ENB Financial Corp
Form 10-K
March 29, 2019

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018

OR

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

For the transition period from ____________________ to ______________________

Commission File Number 000-53297

ENB Financial Corp

(Exact name of registrant as specified in its charter)

Pennsylvania	51-0661129
State or other jurisdiction of incorporation or organization	(IRS Employer Identification No.)
31 E. Main St. Ephrata, PA	17522
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code (717) 733-4181

Securities registered pursuant to Section 12(b) of the Act: None

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

Title of each class

Common Stock, Par Value $0.20 Per Share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

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

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

Large Accelerated filer o	Accelerated filer o
Non-accelerated filer x	Smaller reporting company x
Emerging growth company o	

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2018, was approximately $61,322,930.

The number of shares of the registrant's Common Stock outstanding as of March 8, 2019, was 2,843,132.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's Definitive Proxy Statement for its 2019 Annual Meeting of Shareholders to be held on May 7, 2019, is incorporated into Parts III and IV hereof.

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Part I

Forward-Looking Statements

The U.S. Private Securities Litigation Reform Act of 1995 provides safe harbor in regard to the inclusion of forward-looking statements in this document and documents incorporated by reference. Forward-looking statements pertain to possible or assumed future results that are made using current information. These forward-looking statements are generally identified when terms such as; “believe,” “estimate,” “anticipate,” “expect,” “project,” “forecast,” and other similar wordings are used. The readers of this report should take into consideration that these forward-looking statements represent management’s expectations as to future forecasts of financial performance, or the likelihood that certain events will or will not occur. Due to the very nature of estimates or predictions, these forward-looking statements should not be construed to be indicative of actual future results. Additionally, management may change estimates of future performance, or the likelihood of future events, as additional information is obtained. This document may also address targets, guidelines, or strategic goals that management is striving to reach but may not be indicative of actual results.

Readers should note that many factors affect this forward-looking information, some of which are discussed elsewhere in this document and in the documents that are incorporated by reference into this document. These factors include, but are not limited to, the following:

- Economic conditions
- Monetary and interest rate policies of the Federal Reserve Board
- Volatility of the securities markets
- Possible impacts of the capital and liquidity requirements of Basel III standards and other regulatory pronouncements
- Effects of short- and long-term federal budget and tax negotiations and their effects on economic and business conditions
- Effects of the failure of the Federal government to reach agreement to raise the debt ceiling and the negative effects on economic or business conditions as a result
- Effects of weak market conditions, specifically the effect on loan customers to repay loans
- Political changes and their impact on new laws and regulations
- Competitive forces
- Changes in deposit flows, loan demand, or real estate and investment securities values
- Changes in accounting principles, policies, or guidelines as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board, and other accounting standards setters
- Ineffective business strategy due to current or future market and competitive conditions

- Management's ability to manage credit risk, liquidity risk, interest rate risk, and fair value risk
- Operation, legal, and reputation risk
- The risk that our analyses of these risks and forces could be incorrect and/or that the strategies developed to address them could be unsuccessful
- The impact of new laws and regulations, including the impact of the Tax Cuts and Jobs Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the regulations issued thereunder.

Readers should be aware if any of the above factors change significantly, the statements regarding future performance could also change materially. The safe harbor provision provides that ENB Financial Corp is not required to publicly update or revise forward-looking statements to reflect events or circumstances that arise after the date of this report. Readers should review any changes in risk factors in documents filed by ENB Financial Corp periodically with the Securities and Exchange Commission, including Item 1A. of this Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K.

Item 1. Business

General

ENB Financial Corp ("the Corporation") is a bank holding company that was formed on July 1, 2008. The Corporation's wholly owned subsidiary, Ephrata National Bank ("the Bank"), also referred to as ENB, is a full service commercial bank organized under the laws of the United States. Presently, no other subsidiaries exist under the bank holding company. The Corporation and the Bank are both headquartered in Ephrata, Lancaster County, Pennsylvania. The Bank was incorporated on April 11, 1881, pursuant to The National Bank Act under a charter granted by the Office of the Comptroller of the Currency (OCC). The Federal Deposit Insurance Corporation (FDIC) insures deposit accounts to the maximum extent provided by law. The Corporation's retail, operational, and administrative offices are predominantly located in Lancaster County, southeastern Lebanon County, and southern Berks County, Pennsylvania. Ten full service offices are located in Lancaster County with one full service office in Lebanon County and one full service office in Berks County, Pennsylvania.

The basic business of the Corporation is to provide a broad range of financial services to individuals and small-to-medium-sized businesses in Lancaster County as well as Berks and Lebanon Counties. The Corporation utilizes funds gathered through deposits from the general public to originate loans. The Corporation offers a range of demand accounts, in addition to savings and time deposits. The Corporation also offers secured and unsecured commercial, real estate, and consumer loans. Ancillary services that provide added convenience to customers include direct deposit and direct payments of funds through Electronic Funds Transfer, ATMs linked to the Star® network, telephone banking, MasterCard® debit cards, Visa® or MasterCard credit cards, and safe deposit box facilities. In addition, the Corporation offers internet banking including bill pay and wire transfer capabilities, remote deposit capture, and an ENB Bank on the Go! app for iPhones or Android phones. The Corporation also offers a full complement of trust and investment advisory services through ENB's Money Management Group.

As of December 31, 2018, the Corporation employed 294 persons, consisting of 257 full-time and 37 part-time employees. The number of full-time employees increased by ten employees, and the number of part-time employees decreased by one from the previous year-end**.** The increase in the number of full-time employees, while small, is attributable to various items in 2018; additional Commercial Relationship Managers and back office personnel to support loan growth, growth in the mortgage sales and support staff, and general staff increases due to bank asset and loan growth. The Bank expects to continue growing in 2019 at a similar rate as in 2018. A collective bargaining agent does not represent the employees.

Operating Segments

The Corporation's business is providing financial products and services. These products and services are provided through the Corporation's wholly owned subsidiary, the Bank. The Bank is presently the only subsidiary of the Corporation, and the Bank only has one reportable operating segment, community banking, as described in Note A of the Notes to the Consolidated Financial Statements included in this Report. The segment reporting information in Note A is incorporated by reference into this Part I, Item 1.

Business Operations

Products and Services with Reputation Risk

The Corporation offers a diverse range of financial and banking products and services. In the event one or more customers and/or governmental agencies becomes dissatisfied with or objects to any product or service offered by the Corporation, negative publicity with respect to any such product or service, whether legally justified or not, could have a negative impact on the Corporation's reputation. The discontinuance of any product or service, whether or not any customer or governmental agency has challenged any such product or service, could have a negative impact on the Corporation's reputation.

Market Area and Competition

The Corporation's primary market area is Lancaster County, Pennsylvania, where ten full service offices are located. However, the Corporation's market area also extends into contiguous Lebanon and Berks Counties. The Corporation opened a full service office in southeastern Lebanon County in 2013 and a full service office in southern Berks County in 2016 to extend physical presence to those counties. The Corporation's greater service area is considered to be Lancaster, Lebanon, and Berks Counties of Pennsylvania. The area served by the Corporation is a mix of rural communities and small to mid-sized towns.

The Corporation's headquarters and main campus are located in Ephrata, Pennsylvania. The Corporation's main office and drive-up are located in downtown Ephrata, while the Cloister office is also located within Ephrata Borough. As such, the Corporation has a very strong presence in Ephrata Borough, a community with a population of approximately 13,000. When surrounding areas that also share an Ephrata address and zip code are included, the population is over 32,000 based on 2010 census data. The Corporation ranks a commanding first in deposit market

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share in the Ephrata area with 40.6% of deposits as of June 30, 2018, based on data compiled annually by the Federal Deposit Insurance Corporation (FDIC). The Corporation’s deposit market share in the Ephrata area was also 40.6% as of June 30, 2017. The Corporation’s very high market share in the Ephrata area equates to a saturation of the local market that has led to the expansion of the Corporation’s branch network.

In the past 15 years, the Corporation’s market area has expanded beyond the greater Ephrata area to encompass most of northern Lancaster County, with the exception of the most western parts of the County. The majority of this expansion has occurred in recent history with the addition of eight new branch offices since 1999, bringing the total offices to twelve. Lancaster County ranks high nationally as a favored place to reside due to its scenic and fertile farmland, low cost of living, diverse local economy, and proximity to several large metropolitan areas. As a result, the area has experienced significant population growth and development. The population growth of Lancaster County has remained above both Pennsylvania and national growth levels over the past fifty years. Additionally, the population of Lancaster County has recently eclipsed half a million, with 2010 census information showing an estimated population of 508,000. The FDIC deposit market share data ranked the Corporation 5th in deposit market share in Lancaster County, with 7.5% of deposits as of June 30, 2018. The Corporation held 7.3% of deposit market share as of June 30, 2017.

In the course of attracting and retaining deposits and originating loans, the Corporation faces considerable competition. The Corporation competes with other commercial banks, savings and loan institutions, and credit unions for traditional banking products, such as deposits and loans. Based on FDIC summary of deposit data, there were 22 banks and savings associations and 12 credit unions operating in Lancaster County as of June 30, 2018, representing same number of banks and credit unions compared to the prior year. The Corporation competes with consumer finance companies for loans, mutual funds, and other investment alternatives for deposits. The Corporation competes for deposits based on the ability to provide a range of products, low fees, quality service, competitive rates, and convenient locations and hours. The competition for loan origination generally relates to interest rates offered, products available, quality of service, and loan origination fees charged. Several competitors within the Corporation’s primary market have substantially higher legal lending limits that enable them to service larger loans and larger commercial customers.

The Corporation continues to assess the competition and market area to determine the best way to meet the financial needs of the communities it serves. Management also continues to pursue new market opportunities based on the strategic plan to efficiently grow the Corporation, improve earnings performance, and bring the Corporation’s products and services to customers currently not being reached. Management strategically addresses growth opportunities versus competitive issues by determining the new products and services to be offered, expansion of existing footprint with new locations, as well as investing in the expertise of staffing for expansion of these services.

Concentrations and Seasonality

The Corporation does not have any portion of its businesses dependent on a single or limited number of customers, the loss of which would have a material adverse effect on its businesses. No substantial portion of loans or investments is concentrated within a single industry or group of related industries, although a significant amount of loans are secured by real estate located in northern Lancaster County, Pennsylvania. Agricultural purpose loans make up approximately 29% of the loan portfolio; however, these loans are further diversified according to type of agriculture, of which dairy is the largest component accounting for approximately 12% of the loan portfolio. The business activities of the Corporation are generally not seasonal in nature. The sizable agricultural portfolio has minority elements that are predominately seasonal in nature due to typical farming operations. Financial instruments with concentrations of credit risk are described in Note P of the Notes to Consolidated Financial Statements included in this Report. The concentration of credit risk information in Note P is incorporated by reference into this Part I, Item 1.

Supervision and Regulation

Bank holding companies operate in a highly regulated environment and are routinely examined by federal and state regulatory authorities. The following discussion concerns various federal and state laws and regulations and the potential impact of such laws and regulations on the Corporation and the Bank.

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To the extent that the following information describes statutory or regulatory provisions, it is qualified in its entirety by reference to the particular statutory or regulatory provisions themselves. Proposals to change laws and regulations are frequently introduced in Congress, the state legislatures, and before the various bank regulatory agencies. The Corporation cannot determine the likelihood or timing of any such proposals or legislation, or the impact they may have on the Corporation and the Bank. A change in law, regulations, or regulatory policy may have a material effect on the Corporation and the Bank's business.

The operations of the Bank are subject to federal and state statutes applicable to banks chartered under the banking laws of the United States, to members of the Federal Reserve System, and to banks whose deposits are insured by the FDIC. Bank operations are subject to regulations of the OCC, the Consumer Financial Protection Bureau (CFPB), the Board of Governors of the Federal Reserve System, and the FDIC.

Bank Holding Company Supervision and Regulation

The Bank Holding Company Act of 1956

The Corporation is subject to the provisions of the Bank Holding Company Act of 1956, as amended, and to supervision by the Federal Reserve Board. The following restrictions apply:

General Supervision by the Federal Reserve Board

As a bank holding company, the Corporation's activities are limited to the business of banking and activities closely related or incidental to banking. Bank holding companies are required to file periodic reports with and are subject to examination by the Federal Reserve Board. The Federal Reserve Board has adopted a risk-focused supervision program for small shell bank holding companies that is tied to the examination results of the subsidiary bank. The Federal Reserve Board has issued regulations under the Bank Holding Company Act that require a bank holding company to serve as a source of financial and managerial strength to its subsidiary banks. As a result, the Federal Reserve Board may require that the Corporation stand ready to provide adequate capital funds to the Bank during periods of financial stress or adversity.

Restrictions on Acquiring Control of Other Banks and Companies

A bank holding company may not:

- acquire direct or indirect control of more than 5% of the outstanding shares of any class of voting stock, or substantially all of the assets of any bank, or
- merge or consolidate with another bank holding company, without prior approval of the Federal Reserve Board.

In addition, a bank holding company may not:

- engage in a non-banking business, or
- acquire ownership or control of more than 5% of the outstanding shares of any class of voting stock of any company engaged in a non-banking business,

unless the Federal Reserve Board determines the business to be so closely related to banking as to be a proper incident to banking. In making this determination, the Federal Reserve Board considers whether these activities offer benefits to the public that outweigh any possible adverse effects.

Anti-Tie-In Provisions

A bank holding company and its subsidiaries may not engage in tie-in arrangements in connection with any extension of credit or provision of any property or services. These anti-tie-in provisions state generally that a bank may not:

- extend credit,
- lease or sell property, or
- furnish any service to a customer,

on the condition that the customer provides additional credit or service to a bank or its affiliates, or on the condition that the customer not obtain other credit or service from a competitor of the bank.

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Restrictions on Extensions of Credit by Banks to their Holding Companies

Subsidiary banks of a holding company are also subject to restrictions imposed by the Federal Reserve Act on:

- any extensions of credit to the bank holding company or any of its subsidiaries,
- investments in the stock or other securities of the Corporation, and
- taking these stock or securities as collateral for loans to any borrower.

Risk-Based Capital Guidelines

Bank holding companies must comply with the Federal Reserve Board's current risk-based capital guidelines, which are amended provisions of the Bank Holding Company Act of 1956. The required minimum ratio of total capital to risk-weighted assets, including some off-balance sheet activities, such as standby letters of credit, is 8%. At least half of the total capital is required to be Tier I Capital, consisting principally of common shareholders' equity, less certain intangible assets. The remainder, Tier II Capital, may consist of:

- some types of preferred stock,
- a limited amount of subordinated debt,
- some hybrid capital instruments,
- other debt securities, and
- a limited amount of the general loan loss allowance.

The risk-based capital guidelines are required to take adequate account of interest rate risk, concentrations of credit risk, and risks of nontraditional activities.

Capital Leverage Ratio Requirements

The Federal Reserve Board requires a bank holding company to maintain a leverage ratio of a minimum level of Tier I capital, as determined under the risk-based capital guidelines, equal to 3% of average total consolidated assets for those bank holding companies that have the highest regulatory examination rating and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a ratio of at least 1% to 2% above the stated minimum. The Bank is subject to similar capital requirements pursuant to the Federal Deposit Insurance Act.

Restrictions on Control Changes

The Change in Bank Control Act of 1978 requires persons seeking control of a bank or bank holding company to obtain approval from the appropriate federal banking agency before completing the transaction. The law contains a presumption that the power to vote 10% or more of voting stock confers control of a bank or bank holding company. The Federal Reserve Board is responsible for reviewing changes in control of bank holding companies. In doing so, the Federal Reserve Board reviews the financial position, experience and integrity of the acquiring person, and the effect the change of control will have on the financial condition of the Corporation, relevant markets, and federal deposit insurance funds.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act (SOX), also known as the "Public Company Accounting Reform and Investor Protection Act," was established in 2002 and introduced major changes to the regulation of financial practice. SOX was established as a reaction to the outbreak of corporate and accounting scandals, including Enron and WorldCom. SOX represents a comprehensive revision of laws affecting corporate governance, accounting obligations, and corporate reporting. SOX is applicable to all companies with equity or debt securities that are either registered, or file reports under the Securities Exchange Act of 1934.

Section 404 of SOX requires publicly held companies to document and test their internal controls that impact financial reporting and report on the findings, known as Section 404a. External auditors also must test and report on the effectiveness of a company's internal controls to ensure accurate financial reporting, which is known as Section 404b. Companies must report any deficiencies or material weaknesses in their internal controls, as well as their remediation efforts. To ensure greater investor confidence in corporate disclosures from public companies, SOX restricts the services that public accounting firms can provide to publicly traded companies. The Corporation does not engage the same professional accounting firm for external and internal auditing.

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The provisions of Sections 404a and 404b of SOX vary according to the publically traded market capitalization, referred to as accelerated or non-accelerated filers. While accelerated filers had to comply with Section 404a and 404b since 2004, with their auditors required to report on the effectiveness of internal controls, the Corporation has been a non-accelerated filer with a publicly traded market capitalization under $75 million, and therefore was not required to comply with Section 404b. The Corporation has always been subject to Section 404a.

In 2008, the SEC expanded the definitions of smaller public companies beyond non-accelerated filers to include a new definition of smaller reporting company. The smaller reporting company definition was more favorable to smaller businesses that qualified under certain conditions. On July 1, 2008, the Corporation came into existence as ENB Financial Corp, which succeeded Ephrata National Bank. With the new entity and new SEC registration, the Corporation changed the filing status from non-accelerated filer to smaller reporting company. The Corporation continues to meet the definition of a smaller reporting company as it has a public equity float of approximately $61.3 million as of June 30, 2018.

On July 21, 2010, when the Dodd-Frank Act was signed into law, Section 404b was permanently deferred for all smaller reporting companies. The Corporation would become subject to Section 404b requirements of SOX at the end of 2019 if public float exceeds $75 million on June 30, 2019, at which time the Corporation would be considered an accelerated filer.

Bank Supervision and Regulation

Safety and Soundness

The primary regulator for the Bank is the OCC. The OCC has the authority under the Financial Institutions Supervisory Act and the Federal Deposit Insurance Act to prevent a national bank from engaging in any unsafe or unsound practice in conducting business or from otherwise conducting activities in violation of the law.

Federal and state banking laws and regulations govern, but are not limited to, the following:

- Scope of a bank’s business
- Investments a bank may make
- Reserves that must be maintained against certain deposits

- Loans a bank makes and collateral it takes
- Merger and consolidation activities
- Establishment of branches

The Corporation is a member of the Federal Reserve System. Therefore, the policies and regulations of the Federal Reserve Board have a significant impact on many elements of the Corporation’s operations, including:

- Loan and deposit growth
- Rate of interest earned and paid
- Types of securities
- Breadth of financial services provided
- Levels of liquidity
- Levels of required capital

Management cannot predict the effect of changes to such policies and regulations upon the Corporation’s business model and the corresponding impact they may have on future earnings.

FDIC Insurance Assessments

The FDIC imposes a risk-related premium schedule for all insured depository institutions that results in the assessment of premiums based on the Bank’s capital and supervisory measures. Under the risk-related premium schedule, the FDIC assigns, on a semi-annual basis, each depository institution to one of three capital groups, the best of these being “Well Capitalized.” For purposes of calculating the insurance assessment, the Bank was considered “Well Capitalized” as of December 31, 2018, and December 31, 2017. This designation has benefited the Bank in the past and continues to benefit it in terms of a lower quarterly FDIC rate. The FDIC adjusts the insurance rates when necessary. FDIC insurance rates have been significantly higher in recent years compared to years prior to the financial crisis. In 2008, during the financial crisis, the FDIC insurance limit was increased from

$100,000 to $250,000 along with unlimited insurance coverage on non-interest bearing deposits and interest bearing deposit balances with interest rates less than or equal to 0.50%. Significant increases in the FDIC insurance costs were assessed in 2009 to both cover the increased level of bank failures that were occurring and the higher level of coverage. Since then the number of bank failures has significantly declined and the FDIC has been able to decrease the cost of the insurance. The total FDIC assessments paid by the Bank in 2018 were $285,000, compared to $268,000 in 2017.

In addition to FDIC insurance costs, the Bank is subject to assessments to pay the interest on Financing Corporation Bonds. Congress created the Financing Corporation to issue bonds to finance the resolution of failed thrift institutions. These assessment rates are set quarterly. The total Financing Corporation assessments paid by the Bank in 2018 were $29,000 compared to $53,000 in 2017.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act made the temporary $250,000 FDIC insurance coverage the permanent standard maximum deposit insurance amount. Additionally, on February 7, 2011, the Board of Directors of the FDIC approved a final rule based on the Dodd-Frank Act that revises the assessment base from one based on domestic deposits to one based on assets. This change, which was effective in April 2011, saved the Corporation a significant amount of FDIC insurance premiums.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), as amended, the OCC is required to assess all financial institutions that it regulates to determine whether these institutions are meeting the credit needs of the community that they serve. The Act focuses specifically on low and moderate income neighborhoods. The OCC takes an institution’s CRA record into account in its evaluation of any application made by any of such institutions for, among other things:

- Approval of a new branch or other deposit facility
- Closing of a branch or other deposit facility
- An office relocation or a merger
- Any acquisition of bank shares

The CRA, as amended, also requires that the OCC make publicly available the evaluation of a bank’s record of meeting the credit needs of its entire community, including low and moderate income neighborhoods. This evaluation includes a descriptive rating of either outstanding, satisfactory, needs to improve, or substantial noncompliance, along with a statement describing the basis for the rating. These ratings are publicly disclosed. The Bank received an outstanding rating on the most recent CRA Performance Evaluation completed on June 22, 2015.

The Federal Deposit Insurance Corporation Improvement Act of 1991

Capital Adequacy

Under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), institutions are classified in one of five defined categories as illustrated below:

Capital Category	Total Capital Ratio	Tier I Capital Ratio	Common Equity Tier I Capital Ratio	Leverage Ratio
Well Capitalized	≥ 10.0	> 8.0	≥ 6.5	≥ 5.0
Adequately Capitalized	≥ 8.0	> 6.0	≥ 4.5	≥ 4.0*
Undercapitalized	< 8.0	< 6.0	< 4.5	< 4.0*
Significantly Undercapitalized	< 6.0	< 4.0	< 3.5	< 3.0
Critically Undercapitalized				≤ 2.0

*3.0 for those banks having the highest available regulatory rating.

The Bank's and Corporation's capital ratios exceed the regulatory requirements to be considered well capitalized for Total Risk-Based Capital, Tier I Risk-Based Capital, Common Equity Tier I Capital, and Tier I Leverage Capital. The capital ratio table and Consolidated Financial Statement Note M – Regulatory Matters and Restrictions, are incorporated by reference herein, from Item 8, and made a part hereof. Note M discloses capital ratios for both the Bank and the Corporation, shown as Consolidated.

Regulatory Capital Changes

In July 2013, the federal banking agencies issued final rules to implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act. The phase-in period for community banking organizations began January 1, 2015, while larger institutions (generally those with assets of $250 billion or more) began compliance on January 1, 2014. The final rules call for the following capital requirements:

- A minimum ratio of common equity tier I capital to risk-weighted assets of 4.5%
- A minimum ratio of tier I capital to risk-weighted assets of 6%
- A minimum ratio of total capital to risk-weighted assets of 8%
- A minimum leverage ratio of 4%

In addition, the final rules established a common equity tier I capital conservation buffer of 2.5% of risk-weighted assets applicable to all banking organizations. If a banking organization fails to hold capital above the minimum capital ratios and the capital conservation buffer, it will be subject to certain restrictions on capital distributions and discretionary bonus payments. The phase-in period for the capital conservation and countercyclical capital buffers for all banking organizations began on January 1, 2016.

Under the initially proposed rules, accumulated other comprehensive income (AOCI) would have been included in a banking organization's common equity tier I capital. The final rules allowed community banks to make a one-time election not to include these additional components of AOCI in regulatory capital and instead use the existing treatment under the general risk-based capital rules that excludes most AOCI components from regulatory capital. The opt-out election was made by the Corporation with the filing of the first quarter Call Report as of March 31, 2015.

