2016 and 2015:

	Actual		Minimum Capital Required		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>December 31, 2016</b>						
<b>The Company</b>						
Total capital (to risk-weighted assets)	\$ 24,588	11.81%	\$ 16,651	8.00%	n/a	n/a
Tier 1 capital (to risk-weighted assets)	22,450	10.79%	12,489	6.00%	n/a	n/a
Common equity (to risk-weighted assets)	22,450	10.79%	9,366	4.50%	n/a	n/a
Tier 1 capital (to average assets)	22,450	9.11%	9,856	4.00%	n/a	n/a
<b>The Bank</b>						
Total capital (to risk-weighted assets)	\$ 24,116	11.61%	\$ 16,610	8.00%	\$ 20,763	10.00%
Tier 1 capital (to risk-weighted assets)	21,978	11.59%	12,458	6.00%	16,610	8.00%
Common equity (to risk-weighted assets)	21,978	10.59%	9,366	4.50%	13,496	6.50%
Tier 1 capital (to average assets)	21,978	8.97%	9,856	4.00%	12,254	5.00%
<b>December 31, 2015</b>						
<b>The Company</b>						
Total capital (to risk-weighted assets)	\$ 24,068	13.49%	\$ 14,269	8.00%	n/a	n/a
Tier 1 capital (to risk-weighted assets)	21,838	12.24%	10,702	6.00%	n/a	n/a
Common equity (to risk-weighted assets)	21,838	12.24%	8,026	4.50%	n/a	n/a
Tier 1 capital (to average assets)	21,838	8.79%	9,936	4.00%	n/a	n/a
<b>The Bank</b>						
Total capital (to risk-weighted assets)	\$ 23,489	13.20%	\$ 14,239	8.00%	\$ 17,799	10.00%
Tier 1 capital (to risk-weighted assets)	21,252	11.94%	10,679	6.00%	14,239	8.00%
Common equity (to risk-weighted assets)	21,252	11.94%	8,009	4.50%	11,569	6.50%
Tier 1 capital (to average assets)	21,252	8.60%	9,806	4.00%	12,357	5.00%

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

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 23. Capital Requirements, Continued**

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

During 2015, the Company closed a secondary common stock offering in which it issued an additional 1,214,285 shares of common stock at a price of \$7.00 per share. The proceeds of the stock issuance amounted to \$8,499,995. Stock issuance costs totaling \$507,792 were netted from additional paid in capital. Net proceeds of \$6,238,000 were utilized to redeem 6,238 shares of preferred stock, previously issued to the Secretary of the Treasury (the “Treasury”) under the Small Business Lending Fund (SBLF).

**Note 24. Restrictions on Dividends, Loans, or Advances**

The Bank, as a North Carolina banking corporation, may pay dividends pursuant to North Carolina General Statutes Section 53C-4-7. However, regulatory authorities may limit payment of dividends by any bank when it is determined that such a limitation is in the public interest and is necessary to ensure the financial soundness of the Bank.

**Note 25. Financial Instruments with Off-Balance-Sheet Risk**

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

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

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

## Premara Financial, Inc. and Subsidiary

### Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

#### Note 25. Financial Instruments with Off-Balance-Sheet Risk, Continued

The Company is an investor in two private equity limited partnerships which were formed to invest in middle market companies throughout the United States. The partnerships have been licensed by the Small Business Administration (SBA) to operate as a Small Business Investment Company under the authority of the SBA. The bank's investment commitment is \$1,000,000 of which \$443,699 had been invested at December 31, 2016 and is included in nonmarketable equity securities. The Company's unfunded commitment at December 31, 2016 was \$537,907.

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

The following table summarizes the Company's off-balance-sheet financial instruments at December 31, 2016 and 2015 whose contract amounts represent credit risk:

	At December 31,	
	2016	2015
Unfunded lines of credit	\$ 31,449,668	\$ 16,230,318
Commitments to extend credit	-	-
Standby letters of credit	692,824	1,148,515
Other commitments	537,907	592,333

#### Note 26. Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for transaction costs. An orderly transaction is a transaction that assumes exposure to the market for a period prior to the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets and liabilities; it is not a forced transaction. Market participants are buyers and sellers in the principal market that are (i) independent, (ii) knowledgeable, (iii) able to transact and (iv) willing to transact.

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**Premara Financial, Inc. and Subsidiary**  
***Notes to Consolidated Financial Statements***  
***As of and for the Years Ended December 31, 2016 and 2015***

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**Note 26. Fair Value of Financial Instruments, Continued**

The use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach are required. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities. The income approach uses valuation techniques to convert future amounts, such as cash flows or earnings, to a single present amount on a discounted basis. The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (replacement cost). Valuation techniques should be consistently applied. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, a fair value hierarchy is established for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

*Fair value hierarchy:*

- Level 1* Valuation is based upon quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.
- Level 2* Valuation is based upon quoted prices for similar assets and liabilities in active markets, as well as inputs that are observable for the asset or liability (other than quoted prices), such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.
- Level 3* Valuation is generated from model-based techniques that use at least one significant assumption based on unobservable inputs for the assets or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. In instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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

*Securities available-for-sale:*

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



## **Premara Financial, Inc. and Subsidiary**

### ***Notes to Consolidated Financial Statements***

***As of and for the Years Ended December 31, 2016 and 2015***

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#### **Note 26. Fair Value of Financial Instruments, Continued**

##### *Derivative assets and liabilities:*

The values of derivative instruments held or issued by the Company for risk management purposes are traded in over-the-counter markets where quoted market prices are not readily available. For those derivatives, the Company measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty credit risk. The Company classifies derivative instruments as Level 2 valuation.