The final rules permanently grandfather non-qualifying capital instruments (such as trust preferred securities and cumulative perpetual preferred stock) issued before May 19, 2010 for inclusion in the tier I capital of banking organizations with total consolidated assets less than $15 billion as of December 31, 2009, and banking organizations that were mutual holding companies as of May 19, 2010. The Corporation does not have trust preferred securities or cumulative perpetual preferred stock with no plans to add these to the capital structure.

The proposed rules would have modified the risk-weight framework applicable to residential mortgage exposures to require banking organizations to divide residential mortgage exposures into two categories in order to determine the applicable risk weight. In response to commenter concerns about the burden of calculating the risk weights and the potential negative effect on credit availability, the final rules do not adopt the proposed risk weights but retain the current risk weights for mortgage exposures under the general risk-based capital rules.

Consistent with the Dodd-Frank Act, the new rules replace the ratings-based approach to securitization exposures, which is based on external credit ratings, with the simplified supervisory formula approach in order to determine the appropriate risk weights for these exposures. Alternatively, banking organizations may use the existing gross-up approach to assign securitization exposures to a risk weight category or choose to assign such exposures a 1,250 percent risk weight. The Corporation does not securitize assets and has no plans to do so.

Under the new rules, mortgage servicing assets (MSAs) and certain deferred tax assets (DTAs) are subject to stricter limitations than those applicable under the current general risk-based capital rule. The new rules also increase the risk weights for past-due loans, certain commercial real estate loans, and some equity exposures, and makes selected other changes in risk weights and credit conversion factors.

Management has evaluated the impact of the above rules on levels of the Corporation's capital. The final rulings were highly favorable in terms of the items that would have a more significant impact to the Corporation and community banks in general. Specifically, the AOCI final ruling, which would have had the greatest impact, now provides the Corporation with an opt-out provision. The final ruling on the risk weightings of mortgages was favorable and did not have a material negative impact. The rulings as to trust preferred securities, preferred stock, and securitization of assets are not applicable to the Corporation, and presently the revised treatment of MSAs is not material to capital. The remaining changes to risk weightings on several items mentioned above such as past-due loans and certain commercial real estate loans do not have a material impact to capital presently, but could change as these levels change.

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Real Estate Lending Standards

Pursuant to the FDICIA, federal banking agencies adopted real estate lending guidelines which would set loan-to-value ("LTV") ratios for different types of real estate loans. The LTV ratio is generally defined as the total loan amount divided by the appraised value of the property at the time the loan is originated. If the institution does not hold a first lien position, the total loan amount would be combined with the amount of all junior liens when calculating the ratio. In addition to establishing the LTV ratios, the guidelines require all real estate loans to be based upon proper loan documentation and a recent appraisal or certificate of inspection of the property.

Prompt Corrective Action

In the event that an institution's capital deteriorates to the Undercapitalized category or below, FDICIA prescribes an increasing amount of regulatory intervention, including:

- Implementation of a capital restoration plan and a guarantee of the plan by a parent institution
- Placement of a hold on increases in assets, number of branches, or lines of business

If capital reaches the significantly or critically undercapitalized level, further material restrictions can be imposed, including restrictions on interest payable on accounts, dismissal of management, and (in critically undercapitalized situations) appointment of a receiver. For well-capitalized institutions, FDICIA provides authority for regulatory intervention where they deem the institution to be engaging in unsafe or unsound practices, or if the institution receives a less than satisfactory examination report rating for asset quality, management, earnings, liquidity, or sensitivity to market risk.

Other FDICIA Provisions

Each depository institution must submit audited financial statements to its primary regulator and the FDIC, whose reports are made publicly available. In addition, the audit committee of each depository institution must consist of outside directors and the audit committee at "large institutions" (as defined by FDIC regulation) must include members with banking or financial management expertise. The audit committee at "large institutions" must also have access to independent outside counsel. In addition, an institution must notify the FDIC and the institution's primary regulator of any change in the institution's independent auditor, and annual management letters must be provided to the FDIC and the depository institution's primary regulator. The regulations define a "large institution" as one with over $500 million in assets, which does include the Bank. Also, under the rule, an institution's independent public accountant must examine the institution's internal controls over financial reporting and perform agreed-upon procedures to test compliance with laws and regulations concerning safety and soundness.

Under the FDICIA, each federal banking agency must prescribe certain safety and soundness standards for depository institutions and their holding companies. Three types of standards must be prescribed:

- asset quality and earnings
- operational and managerial, and
- compensation

Such standards would include a ratio of classified assets to capital, minimum earnings, and, to the extent feasible, a minimum ratio of market value to book value for publicly traded securities of such institutions and holding companies. Operational and managerial standards must relate to:

- internal controls, information systems and internal audit systems
- loan documentation
- credit underwriting
- interest rate exposure
- asset growth, and
- compensation, fees and benefits

The FDICIA also sets forth Truth in Savings disclosure and advertising requirements applicable to all depository institutions.

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USA PATRIOT Act of 2001/Bank Secrecy Act

In October 2001, the USA Patriot Act of 2001 (Patriot Act) was enacted in response to the terrorist attacks in New York, Pennsylvania and Washington, D.C., which occurred on September 11, 2001. The Patriot Act is intended to strengthen U.S. law enforcement's and the intelligence communities' abilities to work cohesively to combat terrorism on a variety of fronts. The impact of the Patriot Act on financial institutions of all kinds is significant and wide ranging. The Patriot Act contains sweeping anti-money laundering and financial transparency laws and imposes various regulations, including standards for verifying client identification at account opening, and rules to promote cooperation among financial institutions, regulators and law enforcement entities in identifying parties that may be involved in terrorism or money laundering.

Under the Bank Secrecy Act (BSA), banks and other financial institutions are required to report to the Internal Revenue Service currency transactions of more than $10,000 or multiple transactions of which a bank is aware in any one day that aggregate in excess of $10,000 and to report suspicious transactions under specified criteria. Civil and criminal penalties are provided under the BSA for failure to file a required report, for failure to supply information required by the BSA, or for filing a false or fraudulent report.

Loans to Insiders/Regulation O

Regulation O, also known as Loans to Insiders, governs the permissible lending relationships between a bank and its executive officers, directors, and principal shareholders and their related interests. The primary restriction of Regulation O is that loan terms and conditions, including interest rates and collateral coverage, can be no more favorable to the insider than loans made in comparable transactions to non-covered parties. Additionally, the loan may not involve more than normal risk. The regulation requires quarterly reporting to regulators of the total amount of credit extended to insiders.

Under Regulation O, a bank is not required to obtain approval from the bank's Board of Directors prior to making a loan to an executive officer or Board of Director member as long as a first lien on the executive officer's residence secures the loan. The Corporation's policy requires prior Board of Director approval of any Executive Officer or Director loan that when aggregated with other outstanding extensions of credit to the Insider and their related interests exceeds $500,000. Loans to any Executive Officer or Director with aggregate exposure of under $500,000 must be reported at the next scheduled Board of Director meeting. Further amendments allow bank insiders to take advantage of preferential loan terms that are available to substantially all employees. Regulation O does permit an insider to participate in a plan that provides more favorable credit terms than the bank provides to non-employee customers provided that the plan:

- Is widely available to employees
- Does not give preference to any insider over other employees

The Bank has a policy in place that offers general employees more favorable loan terms than those offered to non-employee customers. The Bank’s policy on loans to insiders allows insiders to participate in the same favorable rate and terms offered to all other employees; however, any loan to an insider that does not fall within permissible regulatory exceptions must receive the prior approval of the Bank’s Board of Directors.

Dodd-Frank Wall Street Reform and Consumer Protection Act

Dodd-Frank Act, was the culmination of the legislative efforts in response to the financial crisis of 2007 - 2008. The act reshaped Wall Street and the American banking industry by bringing the most significant changes to financial regulation in the United States since the regulatory reform that followed the Great Depression. The Act’s numerous provisions were to be implemented over a period of several years and were intended to decrease various risks in the U.S. financial system. Dodd-Frank created a new Financial Stability Oversight Council to identify systemic risks in the financial system and gave federal regulators new authority to take control of and liquidate financial firms. Dodd-Frank was expected to and did have an impact on the Corporation’s business operations as its provisions began to take effect. To date the provisions that did go into effect, or began to phase in, did at a minimum increase the Corporation’s operating and compliance costs. Some of the provisions could possibly reduce fee revenue and/or increase interest expense. It is difficult to predict at this time what additional provisions of the Dodd-Frank Act will occur or be rolled back under the Trump administration. President Trump signed an executive order on February 3, 2017 designed to scale back the Dodd-Frank Act. The order lays the groundwork for sweeping change to the current law and if successfully pushed through Congress, could eventually lead to a replacement of Dodd-Frank. As such it is difficult to predict the impact that this legislation, or replacement legislation, will have on community banks going forward. Among the provisions that have either begun to affect the Corporation, or are likely to in the future, are the following:

Holding Company Capital Requirements

Dodd-Frank requires the Federal Reserve to apply consolidated capital requirements to bank holding companies that are no less stringent than those currently applied to depository institutions. Under these standards, trust preferred securities will be excluded from Tier I capital unless such securities were issued prior to May 19, 2010, by a bank holding company with less than $15 billion in assets. Dodd-Frank additionally requires that bank regulators issue countercyclical capital requirements so that the required amount of capital increases in times of economic expansion and decreases in times of economic contraction, are consistent with safety and soundness.

Corporate Governance

Dodd-Frank requires publicly traded companies to give stockholders a non-binding vote on executive compensation at least every three years, a non-binding vote regarding the frequency of the vote on executive compensation at least every six years, and a non-binding vote on “golden parachute” payments in connection with approvals of mergers and acquisitions unless previously voted on by shareholders. The SEC has finalized the rules implementing these requirements which took effect on January 21, 2011. The Corporation was exempt from these requirements until January 21, 2013, due to its status as a smaller reporting company. Additionally, Dodd-Frank directs the federal banking regulators to promulgate rules prohibiting excessive compensation paid to executives of depository institutions and their holding companies with assets in excess of $1 billion, regardless of whether the company is publicly traded. Dodd-Frank also gives the SEC authority to prohibit broker discretionary voting on elections of directors and executive compensation matters.

Consumer Financial Protection Bureau (CFPB)

Dodd-Frank created a new, independent federal agency called the Consumer Financial Protection Bureau (CFPB), which is granted broad rulemaking, supervisory and enforcement powers under various federal consumer financial protection laws, including the Equal Credit Opportunity Act, Truth in Lending Act, Real Estate Settlement Procedures Act, Fair Credit Reporting Act, Fair Debt Collection Act, the Consumer Financial Privacy Provisions of the Gramm-Leach-Bliley Act, and certain other statutes. The CFPB has examination and primary enforcement authority with respect to depository institutions with $10 billion or more in assets. Smaller institutions are subject to rules promulgated by the CFPB but continue to be examined and supervised by federal banking regulators for consumer compliance purposes. The CFPB has authority to prevent unfair, deceptive, or abusive practices in connection with the offering of consumer financial products. Dodd-Frank authorized the CFPB to establish certain minimum standards for the origination of residential mortgages including a determination of the borrower’s ability to repay. In addition, Dodd-Frank allows borrowers to raise certain defenses to foreclosure if they receive any loan other than a “qualified mortgage” as defined by the CFPB. Dodd-Frank permits states to adopt consumer protection laws and standards that are more stringent than those adopted at the federal level and, in certain circumstances, permits state attorneys general to enforce compliance with both the state and federal laws and regulations.

Ability-to-Repay and Qualified Mortgage Rule

Pursuant to the Dodd-Frank Act, the CFPB issued a final rule on January 10, 2013 (effective on January 10, 2014), amending Regulation Z as implemented by the Truth in Lending Act, requiring mortgage lenders to make a reasonable and good faith determination based on verified and documented information that a consumer applying for a mortgage loan has a reasonable ability to repay the loan according to its terms. Mortgage lenders are required to determine consumers' ability to repay in one of two ways. The first alternative requires the mortgage lender to consider the following eight underwriting factors when making the credit decision: (1) current or reasonably expected income or assets; (2) current employment status; (3) the monthly payment on the covered transaction; (4) the monthly payment on any simultaneous loan; (5) the monthly payment for mortgage-related obligations; (6) current debt obligations, alimony, and child support; (7) the monthly debt-to-income ratio or residual income; and (8) credit history. Alternatively, the mortgage lender can originate "qualified mortgages," which are entitled to a presumption that the creditor making the loan satisfied the ability-to-repay requirements. In general, a "qualified mortgage" is a mortgage loan without negative amortization, interest-only payments, balloon payments, or terms exceeding 30 years. In addition, to be a qualified mortgage the points and fees paid by a consumer cannot exceed 3% of the total loan amount. Loans which meet these criteria will be considered qualified mortgages, and as a result generally protect lenders from fines or litigation in the event of foreclosure. Qualified mortgages that are "higher-priced" (e.g. subprime loans) garner a rebuttable presumption of compliance with the ability-to-repay rules, while qualified mortgages that are not "higher-priced" (e.g. Prime loans) are given a safe harbor of compliance. The final rule, as issued, is not expected to have a material impact on the Corporation's lending activities and on the Corporation's Consolidated Financial Statements.

Interchange Fees

Under the Durbin Amendment to the Dodd-Frank Act, the Federal Reserve adopted rules establishing standards for assessing whether the interchange fees that may be charged with respect to certain electronic debit transactions are "reasonable and proportional" to the costs incurred by issuers for processing such transactions.

Interchange fees or "swipe" fees, are charges that merchants pay to the Corporation and other card-issuing banks for processing electronic payment transactions. The Federal Reserve Board has ruled that for financial institutions with assets of $10 billion or more the maximum permissible interchange fee for an electronic debit transaction is the sum of 21 cents per transaction and 5 basis points multiplied by the value of the transaction. The Federal Reserve Board also has rules governing routing and exclusivity that require issuers to offer two unaffiliated networks for routing transactions on each debit or prepaid product. While the Corporation's asset size is presently under $10 billion, there is concern that these requirements impacting financial institutions over $10 billion in assets will eventually be pushed down to either financial institutions over $1 billion or to all financial institutions. This would negatively impact the Corporation's non-interest income.

TILA/RESPA Integrated Disclosure (TRID) Rules

The TRID rules were mandated by Dodd-Frank to address the problem of the sometimes duplicative and overlapping disclosures required by the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) involving consumer purpose, closed end loans secured by real property. The CFPB was tasked with developing the new disclosures, defining the regulatory compliance parameters, and implementation. The timing elements built around these new disclosures were established to provide the consumer with ample time to consider the credit transaction and its associated costs. The final rules were implemented by amending the Truth in Lending Act; however implementation proved to be difficult as this marked the first time in thirty years that these standard disclosures were changed. Much reliance was placed on third party providers to the financial institutions to make all the necessary changes to the disclosures. After one delay, the rules became effective October 3, 2015. The Corporation partnered with its loan document software providers to ensure timely, compliant implementation.

Department of Defense Military Lending Rule

In 2015, the U.S. Department of Defense issued a final rule which restricts pricing and terms of certain credit extended to active duty military personnel and their families. This rule, which was implemented effective October 3, 2016, caps the interest rate on certain credit extensions to an annual percentage rate of 36% and restricts other fees. The rule requires financial institutions to verify whether customers are military personnel subject to the rule. The impact of this final rule, and any subsequent amendments thereto, on the Corporation's lending activities and the Corporation's statements of income or condition has had little or no impact; however, management will continue to monitor the implementation of the rule for any potential side effects on the Corporation's business.

Tax Cuts and Jobs Act

The Tax Cuts and Jobs Act was signed into law in December 2017. Among other changes, the Tax Cuts and Jobs Act reduced the federal corporate tax rate from 35% to 21% effective January 1, 2018. This tax rate change reduced the Corporation's income tax liability in 2018 and should continue to reduce it in future years. However, the Corporation did recognize certain effects of the tax law changes in 2017. U.S. generally accepted accounting principles require companies to re-value their deferred tax assets and liabilities as of the date of enactment, with resulting tax effects accounted for in the reporting period of enactment. Since the enactment took place in December 2017, the Corporation revalued its net deferred tax assets in the fourth quarter of 2017 resulting in an approximately $1.1 million reduction to earnings in 2017.

Cybersecurity

In March 2015, federal regulators issued two related statements regarding cybersecurity. One statement instructed financial institutions to design multiple layers of security controls to establish lines of defense and to ensure that their risk management practices cover the risk of compromised customer credentials, including security measures to reliably authenticate customers accessing internet-based services of the financial institution. The other statement indicates that a financial institution's management is expected to maintain sufficient business continuity planning processes to ensure the rapid recovery, resumption and maintenance of the institution's operations after a cyber-attack involving malware. Financial institutions are expected to develop appropriate processes to enable recovery of data and business operations and address the rebuilding of network capabilities and restoring data if the institution or its critical service providers are victim to a cyber-attack. The Corporation could be subject to fines or penalties if it fails to observe this regulatory guidance. See Item 1A. Risk Factors for further discussion of risks related to cybersecurity.

Ongoing Legislation

As a consequence of the extensive regulation of the financial services industry and specifically commercial banking activities in the United States, the Corporation's business is particularly susceptible to changes in federal and state legislation and regulations. Over the course of time, various federal and state proposals for legislation could result in additional regulatory and legal requirements for the Corporation. Management cannot predict if any such legislation will be adopted, or if adopted, how it would affect the business of the Corporation. Past history has demonstrated that new legislation or changes to existing legislation usually results in a heavier compliance burden and generally increases the cost of doing business.

Management believes that the effect of any current legislative proposals on the liquidity, capital resources and the results of operations of the Corporation and the Bank will be minimal. It is possible that there will be regulatory proposals which, if implemented, could have a material effect upon our liquidity, capital resources and results of operations. In addition, the general cost of compliance with numerous federal and state laws does have, and in the future may have, a negative impact on our results of operations. As with other banks, the status of the financial services industry can affect the Bank. Consolidations of institutions are expected to continue as the financial services industry seeks greater efficiencies and market share. Bank management believes that such consolidations may enhance the Bank's competitive position as a community bank. See Item 1A. Risk Factors for more information.

Statistical Data

The statistical disclosures required by this item are incorporated by reference herein, from Item 6 on page 30 and the Consolidated Statements of Income on page 80 as found in this Form 10-K filing.

Available Information

A copy of the Corporation's Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, as required to be filed with the Securities and Exchange Commission pursuant to Securities Exchange Act Rule 13a-1, may be obtained, without charge, from our website: www.enbfc.com or by request via e-mail to bharting@epnb.com. This information may also be obtained via written request to Mr. Barry W. Harting, Vice President and Corporate Secretary at ENB Financial Corp, 31 East Main Street, P.O. Box 457, Ephrata, PA, 17522.

The Corporation's reports, proxy statements, and other information are available for inspection and copying at the SEC Public Reference Room at 100 F Street, N.E., Washington, DC, 20549 at prescribed rates. The public may obtain information on the operation of the Public Reference Room by calling the Commission at 1-800-SEC-0330. The Corporation is an electronic filer with the Commission. The Commission maintains a website that contains reports, proxy and information statements, and other information regarding registrants that file electronically with the Commission. The address of the Commission's website is http://www.sec.gov.

Item 1A. Risk Factors

An investment in the Corporation's common stock is subject to risks inherent to the banking industry and the equity markets. The material risks and uncertainties that management believes affect the Corporation are described below. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included or incorporated by reference in this report. The risks and uncertainties described below are not the only ones facing the Corporation. Additional risks and uncertainties that management is not aware of or is not focused on, or currently deems immaterial, may also impair the Corporation's business operations. This report is qualified in its entirety by these risk factors.

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If any of the following risks actually occur, the Corporation’s financial condition and results of operations could be materially and adversely affected. If this were to happen, the value of the Corporation’s common stock could decline significantly, and you could lose all or part of your investment.

Risks Related To The Corporation’s Business

The Corporation Is Subject To Interest Rate Risk

The Corporation’s earnings and cash flows are largely dependent upon its net interest income. Net interest income is the difference between interest income earned on interest earning assets, such as loans and securities, and interest expense paid on interest bearing liabilities, such as deposits and borrowed funds. Interest rates are highly sensitive to many factors that are beyond the Corporation’s control, including general economic conditions and policies of various governmental and regulatory agencies, particularly, the Board of Governors of the Federal Reserve System. Changes in monetary policy, including changes in interest rates, could influence not only the interest the Corporation receives on loans and securities, but also the amount of interest it pays on deposits and borrowings. Changes in interest rates could also affect:

- The Corporation’s ability to originate loans and obtain deposits
- The fair value of the Corporation’s financial assets and liabilities
- The average duration of the Corporation’s assets and liabilities
- The future liquidity of the Corporation

If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other securities, the Corporation’s net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other securities fall more quickly than the interest rates paid on deposits and other borrowings.

Although management believes it has implemented effective asset and liability management strategies to reduce the potential effects of changes in interest rates on the Corporation’s results of operations, any substantial, unexpected, prolonged change in market interest rates could have a material adverse effect on the Corporation’s financial condition and results of operations.

The Corporation Is Subject To Lending Risk

There are inherent risks associated with the Corporation's lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where the Corporation operates, as well as those across the Commonwealth of Pennsylvania and the United States. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing these loans. The Corporation is also subject to various laws and regulations that affect its lending activities. Failure to comply with applicable laws and regulations could subject the Corporation to regulatory enforcement action that could result in the assessment of significant civil money penalties against the Corporation.

As of December 31, 2018, 41.2% of the Corporation's loan portfolio consisted of commercial, industrial, and construction loans secured by real estate. Another 15.0% of the Corporation's loan portfolio consisted of commercial loans not secured by real estate. These types of loans are generally viewed as having more risk of default than consumer real estate loans or other consumer loans. These types of loans are also typically larger than consumer real estate loans and other consumer loans. Because the Corporation's loan portfolio contains a significant number of commercial and industrial, construction, and commercial real estate loans with relatively large balances, the deterioration of one or a few of these loans could cause a significant increase in non-performing loans. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for possible loan losses, and an increase in loan charge-offs, all of which could have a material adverse effect on the Corporation's financial condition and results of operations.

A New Accounting Standard Will Result In A Significant Change In How We Recognize Credit Losses And May Have A Material Impact On Our Financial Condition Or Results Of Operations.

In June 2016, the Financial Accounting Standards Board ("FASB") issued an accounting standard update, "Financial Instruments-Credit Losses (Topic 326), Measurement of Credit Losses on Financial Instruments," which replaces the current “incurred loss” model for recognizing credit losses with an “expected loss” model referred to as the Current Expected Credit Loss (“CECL”) model. Under the CECL model, we will be required to present certain financial assets carried at amortized cost, such as loans held for investment and held-to-maturity debt securities, at the net amount expected to be collected. The measurement of expected credit losses is to be based on information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. This measurement will take place at the time the financial asset is first added to the balance sheet and periodically thereafter. This differs significantly from the “incurred loss” model required under current generally accepted accounting principles (“GAAP”), which delays recognition until it is probable a loss has been incurred. Accordingly, we expect that the adoption of the CECL model will materially affect how we determine our allowance for loan losses and could require us to significantly increase our allowance. Moreover, the CECL model may create more volatility in the level of our allowance for loan losses. If we are required to materially increase our level of allowance for loan losses for any reason, such increase could adversely affect our business, financial condition and results of operations.

The new CECL standard will become effective for us on January 1, 2020, and for interim periods within that year. We are currently evaluating the impact the CECL model will have on our accounting, but we expect to recognize a one-time cumulative-effect adjustment to our allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, consistent with regulatory expectations set forth in interagency guidance issued at the end of 2016. We cannot yet determine the magnitude of any such one-time cumulative adjustment or of the overall impact of the new standard on our business, financial condition and results of operations.

The Corporation’s Allowance For Possible Loan Losses May Be Insufficient

The Corporation maintains an allowance for possible loan losses, which is a reserve established through a provision for loan losses, charged to expense. The allowance represents management’s best estimate of expected losses inherent in the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The level of the allowance reflects management’s continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political, and regulatory conditions, and unidentified losses inherent in the current loan portfolio. Determining the appropriate level of the allowance for possible loan losses understandably involves a high degree of subjectivity and requires the Corporation to make significant estimates of current credit risks and future trends, all of which may undergo material changes. Changes in economic conditions affecting borrowers, new information regarding existing loans, identification of additional problem loans, and other factors, both within and outside of the Corporation’s control, may require an increase in the allowance for possible loan losses. In addition, bank regulatory agencies periodically review the Corporation’s allowance for loan losses and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management. In addition, if charge-offs in future periods exceed the allowance for possible loan losses, the Corporation will need additional provisions to increase the allowance for possible loan losses. Any increases in the allowance for possible loan losses will result in a decrease in net income, and may have a material adverse effect on the Corporation’s financial condition and results of operations.

The Basel III Capital Requirements May Require Us To Maintain Higher Levels Of Capital, Which Could Reduce Our Profitability

Basel III targets higher levels of base capital, certain capital buffers, and a migration toward common equity as the key source of regulatory capital. Although the new capital requirements are phased in over the next decade, Basel III signals a growing effort by domestic and international bank regulatory agencies to require financial institutions, including depository institutions, to maintain higher levels of capital. As Basel III is implemented, regulatory viewpoints could change and require additional capital to support our business risk profile. If the Corporation and the Bank are required to maintain higher levels of capital, the Corporation and the Bank may have fewer opportunities to invest capital into interest-earning assets, which could limit the profitable business operations available to the Corporation and the Bank and adversely impact our financial condition and results of operations.

Future Credit Downgrades Of The United States Government Due To Issues Relating To Debt And The Deficit May Adversely Affect The Corporation

As a result of past difficulties of the federal government to reach agreement over federal debt and issues connected with the debt ceiling, certain rating agencies placed the United States Government's long-term sovereign debt rating on their equivalent of negative watch and announced the possibility of a rating downgrade. The rating agencies, due to constraints related to the rating of the United States, also placed government-sponsored enterprises in which the

Corporation invests and receives lines of credit on negative watch and a downgrade of the United States credit rating would trigger a similar downgrade in the credit rating of these government-sponsored enterprises. Furthermore, the credit rating of other entities, such as state and local governments, may also be downgraded should the United States credit rating be downgraded. Credit downgrades often cause a lower valuation of the Corporation's securities.

The Corporation Is Subject To Environmental Liability Risk Associated With Lending Activities

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

If The Corporation Concludes That The Decline In Value Of Any Of Its Investment Securities Is Other Than Temporary, The Corporation is Required To Write Down The Value Of That Security Through A Charge To Earnings

The Corporation reviews the investment securities portfolio at each quarter-end reporting period to determine whether the fair value is below the current carrying value. When the fair value of any of the investment securities has declined below its carrying value, the Corporation is required to assess whether the decline is other than temporary. If it concludes that the decline is other than temporary, it is required to write down the value of that security through a charge to earnings. Changes in the expected cash flows of these securities and/or prolonged price declines have resulted and may result in concluding in future periods that there is additional impairment of these securities that is other than temporary, which would require a charge to earnings to write down these securities to their fair value. Due to the complexity of the calculations and assumptions used in determining whether an asset is impaired, the impairment disclosed may not accurately reflect the actual impairment in the future.

The Corporation's Profitability Depends Significantly On Economic Conditions In The Commonwealth Of Pennsylvania And Its Market Area

The Corporation's success depends primarily on the general economic conditions of the Commonwealth of Pennsylvania, and more specifically, the local markets in which the Corporation operates. Unlike larger national or other regional banks that are more geographically diversified, the Corporation provides banking and financial services to customers primarily located in Lancaster County, as well as Berks, Chester, and Lebanon Counties. The local economic conditions in these areas have a significant impact on the demand for the Corporation's products and services as well as the ability of the Corporation's customers to repay loans, the value of the collateral securing loans, and the stability of the Corporation's deposit funding sources. A significant decline in general economic conditions, caused by inflation, recession, acts of terrorism, outbreak of hostilities or other international or domestic occurrences, unemployment, changes in securities markets, or other factors could impact these local economic conditions and, in turn, have a material adverse effect on the Corporation's financial condition and results of operations.

The Earnings Of Financial Services Companies Are Significantly Affected By General Business And Economic Conditions

The Corporation's operations and profitability are impacted by general business and economic conditions in the United States and abroad. These conditions include short-term and long-term interest rates, inflation, money supply, political issues, legislative and regulatory changes, fluctuations in both debt and equity capital markets, broad trends in industry and finance, and the strength of the U.S. economy and the local economies in which the Corporation operates, all of which are beyond the Corporation's control. Deterioration in economic conditions could result in an increase in loan delinquencies and non-performing assets, decreases in loan collateral values and a decrease in demand for the Corporation's products and services, among other things, any of which could have a material adverse impact on the Corporation's financial condition and results of operations.

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The Corporation Operates In A Highly Competitive Industry And Market Area

The Corporation faces substantial competition in all areas of its operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional, and community banks within the various markets in which the Corporation operates. Additionally, various out-of-state banks have begun to enter or have announced plans to enter the market areas in which the Corporation currently operates. The Corporation also faces competition from many other types of financial institutions, including, without limitation, online banks, savings and loans, credit unions, finance companies, brokerage firms, insurance companies, and other financial intermediaries. The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes, and continued consolidation. Banks, securities firms, and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting), and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of the Corporation’s competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than the Corporation can offer.

The Corporation’s ability to compete successfully depends on a number of factors, including, among other things:

- The ability to develop, maintain, and build upon long-term customer relationships based on quality service, high ethical standards, and safe, sound management practices
- The ability to expand the Corporation’s market position
- The scope, relevance, and pricing of products and services offered to meet customer needs and demands
- The rate at which the Corporation introduces new products and services relative to its competitors
- Customer satisfaction with the Corporation’s level of service
- Industry and general economic trends

Failure to perform in any of these areas could significantly weaken the Corporation’s competitive position, which could adversely affect the Corporation’s growth and profitability and have a material adverse effect on the Corporation’s financial condition and results of operations.

The Corporation Is Subject To Extensive Government Regulation And Supervision

The Corporation is subject to extensive federal and state regulation and supervision. Banking regulations are primarily intended to protect depositors’ funds, federal deposit insurance funds, and the banking system as a whole, not shareholders. These regulations affect the Corporation's lending practices, capital structure, investment practices, dividend policy, and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations, and policies for possible changes. Changes to statutes, regulations, or regulatory policies, including changes in interpretation or implementation of statutes, regulations, or policies, could affect the Corporation in substantial and unpredictable ways. Such changes could subject the Corporation to additional costs, limit the types of financial services and products the Corporation may offer, and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations, or policies could result in sanctions by regulatory agencies, civil money penalties, and/or reputation damage, which could have a material adverse effect on the Corporation's business, financial condition, and results of operations. While the Corporation has policies and procedures designed to prevent any such violations, there can be no assurance that such violations will not occur.

Future Governmental Regulation And Legislation Could Limit The Corporation's Future Growth

The Corporation is a registered bank holding company, and its subsidiary bank is a depository institution whose deposits are insured by the FDIC. As a result, the Corporation is subject to various regulations and examinations by various regulatory authorities. In general, statutes establish the corporate governance and eligible business activities for the Corporation, certain acquisition and merger restrictions, limitations on inter-company transactions such as loans and dividends, capital adequacy requirements, requirements for anti-money laundering programs and other compliance matters, among other regulations. The Corporation is extensively regulated under federal and state banking laws and regulations that are intended primarily for the protection of depositors, federal deposit insurance funds and the banking system as a whole. Compliance with these statutes and regulations is important to the Corporation's ability to engage in new activities and consummate additional acquisitions.

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In addition, the Corporation is subject to changes in federal and state tax laws as well as changes in banking and credit regulations, accounting principles and governmental economic and monetary policies. The Corporation cannot predict whether any of these changes may adversely and materially affect it. Federal and state banking regulators also possess broad powers to take supervisory actions as they deem appropriate. These supervisory actions may result in higher capital requirements, higher insurance premiums and limitations on the Corporation's activities that could have a material adverse effect on its business and profitability. While these statutes are generally designed to minimize potential loss to depositors and the FDIC insurance funds, they do not eliminate risk, and compliance with such statutes increases the Corporation's expense, requires management's attention and can be a disadvantage from a competitive standpoint with respect to non-regulated competitors.

The Regulatory Environment For The Financial Services Industry Is Being Significantly Impacted By Financial Regulatory Reform Initiatives In The United States And Elsewhere, Including Dodd-Frank And Regulations Promulgated To Implement It

Dodd-Frank, which was signed into law on July 21, 2010, comprehensively reforms the regulation of financial institutions, products and services. Dodd-Frank requires various federal regulatory agencies to implement numerous rules and regulations. Because the federal agencies are granted broad discretion in drafting these rules and regulations, many of the details and the impact of Dodd-Frank may not be known for many months or years. While much of how the Dodd-Frank and other financial industry reforms will change our current business operations depends on the specific regulatory reforms and interpretations, many of which have yet to be released or finalized, it is clear that the reforms, both under Dodd-Frank and otherwise, will have a significant effect on our entire industry. Although Dodd-Frank and other reforms will affect a number of the areas in which we do business, it is not clear at this time the full extent of the adjustments that will be required and the extent to which we will be able to adjust our businesses in response to the requirements. Although it is difficult to predict the magnitude and extent of these effects at this stage, we believe compliance with Dodd-Frank and implementing its regulations and initiatives will negatively impact revenue and increase the cost of doing business, both in terms of transition expenses and on an ongoing basis, and it may also limit our ability to pursue certain business opportunities.

The Corporation's Banking Subsidiary May Be Required To Pay Higher FDIC Insurance Premiums Or Special Assessments Which May Adversely Affect Its Earnings

Future bank failures may prompt the FDIC to increase its premiums above the current levels or to issue special assessments. The Corporation generally is unable to control the amount of premiums or special assessments that its subsidiary is required to pay for FDIC insurance. Any future changes in the calculation or assessment of FDIC insurance premiums may have a material adverse effect on the Corporation's results of operations, financial condition, and the ability to continue to pay dividends on common stock at the current rate or at all.

The Corporation's Controls And Procedures May Fail Or Be Circumvented

Management regularly reviews and updates the Corporation’s internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of the Corporation’s controls and procedures or failure to comply with regulations related to controls and procedures could have a material adverse effect on the Corporation’s business, results of operations, and financial condition.

New Lines Of Business Or New Products And Services May Subject The Corporation To Additional Risks

From time to time, the Corporation may implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts, particularly in instances where the markets are not fully developed. In developing and marketing new lines of business and/or new products and services, the Corporation may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of the Corporation’s system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business or new products or services could have a material adverse effect on the Corporation’s business, results of operations, and financial condition.

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The Corporation's Ability To Pay Dividends Depends On Earnings And Is Subject To Regulatory Limits

The Corporation's ability to pay dividends is also subject to its profitability, financial condition, capital expenditures, and other cash flow requirements. Dividend payments are subject to legal and regulatory limitations, generally based on net profits and retained earnings, imposed by the various banking regulatory agencies. There is no assurance that the Corporation will have sufficient earnings to be able to pay dividends or generate adequate cash flow to pay dividends in the future. The Corporation's failure to pay dividends on its common stock could have a material adverse effect on the market price of its common stock.

Future Acquisitions May Disrupt The Corporation's Business And Dilute Stockholder Value

The Corporation may use its common stock to acquire other companies or make investments in corporations and other complementary businesses. The Corporation may issue additional shares of common stock to pay for future acquisitions, which would dilute the ownership interest of current shareholders of the Corporation. Future business acquisitions could be material to the Corporation, and the degree of success achieved in acquiring and integrating these businesses into the Corporation could have a material effect on the value of the Corporation's common stock. In addition, any acquisition could require the Corporation to use substantial cash or other liquid assets or to incur debt. In those events, the Corporation could become more susceptible to economic downturns and competitive pressures.

The Corporation May Need To Or Be Required To Raise Additional Capital In The Future, And Capital May Not Be Available When Needed And On Terms Favorable To Current Shareholders

Federal banking regulators require the Corporation and its subsidiary bank to maintain adequate levels of capital to support their operations. These capital levels are determined and dictated by law, regulation, and banking regulatory agencies. In addition, capital levels are also determined by the Corporation's management and board of directors based on capital levels that they believe are necessary to support the Corporation's business operations.

If the Corporation raises capital through the issuance of additional shares of its common stock or other securities, it would likely dilute the ownership interests of current investors and could dilute the per share book value and earnings per share of its common stock. Furthermore, a capital raise through issuance of additional shares may have an adverse impact on the Corporation's stock price. New investors also may have rights, preferences and privileges senior to the Corporation's current shareholders, which may adversely impact its current shareholders. The Corporation's ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside of its control, and on its financial performance. Accordingly, the Corporation cannot be certain of its ability to raise additional capital on acceptable terms and acceptable time frames or to raise additional capital at all. If the Corporation cannot raise additional capital in sufficient amounts when needed, its ability to comply with regulatory capital requirements could be materially impaired. Additionally, the inability to raise capital in sufficient amounts may adversely affect the Corporation's financial condition and results of operations.

The Corporation May Not Be Able To Attract And Retain Skilled People

The Corporation's success highly depends on its ability to attract and retain key people. Competition for the best people in most activities engaged in by the Corporation can be intense and the Corporation may not be able to hire people or to retain them. The unexpected loss of services of one or more of the Corporation's key personnel could have a material adverse impact on the Corporation's business because of their skills, knowledge of the Corporation's market, years of industry experience, and the difficulty of promptly finding qualified replacement personnel. The Corporation does not currently have employment agreements or non-competition agreements with any of its senior officers.

The Corporation's Information Systems May Experience An Interruption Or Breach In Security

The Corporation relies heavily on communications and information systems to conduct its business. Any failure, interruption, or breach in security of these systems could result in failures or disruptions in the Corporation's customer relationship management, general ledger, deposit, loan, and other systems. While the Corporation has policies and procedures designed to prevent or limit the effect of the failure, interruption, or security breach of its information systems, there can be no assurance that any such failures, interruptions, or security breaches will not occur or, if they do occur, that they will be adequately addressed. Further, while the Corporation maintains insurance coverage that may, subject to policy terms and conditions including significant self-insured deductibles, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses. The occurrence of any failures, interruptions, or security breaches of the Corporation's information systems could damage the Corporation's reputation, adversely affecting customer or consumer confidence, result in a loss of customer business, subject the Corporation to additional regulatory scrutiny and possible regulatory penalties, or expose the

Corporation to civil litigation and possible financial liability, any of which could have a material adverse effect on the Corporation's financial condition and results of operations.

The Corporation Continually Encounters Technological Change

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. The Corporation's future success depends, in part, upon its ability to address the needs of its customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in the Corporation's operations. Many of the Corporation's competitors have substantially greater resources to invest in technological improvements. The Corporation may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could have a material adverse impact on the Corporation's business, financial condition, and results of operations.

The Corporation's Operations Of Its Business, Including Its Interaction With Customers, Are Increasingly Done Via Electronic Means, And This Has Increased Its Risks Related To Cyber Security

The Corporation is exposed to the risk of cyber-attacks in the normal course of business. In general, cyber incidents can result from deliberate attacks or unintentional events. The Corporation has observed an increased level of attention in the industry focused on cyber-attacks that include, but are not limited to, gaining unauthorized access to digital systems for purposes of misappropriating assets or sensitive information, corrupting data, or causing operational disruption. To combat against these attacks, policies and procedures are in place to prevent or limit the effect on the possible security breach of its information systems. While the Corporation maintains insurance coverage that may, subject to policy terms and conditions including significant self-insured deductibles, cover certain aspects of cyber risks, such insurance coverage may be insufficient to cover all losses. While the Corporation has not incurred any material losses related to cyber-attacks, nor is it aware of any specific or threatened cyber-incidents as of the date of this report, it may incur substantial costs and suffer other negative consequences if it falls victim to successful cyber-attacks. Such negative consequences could include remediation costs that may include liability for stolen assets or information and repairing system damage that may have been caused; deploying additional personnel and protection technologies, training employees, and engaging third party experts and consultants; lost revenues resulting from unauthorized use of proprietary information or the failure to retain or attract customers following an attack; disruption or failures of physical infrastructure, operating systems or networks that support our business and customers resulting in the loss of customers and business opportunities; additional regulatory scrutiny and possible regulatory penalties; litigation; and reputational damage adversely affecting customer or investor confidence.

The Increasing Use Of Social Media Platforms Presents New Risks And Challenges And Our Inability Or Failure To Recognize, Respond To And Effectively Manage The Accelerated Impact Of Social Media Could Materially Adversely Impact Our Business

There has been a marked increase in the use of social media platforms, including weblogs (blogs), social media websites, and other forms of Internet-based communications which allow individuals access to a broad audience of consumers and other interested persons. Social media practices in the banking industry are evolving, which creates uncertainty and risk of noncompliance with regulations applicable to our business. Consumers value readily available information concerning businesses and their goods and services and often act on such information without further investigation and without regard to its accuracy. Many social media platforms immediately publish the content their subscribers and participants post, often without filters or checks on accuracy of the content posted. Information posted on such platforms at any time may be adverse to our interests and/or may be inaccurate. The dissemination of information online could harm our business, prospects, financial condition, and results of operations, regardless of the information's accuracy. The harm may be immediate without affording us an opportunity for redress or correction.

Other risks associated with the use of social media include improper disclosure of proprietary information, negative comments about our business, exposure of personally identifiable information, fraud, out-of-date information, and improper use by employees and customers. The inappropriate use of social media by our customers or employees could result in negative consequences including remediation costs including training for employees, additional regulatory scrutiny and possible regulatory penalties, litigation or negative publicity that could damage our reputation adversely affecting customer or investor confidence.

The Corporation Is Subject To Claims And Litigation Pertaining To Fiduciary Responsibility

From time to time, customers make claims and take legal action pertaining to the Corporation’s performance of its fiduciary responsibilities. Whether customer claims and legal action related to the Corporation’s performance of its fiduciary responsibilities are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to the Corporation, they may result in significant financial liability and/or adversely affect the market perception of the Corporation and its products and services as well as impact customer demand for those products and services. Any financial liability or reputation damage could have a material adverse effect on the Corporation’s business, financial condition, and results of operations.

Financial Services Companies Depend On The Accuracy And Completeness Of Information About Customers And Counterparties

In deciding whether to extend credit or enter into other transactions, the Corporation may rely on information furnished by, or on behalf of, customers and counterparties, including financial statements, credit reports, and other financial information. The Corporation may also rely on representations of those customers, counterparties, or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports, or other financial information could have a material adverse impact on the Corporation’s business and, in turn, the Corporation’s financial condition and results of operations.

Consumers May Decide Not To Use Banks To Complete Their Financial Transactions

Technology and other changes are allowing parties to complete financial transactions that historically have involved banks through alternative methods. For example, consumers can now maintain funds that would have historically been held as bank deposits in brokerage accounts or mutual funds. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries, known as “disintermediation,” could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on the Corporation’s financial condition and results of operations.

A Change In Control Of The United States Government And Issues Relating To Debt And The Deficit May Adversely Affect The Corporation

The outcome of future elections could result in changes in control of the federal government and bring significant changes (or uncertainty) in governmental policies, regulatory environments, spending sentiment and many other factors and conditions, some of which could adversely impact the Corporation’s business, financial condition and results of operations.

Other Events

Natural Disasters, Acts Of War Or Terrorism, and Other External Events Could Significantly Impact The Corporation's Business

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events could have a significant impact on the Corporation's ability to conduct business. Such events could affect the stability of the Corporation's deposit base; impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue, and/or cause the Corporation to incur additional expenses. Severe weather or natural disasters, acts of war or terrorism, or other adverse external events, may occur in the future. Although management has established disaster recovery policies and procedures, the occurrence of any such event could have a material adverse effect on the Corporation's business, financial condition, and results of operations.

Risks Associated With The Corporation's Common Stock

The Corporation's Stock Price Can Be Volatile

Stock price volatility may make it more difficult for shareholders to resell their shares of common stock when they desire and at prices they find attractive. The Corporation's stock price can fluctuate significantly in response to a variety of factors including, among other things:

- Actual or anticipated variations in quarterly results of operations
- Recommendations by securities analysts
- Operating and stock price performance of other companies that investors deem comparable to the

Corporation

- News reports relating to trends, concerns, and other issues in the financial services industry
- Perceptions in the marketplace regarding the Corporation and/or its competitors
- New technology used, or services offered, by competitors
- Significant acquisitions or business combinations, strategic partnerships, joint ventures, or capital commitments by, or involving, the Corporation or its competitors
- Changes in government regulations
- Geopolitical conditions such as acts or threats of terrorism or military conflicts

General market fluctuations, industry factors, and general economic and political conditions and events, such as economic slowdowns or recessions, interest rate changes, or credit loss trends, could also cause the Corporation's stock price to decrease regardless of operating results.

The Trading Volume In The Corporation's Common Stock Is Less Than That Of Other Larger Financial Services Companies

The Corporation's common stock is listed for trading on the Over the Counter Bulletin Board (OTCBB) exchange. The trading volume in its common stock is a fraction of that of other larger financial services companies. A public trading market having the desired characteristics of depth, liquidity, and orderliness depends on the presence in the marketplace of willing buyers and sellers of the Corporation's common stock at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which the Corporation has no control. Given the lower trading volume of the Corporation's common stock, significant sales of the Corporation's common stock, or the expectation of these sales, could cause the Corporation's stock price to fall.

An Investment In The Corporation's Common Stock Is Not An Insured Deposit

The Corporation's common stock is not a bank deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund, or by any other public or private entity. Investment in the Corporation's common stock is inherently risky for the reasons described in this "Risk Factors" section and elsewhere in this report and is subject to the same market forces that affect the price of common stock in any company. As a result, an investor in the Corporation's common stock may lose some or all of their investment.

The Corporation's Articles Of Association And Bylaws, As Well As Certain Banking Laws, May Have An Anti-Takeover Effect

Provisions of the Corporation's articles of incorporation and bylaws, federal banking laws, including regulatory approval requirements, and the Corporation's stock purchase rights plan, could make it more difficult for a third party to acquire the Corporation, even if doing so would be perceived to be beneficial to the Corporation's shareholders. The combination of these provisions effectively inhibits a non-negotiated merger or other business combination that could adversely affect the market price of the Corporation's common stock.

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

ENB Financial Corp's headquarters and main office of Ephrata National Bank are located at 31 East Main Street, Ephrata, Pennsylvania.

Listed below are the office locations of properties owned or leased by the Corporation. No mortgages, liens, or encumbrances exist on any of the Corporation's owned properties. As of December 31, 2018, the Corporation leased three properties.

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Property Location	Owned or Leased	Location Acreage	Bldg Sq Ftg
Corporate Headquarters/Main Office 31 East Main Street Ephrata, Pennsylvania	Owned	0.50	42,539
ENB's Money Management Group 47 East Main Street Ephrata, Pennsylvania	Owned	0.17	11,156
Technology Center 31 East Franklin Street Ephrata, Pennsylvania	Owned	0.43	12,208
Administrative Offices 124 East Main Street Ephrata, Pennsylvania	Leased	N/A	5,867
Main Street Drive-In 42 East Main Street Ephrata, Pennsylvania	Owned	0.41	700
Cloister Office 809 Martin Avenue Ephrata, Pennsylvania	Owned	2.00	7,393
Hinkletown Office 935 North Railroad Avenue New Holland, Pennsylvania	Owned	1.30	4,563
Denver Office 1 Main Street Denver, Pennsylvania	Owned	1.40	5,181
Akron Office 351 South 7th Street Akron, Pennsylvania	Owned	1.50	5,861
Lititz Office 3190 Lititz Pike Lititz, Pennsylvania	Owned	3.53	5,555
Blue Ball Office 110 Marble Avenue	Owned	2.27	5,900

East Earl, Pennsylvania			
Manheim Office 1 North Penryn Road Manheim, Pennsylvania	Owned	2.81	5,148
Leola Office 361 West Main Street Leola, Pennsylvania	Leased	N/A	3,736
Myerstown Office 615 East Lincoln Avenue Myerstown, Pennsylvania	Owned	2.07	4,426
Morgantown Office 6296 Morgantown Road Morgantown, Pennsylvania	Owned	0.52	3,520
Georgetown Drive-Thru Office 1298 Georgetown Road Quarryville, Pennsylvania	Leased	N/A	252
Strasburg Office 60 Historic Drive Strasburg, Pennsylvania	Owned	1.86	3,712

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In addition to the above properties, the Corporation owns two other properties located in the Corporation's Ephrata Main Street Campus. These properties were acquired in 2002, when a group of properties adjacent to and surrounding the Corporation's Main Office was purchased. These two properties are being held for future use or possible sale. The other properties purchased in 2002 have been remodeled as office or operational space and are reflected in the offices shown above. The Corporation also owns a four acre parcel of land in Ephrata Borough that was converted from other real estate owned to Bank property as of December 31, 2011. The parcel is being evaluated for future expansion plans.