##### *Loans:*

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment by estimating the fair value of the impaired loan using one of several methods; including collateral value, market value of similar debt, enterprise value, liquidation value or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans.

For impaired loans that have an allowance established based on the fair value of collateral, a classification in the fair value hierarchy is required. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

##### *Other real estate owned (OREO):*

Foreclosed assets are adjusted to fair value upon transfer of the loans to OREO. Subsequently, OREO is carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank records the OREO as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank records the OREO as nonrecurring Level 3.

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

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### Note 26. Fair Value of Financial Instruments, Continued

#### Assets and liabilities measured at fair value on a recurring basis:

The tables below present the Company's assets and liabilities measured at fair value on a recurring basis as of December 31, 2016 and 2015, aggregated by the level in the fair value hierarchy within which those measurements fall:

	Level 1	Level 2	Level 3	Total
<b>December 31, 2016</b>				
<b>Assets:</b>				
Securities available for sale:				
Collateralized mortgage obligations	\$ -	\$ 558,314	\$ -	\$ 558,314
Mortgage-backed securities	-	7,066,845	-	7,066,845
Municipal bonds - non-taxable	-	16,231,530	-	16,231,530
Municipal bonds - taxable	-	4,581,258	-	4,581,258
Other securities	-	3,022,246	-	3,022,246
Total Investments	-	31,460,193	-	31,460,193
Total assets measured at fair value on a recurring basis	<u>\$ -</u>	<u>\$ 31,460,193</u>	<u>\$ -</u>	<u>\$ 31,460,193</u>
<b>Liabilities:</b>				
Derivative instruments:				
Interest rate swaps	\$ -	\$ 208,748	\$ -	\$ 208,748
Total liabilities measured at fair value on a recurring basis	<u>\$ -</u>	<u>\$ 208,748</u>	<u>\$ -</u>	<u>\$ 208,748</u>
	Level 1	Level 2	Level 3	Total
<b>December 31, 2015</b>				
<b>Assets:</b>				
Securities available for sale:				
U.S. government agencies	\$ -	\$ 986,114	\$ -	\$ 986,114
Collateralized mortgage obligations	-	735,387	-	735,387
Mortgage-backed securities	-	5,042,669	-	5,042,669
Municipal bonds - non-taxable	-	22,254,487	-	22,254,487
Municipal bonds - taxable	-	5,633,374	-	5,633,374
Other securities	-	2,795,582	-	2,795,582
Total Investments	-	37,447,613	-	37,447,613
Total assets measured at fair value on a recurring basis	<u>\$ -</u>	<u>\$ 37,447,613</u>	<u>\$ -</u>	<u>\$ 37,447,613</u>
<b>Liabilities:</b>				
Derivative instruments:				
Interest rate swaps	\$ -	\$ 318,969	\$ -	\$ 318,969
Total liabilities measured at fair value on a recurring basis	<u>\$ -</u>	<u>\$ 318,969</u>	<u>\$ -</u>	<u>\$ 318,969</u>

# Premara Financial, Inc. and Subsidiary

## Notes to Consolidated Financial Statements

As of and for the Years Ended December 31, 2016 and 2015

### Note 26. Fair Value of Financial Instruments, Continued

#### Assets and liabilities measured at fair value on a non-recurring basis:

The table below presents the Company's assets measured at fair value on a non-recurring basis as of December 31, 2016 and 2015, aggregated by the level in the fair value hierarchy within which those measurements fall:

	Level 1	Level 2	Level 3	Total
<b>December 31, 2016</b>				
Impaired loans	\$ -	\$ -	\$ 3,952,937	\$ 3,952,937
Other real estate owned	-	-	-	-
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,952,937</u>	<u>\$ 3,952,937</u>
	Level 1	Level 2	Level 3	Total
<b>December 31, 2015</b>				
Impaired loans	\$ -	\$ -	\$ 5,293,757	\$ 5,293,757
Other real estate owned	-	-	54,119	54,119
Total	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,347,876</u>	<u>\$ 5,347,876</u>

The Company had no liabilities measured at fair value on a non-recurring basis at December 31, 2016 or 2015.

For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2016 and 2015, the significant unobservable inputs used in the fair value measurements were as follows:

	Fair Value at December 31, 2016	Fair Value at December 31, 2015	Valuation Technique	Significant Unobservable Inputs	General Range of Significant Unobservable Input Values
Impaired Loans	\$ 3,952,937	\$ 5,293,757	Appraised Value/Discounted Cash Flows/Market Value of Note	Discounts to reflect current market conditions, ultimate collectability, and estimated costs to sell	0 – 10%
Other Real Estate Owned	\$ -	\$ 54,119	Appraised Value/Comparable Sales/Other Estimates from Independent Sources	Discounts to reflect current market conditions and estimated costs to sell	6 – 10%

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**Premara Financial, Inc. and Subsidiary*****Notes to Consolidated Financial Statements******As of and for the Years Ended December 31, 2016 and 2015***

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**Note 27. Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date, but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 27, 2016, the date the financial statements were available to be issued, and no subsequent events occurred requiring accrual or disclosure.