Item 3. Legal Proceedings

The nature of the Corporation's business generates a certain amount of litigation involving matters arising in the ordinary course of business; however, in the opinion of management, there are no material proceedings pending to which the Corporation is a party to, or which would be material in relation to the Corporation's undivided profits or financial condition. There are no proceedings pending other than ordinary routine litigation incident to the business of the Corporation. In addition, no material proceedings are pending, known to be threatened, or contemplated against the Corporation by governmental authorities.

Item 4. Mine Safety Disclosures – Not Applicable

Part II

Item 5. Market for Registrant's Common Equity, Related Shareholder Matters, and Issuer Purchases of Equity Securities

The Corporation has only one class of stock authorized, issued, and outstanding, which consists of common stock with a par value of $0.20 per share. As of December 31, 2018, there were 12,000,000 shares of common stock authorized with 2,869,557 shares issued, and 2,852,532 shares outstanding to approximately 1,475 shareholders. The Corporation's common stock is traded on a limited basis on the OTCBB under the symbol "ENBP." Prices presented in the table below reflect high and low prices of actual transactions known to management. Prices and dividends per share are adjusted for stock splits. Market quotations reflect inter-dealer prices, without retail mark up, mark down, or commission and may not reflect actual transactions.

	2018			2017		
	High	Low	Dividend	High	Low	Dividend
First quarter	$35.20	$34.06	$ 0.28	$35.75	$33.90	$ 0.28
Second quarter	34.95	34.11	0.29	35.60	34.00	0.28
Third quarter	37.50	34.95	0.29	34.45	33.00	0.28
Fourth quarter	36.90	34.55	0.29	34.45	32.75	0.28

Source - SNL Financial LC

Dividends

Since 1973, the Corporation, and before it the Bank, has paid quarterly cash dividends on or around March 15, June 15, September 15, and December 15 of each year. The Corporation currently expects to continue the practice of paying quarterly cash dividends to its shareholders for the foreseeable future. However, future dividends are dependent upon future earnings. The dividend payments reflected above amount to 33.6% and 50.2% dividend payout ratio for 2018 and 2017, respectively. The higher dividend payout ratio in 2017 was directly impacted by lower earnings as a result of the tax law changes that required a write-down of the valuation of deferred tax assets. The dividend payout ratio is only one element of management's plan for managing capital. Certain laws restrict the amount of dividends that may be paid to shareholders in any given year. In addition, under Pennsylvania corporate law, the Corporation may not pay a dividend if, after issuing the dividend (1) the Corporation would be unable to pay its debts as they become due, or (2) the Corporation's total assets would be less than its total liabilities plus the amount needed to satisfy any preferential rights of shareholders. In addition, as declared by the Board of Directors, Ephrata National Bank's dividend restrictions apply indirectly to ENB Financial Corp because cash available for

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dividend distributions will initially come from dividends Ephrata National Bank pays to ENB Financial Corp. See Note M to the consolidated financial statements in this Form 10-K filing, for information that discusses and quantifies this regulatory restriction.

ENB Financial Corp offers its shareholders the convenience of a Dividend Reinvestment Plan (DRP) and the direct deposit of cash dividends. The DRP gives shareholders registered with the Corporation the opportunity to have their quarterly dividends invested automatically in additional shares of the Corporation's common stock. Shareholders who prefer a cash dividend may have their quarterly dividends deposited directly into a checking or savings account at their financial institution. For additional information on either program, contact the Corporation's stock registrar and dividend paying agent, Computershare Shareholder Services, P.O. Box 505000, Louisville, KY 40233-5000.

Purchases

The following table details the Corporation's purchase of its own common stock during the three months ended December 31, 2018.

Issuer Purchase of Equity Securites

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans *	Maximum Number of Shares that May Yet be Purchased Under the Plan *
October 2018	6,400	$ 36.50	6,400	90,965
November 2018	4,500	35.71	4,500	86,465
December 2018	2,000	34.70	2,000	84,465
Total	12,900			

* On June 17, 2015, the Board of Directors of ENB Financial Corp announced the approval of a plan to purchase, in open market and privately negotiated transactions, up to 140,000 shares of its outstanding common stock. Shares repurchased are being held as treasury shares to be utilized in connection with the Corporation's three stock purchase

plans. The first purchase of common stock under this plan occurred on July 31, 2015. By December 31, 2018, a total of 55,535 shares were repurchased at a total cost of $1,894,000, for an average cost per share of $34.10. On February 20, 2019, ENB Financial Corp announced the approval of a plan to purchase, in the open market and privately negotiated transactions, up to 100,000 shares of its outstanding common stock. This plan replaces the 2015 plan.

Recent Sales of Unregistered Securities and Equity Compensation Plan

The Corporation does not have an equity compensation plan and has not sold any unregistered securities.

Shareholder Performance Graph

Set forth below is a line graph comparing the yearly change in the cumulative total shareholder return on ENB Financial Corp's common stock against the cumulative total return of the Russell 2000 Index, the Mid-Atlantic Custom Peer Group Index, and the SNL Small Cap Bank Index for the period of five fiscal years commencing December 31, 2013, and ending December 31, 2018. The graph shows that the cumulative investment return to shareholders, based on the assumption that a $100 investment was made on December 31, 2013, in each of the following: the Corporation's common stock, the Russell 2000 Index, the Mid-Atlantic Custom Peer Group Index, and the SNL Small Cap Bank Index and that all dividends were reinvested in those securities over the past five years, the cumulative total return on such investment would be $136.03, $124.09, $155.81, and $153.83, respectively. The shareholder return shown on the graph below is not necessarily indicative of future performance.

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	Period Ending					
Index	**12/31/13**	**12/31/14**	**12/31/15**	**12/31/16**	**12/31/17**	**12/31/18**
ENB Financial Corp	100.00	110.51	115.98	126.91	130.55	136.03
Russell 2000	100.00	104.89	100.26	121.63	139.44	124.09
Peer Group*	100.00	107.85	113.30	149.58	171.93	155.81
SNL Small Bank	100.00	105.40	115.43	163.66	171.65	153.83

Peer Group consists of Mid-Atlantic commercial banks with assets between $1B - $3B as of 12/31/2018

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Item 6 - Selected Financial Data

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

The selected financial data set forth below should be read in conjunction with the Corporation's financial statements and their accompanying notes presented elsewhere herein.

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	$	$	$	$	$
INCOME STATEMENT DATA					
Interest income	36,498	33,117	28,341	26,842	27,137
Interest expense	3,374	2,939	3,054	3,744	4,676
Net interest income	33,124	30,178	25,287	23,098	22,461
Provision (credit) for loan losses	660	940	325	150	(50)
Other income	11,037	10,321	11,144	10,055	9,548
Other expenses	32,446	30,877	27,200	24,735	23,421
Income before income taxes	11,055	8,682	8,906	8,268	8,638
Provision for federal income taxes	1,306	2,338	1,353	1,358	1,546
Net income	9,749	6,344	7,553	6,910	7,092
PER SHARE DATA					
Net income (basic and diluted)	3.42	2.23	2.65	2.42	2.48
Cash dividends paid	1.15	1.12	1.09	1.08	1.07
Book value at year-end	36.04	35.01	33.31	33.37	32.47
BALANCE SHEET DATA					
Total assets	1,097,842	1,033,622	984,253	905,601	857,208
Total loans	694,073	597,553	571,567	520,283	471,168
Securities	299,999	319,661	308,111	289,423	295,822
Deposits	919,734	866,477	817,491	740,062	699,651
Total long-term debt	65,386	65,850	61,257	59,594	62,300
Stockholders' equity	102,802	99,759	94,939	95,102	92,767
SELECTED RATIOS					
Return on average assets	0.93%	0.63%	0.80%	0.79%	0.84%
Return on average stockholders' equity	9.94%	6.46%	7.74%	7.38%	7.98%
Average equity to average assets ratio	9.36%	9.79%	10.36%	10.74%	10.57%

Dividend payout ratio	33.63%	50.22%	41.13%	44.63%	43.15%
Efficiency ratio	71.58%	73.23%	75.12%	76.86%	76.11%
Net interest margin	3.46%	3.46%	3.12%	3.07%	3.10%

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis represents management's view of the financial condition and results of operations of the Corporation. This discussion and analysis should be read in conjunction with the consolidated financial statements and other financial schedules included in this annual report. The financial condition and results of operations presented are not indicative of future performance.

Strategic Overview

ENB Financial Corp and its wholly owned subsidiary, Ephrata National Bank, are committed to remaining an independent community bank serving the greater communities surrounding Lancaster County, Pennsylvania. The Corporation's roots date back to the April 11, 1881 charter granted to Ephrata National Bank by the Office of the Comptroller of the Currency. The Bank's growth has been entirely organic over 137 years of existence. The Board and Management are committed to the principals and values that have served the company well over this long history. In order to remain an independent bank of undisputed integrity, the Board and Management's desire is to produce strong financial results that will ensure trust from the Bank's depositors and favorable returns to the shareholder over the long term.

Every three years Management and the Board evaluate and revise the strategic plan to ensure the continuing success of the Corporation into the future. This endeavor is designed to continually sharpen the products and services the Bank provides in a manner that best serves the customer and attains the financial performance that shareholders expect. In the most recent strategic plan that covers the years 2019 to 2021, the Board and Management have laid out a five-point plan to ensure success in the next three years and beyond. Succession planning and managing leadership changes were a key element of this strategic plan. The Board and Management also set into place bold goals to further strengthen the Corporation's financial performance ratios so the Corporation is in a position to outperform the local peer group. The most visible of those targets is to meet and exceed a return on assets of over 1.00% and to maintain a return on stockholder's equity of over 10.0%, with a target range of 10.5% to 11.0%. Management also desires to reduce the efficiency ratio under 70% for 2019 with a three-year goal of reducing to no greater than 68.5%. Management views return on assets as the best overall indicator of a financial institution's performance. Management and the Board believe that achieving a higher return on assets will directly correlate to improved earnings per share and dividends per share, and higher book value of common stock, which in the end will produce higher returns to the shareholder.

Results of Operations

Overview

The Corporation recorded net income of $9,749,000 for the year ended December 31, 2018, a 53.7% increase from the $6,344,000 earned during the same period in 2017. The 2017 net income was 16.0% lower than the 2016 net income of $7,553,000. Earnings per share, basic and diluted, were $3.42 in 2018, compared to $2.23 in 2017, and $2.65 in 2016.

The increase in the Corporation's 2018 earnings was caused primarily by an increase in net interest income of $2.9 million, or 9.8%. There was also a significant BOLI event which resulted in income of $913,000. The Tax Cuts and Jobs Act lowered the Corporate tax rate from 34% to 21%, which lowered the Corporation's provision for Federal income taxes in 2018. However, the Corporation was required to write down the value of its net deferred tax assets by $1.1 million as of December 31, 2017, causing a decline in year-to-date 2017 earnings.

Net interest income accounts for nearly 75% of the gross income stream of the Corporation. Net interest income increased by $2.9 million, or 9.8%, compared to an increase of $4.9 million, or 19.3% in 2017. During 2016, there was non-recurring security amortization recorded in the amount of $1.7 million as a result of accelerated amortization on bonds issued by two U.S. sub-agencies. The Corporation's net interest margin remained stable in 2018 at 3.46%, the same margin as 2017, however this was with higher yields on loans and lower yields on tax-exempt securities due to the change in Corporate tax law. Loan yields increased as a result of four Federal Reserve rate moves in 2018, lifting the yields on the Corporation's variable rate loans. This coupled with volume growth in the loan portfolio, increased loan interest income by $3.7 million, or 15.3%.

The Corporation's non-interest income increased by $716,000, or 6.9%, from 2017 to 2018. Earnings on bank owned life insurance were $1,638,000 in 2018, compared to $688,000 in 2017, resulting in higher non-interest

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income. Losses on securities transactions were $291,000 in 2018, compared to gains of $675,000 in 2017, a decrease in income of $966,000.

The financial services industry uses two primary performance measurements to gauge performance: return on average assets (ROA) and return on average equity (ROE). ROA measures how efficiently a bank generates income based on the amount of assets or size of a company. ROE measures the efficiency of a company in generating income based on the amount of equity or capital utilized. The latter measurement typically receives more attention from shareholders. The Corporation's 2018 ROA was 0.93%, compared to 0.63% in 2017. ROE increased from 6.46% in 2017 to 9.94% in 2018. The increase in ROA and ROE was primarily due to higher income in 2018 compared to 2017.

The below table highlights the Corporation's key performance ratios for the years ended 2018, 2017, and 2016.

Key Performance Ratios

	Year ended December 31,		
	2018	2017	2016
Return on Average Assets	0.93%	0.63%	0.80%
Return on Average Equity	9.94%	6.46%	7.74%

The results of the Corporation's operations are best explained by addressing in further detail the five major sections of the income statement, which are as follows:

- Net interest income
- Provision for loan losses
- Other income
- Operating expenses
- Income taxes

The following discussion analyzes each of these five components.

Net Interest Income

Net interest income (NII) represents the largest portion of the Corporation's operating income. In 2018, NII generated 75.0% of the Corporation's gross revenue stream, compared to 74.5% in 2017, and 69.4% in 2016. Since NII comprises a significant portion of the operating income, the direction and rate of increase or decrease will often indicate the overall performance of the Corporation.

The following table shows a summary analysis of NII on a fully taxable equivalent (FTE) basis. For analytical purposes and throughout this discussion, yields, rates, and measurements such as NII, net interest spread, and net yield on interest earning assets, are presented on an FTE basis. This differs from the NII reflected on the Corporation's Consolidated Statements of Income, where the NII is simply the interest earned on loans and securities less the interest paid on deposits and borrowings. By calculating the NII on an FTE basis, the added benefit of having tax-free loans and securities is factored in to more accurately represent what the Corporation earns through the NII. The FTE adjustment shows the benefit these tax free loans and securities bring in a dollar amount because the Corporation does not pay tax on the income they generate. As a result, the FTE NII shown in both tables below will exceed the NII reported on the consolidated statements of income. The amount of FTE adjustment totaled $879,000 for 2018, $2,341,000 for 2017, and $2,151,000 for 2016. The significant decline in FTE adjustment in 2018 was primarily due to the Corporate tax rate change implemented at the end of 2017 as well as lower levels of tax-free income.

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Net Interest Income

(DOLLARS IN THOUSANDS)

	Year ended		
	2018	2017	2016
	$	$	$
Total interest income	36,498	33,117	28,341
Total interest expense	3,374	2,938	3,054
Net interest income	33,124	30,179	25,287
Tax equivalent adjustment	879	2,341	2,151
Net interest income (fully taxable equivalent)	34,003	32,520	27,438

NII is the difference between interest income earned on assets and interest expense incurred on liabilities. Accordingly, two factors affect NII:

- The rates charged on interest earning assets and paid on interest bearing liabilities
- The average balance of interest earning assets and interest bearing liabilities

The Federal funds rate, the Prime rate, the shape of the U.S. Treasury curve, and other wholesale funding curves, all affect NII. The Federal Reserve controls the Federal funds rate, which is one of a number of tools available to the Federal Reserve to conduct monetary policy. The Federal funds rate, and guidance on when the rate might be changed, is often the focal point of discussion regarding the direction of interest rates. Until December 16, 2015, the Federal funds rate had not changed since December 16, 2008. On December 16, 2015, the Federal funds rate was increased 25 basis points to 0.50%, from 0.25%. Then again, on December 14, 2016, the Federal funds rate was increased another 25 basis points to 0.75%. The Federal funds rate was increased by 25 basis points three additional times during 2017 and four additional times during 2018 taking the rate to 2.50% by December 31, 2018. Prior to December of 2015, the period of seven years with extremely low and unchanged overnight rates was the lowest and longest in U.S. history. The impact was a lower net interest margin to the Corporation and generally across the financial industry. The increases since December of 2015 resulted in higher short-term U.S. Treasury rates, but not significantly higher long-term U.S. Treasury rates, resulting in a flattening of the yield curve. Long-term U.S. Treasury rates have fluctuated over the last three-year period where short-term rates were increasing. Despite having four Federal Reserve rate increases in 2018, the U.S. Treasury yield curve actually became flatter. A flat yield curve generally signals the end of a period of economic expansion and the beginning of a recession. Long-term rates like the ten-year U.S.

Treasury were 273 basis points under the 5.50% Prime rate as of December 31, 2018. Long-term Treasury rates did see some increases throughout the first three quarters of 2018, but the increases were smaller than the Federal Reserve short-term rate increases and long-term rates actually declined throughout the fourth quarter of 2018, making the yield curve essentially flat. Management had anticipated a slowing in the Fed rate increases throughout 2019 with the possibility of one or two rate increases. But more recently, it appears the Federal Reserve has paused and may not increase rates at all in 2019. It remains to be seen whether mid and long-term U.S. Treasury rates will increase. If they do not, the yield curve would flatten further making it harder for the Corporation to increase asset yield.

The Prime rate is generally used by commercial banks to extend variable rate loans to business and commercial customers. For many years, the Prime rate has been set at 300 basis points, or 3.00% higher, than the Federal funds rate and typically moves when the Federal funds rate changes. As such, the Prime rate increased from 4.50% on December 31, 2017 to 5.50% on December 31, 2018, after four rate movements in 2018. The Prime rate was 3.75% at the end of 2016 and 3.50% at the end of 2015. The Corporation's Prime-based loans generally reprice a day after the Federal Reserve rate movement.

As a result of the Federal Reserve rate increases, the Corporation's NII on a tax equivalent basis increased in 2018 with the Corporation's margin remaining the same as 2017 at 3.46% for the year. While loan yields increased significantly throughout 2018, a decline in security yields offset this increase due to the change in Corporate tax rate that negatively impacted the yield on municipal securities. The Corporation's NII for 2018 increased substantially over 2017, by $2,946,000, or 9.8%. Management's asset liability sensitivity measurements continue to show a benefit to both margin and NII given further Federal Reserve rate increases. Actual results over the past two years have confirmed the asset sensitivity of the Corporation’s balance sheet. Should the Federal Reserve increase short-term rates in 2019, management would expect further improvement in both margin and NII.

After many years of declining interest expense and a declining cost of funds, 2018 marked the first year that interest expense and the Corporation’s internal cost of funds increased. Deposit rates were increased marginally throughout 2018 with some CD special rates introduced in the fourth quarter of 2018 to help with deposit retention. Aside from that, borrowing rates are now higher as the market has moved up and lower rate advances are maturing and being replaced at higher rates. With a higher Prime rate and elevated Treasury rates, higher asset yields should be possible throughout 2019. Due to the variable rate loans in the Corporation’s loan portfolio, the Prime rate increases throughout the past couple of years have allowed for higher NII. The extent of NII improvement in 2019 will depend partially on whether the Federal Reserve does act to increase short-term interest rates.

Security yields will generally fluctuate more rapidly than loan yields based on changes to the U.S. Treasury rates and yield curve. With generally higher Treasury rates in 2018 compared to 2017, security reinvestment has been occurring at slightly higher yields and amortization has slowed resulting in higher yields. The Corporation’s loan yield has begun to increase as the variable rate portion of the loan portfolio is repricing higher with each Federal Reserve rate movement and fixed loan rates have also increased with more volume and less competition for loans. The vast majority of the Corporation’s commercial Prime-based loans are priced at the Prime rate, currently at 5.50%. The pricing for the most typical five-year fixed rate commercial loans is currently very similar to the Prime rate. Previously, any increases in variable rate loans acted to bring down overall loan yield. However, once Prime got to 5.00% and above, it was more advantageous for the Bank to grow Prime-based loans while interest rates were still increasing. Now with the Prime rate reaching 5.50% in December 2018, the demand for variable rate loans has cooled. This could change if there becomes an expectation that the Federal Reserve would need to start reducing the overnight rate in 2019 or 2020. An element of the Corporation’s Prime-based commercial loans is priced above the Prime rate based on the level of credit risk of the borrower. Management does price a portion of consumer variable rate loans above the Prime rate, which also helps to improve loan yield. Both commercial and consumer Prime-based pricing continues to be driven largely by local competition.

Mid-term and long-term interest rates on average were higher in 2018 compared to 2017. The average rate of the 10-year U.S. Treasury was 2.91% in 2018 compared to 2.33% in 2017, and it stood at 2.77% on December 31, 2018, compared to 2.40% at December 31, 2017. The slope of the yield curve has been compressed throughout most of 2017 and 2018, with a difference of only 27 basis points between the Fed Funds rate of 2.50% and the 10-year U.S. Treasury as of December 31, 2018, compared to 90 basis points as of December 31, 2017. The slope of the yield curve has fluctuated many times in the past two years with the 10-year U.S. Treasury yield as high as 3.24% in 2018 and 2.62% in 2017, and as low as 2.44% in 2018 and 2.05% in 2017. Because the Prime rate has increased and fixed rate loan yields have also increased throughout 2018, the overall loan yield has increased, but security yields have declined significantly due to the change in Corporate tax rate that negatively impacted the yield on tax-exempt securities. With higher asset yields generally available on both the loan and securities sides, the Corporation’s asset yield should continue to increase throughout 2019 making NIM improvement possible even without an additional Federal Reserve rate movement.

While the Corporation's cost of funds remains very low, it has become difficult to achieve any further savings on the deposit or borrowings side. With higher market rates and more deposit competition, small increases in rate were made throughout 2019 to retain deposit balances. Borrowing costs, and the wholesale borrowing curves that they are based on, generally follow the direction and slope of the U.S. Treasury curve. However, these curves can be quicker to rise and slower to fall as the providers of these funds seek to protect themselves from rate movements. The Corporation's cost of borrowings continues to increase as maturing borrowings roll off at lower interest rates and new borrowings are initiated at the higher market rates. It is anticipated that further deposit interest rate increases may need to be implemented in 2019 if the Federal Reserve acts to increase short-term rates further. If the Fed holds rates where they are at currently, Management will have some flexibility to hold deposit rates lower for a longer period of time.

Management currently anticipates that the overnight interest rate and Prime rate will remain at the current levels through the first part of 2019 with the possibility of one and a smaller possibility of two 0.25% rate increases later in the year. It is likely that mid and long-term U.S. Treasury rates will remain at current levels extending the time that the yield curve remains flat. This would make it more difficult for management to lend out or reinvest at higher interest rates out further on the yield curve. However, loan yields have increased and as long as market rates do not decrease, Management should be able to continue to make loans at these slightly higher rates to help improve the NIM. Additionally, any Federal Reserve rate increases would have an impact on asset yield but could potentially

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have a greater effect on the repricing of the Corporation's liabilities as the cost of money increases and more marketplace competition returns.

The following table provides an analysis of year-to-year changes in net interest income by distinguishing what changes were a result of average balance increases or decreases and what changes were a result of interest rate increases or decreases.

RATE/VOLUME ANALYSIS OF CHANGES IN NET INTEREST INCOME

(TAXABLE EQUIVALENT BASIS, DOLLARS IN THOUSANDS)

	2018 vs. 2017 Increase (Decrease) Due To Change In			2017 vs. 2016 Increase (Decrease) Due To Change In		
	Average Balances $	Interest Rates $	Net Increase (Decrease) $	Average Balances $	Interest Rates $	Net Increase (Decrease) $
INTEREST INCOME						
Interest on deposits at other banks	(170)	174	4	33	217	250
Securities available for sale:						
Taxable	339	554	893	118	2,263	2,381
Tax-exempt	(901)	(1,866)	(2,767)	681	(128)	553
Total securities	(562)	(1,312)	(1,874)	799	2,135	2,934
Loans	2,489	1,142	3,631	1,140	610	1,750
Regulatory stock	32	126	158	37	(4)	33
Total interest income	1,789	130	1,919	2,009	2,958	4,967
INTEREST EXPENSE						
Deposits:						
Demand deposits	21	176	197	20	51	71
Savings deposits	5	—	5	12	(1)	11
Time deposits	(129)	65	(64)	(126)	(94)	(220)
Total deposits	(103)	241	138	(94)	(44)	(138)

Borrowings:						
Total borrowings	36	261	297	(46)	69	23
Total interest expense	(67)	502	435	(140)	25	(115)
NET INTEREST INCOME	1,856	(372)	1,484	2,149	2,933	5,082

In 2018, the Corporation's NII on an FTE basis increased by $1,484,000, a 4.6% increase over 2017. Total interest income increased $1,919,000, or 5.4%, while interest expense increased $435,000, or 14.8%, from 2017 to 2018. The FTE interest income from the securities portfolio decreased by $1,874,000, or 18.2%, while loan interest income increased $3,631,000, or 14.8%. During 2018, additional loan volume added $2,489,000 to net interest income, and higher yields primarily due to the multiple Prime rate increases throughout the year caused a $1,142,000 increase, resulting in a net increase of $3,631,000. Lower balances in the securities portfolio caused a decrease of $562,000 in net interest income, while lower yields on securities caused a $1,312,000 decrease, resulting in a net decrease of $1,874,000. Interest income on tax-exempt securities declined $1,866,000 due to rates and $901,000 due to lower balances. A lower effective Corporate tax rate influenced both of these by causing a lower tax-equivalent yield, which affected the rate, which in turn caused management to reduce the municipal bond allocation, bringing down the balances. Some of the reduction in municipal securities can be directly attributed to funding loan growth.

The average balance of interest bearing liabilities increased by 1.5% during 2018, driven by the growth in deposit balances. Deposit rates increased slightly throughout 2018 resulting in higher interest expense. However, lower balances of higher cost deposits contributed to savings of $103,000 on deposit costs while higher interest rates on all deposit groups caused $241,000 of increased expense, resulting in total increased interest expense of $138,000.

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Out of all the Corporation's deposit types, interest-bearing demand deposits reprice the most rapidly, as these rates can be adjusted higher after a Federal Reserve rate increase in order for the Corporation to remain competitive. Demand deposit interest expense increased a total of $197,000 in 2018, with $176,000 due to higher rates and $21,000 due to higher balances. Time deposit balances decreased resulting in a $129,000 reduction to expense, and time deposits repricing to higher interest rates increased interest expense by $65,000, causing a net reduction of $64,000 in time deposit interest expense. Even with short-term interest rates increasing throughout 2018, the Corporation was successful in increasing balances of other deposit types.

The average balance of short-term and long-term borrowings increased by $1.7 million, or 2.4%, from December 31, 2017, to December 31, 2018. The increase in total borrowings increased interest expense by $36,000. The increase in interest rates increased interest expense by $261,000, as long-term borrowings at lower rates matured and were replaced with new advances at higher rates. The aggregate of these amounts was an increase in interest expense of $297,000 related to total borrowings.

The following table shows a more detailed analysis of net interest income on an FTE basis shown with all the major elements of the Corporation's balance sheet, which consists of interest earning and non-interest earning assets and interest bearing and non-interest bearing liabilities. Additionally, the analysis provides the net interest spread and the net yield on interest earning assets. The net interest spread is the difference between the yield on interest earning assets and the interest rate paid on interest bearing liabilities. The net interest spread has the deficiency of not giving credit for the non-interest bearing funds and capital used to fund a portion of the total interest earning assets. For this reason, management emphasizes the net yield on interest earning assets, also referred to as the net interest margin (NIM). The NIM is calculated by dividing net interest income on an FTE basis into total average interest earning assets. The NIM is generally the benchmark used by analysts to measure how efficiently a bank generates NII.

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COMPARATIVE AVERAGE BALANCE SHEETS AND NET INTEREST INCOME

(TAXABLE EQUIVALENT BASIS, DOLLARS IN THOUSANDS)

	December 31, 2018			2017			2016		
	Average Balance $	Interest $	Yield/ Rate %	Average Balance $	Interest $	Yield/ Rate %	Average Balance $	Interest $	Yield/ Rate %
ASSETS									
Interest earning assets:									
Federal funds sold and deposits at other banks	18,772	392	2.09	29,277	388	1.33	24,325	138	0.57
Securities available for sale:									
Taxable	213,907	4,853	2.27	197,788	3,960	2.00	184,851	1,579	0.85
Tax-exempt	105,513	3,566	3.38	125,529	6,333	5.05	112,074	5,780	5.16
Total securities (d)	319,420	8,419	2.64	323,317	10,293	3.18	296,925	7,359	2.48
Loans (a)	638,524	28,139	4.41	581,267	24,508	4.22	553,994	22,759	4.11
Regulatory stock	6,246	427	6.84	5,629	269	4.78	4,851	236	4.86
Total interest earning assets	982,962	37,377	3.80	939,490	35,458	3.78	880,095	30,492	3.46
Non-interest earning assets (d)	64,607			63,682			62,546		
Total assets	1,047,569			1,003,172			942,641		
LIABILITIES & STOCKHOLDERS' EQUITY									
Interest bearing liabilities:									
Demand deposits	213,037	548	0.26	201,522	351	0.17	188,758	281	0.15
Savings accounts	196,392	100	0.05	187,018	95	0.05	163,210	84	0.05
Time deposits	142,125	1,418	1.00	155,285	1,482	0.95	168,182	1,702	1.01
Borrowed funds	72,282	1,307	1.81	70,557	1,010	1.43	74,381	987	1.33
Total interest bearing liabilities	623,836	3,373	0.54	614,382	2,938	0.48	594,531	3,054	0.51
Non-interest bearing liabilities:									
Demand deposits	322,733			287,928			247,730		
Other	2,899			2,641			2,740		

Total liabilities	949,468		904,951		845,001	
Stockholders' equity	98,101		98,221		97,640	
Total liabilities & stockholders' equity	1,047,569		1,003,172		942,641	
Net interest income (FTE)	34,004		32,520		27,438	
Net interest spread (b)		3.26		3.30		2.95
Effect of non-interest bearing funds		0.20		0.16		0.17
Net yield on interest earning assets (c)		3.46		3.46		3.12

(a) Includes balances of non-accrual loans and the recognition of any related interest income. Average balances also include net deferred loan costs of $1,429,000 in 2018, $1,098,000 in 2017, and $836,000 in 2016. Such fees recognized through income and included in the interest amounts totaled ($534,000) in 2018, ($445,000) in 2017, and ($382,000) in 2016.

(b) Net interest spread is the arithmetic difference between the yield on interest earning assets and the rate paid on interest bearing liabilities.

(c) Net yield, also referred to as net interest margin, is computed by dividing net interest income (FTE) by total interest earning assets.

(d) Securities recorded at amortized cost. Unrealized holding gains and losses are included in non-interest earning assets.

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The Corporation's interest income increased and interest expense increased, resulting in a NIM of 3.46% for 2018, maintaining the same NIM as 2017. The yield earned on assets increased two basis points while the rate paid on liabilities increased six basis points. The yield on assets did not increase significantly due to the Corporate tax rate change at the end of 2017 that resulted in a much lower tax-equivalent yield on tax-free loans and securities in 2018. Offsetting the decrease in security yield, the loan yield increased significantly during 2018 due to four Federal Reserve rate increases that impacted the variable rate loans as well as improvements made to fixed rate loan yields due to a slightly higher yield curve. Management anticipates further improvements in NIM in 2019 as asset yields improve further with higher rates and the potential for more Fed rate increases. Fixed-rate loan yields were at low levels during 2017 due to the extended low-rate environment as well as extremely competitive pricing for the loan opportunities in the market. These yields improved throughout 2018 as the economy improved and loan demand increased, reducing pricing pressures and intense competition for loans. The growth in the loan portfolio as well as variable-rate loans repricing to higher levels contributed to the increase in loan interest income in 2018.

Loan pricing was challenging in 2017 as a result of intense competition resulting in fixed-rate loans being priced at very low levels and variable-rate loans priced at the Prime rate or below. However, in 2018, pricing for fixed-rate loans improved with more loan volume and less competition. The current Prime rate of 5.50% is similar to most fixed-rate business and commercial loans, which typically range between 4.50% and 6.50%, depending on term and credit risk. Management is able to price loan customers with higher levels of credit risk at Prime plus pricing, such as Prime plus 0.75%, currently 6.25%. However, there are relatively few of these higher rate loans in the commercial and agricultural portfolios due to the strong credit quality of the Corporation's borrowers. The Asset Liability Committee (ALCO) carefully monitors the NIM because it indicates trends in net interest income, the Corporation's largest source of revenue. For more information on the plans and strategies in place to protect the NIM and moderate the impact of rising rates, please refer to Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

Earnings and yields on the Corporation's securities decreased by 54 basis points for the year ended December 31, 2018, compared to the same period in 2017. The Corporation's securities portfolio consists of nearly all fixed income debt instruments. The Corporation's taxable securities experienced a 27 basis-point increase in yield for 2018, compared to 2017. Some security reinvestment in 2018 had been occurring at higher rates and regular amortization was lower due to the slightly higher interest rate environment. These variables caused taxable security yields to increase. The yield on tax-exempt securities decreased by 167 basis points in 2018, compared to 2017, primarily due to the lower Corporate tax rate, which negatively impacted the tax equivalent yield on municipal securities.

The interest rate paid on deposits increased for the year ended December 31, 2018, from the same period in 2017. Management follows a disciplined pricing strategy on core deposit products that are not rate sensitive, meaning that the balances do not fluctuate significantly when interest rates change. Rates on interest-bearing checking accounts and money market accounts were changed minimally in 2018, and two time deposit specials were introduced in the fourth quarter of 2018 resulting in the cost of funds on these instruments increasing by five basis points during the year. Typically, the Corporation sees increases in time deposits during periods when consumers are not confident in the stock market and economic conditions deteriorate. During these periods, there is a "flight to safety" to federally insured deposits. This trend occurred in past years, but time deposit balances declined throughout 2016, 2017, and 2018. As the rate between time deposits and core deposits narrowed, many customers chose to transfer funds from maturing time deposits into checking and savings accounts.

Since the financial crisis, depositors have been more concerned about the financial health of their financial institution. This concern affects their desire to obtain the best possible market interest rates. This trend benefits the Corporation due to its high capital levels and track record of strong and stable earnings. The Corporation's Bauer Financial rating of 5, the highest level of their rating scale, has assisted the Bank in gaining core deposits over the past several years.

The Corporation's average rate on borrowed funds increased by 38 basis points from 2017 to 2018, as refinancing of several long-term borrowings maturing in 2018 was completed at higher market interest rates. Throughout 2018, the new fixed borrowing rates were higher than the average rate paid on the Corporation's existing borrowings. The Corporation will likely not have opportunities to decrease borrowing costs in 2019 because the fixed rate borrowings that will be maturing were initiated in prior years when market interest rates were materially lower.

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Provision for Loan Losses

The allowance for loan losses provides for losses inherent in the loan portfolio as determined by a quarterly analysis and calculation of various factors related to the loan portfolio. The amount of the provision reflects the adjustment that management determines is necessary to ensure that the allowance for loan losses is adequate to cover any losses inherent in the loan portfolio. The Corporation gives special attention to the level of underperforming loans when calculating the necessary provision for loan losses. The analysis of the loan loss allowance takes into consideration, among other things, the following factors:

- levels and trends in delinquencies, non-accruals, and charge-offs,
- levels of classified loans,
- trends within the loan portfolio,
- changes in lending policies and procedures,
- experience of lending personnel and management oversight,
- national and local economic trends,
- concentrations of credit,
- external factors such as legal and regulatory requirements,
- changes in the quality of loan review and Board oversight, and
- changes in the value of underlying collateral.

A provision expense of $660,000 was recorded in 2018, compared to $940,000 in 2017, and $325,000 in 2016. The provision expense in 2018 was primarily due to higher levels of charge-offs during the year as well as organic loan portfolio growth. While charge-offs were higher in 2018 than 2017, net charge-offs were lower than 2017 resulting in a lower provision compared to the prior year. Net charge-offs improved by $28,000 from 2017 to 2018. In addition, the amount of business and commercial substandard loans as of December 31, 2018, was $688,000 lower than on December 31, 2017. The amount of substandard loans has a larger influence over the allowance for loan loss calculation due to a greater likelihood of further credit deterioration. These factors led to a lower provision for loan losses in 2018 than in 2017. The allowance as a percentage of loans decreased from 1.38% at December 31, 2017, to 1.25% by the end of 2017. It is anticipated that the Corporation will record a provision expense again in 2019 based on projected loan growth and projected delinquencies and levels of classified loans.

Management also continues to provide for estimated losses on pools of similar loans based on historical loss experience. Management employs qualitative factors every quarter in addition to historical loss experience to take into consideration the current trends in loan volume, concentrations of credit, delinquencies, changes in lending practices, and the quality of the Corporation's underwriting, credit analysis, lending staff, and Board oversight. National and local economic trends and conditions are also considered when calculating an appropriate loan loss allowance for each loan pool. Qualitative factors only increased for the dairy loan pool in 2018 as a result of continued growth and economic factors impacting the health of the dairy industry. Factors for seven of the remaining loan pools were decreased during 2018 and one factor remained the same. The overall decline in qualitative factors in 2018 compared to 2017 resulted in a lower required allowance and a smaller provision for loan losses during the year.

Management continues to evaluate the allowance for loan losses in relation to the growth or decline of the loan portfolio and its associated credit risk, and believes the provision and the allowance for loan losses are adequate to provide for future loan losses. For further discussion of the calculation, see the “Allowance for Loan Losses” section.

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Other Income

Other income for 2018 was $11,037,000, an increase of $716,000, or 6.9%, compared to the $10,321,000 earned in 2017. The following table details the categories that comprise other income.

OTHER INCOME

(DOLLARS IN THOUSANDS)

	2018 vs. 2017				2017 vs. 2016			
	2018	2017	Increase (Decrease)		2017	2016	Increase (Decrease)	
	$	$	$	%	$	$	$	%
Trust and investment services	1,959	1,776	183	10.3	1,776	1,475	301	20.4
Service charges on deposit accounts	1,351	1,235	116	9.4	1,235	1,123	112	10.0
Other fees	1,578	1,434	144	10.0	1,434	1,136	298	26.2
Commissions	2,596	2,303	293	12.7	2,303	2,169	134	6.2
Net realized gains on sales of securities available for sale	(291)	675	(966)	(143.1)	675	2,370	(1,695)	(71.5)
Gains on sale of mortgages	1,602	1,715	(113)	(6.6)	1,715	1,512	203	13.4
Earnings on bank-owned life insurance	1,638	688	950	138.1	688	785	(97)	(12.4)
Other miscellaneous income	604	495	109	22.0	495	574	(79)	(13.8)
Total other income	11,037	10,321	716	6.9	10,321	11,144	(823)	(7.4)

Trust and investment services income increased by $183,000, or 10.3%, from 2017 to 2018, after increasing 20.4% from 2016 to 2017. In 2018, trust and investment services revenue accounted for 4.4% of the Corporation's gross revenue stream, including gains and losses on securities and mortgages, compared to 4.4% in 2017 and 4.0% in 2016. Trust and investment services revenue consists of income from traditional trust services and income from investment services provided through a third party. In 2018, the traditional trust business accounted for $1,212,000, or 61.9%, of total trust and investment services income, with the investment services totaling $747,000, or 38.1%. In 2018, traditional trust services income increased by $19,000, or 1.6%, from 2017 levels, while investment services income increased $164,000, or 28.1%. The amount of customer investment activity drives the investment services income. Market increases and a larger customer base primarily caused the increase in trust revenue in 2018. The trust and investment services area continues to be an area of strategic focus for the Corporation. Management believes there is a great need for retirement, estate, and small business planning in the Corporation's service area. Management also sees these services as being a necessary part of a comprehensive line of financial solutions across the organization.

Service charges on deposit accounts for the year ended December 31, 2018, increased by $116,000, or 9.4%, compared to 2017. Overdraft service charges for 2018, which comprise 79.6% of the total deposit service charges, increased to $1,075,000, from $991,000 in 2017, an 8.5% increase. Several other categories of fees increased or decreased by lesser amounts.

Other fees increased for the year ended December 31, 2018, by $144,000, or 10.0%, compared to the previous year. This increase was primarily due to loan-related fees, which increased due to the increase in commercial, agriculture, and mortgage related fees. Loan administration fees increased by $88,000, or 14.4%, for the year ended December 31, 2018, compared to 2017. Additionally, mortgage origination fees increased by $21,000, or 7.5%, for the same period. Account analysis fees increased by $38,000, or 50.5% in 2018 compared to 2017, due to pricing changes as well as the addition of clients to the cash management program throughout the year. Various other fee income categories increased or decreased slightly accounting for the remainder of the change.

Commissions increased by $293,000, or 12.7%, for the year ended December 31, 2018, compared to the previous year. This was primarily caused by debit card interchange income, which increased by $260,000, or 13.0%. The interchange income is a direct result of the volume of debit card transactions processed and this income increases as customer accounts increase or as customers utilize their debit cards to a higher degree. Additionally, commissions earned on merchant credit card relationships increased by $46,000, or 31.2% for 2018 compared to the prior year. Commissions received from a mortgage settlement company decreased by $30,000, or 27.6%, partially offsetting the increases above.

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Gains/losses on security transactions were lower for the year ended December 31, 2018, with a total of $291,000 of losses recorded compared to $675,000 of gains recorded for 2017, a $966,000 decrease in income. Gains or losses taken on securities fluctuate based on market conditions including:

- large swings in market pricing, utilizing volatility and market timing to the Corporation's advantage,
- appreciation or deterioration of securities values due to changes in interest rates, credit risk, financial performance, or market dynamics such as spread and liquidity,
- sale of securities at gains or losses to fund loan growth,
- opportunities to reposition the securities portfolio to improve long-term earnings, or
- management's asset liability goals to improve liquidity or reduce interest rate or fair value risk.

The gains or losses recorded depend entirely on management's active trades based on the above. Losses can be in the form of active sales of securities, or impairment of securities, which involve writing the security down to a lower value based on anticipated credit losses. There were no impairment charges in 2016, 2017, or 2018, therefore all security gains and losses incurred during these years were active sales designed to either take gains or losses, or reposition the portfolio.

The number of securities sold in 2016 was much higher because of the very low interest rate environment that presented many opportunities to sell securities at large gains. Bond pricing was significantly higher in 2016 allowing management to sell securities at large gains. Meanwhile, loan growth was strong in 2017 providing opportunities to both sell securities at gains and use the proceeds to fund new loans. During 2018, the rate environment was not as conducive to taking gains and Management made the decision to sell off some securities at losses to fund loan growth and to reposition the portfolio for better rates-up performance. Loan growth was very strong in 2018 and this continues to be one of the core elements of Management's plan to increase asset yield and protect margin, by converting securities into loans and improving the Corporation's loan-to-deposit ratio.

Gains on the sale of mortgages in 2018 decreased $113,000, or 6.6%, from 2017. Because of the interest rate environment in 2017, margins received on sold loans were extremely high resulting in a higher level of gains compared to 2018. Management has budgeted for a small decrease in the gains on the sale of mortgages in 2019, as with U.S. treasury rates moving up it will be more difficult to grow mortgage volume and the margins on gains on sales will likely be diminished.

Earnings on bank-owned life insurance (BOLI) increased by $950,000, or 138.1%, for the year ended December 31, 2018, compared to the prior year. Increases and decreases in BOLI income depend on insurance cost components on the Corporation's BOLI policies, the actual annual return of the policies, and any benefits paid upon death that exceed the policy’s cash surrender value. The large year-to-date increase in BOLI income was caused by $913,000 of insurance proceeds received in the first quarter of 2018 due to the death of a participant. Increases in cash surrender value are a function of the return of the policy net of all expenses.

The miscellaneous income category increased by $109,000, or 22.0%, for the year ended December 31, 2018, compared to the same period in 2017. The primary reason for the increase in miscellaneous income was an increase in net mortgage servicing income and credit enhancement fees which were up $43,000, or 26.2%, and $27,000, or 56.0%, respectively, for the year ended December 31, 2018, compared to 2017. Additionally, income from sales tax refunds totaled $32,000 in 2018 with no corresponding income in 2017.

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Operating Expenses

The following table provides details of the Corporation's operating expenses for the last three years along with the percentage increase or decrease compared to the previous year.

OPERATING EXPENSES

(DOLLARS IN THOUSANDS)

	2018 vs. 2017				2017 vs. 2016			
	2018	2017	Increase (Decrease)		2017	2016	Increase (Decrease)	
	$	$	$	%	$	$	$	%
Salaries and employee benefits	20,240	19,340	900	4.7	19,340	16,769	2,571	15.3
Occupancy expenses	2,475	2,413	62	2.6	2,413	2,183	230	10.5
Equipment expenses	1,129	1,166	(37)	(3.2)	1,166	1,091	75	6.9
Advertising & marketing expenses	773	698	75	10.7	698	614	84	13.7
Computer software & data processing expenses	2,341	2,210	131	5.9	2,210	1,831	379	20.7
Shares tax	901	859	42	4.9	859	807	52	6.4
Professional services	1,974	1,673	301	18.0	1,673	1,590	83	5.2
Other operating expenses	2,613	2,518	95	3.8	2,518	2,315	203	8.8
Total operating expenses	32,446	30,877	1,569	5.1	30,877	27,200	3,677	13.5

Salaries and employee benefits are the largest category of other expenses. In general, they comprise 62% of the Corporation's total operating expenses. For the year 2018, salaries and benefits increased $900,000, or 4.7%, compared to 2017. Salaries increased by $911,000, or 6.4% for the year, while employee benefits decreased by $11,000, or 0.2%. Salary expenses are growing because of limited sales and back office staff additions on top of normal merit increases. Employee benefits expense decreased minimally for 2018 due to a combination of lower pension costs, health insurance costs, recruitment and other personnel costs. Benefit insurance costs in total increased minimally by $12,000, or 0.4%, from 2017 to 2018. Pension and 401(k) expenses were down $55,000, or 5.4%, in 2018, compared to 2017. The pension portion experienced an $84,000, or 11.9% decrease primarily related to an adjustment to the prior year's contribution.

As of January 1, 2016, the balance of the Corporation's Money Purchase Pension Plan was transferred into the new 401(k) Savings Plan, which now functions as the Corporation's profit sharing plan. Several other changes were made consistent with safe harbor provisions of non-discriminatory profit sharing plans. Before 2016, management made a non-elective contribution equal to 5% of all employee compensation into the Corporation's pension plan for all qualifying employees. Beginning in 2016, management split the 5% into two components as part of a new profit sharing plan with a non-elective safe harbor contribution of 3% of all employee compensation for the year, plus a non-elective employer contribution of up to 2% of all employee compensation based on the performance of the Corporation. The plan conversion also included changes that resulted in an accelerating vesting schedule for new employees and provided better benefits to a long-term employee in the year of termination. These changes along with both a record number of new hires and record year for employee turnover caused the Corporation's pension expense to accelerate in 2016, but then moderate in 2017 and decline in 2018. The 401(k) match portion of the profit sharing expense is much smaller in scope than the non-elective safe harbor and employer contribution expenses since the Corporation is matching a maximum of up to 2.5% of salary depending on employee contributions, compared to contributing up to 5.0% of salary in the profit sharing plan components. The 401(k) match expense portion of the new 401(k) Savings Plan increased $29,000, or 9.1% in 2018, a function of a larger workforce and greater employee participation.

Occupancy expenses consist of the following:

- Depreciation of bank buildings
- Real estate taxes and property insurance
- Utilities
- Building repair and maintenance
- Lease expense

Occupancy expenses have increased by $62,000, or 2.6%, for 2018 compared to 2017. Snow removal costs increased by $48,000, or 144.3% in 2018 compared to 2017, and utilities costs increased by $44,000, or 6.4%, when comparing

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both years. Building depreciation costs increased by $36,000, or 5.4% in 2018 compared to 2017. Partially offsetting these increases, building repair and maintenance costs decreased by $86,000, or 36.4%.

Equipment expenses decreased by $37,000, or 3.2%, for 2018 compared to 2017. Equipment service contract expenses decreased by $47,000, or 18.1%, for the year ended December 31, 2018, compared to the same period in 2017, and miscellaneous equipment expenses decreased by $16,000, or 18.7%. Partially offsetting these decreases, depreciation on furniture and equipment increased by $28,000, or 3.9%.

Advertising and marketing expenses for the year increased by $75,000, or 10.7%, from 2017 levels. These expenses can be further broken down into two categories, marketing expenses and public relations. The marketing expenses alone totaled $501,000 in 2018, which was a $41,000, or 8.9% increase, over 2017. Marketing expenses support the overall business strategies of the Corporation; therefore, the timing of these expenses is dependent upon those strategies. Public relations, the smaller category of advertising and marketing expenses, totaled $273,000 for 2018, compared to $238,000 for 2017, an increase of $35,000, or 14.7%. Fairs and expos, promotional items, and sponsorships make up this category. Management has increased marketing outreach efforts consistent with the Corporation's expanded market area in 2018.

Computer software and data processing expenses increased by $131,000, or 5.9%, for 2018 compared to 2017. Software-related expenses were up by $120,000, or 9.4%, for the year ended December 31, 2018, compared to the prior year, primarily because of increased amortization on existing software as well as purchases of new software platforms to support the strategic initiatives of the Corporation. Software expenses are likely to continue to increase in 2019, but the actual increase will be dependent on how quickly new software platforms are identified, analyzed, approved and placed into service. Data processing fees were up $11,000, or 1.1%, for the year ended December 31, 2018, compared to the same period in 2017. These fees are likely to increase throughout 2019 as data processing fees increase with the increase in customer transactions.

Bank shares tax expense was $901,000 for 2018, an increase of $42,000, or 4.9%, from 2017. Two main factors determine the amount of bank shares tax: the ending value of shareholders' equity and the ending value of tax-exempt U.S. obligations. The shares tax calculation uses a period-end balance of shareholders' equity and a tax rate of 0.95%. The increase in 2018 can be primarily attributed to the Corporation's growing value of shareholders' equity.

Professional services expense increased $301,000, or 18.0%, for 2018, compared to 2017. These services include accounting and auditing fees, legal fees, and fees for other third-party services. Fees paid to an outside consultant to perform a profit and process improvement project were $125,000 in 2018 causing a larger increase in professional fees compared to 2017. Legal fees increased by $80,000 in 2018 compared to the prior year primarily as a result of loan related legal fees. Fees for courier services increased by $19,000, or 26.5%, for the year as a result of courier services provided to customers in our new branch communities, primarily in southern Lancaster County. BOLI expense increased by $17,000, or 20.8%, primarily as a result of higher expenses on an older director's deferred compensation plan. Other professional services expense categories increased or decreased to lesser degrees making up the remainder of the variance.

Other operating expenses increased by $95,000, or 3.8%, for the year ended December 31, 2018, compared to the same period in 2017. Loan-related expenses increased by $94,000, or 27.6%, for the year-to-date periods when comparing 2018 to 2017. The primary reason for this increase was the implementation of a third party origination loan program which generates revenue from loans referred by another financial institution, with a commission paid to that institution which runs through this other operating expense category. Additionally, the provision for off balance sheet credit losses increased by $45,000 in 2018 compared to 2017. Costs related to operating supplies increased by $31,000, or 12.3%, when comparing both years, but partially offsetting these increases, fraud-related charge-offs decreased by $104,000, or 38.0%, for 2018 compared to 2017.

Management uses the efficiency ratio as one metric to evaluate the Corporation's level of operating expenses. The efficiency ratio measures the efficiency of the Corporation in producing one dollar of revenue. For example, an efficiency ratio of 70% means it costs seventy cents to generate one dollar of revenue. A lower ratio represents better operational efficiency. The formula for calculating the efficiency ratio is total operating expenses, excluding foreclosed property and OREO expenses, divided by net interest income on an FTE basis, prior to the provision for loan losses, plus other income, excluding gain or loss on the sale of securities. A higher level of operating expenses may be justified if the Corporation is growing interest earning assets and is increasing net interest income and other income at faster levels. This was the case in 2018 as the Corporation's efficiency ratio was 71.6%, compared to 73.2% for 2017. Management has been successful in increasing both net interest income and fee income during this period, resulting in improved efficiency. In 2019, management anticipates further improvements in net interest margin, which will provide higher net interest income and better efficiency, outside of improvements caused by normal growth. In the near term, management's goal is to reduce the efficiency ratio to below 70%. While management desires a lower efficiency ratio, the desire to capture additional market share in the near future and the interest rate environment, including the timing of the Federal Reserve's rate actions, will play a large part in determining when the Corporation's efficiency ratio improves and the degree to which improvements can be made.

Income Taxes

Nearly all of the Corporation's income is taxed at a corporate rate of 21% for Federal income tax purposes. The Corporation is also subject to Pennsylvania Corporate Net Income Tax; however, no taxable activity is conducted at the corporate level. The Corporation's wholly owned subsidiary, Ephrata National Bank, is not subject to state income tax, but does pay Pennsylvania Bank Shares Tax. The Bank Shares Tax expense appears on the Corporation's Consolidated Statements of Income under operating expenses.

Certain items of income are not subject to Federal income tax, such as tax-exempt interest income on loans and securities, and increases in the cash surrender value of life insurance; therefore, the effective income tax rate for the Corporation is lower than the stated tax rate. The effective tax rate is calculated by dividing the Corporation's provision for income tax by the pre-tax income for the applicable period.

For the year ended December 31, 2018, the Corporation recorded a tax provision of $1,306,000, compared to $2,338,000 for 2017. This decrease in tax provision was caused primarily by a deferred tax asset devaluation of $1.1 million at December 31, 2017, as a result of a lower Corporate tax rate. The Tax Cuts and Jobs Act lowered the Corporate tax rate from 34% to 21% as of January 1, 2018, which lowered the Corporation's provision for Federal income taxes in 2018. However, the Corporation was required to write down the value of its net deferred tax assets by $1.1 million as of December 31, 2017. This devaluation reduced the deferred tax asset and increased tax expense for the year.

The effective tax rate for the Corporation was 11.8% for 2018, compared to 26.9% for 2017. The Corporation's effective tax rate is lower than the 21% corporate rate that was effective December 31, 2018, as a result of tax-free assets that the Corporation holds on its balance sheet. The majority of the Corporation's tax-free assets are in the form of obligations of states and political subdivisions, referred to as municipal bonds.

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Financial Condition

Cash and Cash Equivalents

Cash and cash equivalents consist of the cash on hand in the Corporation's vaults, operational transaction accounts with the Federal Reserve Bank (FRB), and deposits in other banks. The FRB requires a specified amount of cash available either in vault cash or in an FRB account. Known as cash reserves, these funds provide for the daily clearing house activity of the Corporation and fluctuate based on the volume of each day's transactions. Beyond these requirements, the Corporation maintains additional cash levels as part of Management's active asset liability and liquidity strategy. Management has been carrying larger cash balances to provide an immediate hedge against interest rate risk and liquidity risk. As of December 31, 2018, the Corporation had $41.4 million in cash and cash equivalents, compared to $53.1 million as of December 31, 2017.

As a result of the actions of the Board of Governors on December 16, 2008, financial institutions have been able to receive a rate equivalent to the Federal funds rate on reserves held at the FRB. Because this rate matched the Federal funds rate that could be obtained at other correspondent banks, management began to keep larger balances at the FRB and less Federal funds. This overnight rate has increased with every Federal Reserve rate move, so it initially moved to 0.50% in December of 2015 after the first rate move and stands at 2.50% as of December 31, 2018. The Corporation expects to maintain an element of total cash at the Federal Reserve as part of a diversified cash management plan as long as liquidity levels allow for this to happen. Management also invests excess cash in two money market accounts at other financial institutions. One money market account yielded a return of 2.60% at December 31, 2018, and the other money market account yielded a return of 2.75%, both more than the return received from the FRB. This diversification alters the mix of cash and cash equivalents to more interest bearing deposits in banks and less Federal funds sold. The cash and cash equivalents represent only one element of liquidity. For further discussion on liquidity management, refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk.

Sources and Uses of Funds

The following table shows an overview of the Corporation's primary sources and uses of funds. This table utilizes average balances to explain the change in the sources and uses of funding. Management uses this analysis tool to evaluate changes in each balance sheet category. For purposes of this analysis, securities available for sale are shown based on book value and not fair market value. Additionally, short-term investments only include interest-bearing funds. Trends identified from past performance assist management with decisions concerning future growth.

Some conclusions drawn from the following table are as follows:

- Balance sheet growth rate was 4.6% in 2018 compared to 6.7% in 2017.
- Balance sheet mix changed with average balances of loans growing at a rate of 9.9%, compared to a 1.2% decrease in securities.
- Interest bearing demand deposits and savings deposits grew in 2018 compared to a decline in time deposits.
- Non-interest bearing deposits, the most beneficial deposits, grew at a rate of 12.1% in 2018, compared to 16.2% growth in 2017.
- Time deposits continue to decline both in amount and as a percentage of total deposits with a 8.5% decrease in 2018 compared to a 7.7% decline in 2017.
- Borrowings increased by 2.4% in 2018, compared to a decrease of 5.1% in 2017.

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SOURCES AND USES OF FUNDS

(DOLLARS IN THOUSANDS)

	2018 vs. 2017				2017 vs. 2016			
	2018	2017	Increase (Decrease)		2017	2016	Increase (Decrease)	
Average Balances	$	$	$	%	$	$	$	%
Short-term investments	18,772	29,277	(10,505)	(35.9)	29,277	24,325	4,952	20.4
Securities available for sale	319,420	323,317	(3,897)	(1.2)	323,317	296,925	26,392	8.9
Regulatory stock	6,245	5,629	616	10.9	5,629	4,851	778	16.0
Loans	638,525	581,267	57,258	9.9	581,267	553,994	27,273	4.9
Total Uses	982,962	939,490	43,472	4.6	939,490	880,095	59,395	6.7
Interest bearing demand	213,037	201,522	11,515	5.7	201,522	188,758	12,764	6.8
Savings accounts	196,392	187,018	9,374	5.0	187,018	163,210	23,808	14.6
Time deposits	142,125	155,285	(13,160)	(8.5)	155,285	168,182	(12,897)	(7.7)
Borrowings	72,282	70,557	1,725	2.4	70,557	74,381	(3,824)	(5.1)
Non-interest bearing demand	322,733	287,928	34,805	12.1	287,928	247,730	40,198	16.2
Total Sources	946,569	902,310	44,259	4.9	902,310	842,261	60,049	7.1

Investment Securities

The Corporation classifies all of its debt securities as available for sale and reports the portfolio at fair market value. As of December 31, 2018, the Corporation had $300.0 million of investment securities, which accounted for 27.3% of assets, compared to 30.9% as of December 31, 2017. The securities portfolio decreased in size and as a percentage of the balance sheet in 2018 due to increased loan growth resulting in sales of securities to fund higher loan balances. While the ending balance of securities decreased 6.2% from December 31, 2017 to December 31, 2018, the average balance of securities decreased 1.2% for the year compared to 2017.

Each quarter management sets portfolio allocation guidelines and adjusts security portfolio strategy generally based upon the following factors:

- Performance of the various instruments including spreads over U.S. Treasury rates
- Slope of the U.S. Treasury yield curve
- Level of and projected direction of interest rates
- ALCO positions as to liquidity, interest rate risk, and net portfolio value
- Changes in credit risk of the various instruments
- State of the economy and projected economic trends

The securities policy of the Corporation imposes guidelines to ensure diversification within the portfolio. The diversity specifications are designed to control the level of risk presented by each security type. The amount of diversity permitted through the policy allows management to pursue security types with better total return profiles or securities with higher yields. However, those securities that can provide higher levels of return will often bring higher elements of duration or credit risk. Management's goal is to optimize portfolio total return performance over the long term while staying within portfolio policy guidelines. The composition of the securities portfolio at year end based on fair market value is shown in the following table.

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SECURITIES PORTFOLIO

(DOLLARS IN THOUSANDS)

	December 31, 2018		2017		2016	
	$	%	$	%	$	%
U.S. government agencies	30,120	10.0	34,352	10.8	32,261	10.5
U.S. agency mortgage-backed securities	44,639	14.9	52,073	16.3	55,869	18.1
U.S. agency collateralized mortgage obligations	54,090	18.0	54,641	17.1	37,936	12.3
Asset-backed securities	11,399	3.8	—	—	—	—
Corporate bonds	59,192	19.7	60,769	19.0	52,091	16.9
Obligations of states and political subdivisions	94,625	31.6	112,243	35.1	124,430	40.4
Total debt securities, available for sale	294,065	98.0	314,078	98.3	302,587	98.2
Marketable equity securities (a)	5,934	2.0	5,583	1.7	5,524	1.8
Total securities	299,999	100.0	319,661	100.0	308,111	100.0

(a) As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available for sale.

The Corporation typically invests excess liquidity into securities, primarily fixed-income bonds which account for 98.0% of all securities. The securities portfolio provides interest and dividend income to supplement the interest income on loans. Additionally, the securities portfolio assists in the management of both liquidity risk and interest rate risk. Refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk for further discussion of risk strategies. To provide maximum flexibility for management of liquidity and interest rate risks, the securities portfolio is classified as available for sale and reported at fair value. Management adjusts the value of the portfolio on a monthly basis to fair market value as determined in accordance with U.S. generally accepted accounting principles. Management has the ability and intent to hold all debt securities until maturity, and does not generally record impairment on the bonds that are currently valued below book value.

The Corporation's marketable equity securities include an investment in qualified Community Reinvestment Act (CRA) mutual funds and a small portfolio of bank stocks held at the holding company level. A total of $5,410,000 has been invested into one qualified CRA fund that carried an AAA credit rating as of December 31, 2018. The fund is a Small Business Administration (SBA) CRA fund with a $5,410,000 book value and market value as it has a stable dollar price. The current guideline used by management for the minimum amount to be invested in CRA-approved investments is approximately 0.5% of assets. The current $5,410,000 of CRA investments is equivalent to 0.5% of assets. The small portfolio of bank stocks included in marketable equity securities had a book value of $591,000 and a fair market value of $524,000 as of December 31, 2018.

Overall, the tax equivalent yield on all of the Corporation's securities decreased from 3.18% for 2017, to 2.64% for 2018. This decrease was primarily due to the change in Corporate tax rate from 34% to 21% as of December 31, 2017, which caused a significant decline in yield on the portfolio of tax-free municipal securities during 2018. On the taxable segment of the portfolio, Treasury rates were higher in 2018 compared to 2017, so the vast majority of securities that matured or were sold had lower yields than the securities purchased to replace them. The Corporation's securities portfolio underwent a number of changes during 2018 including investments in asset-backed securities and a decrease in obligations of states and political subdivisions. The fair market value of the Corporation's securities portfolio decreased by $19.7 million, or 6.2%, from December 31, 2017 to December 31, 2018, and the portfolio accounted for a smaller amount of the Corporation's assets at 27.3% as of December 31, 2018, compared to 30.9% as of December 31, 2017.

Management invested in asset-backed securities in 2018 in the form of student loan floaters in an effort to provide an instrument that will perform well in a rates-up environment and offset the interest rate risk of the longer fixed-rate municipal bonds. Management also decreased the amount of obligations of states and political subdivisions in response to tax law changes that made these instruments slightly less beneficial from a yield and duration standpoint.

Management views the U.S. government agency sector as foundational to the building of the securities portfolio. U.S. agencies have very low risk and high liquidity, and depending on structure, are fairly predictable in terms of their performance. Non-callable agencies have a set maturity date with no principal payments until maturity. Callable agencies offer a higher yield but carry option risk, the risk that the agency could call the issue after it reaches the call date. This typically occurs if interest rates decline. The non-callable structures have lower yield but a better total return profile when considering all rate scenarios, however given a slow progression of higher rates the callable structure would outperform given the higher yield. As a result, management uses a blend of non-callable and callable instruments to enhance yield performance but ensure a predictable cash flow ladder is built out into the future. Management prefers to use corporate bonds to supplement U.S. agencies in building a ladder of steady maturities in the one-year to five-year time frame. Corporate bonds provide better return than U.S. agencies, especially in this shorter time frame, since they provide better yields and are generally not callable. In the corporate bond market there are also floating rate bonds available that typically reprice quarterly based on a spread to one-month LIBOR. During 2018, management steadily added to the position of floating rate corporate bonds to enable a larger portion of the securities portfolio to benefit from higher interest rates. This strategy worked well as the Federal Reserve increased interest rates at the pace of once a quarter during 2018. Therefore, the floating rate corporate bonds were able to gain the benefit of each Federal Reserve increase as they continued to reprice to a higher coupon at each quarterly reset date. Between these floating rate corporate bonds and the asset backed securities sector, the Corporation's percentage of floating rate securities grew from 3.9% as of December 31, 2017, to 11.1% as of December 31, 2018. While corporate bonds do carry substantially more credit risk than U.S. agencies, the credit risk of corporate bonds is greatly mitigated by maintaining shorter maturities.

Investments in MBS and CMOs assist management in adding to and maintaining a stable five-year ladder of cash flows, which is important in providing stable liquidity and interest rate risk positions. Unlike U.S. agency bonds, corporate bonds, and obligations of states and political subdivisions, which only pay principal at final maturity, the U.S. agency MBS and CMO securities pay monthly principal and interest. The combined effect of all of these instruments paying monthly principal and interest provides the Corporation with a significant and reasonably stable cash flow. Cash flows coming off of MBS and CMOs do slow down and speed up as interest rates increase or decrease. During the majority of 2018, cash flows from these securities were lower than the prior year as a result of higher Treasury rates. Management desires and pursues those MBS and CMO securities that do not experience significant changes in prepayment speeds given changes in interest rates. Since nearly all of these securities are purchased at a premium, management is most concerned with how quickly that premium will be amortized based on the average life of the security. Therefore, management attempts to guard against those securities with fast or volatile prepayment speeds in favor of those that demonstrate more consistent principal payments.

Obligations of states and political subdivisions, often referred to as municipal bonds, are tax-free securities that generally provide the highest yield in the securities portfolio on a tax-equivalent basis. In the continued prolonged period of historically low interest rates, the municipal bond sector has outperformed all other sectors of the portfolio. Municipal tax-equivalent yields generally start well above other taxable bonds; however, they generally carry the longest duration and highest interest rate risk exposure out of all the Corporation's securities. Due to the lower tax rate in 2018, municipal bonds do not provide yields as high as previous years, but they still are an important component of the Corporation's portfolio. The municipal bond portfolio had an unrealized loss position of $1,532,000 as of December 31, 2018, compared to an unrealized loss position of $1,804,000 as of December 31, 2017.

The vast majority of the municipal bonds held by the Corporation on December 31, 2018 carried between an A and an AA credit rating, with 10.1% carrying the highest AAA rating. These are stronger ratings on average than the ratings on the corporate bonds held by the Corporation. These ratings reflect the final rating or the rating with any insurance backing or credit enhancements. The Corporation's securities policy requires that municipal bonds not carrying insurance have a minimum S&P credit rating of A- or a minimum Moody's credit rating of A3 at the time of purchase. It is possible that municipalities have an underlying rating of S&P BBB+ or Moody's Baa1 rating prior to insurance or credit enhancement while having a final rating of S&P A- or Moody's A3 with the insurance and/or credit enhancement. In the current environment, the major rating services have tightened their credit underwriting procedures and are more apt to downgrade municipalities. Additionally, the weaker economy has reduced revenue streams for many municipalities and has called into question the basic premise that municipalities have unlimited power to tax, i.e. the ability to raise taxes to compensate for revenue shortfalls. Therefore, management closely monitors any municipal bonds that have their credit ratings downgraded below initial purchase guidelines. The Corporation has not experienced any losses due to defaults or bankruptcies of states or political subdivisions. As of December 31, 2018, all of the municipal bonds carried credit ratings within the Corporation's initial purchase policy requirements.

As of December 31, 2018, the Corporation held corporate bonds with a total book value of $61.1 million and fair market value of $59.2 million. Corporate bonds, consisting of bonds issued by public companies as unsecured credit, carry a 100% risk weighting for capital purposes and therefore are viewed as a higher risk security. Because of the higher risk posed by corporate bonds, the Corporation has a policy that limits corporates to 20% of the portfolio book value. As of December 31, 2018, this $61.1 million book value of corporate debt amounted to 19.9% of the portfolio book value, compared to $61.3 million book value, or 18.9% of portfolio book value as of December 31, 2017.

Like any security, corporate bonds have both positive and negative qualities and management must evaluate these securities on a risk versus reward basis. Corporate bonds add diversity to the portfolio and provide strong relative yields for short maturities; however, by their very nature, corporate bonds carry a high level of credit risk should the entity experience financial difficulties. Management stands to possibly lose the entire principal amount if the entity that issued the corporate paper fails. As a result of the higher level of credit risk taken on by purchasing a corporate bond, management has in place certain minimal credit ratings that must be met in order for management to purchase a corporate bond. The financial performance of any corporate bond being considered for purchase is analyzed both prior to and after purchase. Management conducts periodic monitoring throughout the year including an internal financial analysis. An independent credit review is conducted at least annually in addition to management's periodic monitoring. Additionally, the Corporation's securities policy calls for corporate bonds purchased to not have maturities greater than six years with the preferred maturity range of two to five years. Credit risk grows exponentially with length. The shorter the maturity the more assurance the company's financial position will remain sufficiently strong to ensure full payment of the bond at maturity. The longer the time horizon the more difficult it is to project the financial health of the company.

Management closely monitors the unrealized gain or loss positions of all the corporate bonds to identify any potential weakness. The trading levels of these securities are closely linked to the financial performance and health of the entity. Significant declines in the valuations of these securities, beyond what can be attributed to movement in interest rates, are generally an indication of higher credit risk. Management reviews all securities with unrealized losses approaching 10% or those carrying unrealized losses for prolonged periods of time, for possible impairment. As of December 31, 2018, the highest percentage of unrealized losses for any corporate bond was 11.4% and 10.8% and those losses were on General Electric bonds that had some credit concerns as of December 31, 2018. After December 31, 2018 but prior to the filing of this report, the unrealized losses on these two bonds had declined to 8.2% and 7.6%, respectively. Management evaluated the bonds and determined that they were not impaired. Management anticipates further improvement in valuation of these bonds in 2019. All but two of the corporate bonds had at least an A credit rating by one of the major credit rating services, with all corporate bonds considered investment grade. Currently, there are no indications that any of these bonds would discontinue contractual payments.

The entire securities portfolio is reviewed monthly for credit risk and evaluated quarterly for possible impairment. Corporate bonds have the most potential credit risk out of the Corporation's debt instruments. Due to the rapidly changing credit environment and improving but sluggish economic conditions, management is closely monitoring all corporate bonds. For further information on impairment see Note B. For further details regarding credit risk see Note P.

The following table shows the weighted-average life and yield on the Corporation's securities by maturity intervals as of December 31, 2018, based on amortized cost. All of the Corporation's securities are classified as available for sale and are reported at fair value; however, for purposes of this schedule they are shown at amortized cost.

SECURITIES PORTFOLIO MATURITY ANALYSIS

(DOLLARS IN THOUSANDS)

	Within 1 Year		1 - 5 Years		5 - 10 Years		Over 10 Years		Total	
	$	% Yield	$	% Yield	$	% Yield	$	% Yield	$	% Yield
U.S. government agencies	—	—	27,025	1.94	4,000	3.24	—	—	31,025	2.11
U.S. agency mortgage-backed securities	7,797	2.28	20,991	2.31	11,973	2.41	5,602	2.48	46,363	2.35
U.S. agency collateralized mortgage obligations	7,111	2.28	29,359	2.31	15,580	2.48	3,132	2.83	55,182	2.38
Corporate bonds	—	—	61,085	2.70	—	—	—	—	61,085	2.70
Obligations of states and political subdivisions	—	—	1,856	1.88	2,410	3.35	91,891	3.04	96,157	3.03
Asset-backed securities	—	—	—	—	—	—	11,440	3.00	11,440	3
Marketable equity securities	—	—	—	—	—	—	6,001	2.60	6,001	2.60
Total securities available for sale	14,908	2.28	140,316	2.40	33,963	2.61	118,066	2.98	307,253	2.64

Securities are assigned to categories based on stated contractual maturity except for MBS and CMOs, which are based on anticipated payment periods.

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The yield on the securities portfolio, including equity securities, was 2.64% as of December 31, 2018, compared to 2.70% as of December 31, 2017. The reduction in yield was primarily due to the decline in Corporate tax rate that had a negative impact on the yield of municipal bonds. These bonds carry the highest yield in the portfolio but this yield was impacted significantly by the tax rate reduction. Management also reduced municipal bonds throughout 2018 to reduce portfolio duration and as a result of the yields being less favorable. As of December 31, 2018, the effective duration of the Corporation's fixed income security portfolio was 3.0 years for the base case or rates unchanged scenario, compared to 3.3 years as of December 31, 2017. Effective duration is the estimated duration or length of a security or portfolio, which is implied by the price volatility. Effective duration is calculated by converting price volatility to a standard measurement representing length, expressed in years. It is a measurement of price sensitivity, with lower durations being advantageous in periods of rising rates and longer durations benefiting the holder in periods of declining rates. An effective duration of 3.0 years would approximate the duration of a three-year U.S. Treasury, a security that has no option risk or call provisions. Management receives effective duration and price volatility information quarterly on an individual security basis. Management's target base case, or rates unchanged effective duration, is 3.0 years. The Corporation manages duration, along with interest rate sensitivity and fair value risk, across the entire balance sheet. Currently, assets are repricing quicker than liabilities, meaning the Corporation is asset sensitive and benefits by higher interest rates. Regardless of the Corporation's asset sensitive balance sheet position, management still desires to maintain the securities portfolio's effective duration at the targeted 3.0 years throughout 2019 to maintain rates-up performance.

Effective duration is only one measurement of the length of the securities portfolio. Management receives and monitors a number of other measurements. In general, a shorter portfolio will adjust more quickly in a rising interest rate environment, whereas a longer portfolio will tend to generate more return over the long-term and will outperform a shorter portfolio when interest rates decline. Because the Corporation's securities portfolio is slightly longer than the average peer bank, it will generally outperform the average peer bank given static rates or a decline in interest rates, and will generally underperform given higher interest rates. Additionally, with fixed rate instruments, the longer the term of the security, generally the more fair value risk there is when interest rates rise. The converse is true when interest rates decline. The securities portfolio is a significant piece of the Corporation's assets, but there are other crucial elements that management also uses to manage the Corporation's asset liability position such as cash and cash equivalents and borrowings. Beyond these, management also utilizes other elements of the Corporation's balance sheet to reduce exposure to higher interest rates. Prime-based loans account for approximately 22% of the Corporation's total loans which results in this segment of the portfolio having very minimal exposure to interest rate risk because these loans reprice to the new Prime rate whenever there is a Federal Reserve rate movement. The unusually extended period of historically low rates also caused the Corporation's deposits to undergo major changes in consistency with non-interest bearing accounts and savings accounts responsible for a larger percentage of deposits while time deposits have declined markedly. This has benefited the Corporation's asset liability position with more core deposits which model with longer lives causing liabilities to extend. The combination of Prime-based loans and longer core deposits has allowed management to historically take on more duration in the securities portfolio. See Item 7A Quantitative and Qualitative Disclosures about Market Risk for further discussion on the Corporation's management of asset liability risks including interest rate risk and fair value risk.

The majority of the Corporation's securities are held at the bank level with only a very small portfolio of bank stocks held at the holding company level. With only $591,000 of book value as of December 31, 2018, the non-maturity nature of the Corporation's bank stock portfolio is not material to the duration of the Corporation's securities portfolio or assets. The decision to purchase these equity securities at the holding company level took into account tax strategies, market conditions, and other strategic decisions.

Loans

Net loans outstanding increased $96.1 million, or 16.3%, from $589.3 million at December 31, 2017, to $685.4 million at December 31, 2017. The following table shows the composition of the loan portfolio as of December 31 for each of the past five years.

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LOANS BY MAJOR CATEGORY

(DOLLARS IN THOUSANDS)

	December 31, 2018		2017		2016		2015		2014	
	$	%	$	%	$	%	$	%	$	%
Commercial real estate										
Commercial mortgages	101,419	14.6	90,072	15.1	86,434	15.2	87,613	16.8	95,914	20.4
Agriculture mortgages	165,926	24.0	152,050	25.5	163,753	28.7	158,321	30.5	140,322	29.8
Construction	18,092	2.6	18,670	3.1	24,880	4.4	14,966	2.9	7,387	1.6
Total commercial real estate	285,437	41.2	260,792	43.7	275,067	48.3	260,900	50.2	243,623	51.8
Consumer real estate (a)										
1-4 family residential mortgages	219,037	31.6	176,971	29.7	150,253	26.3	133,538	25.7	123,395	26.2
Home equity loans	10,271	1.5	11,181	1.9	10,391	1.8	10,288	2.0	12,563	2.7
Home equity lines of credit	64,413	9.3	61,104	10.2	53,127	9.3	37,374	7.2	27,308	5.8
Total consumer real estate	293,721	42.4	249,256	41.8	213,771	37.4	181,200	34.9	163,266	34.7
Commercial and industrial										
Commercial and industrial	61,043	8.8	41,426	6.9	42,471	7.4	36,189	7.0	31,998	6.8
Tax-free loans	22,567	3.3	20,722	3.5	13,091	2.3	19,083	3.7	11,806	2.5
Agriculture loans	20,512	3.0	18,794	3.2	21,630	3.8	18,305	3.5	16,496	3.5
Total commercial and industrial	104,122	15.1	80,942	13.6	77,192	13.5	73,577	14.2	60,300	12.8
Consumer	9,197	1.3	5,320	0.9	4,537	0.8	3,892	0.7	3,517	0.7
Total loans	692,477	100.0	596,310	100.0	570,567	100.0	519,569	100.0	470,706	100.0
Less:										

Deferred loan costs, net	(1,596)	(1,243)	(1,000)	(714)	(462)
Allowance for loan losses	8,666	8,240	7,562	7,078	7,141
Total net loans	685,407	589,313	564,005	513,205	464,027

(a) Residential real estate loans do not include mortgage loans serviced for others. These loans totaled $126,916,000 as of December 31, 2018, $98,262,000 as of December 31, 2017, $66,767,000 as of December 31, 2016, $38,024,000 as of December 31, 2015, and $16,670,000 as of December 31, 2014.

The composition of the loan portfolio has remained relatively stable in recent years, with the one major trend being the growth in 1-4 family residential lending. The total of all categories of real estate loans comprised 83.6% of total loans as of December 31, 2018, compared to 85.5% of total loans as of December 31, 2017. Consumer real estate is now the largest category of the loan portfolio, with commercial real estate being the second largest category.

Commercial real estate consists of 41.2% of total loans as of December 31, 2018, compared to 43.7% of total loans as of December 31, 2017. Within the commercial real estate segment there has been an increase in agricultural mortgages and commercial mortgages over the past year, with construction based mortgages then declining slightly in 2018. Agricultural purpose loans have averaged approximately 30% of the Corporation’s total loans over the past five-year period, and had experienced a period of rapid growth in 2015 followed by slowing in 2016, declines in 2017, and then growth again in 2018. In 2016 the growth rate slowed as economic conditions, namely weaker commodity prices, became more difficult and changes occurred in the Corporation’s agricultural lending team. The reduction in agricultural mortgages in 2017 was caused by a general slowing of the growth rate in the local agricultural industry, a more challenging year for dairy farmers, which account for approximately half the Corporation’s agricultural loans, and a reduction in the pipeline of new agricultural loans caused by the prior changes in the agricultural lending staff. The Corporation has a history of an agricultural focus, which coincides with the market area and type of customers that we serve. In 2018, agricultural loan growth picked up due to the Corporation’s renewed commitment to and more agricultural relationships proceeding with projects. Management believes the agricultural loan portfolio will continue to grow in 2019, but is also closely tracking the impact of weaker commodity prices on the Corporation’s farmers.

Commercial real estate loans increased to $285.4 million at December 31, 2018, from $260.8 million at December 31, 2017, a 9.4% increase. The increase in commercial real estate occurred in the agriculture and commercial mortgages. Agriculture mortgages increased by $13.9 million, or 9.1%, and commercial mortgages increased by $11.3 million, or 12.6%, from December 31, 2017, to December 31, 2018. Due primarily to competitive pressures and a slowdown in the pipeline for agriculture loans, these balances declined throughout 2017 with growth beginning to pick up again towards the end of the year and continuing throughout 2018. The agricultural mortgages, along with agricultural loans not secured by real estate, accounted for 26.9% of the entire loan portfolio as of December 31, 2018, compared to 28.7% as of December 31, 2017. Management expects agricultural and commercial loans to increase in 2019. Management believes as economic conditions improve further in 2019, other elements of the local diversified economy outside of the agriculture industry will expand and cause commercial mortgages to continue to grow as well.

The other area of commercial lending is non-real estate secured commercial lending, referred to as commercial and industrial lending. Commercial and industrial loans not secured by real estate accounted for 15.1% of total loans as of December 31, 2018, compared to 13.6% as of December 31, 2017. In scope, the commercial and industrial loan sector, at 15.1% of total loans, is significantly smaller than the commercial real estate sector at 41.2% of total loans. This is consistent with management's credit preference for obtaining real estate collateral when making commercial loans. The balance of total commercial and industrial loans increased from $80.9 million at December 31, 2017, to $104.1 million at December 31, 2018, a 28.7% increase. This category of loans generally includes unsecured lines of credit, truck, equipment, and receivable and inventory loans, in addition to tax-free loans to municipalities. Based on current levels of demand for these types of loans and the higher level of commercial and industrial expertise that the Corporation now has, management anticipates that these loans will experience moderate growth in 2019.

The Corporation provides credit to many small and medium-sized businesses. Much of this credit is in the form of Prime-based lines of credit to local businesses where the line may not be secured by real estate, but is based on the health of the borrower with other security interests on accounts receivable, inventory, equipment, or through personal guarantees. Commercial and industrial loans increased to $61.0 million at December 31, 2018, a $19.6 million, or 47.3% increase, from the $41.4 million at December 31, 2017. The commercial and industrial agricultural loans grew by $1.7 million, or 9.1%, from balances at December 31, 2017.

As a result of the regulatory concerns regarding commercial real estate (CRE) lending that arose out of the financial crisis of 2008, there has been a renewed focus on the amount of CRE loans as a percentage of total risk-based capital. The CRE loans are viewed as having more risk due to the specific types of commercial loans that fall into this category and their heavy reliance on the value of real estate that is used as collateral. During the financial crisis and years immediately after, many financial institutions had CRE loans in excess of 400% of total risk-based capital. Regulators were warning banks of concentrations in CRE loans and the increased risk that they could potentially bring. The Corporation's level of CRE loans has been low relative to other community banks and the CRE profile has not materially changed over the past several years. The Corporation remains well below the CRE guidelines of 100% of total risk-based capital for construction and development loans, and 300% of risk-based capital for total CRE loans. There are nine categories of CRE loans by definition; however the Corporation only has seven of those types.

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The following chart details the Corporation's CRE loans as of December 31, 2018 and December 31, 2017.

CRE SUMMARY BY CATEGORY
(DOLLARS IN THOUSANDS)

	December 31,			
	2018		2017	
	Total Committed Loan Amount	Risk-Based Capital	Total Committed Loan Amount	Risk-Based Capital
CRE Description	$	%	$	%
Land Development Loans	3,280	2.8	5,130	4.6
1-4 Family Residential Construction Loans	1,046	0.9	800	0.7
Commercial Construction Loans	11,560	9.8	9,083	8.2
Other Land Loans	61	0.1	1,501	1.3
Multi-Family Property	7,259	6.2	7,603	6.8
Nonfarm, Nonresidential Property	17,696	15.1	17,561	15.8
Unsecured Loans to Developers	884	0.7	1,462	1.3
	41,786	35.6	43,140	38.7
Corporation's Risk-Based Capital	117,479		111,512	

The Corporation's level of CRE loans is low relative to other financial institutions in its peer group and as a percentage of risk-based capital, with 35.6% as of December 31, 2018. Management does not believe the Corporation's CRE profile will change significantly during 2019. Management is closely monitoring all CRE loan types to be able to determine any negative trends that may occur. Management does internally monitor the delinquencies and risk ratings of these loans on a monthly basis and has established internal policy guidelines to restrict the amount of each of the above eight types of CRE loans as a percentage of capital. As of December 31, 2018, the Corporation was well under internal guidelines for all of the above CRE loan types.

The consumer residential real estate category represents the largest group of loans for the Corporation. The consumer residential real estate category of total loans increased from $249.3 million on December 31, 2017, to $293.7 million on December 31, 2018, a 17.8% increase. This category includes closed-end fixed rate or adjustable rate residential real estate loans secured by 1-4 family residential properties, including first and junior liens, and floating rate home equity loans. The 1-4 family residential mortgages account for the vast majority of residential real estate loans with fixed and floating home equity loans making up the remainder. Historically, the entire consumer residential real estate component of the loan portfolio has averaged close to 40% of total loans. In 2017, this percentage was 41.8%, and in 2018 it increased to 42.4%. Management expects the consumer residential real estate category to increase at a similar pace in 2019 due to a continued effort to increase mortgage volume. The economic conditions for consumers have also improved slightly going into 2019. Consumer disposable income is higher and home valuations have increased, which has increased the equity available in their homes, however if mortgage rates increase significantly during 2019, it is likely the growth rate could moderate.

The first lien 1-4 family mortgages increased by $42.1 million, or 23.8%, from December 31, 2017, to December 31, 2018. These first lien 1-4 family loans made up 75% of the residential real estate total as of December 31, 2018, and 71% as of December 31, 2017. The vast majority of the first lien 1-4 family closed end loans consist of single family personal first lien residential mortgages and home equity loans, with the remainder consisting of 1-4 family residential non-owner-occupied mortgages. During 2018, mortgage production increased 17.5% over the prior year. The Corporation experienced increases in both portfolio and secondary market production. The percentage of mortgage originations going in the Corporation's held for investment mortgage portfolio increased from 55% in 2017 to 61% in 2018, and held-for-sale production also increased year-over-year by 3%. Market conditions were less favorable throughout the year with gains on the sale of mortgages decreasing by 7% in 2018. The Corporation's continued focus on the growth of the mortgage division led to an incremental increase in purchase-money and new construction concentration; 46% of volume in 2018 was purchase, 32% was residential construction lending, and only 22% was refinance activity. The volume of residential mortgage production in 2017 led to a 23.8% increase in growth of the overall residential loan portfolio, with a significant shift from fixed rate loans to interim adjustable rate mortgages (ARMs), climbing from 39% of the residential loan portfolio at the end of 2017, to 44% at the end of 2018. This shift in production has decreased the bank's interest rate risk profile and this trend is expected to continue in 2019.

As of December 31, 2018, the remainder of the residential real estate loans consisted of $10.3 million of fixed rate junior lien home equity loans, and $64.4 million of variable rate home equity lines of credit (HELOCs). This compares to $11.2 million of fixed rate junior lien home equity loans, and $61.1 million of HELOCs as of December 31, 2017. Therefore, combined, these two types of home equity loans increased from $72.3 million to $74.7 million, an increase of 3.3%. The Prime rate had remained at a very low level of 3.25% for seven years beginning in December of 2008 and increased by 25 basis points to 3.50% in December of 2015 and another 25 basis points to 3.75% in December of 2016 before increasing three more times in 2017 and 4 times in 2018 ending the year at a rate of 5.50%. The majority of borrowers chose variable-rate HELOC products throughout 2017 and 2018 instead of fixed-rate home equity loans. In addition, multiple HELOC specials with a low introductory rate were offered in 2017 and 2018, which encouraged more HELOC activity resulting in the increase in this category of loans since the prior year. Management believes consumers may shift to more fixed-rate home equity lending throughout 2019 if the Prime rate continues to increase. While 2018 did not see a significant shift away from the variable-rate HELOC product, the more times the Prime rate increases, the more likely consumers are to evaluate all options and potentially choose to fix their loan for a specified term as opposed to allowing the interest rate to remain variable.

Consumer loans not secured by real estate represent a very small portion of the Corporation's loan portfolio, accounting for 1.3% of total loans as of December 31, 2018, and 0.9% of loans at December 31, 2017. In recent years, homeowners have turned to equity in their homes to finance cars and education rather than traditional consumer loans for those expenditures. Due to the credit crisis that occurred in 2008 and 2009, specialized lenders began pulling back on the availability of credit and more favorable credit terms. The underwriting standards of major financing and credit card companies began to strengthen in the past few years after years of lower credit standards. This led consumers to seek unsecured credit away from national finance companies and back to their bank of choice. Management has seen the need for additional unsecured credit increase; however, this increased need for credit has only resulted in low levels of additional consumer loans for the Corporation. Slightly higher demand for unsecured credit is being offset by principal payments on existing loans.

Management anticipates that the Corporation's level of consumer loans will likely be relatively unchanged in the near future, as the need for additional unsecured credit in an environment of slowly improving economic conditions is generally being offset by those borrowers wishing to reduce debt levels and move away from the higher cost of unsecured financing relative to other forms of real estate secured financing.

Management does not anticipate that the loan portfolio composition will change materially in 2019, or be subject to any adverse trends, events, or uncertainty. The robust loan growth that occurred in 2018 will likely continue in 2019 with a focus on residential, commercial, and agriculture growth and a full complement of lending staff. Agriculture and commercial mortgage growth will be dependent on economic conditions continuing to improve. Since commercial lending is highly linked to economic conditions it is likely the entire commercial real estate area will grow as a percentage of total loans. The largest single category of 1-4 family residential mortgages is expected to continue growing but with a slower growth rate. Management would expect this single segment of the loan portfolio to remain above 30% of total loans throughout 2019.

The following tables show the maturities for the loan portfolio as of December 31, 2018, by time frame for the major categories, and also the loans, which are floating or fixed, maturing after one year.

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LOAN MATURITIES

(DOLLARS IN THOUSANDS)

	Due in One Year or Less $	Due After One Year Through Five Years $	Due After Five Years $	Total $
Commercial real estate				
Commercial mortgages	5,727	5,510	90,182	101,419
Agriculture mortgages	9,876	5,488	150,562	165,926
Construction	904	374	16,814	18,092
Total commercial real estate	16,507	11,372	257,558	285,437
Consumer real estate				
1-4 family residential mortgages	9,772	6,788	202,477	219,037
Home equity loans	5,594	1,282	3,395	10,271
Home equity lines of credit	—	2,765	61,648	64,413
Total consumer real estate	15,366	10,835	267,520	293,721
Commercial and industrial				
Commercial and industrial	25,529	25,482	10,032	61,043
Tax-free loans	—	2,315	20,252	22,567
Agriculture loans	12,992	5,360	2,160	20,512
Total commercial and industrial	38,521	33,157	32,444	104,122
Consumer	1,462	3,531	4,204	9,197
Total amount due	71,856	58,895	561,726	692,477

FIXED AND FLOATING RATE LOANS DUE AFTER ONE YEAR

(DOLLARS IN THOUSANDS)

	Fixed Rates $	Floating or Adjustable Rates $	Total $
Commercial real estate			
Commercial mortgages	10,273	85,419	95,692
Agriculture mortgages	5,200	150,850	156,050
Construction	497	16,691	17,188
Total commercial real estate	15,970	252,960	268,930
Consumer real estate			
1-4 family residential mortgages	78,617	130,648	209,265
Home equity loans	2,322	2,355	4,677
Home equity lines of credit	14,991	49,422	64,413
Total consumer real estate	95,930	182,425	278,355
Commercial and industrial			
Commercial and industrial	32,985	2,529	35,514
Tax-free loans	16,570	5,997	22,567
Agriculture loans	5,374	2,146	7,520
Total commercial and industrial	54,929	10,672	65,601
Consumer	7,735	—	7,735
Total amount due	174,564	446,057	620,621

The majority of the Corporation's fixed-rate loans have a maturity date longer than five years. The primary reason for the longevity of the portfolio is the high percentage of real estate loans, which typically have maturities of 15 or 20 years. Fixed-rate commercial mortgages have maturities that range from 3 years to 25 years. The most popular commercial mortgage term is a 20-year amortization with a 5-year reset period. In this case, the loan matures in twenty years but after five years either the loan rate resets to the Prime rate plus 0.75%, or a fixed rate for another reset period.

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The original maturity date does not change. Customers will generally opt for another fixed reset period within the original term.

Out of all the loans due after one year, 28.1% are fixed-rate loans as of December 31, 2018. These loans will not reprice to a higher or lower interest rate unless they mature or are refinanced by the borrower. Floating or adjustable rate loans reflect different types of repricing. Approximately 29% of the $446.1 million of loans due after one year are true floating loans. These loans are tied to the Prime rate and will reprice when the Prime rate changes. For commercial customers, generally all pass credits have been granted access to the Prime rate since 2011. However, a number of the Corporation's business and commercial Prime-based loans have been priced at levels above the Prime rate due to the credit standing of the borrower. In terms of consumer real estate loans utilizing the Prime rate for pricing, the most common rate is Prime; however, the Corporation now utilizes risk-based pricing which causes HELOCs to be priced at various multiples of the Prime rate. Outside of a six-month introductory rate, the majority of the Corporation's HELOCs were priced at 5.50%, 5.75%, and 6.00% as of December 31, 2018. The other 71% of the Corporation's floating or adjustable loans due after one year are adjustable in nature and will reprice at a predetermined time in the amortization of the loan. These loans are mostly real estate commercial loans.

As of December 31, 2017, 35% of the $392.0 million of floating or adjustable loans due after one year were true floating rate loans that could reprice immediately, with the other 65% being adjustable after an initial fixed rate period. The percentage of loans that can reprice immediately decreased from 35% as of December 31, 2017, to 29% as of December 31, 2018. This decrease was a function of more consumers fixing their loans during 2018 with multiple Federal Reserve rate increases. True floating rate loans that would immediately reprice according to changes in the Prime rate are favorable in reducing the Corporation's total exposure to interest rate risk and fair value risk should interest rates increase. It is likely the borrowing habits of commercial borrowers will continue to change as the Fed continues to raise rates in 2019. More commercial customers will desire to lock into an initial fixed interest rate period to avoid these future rate increases.

For more details regarding how the length of the loan portfolio and its repricing affects interest rate risk, please see Item 7A Quantitative and Qualitative Disclosures about Market Risk.

Non-Performing Assets

Non-performing assets include:

- Non-accrual loans
- Loans past due 90 days or more and still accruing
- Troubled debt restructurings
- Other real estate owned

NON-PERFORMING ASSETS

(DOLLARS IN THOUSANDS)

	December 31,				
	2018	2017	2016	2015	2014
	$	$	$	$	$
Non-accrual loans	1,833	393	721	380	967
Loans past due 90 days or more and still accruing	397	440	384	378	384
Troubled debt restructurings, non-performing	—	245	—	—	—
Total non-performing loans	2,230	1,078	1,105	758	1,351
Other real estate owned	—	—	—	—	69
Total non-performing assets	2,230	1,078	1,105	758	1,420
Non-performing assets to loans	0.32%	0.18%	0.20%	0.15%	0.31%

Non-performing assets increased by $1,152,000, or 106.9%, from December 31, 2017, to December 31, 2018, primarily as a result of higher levels of non-accrual loans, partially offset by slightly lower loans past due 90 days or more and no loans considered a troubled debt restructuring (TDR). The higher level of non-accrual loans was largely due to a $816,000 loan to a dairy farmer being placed on non-accrual in 2018. The remaining increase was primarily due to a business borrower that had ceased operations. There were no non-performing TDR loans as of December 31, 2018. The

TDR loan as of December 31, 2017, was an agriculture loan restructured in the second quarter of 2017. This loan was paid off in full in July of 2018. The loan was considered a TDR because the borrower was granted a six-month interest-only period on this loan. If a TDR is on non-accrual status, it is considered a non-accrual loan for purposes of this schedule. A TDR is a loan where management has granted a concession to the borrower from the original terms. A concession is generally granted in order to improve the financial position of the borrower and improve the likelihood of full collection by the lender.

Management continues to monitor delinquency trends and the level of non-performing loans as a leading indicator of future credit risk. At this time, management believes that the potential for material losses related to non-performing loans remains low but is likely to trend higher. This is more of a function of the Corporation's non-performing assets already being at very low historical levels. It is far more likely the level of non-performing assets would increase than decline to lower levels. The level of the Corporation's non-performing loans remains very low relative to the size of the portfolio and relative to peers.

As of December 31, 2018, there were eight loans to four unrelated borrowers totaling $1,833,000 on non-accrual compared to four loans to unrelated borrowers totaling $393,000 as of December 31, 2017. The largest non-accrual relationship at December 31, 2018, was two loans to a single borrower with a combined balance of $816,000 to an agricultural borrower in the dairy industry. The dairy sector has been under more pressure over the last two years due to lower milk prices but pricing had improved during the second half of 2018. Management is closely tracking the dairy sector borrowers for delinquencies and other forward indicators of credit difficulty. Even through this more difficult period, the Corporation's dairy sector has been very resilient in terms of levels of delinquencies, non-accruals, and charge-offs. Another commercial loan relationship had four loans on non-accrual totaling $714,000 as of December 31, 2018. These loans were to a customer operating a composting business.

The Corporation's diverse customer base, with many small businesses and industry types represented, has helped to avoid large concentrations in industries where significant non-performance is more likely. See Note P for further discussion on concentrations of credit risk. Severe economic conditions naturally will impact nearly all industries to some extent; however, the impact can vary greatly. Some businesses simply are not as successful in negotiating more difficult times, or may be impacted by non-economic matters like succession planning and poor business practice. Based on present economic conditions, management does not anticipate any significant new trends or the emergence of more severe trends beyond those already discussed.

As of December 31, 2018 and 2017, the Corporation had no properties classified as other real estate owned (OREO). Expenses related to OREO are included in other operating expenses and gains or losses on the sale of OREO are included in other income on the Consolidated Statements of Income.

Total delinquencies include loans 30 to 59 days past due, loans 60 to 89 days past due, loans 90 days or more past due and still accruing, and non-accrual loans. Total delinquencies as a percentage of total loans increased from 0.31% as of December 31, 2017, to 0.46% as of December 31, 2018. Management believes that the low levels of delinquencies experienced in 2017 and 2018 will continue in 2019 as economic conditions continue to improve. All of the Corporation’s delinquency percentages are significantly below the Corporation’s national peer group average. The potential for significant losses related to delinquent loans is difficult to predict as actual charge-offs are dependent on more than the level of delinquency. Management does view that the levels of delinquency, as well as net charge-offs, are at such historic lows that there is more likelihood they will increase going forward than decline. However, management currently does not expect the overall level of delinquencies to change materially in 2019.

Allowance for Loan Losses

The allowance for loan losses is established to cover any losses inherent in the loan portfolio. Management reviews the adequacy of the allowance each quarter based upon a detailed analysis and calculation of the allowance for loan losses. This calculation is based upon a systematic methodology for determining the allowance for loan losses in accordance with U.S. generally accepted accounting principles. The calculation includes estimates and is based upon losses inherent in the loan portfolio. The calculation, and detailed analysis supporting it, emphasizes the level of delinquent, non-performing and classified loans. The allowance calculation includes specific provisions for non-performing loans and general allocations to cover anticipated losses on all loan types based on historical losses. Based on the quarterly loan loss calculation, management will adjust the allowance for loan losses through the provision as necessary. Changes to the allowance for loan losses during the year are primarily affected by three events:

- Charge off of loans considered not recoverable
- Recovery of loans previously charged off

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· Provision or credit for loan losses

The Corporation's strong credit and collateral policies have been instrumental in producing a favorable history of loan losses. While many financial institutions experienced a pattern of an escalation of allowance for loan losses after the financial crisis, then followed with reductions to the allowance in the form of credit provisions, the Corporation generally lagged this trend. This was due to following a steady decline of the Corporation's classified assets, delinquencies and non-performing loans. It took a longer period to bring the allowance back down to levels supported by the quarterly allowance for loan loss calculation. After three years of credit provisions, 2015, 2016, 2017, and 2018 marked a return to a more normal provision expense.

The Allowance for Loan Losses table below shows the activity in the allowance for loan losses for each of the past five years. At the bottom of the table, two benchmark percentages are shown. The first is net charge-offs as a percentage of average loans outstanding for the year. The second is the total allowance for loan losses as a percentage of total loans.

ALLOWANCE FOR LOAN LOSSES

(DOLLARS IN THOUSANDS)

	December 31,				
	2018	2017	2016	2015	2014
	$	$	$	$	$
Balance at January 1,	8,240	7,562	7,078	7,141	7,219
Loans charged off:					
Commercial real estate	(223)	(200)	—	(272)	(204)
Consumer real estate	(20)	—	—	(28)	—
Commercial and industrial	(110)	(89)	(23)	(44)	(12)
Consumer	(27)	(28)	(31)	(18)	(19)
Total charge-offs	(380)	(317)	(54)	(362)	(235)
Recoveries of loans previously charged off:					
Commercial real estate	72	—	—	34	—
Consumer real estate	—	20	10	—	5
Commercial and industrial	66	24	193	112	201
Consumer	8	11	10	3	1

Total recoveries	146	55	213	149	207
Net loans recovered (charged off)	(234)	(262)	159	(213)	(28)
Provision charged (credited) to operating expense	660	940	325	150	(50)
Balance at December 31,	8,666	8,240	7,562	7,078	7,141
Net (charge-offs) recoveries as a % of average total loans outstanding	(0.04)	(0.05)	0.03	(0.04)	(0.01)
Allowance at year end as a % of total loans	1.25	1.38	1.32	1.36	1.52

Charge-offs for the year ended December 31, 2018, were $380,000, compared to $317,000 for the same period in 2017. The Corporation charged off $223,000 in the first quarter of 2018 related to one commercial loan borrower and $100,000 related to a commercial and industrial loan. The Corporation's level of charge-offs are still very low compared to the peer group average. Outside of these commercial charge-offs, the other charge-offs represent a fairly typical level of consumer and small business loan charge-offs that would result from management charging off unsecured debt over 90 days delinquent with little likelihood of recovery.

During 2018, the Corporation recorded provision expense of $660,000 compared to $940,000 during 2017. The provision is used to increase or decrease the allowance for loan losses to a level considered adequate to provide for losses inherent in the loan portfolio. Provision expense grew in 2017, and 2018 primarily due to slightly higher charge-offs as well as significant loan portfolio growth in all years. Management heavily utilizes loan ratings in the allowance for loan loss calculation. From December 31, 2017 to December 31, 2018, there was a $737,000, or 4.4% decrease, in substandard loans, which are considered classified loans and receive the highest degree of attention from management due to identified weaknesses. Substandard loans also have a larger impact to the allowance for loan loss calculation due to the increased likelihood of further credit deterioration. Special mention loans decreased $1.0 million, from $6.7 million at December 31, 2017, to $5.7 million at December 31, 2018. The decrease in special mention loans resulted from a mix of downgrades to substandard, loan payoffs, and upgrades to various pass ratings. Special mention loans,

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while not considered classified loans, do receive more scrutiny than a standard pass grade commercial loan and are assigned higher allocations for loan losses due to their status. All of the Corporation's substandard and special mention borrowers will be reassessed as final 2018 financial information is received in early 2019.

The allowance as a percentage of total loans represents the portion of the total loan portfolio for which an allowance has been provided. For the five-year period from 2014 through 2018, the Corporation maintained an allowance as a percentage of loans in a range between 1.25% and 1.52%. In 2018, the percentage decreased from 1.38% at the beginning of the year, to 1.25% as of December 31, 2018. The composition of the Corporation's loan portfolio has not changed materially from 2017 to 2018 and management views the overall risk profile of the portfolio to be similar to what it was in 2017. Management will continue to increase or decrease the allowance as a percentage of total loans based on the quarterly calculation of the allowance for loan losses. Any increases are based on the need to allocate additional amounts based on estimated credit losses inherent in the current portfolio, utilizing historical and projected credit losses and levels of qualitative and quantitative risks that are appropriate based on the current credit environment. The Corporation's allowance for loan losses as a percentage of loans will likely remain relatively unchanged throughout 2019.

The net charge-offs as a percentage of average total loans outstanding indicates the percentage of the Corporation's total loan portfolio that has been charged off during the period. The Corporation has historically experienced very low net charge-off percentages due to conservative credit practices. In 2018, net charge-offs represented 0.04% of average total loans outstanding compared to net charge-offs of 0.05% in 2017.

The following table provides the allocation of the Corporation's allowance for loan losses by major loan classifications. The percentage of loans indicates the percentage of the loan portfolio represented by the indicated loan type.

ALLOCATION OF RESERVE

(DOLLARS IN THOUSANDS)

	December 31,									
	2018		2017		2016		2015		2014	
	$	% of Loans	$	% of Loans	$	% of Loans	$	% of Loans	$	% of Loans
Real estate	6,704	83.6	5,915	85.5	5,447	85.7	5,234	85.1	5,201	86.5

Commercial and industrial	1,428	15.1	1,829	13.6	1,552	13.5	1,314	14.2	1,301	12.8
Consumer	103	1.3	98	0.9	82	0.8	62	0.7	66	0.7
Unallocated	431	—	398	—	481	—	468	—	573	—
Total allowance for loan losses	8,666	100.0	8,240	100.0	7,562	100.0	7,078	100.0	7,141	100.0

Real estate loans represent 83.6% of total loans with 77.4% of the allowance covering these loans. Real estate secured loans have historically experienced lower losses than non-real estate secured loans, accounting for the difference. The combined consumer and business real estate portion of the loan portfolio increased by $69.1 million, or 13.5%, from December 31, 2017, to December 31, 2018 causing an additional $789,000 to be placed in the allowance for these loans.

Commercial and industrial loans not secured by real estate have historically experienced higher loan losses as a percentage of balances and therefore require a larger relative percentage of the reserve. The reserve allocated to these loans has increased and decreased in recent years, but has not changed significantly as a percentage of total loans. For 2018, the dollar amount of allocation for commercial and industrial loans decreased by $401,000, or 21.9%, with this allocation accounting for 16.5% of the total allowance as of December 31, 2018 compared to 22.2% of the total allowance as of December 31, 2017. The decrease in the commercial and industrial allocation is a reflection of the lower level of risk taken on in this category of loans.

As of December 31, 2018, 77.4% of the allowance was allocated to real estate secured loans, both consumer and commercial, which make up 83.6% of all loans, while 16.5% of the allowance was allocated to commercial and industrial loans, which make up 15.1% of all loans.

The amount of allowance allocated to consumer loans has always been very small as generally consumer loans more than 90 days delinquent are charged off. The amount of allowance allocated to consumer loans and personal loans is based on historical losses and qualitative factors.

The $431,000 unallocated portion of the allowance as of December 31, 2018, increased slightly from the balance at the end of 2017, and the unallocated portion as a percentage of the total allowance increased from 4.8% at December 31, 2017, to 5.0% at December 31, 2018.

Premises and Equipment

Premises and equipment, net of accumulated depreciation, decreased by $136,000, or 0.5%, to $25,551,000 on December 31, 2018, from $25,687,000 as of December 31, 2017. During 2018, capital investments were made by the Corporation in various small projects and normal ongoing capital needs. However, the new investments were more than offset by depreciation of the existing premises and equipment. In 2018, $1,320,000 of new investments were made in premises and equipment, while the Corporation recorded $1,456,000 of accumulated depreciation on existing assets, resulting in the decrease in net premises and equipment during the year. The Corporation had $133,000 in construction in process at the end of 2018 compared to $2,773,000 at the end of 2017. This lower level of construction in process was due to the construction of the full-service Strasburg branch office which was completed and opened in January of 2018, but remained in construction in process as of December 31, 2017. For further information on fixed assets refer to Note D to the Consolidated Financial Statements.

Regulatory Stock

The Corporation owns multiple forms of regulatory stock that is required to be a member of the Federal Reserve Bank (FRB) and members of banks such as the Federal Home Loan Bank (FHLB) of Pittsburgh and Atlantic Community Bankers Bank (ACBB). The Corporation's $6,348,000 of regulatory stock holdings as of December 31, 2018, consisted of $6,160,000 of FHLB of Pittsburgh stock, $151,000 of FRB stock, and $37,000 of Atlantic Community Bancshares, Inc. stock, the Bank Holding Company of ACBB. All of these stocks are valued at a stable dollar price, which is the price used to purchase or liquidate shares; therefore, the investment is carried at book value and there is no fair market value adjustment.

The Corporation's investment in FHLB stock is required for membership in the organization. The amount of stock required is dependent upon the relative size of outstanding borrowings from FHLB. Excess stock is typically repurchased from the Corporation on a quarterly basis at par if outstanding borrowings decline to a predetermined level. The FHLB also pays a quarterly dividend on the outstanding shares held by the Corporation. The FHLB's quarterly dividend yield was 6.75% annualized on activity stock and 3.50% annualized on membership stock as of December 31, 2018. Most of the Corporation's dividend is based on the activity stock, which is based on the amount of borrowings and mortgage activity with FHLB. The Corporation will continue to monitor the financial condition of the

FHLB quarterly to assess its ability to continue to regularly repurchase excess capital stock and pay a quarterly dividend.

Management believes that the FHLB will continue to be a primary source of wholesale liquidity for both short-term and long-term funding. Management's strategy in terms of future use of FHLB borrowings is addressed under the Borrowings section of this Management's Discussion and Analysis.

Bank-Owned Life Insurance (BOLI)

The Corporation owned life insurance with a total recorded cash surrender value (CSV) of $28,085,000 on December 31, 2018, compared to $27,814,000 on December 31, 2017. The Corporation holds two distinct BOLI programs. The first, with a CSV of $4,873,000, was the result of insurance policies taken out on directors of the Corporation electing to participate in a directors' deferred compensation plan. The program was designed to use the insurance policies to fund future annuity payments as part of a directors' deferred compensation plan that permitted deferral of Board pay from 1979 through 1999. The plan was closed to entry in 1999, when directors were no longer provided the option of deferring their Board pay. The Corporation pays the required premiums for the policies and is the owner and beneficiary of the policies. The life insurance policies in the plan generally have annual premiums; however, the premium payments are not required after the first five years.

The second BOLI plan was originated in 2006 when life insurance was first taken out on a select group of the Corporation's officers. The additional income generated from this BOLI plan is to assist in offsetting the rising cost of benefits currently being provided to all employees. The most recent BOLI investment was a $2.5 million investment made in December of 2017. This caused a sharper increase in BOLI CSV in 2017. The CSV for this plan was $23,212,000 as of December 31, 2018, compared to $23,039,000 at December 31, 2017. The CSV increase of $173,000 during 2018 was the result of the internal return generated from these policies net of the cost of insurance. The Corporation purchased whole life policies for this BOLI plan and is the owner and beneficiary of the policies.

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Deposits

The Corporation’s total ending deposits increased $53.2 million, or 6.1%, from $866.5 million on December 31, 2017, to $919.7 million on December 31, 2018. Customer deposits are the Corporation’s primary source of funding for loans and investments. In recent years the economic weakness and volatile performance of the stock market and other types of investments like real estate led customers back to banks as safe places to invest money, in spite of historically low interest rates. In addition to this trend, there was significant market disruption in the Corporation’s market area beginning in 2015 that greatly impacted 2016, and 2017, which resulted in customers seeking a new local financial institution to meet their needs. In 2018, deposit growth was a little more challenging as competitive rates returned to the market giving customers more options to place their funds. Most of the growth in deposit balances during 2018 was in non-interest bearing demand accounts, money market deposit accounts, and savings accounts, with higher cost deposits like time deposits decreasing.

The Deposits By Major Classification table, shown below, provides the average balances and rates paid on each deposit category for each of the past three years. The average 2018 balance carried on all deposits was $874.3 million, compared to $831.8 million for 2017. This represents an increase of 5.1% on average deposit balances. The increase in average deposit balances from 2016 to 2017 was 8.3%. Average balances provide a more accurate picture of growth in deposits because deposit balances can vary throughout the year. In addition, the interest paid is based on average deposit balances carried during the year calculated on a daily basis.

DEPOSITS BY MAJOR CLASSIFICATION

(DOLLARS IN THOUSANDS)

Average balances and average rates paid on deposits by major category are summarized as follows:

	December 31,					
	2018		2017		2016	
	$	%	$	%	$	%
Non-interest bearing demand	322,733	—	287,928	—	247,730	—
Interest-bearing demand	20,079	0.35	18,742	0.25	17,360	0.22
NOW accounts	88,219	0.24	84,232	0.15	85,222	0.13
Money market deposit accounts	104,739	0.25	98,548	0.18	86,176	0.15

Savings accounts	196,392	0.05	187,018	0.05	163,210	0.05
Time deposits	142,125	1.00	155,285	0.95	168,182	1.01
Total deposits	874,287		831,753		767,880	

The growth and mix of deposits is often driven by several factors including:

- Convenience and service provided
- Fees
- Strength of the financial institution
- Permanence of the financial institution
- Possible risks associated with other investment opportunities
- Current rates paid on deposits compared to financial competition

The Corporation has been a stable presence in the market area and offers convenient locations, relatively low service fees, and competitive interest rates because of a strong commitment to the customers and the communities that it serves. Management has always priced products and services in a manner that makes them affordable for all customers. This, in turn, creates a high degree of customer loyalty, which has provided stability to the deposit base. In 2017, management saw significant deposit inflows due to merger activity in the local market. While this deposit growth slowed during 2018, there was still deposit growth experienced throughout the year. The Corporation continues to generally benefit from the customers' preference to conduct business with a smaller financial institution versus a larger institution. The Corporation's deposits also grew in the Morgantown, Georgetown, and Strasburg market areas where new branches were opened in 2016 and 2017. These offices significantly expanded the Corporation's market area, which management continues to execute as part of the strategic plan.

The average balance of the Corporation's core deposits, including non-interest bearing demand deposits, interest-bearing demand deposits, NOW accounts, MMDA accounts, and savings accounts, grew $55.7 million, or 8.2%, since December

31, 2017. Interest rates have increased, but are still relatively low on a historical basis. Management believes that throughout 2018 customers were sitting on more liquidity as a matter of prudence to position to invest at a later point when rates rise even more. The safety of FDIC-insured funds and immediate access to funds in a low interest rate environment was more of a priority to customers than interest rates. However, as interest rates continue to increase, this attitude is beginning to change which will likely result in a change in the mix of deposits and more deposits potentially leaving the Corporation.

Time deposits are typically a more rate-sensitive product making them a less reliable source of funding. Time deposits fluctuate as consumers search for the best rates in the market, with less allegiance to any particular financial institution. Due to adequate funding levels from all sources, the Corporation’s time deposit strategy prior to 2018 had been to offer rates that were not the highest in the local market or the lowest, but close to the average. This strategy will not grow time deposits in the current environment because interest rates being offered are still at historically low levels not attractive to many depositors. In the latter part of 2018, the Corporation offered some odd-term time deposit specials with better pricing to encourage the retention of existing time deposits that were rolling over. This strategy should act to stem the decline in time deposit balances and retain some of that funding from a liquidity standpoint to fund loan growth. Monitoring deposit rates going forward will be important as the interest rate environment will draw more and more attention from depositors.

In 2018, time deposits declined in both dollars and as a percentage of the Corporation’s deposits with the average balance decreasing by $13.2 million, or 8.5%, compared to 2017 average balances. This is a function of the interest rate environment and the relatively small difference between time deposit rates and interest bearing demand deposit and money market fund rates. The consumer weighs the benefit of the higher rate versus the inability to gain access to the time deposit funds until the maturity date. There is a greater likelihood in 2019 that the consumer will seek additional deposit or investment options should the Federal Reserve continue to raise interest rates. The higher market rates become, the less willingness there will be for consumers to be content in low or non-interest bearing deposit accounts which could cause an increase in time deposit balances or a move to alternative investment options outside of deposits. A portion of the decrease in time deposit balances from 2017 to 2018 can also be attributed to customers redeploying their time deposits into the equity market and other investments, and other competing financial institutions that have different pricing strategies. A reduction in time deposits has worked in concert with management’s asset liability plan for a better mix of core deposits relative to time deposits. Management was willing to see a decline in time deposit balances as the most expensive source of funding for the Corporation. With several better rate options for odd-month term time deposits that began in the fourth quarter of 2018, management does expect there could be a minimal increase in time deposits throughout 2019.

Management follows a disciplined pricing strategy with regard to time deposit funds desiring not to pay materially above wholesale pricing levels. In this regard, if some elements of market competition prices materially above wholesale rates, management will not meet those pricing levels and will seek more cost effective wholesale funding opportunities.

As of December 31, 2018, time deposits over $100,000 made up 28.2% of the total time deposits. This compares to 31.6% on December 31, 2017. The total dollar amount of time deposits over $100,000 declined $9.7 million, or 20.5%, from December 31, 2017 to December 31, 2018. Since time deposits over $100,000 are made up of relatively few customers with large dollar accounts, management monitors these accounts closely due to the potential for these deposits to rapidly increase or decrease. The following table provides the total amount of time deposits of $100,000 or more for the past three years by maturity distribution.

MATURITY OF TIME DEPOSITS OF $100,000 OR MORE

(DOLLARS IN THOUSANDS)

	December 31,		
	2018	2017	2016
	$	$	$
Three months or less	7,656	9,220	7,496
Over three months through six months	3,337	3,115	4,165
Over six months through twelve months	4,592	8,724	7,738
Over twelve months	21,998	26,205	31,488
Total	37,583	47,264	50,887

In order to meet future funding obligations, it is necessary to review the timing of maturity for large depositors, like the time deposits of $100,000 or more. The Corporation monitors all large depositors to ensure that there is a steady flow of maturities. As of December 31, 2018, the Corporation had a typical laddering of large time deposits; however the portfolio was smaller and more heavily weighted to longer time deposits. Shorter term time deposits have declined as depositors have either lengthened the term to pursue a higher interest rate or allowed the time deposit to mature. For more information on liquidity management, refer to Item 7A Quantitative and Qualitative Disclosures about Market Risk. Additionally, for more information on the maturity of time deposits, see Note F to the Consolidated Financial Statements.

Borrowings

Total borrowings were $73.3 million as of December 31, 2018, and $65.9 million as of December 31, 2017. The Corporation had $7.9 million of short-term borrowings at December 31, 2018, and no short-term borrowings as of December 31, 2017. Short-term borrowings are used for immediate liquidity needs and are not typically part of an ongoing liquidity or interest rate risk strategy; therefore, they fluctuate more rapidly.

Long-term borrowings decreased to $65.4 million as of December 31, 2018, from $65.9 million as of December 31, 2017. The Corporation primarily uses Federal Home Loan Bank (FHLB) advances as the source for long-term borrowings. These borrowings are used as a secondary source of funding and to mitigate interest rate risk. Management will continue to analyze and compare the costs and benefits of borrowing versus obtaining funding from deposits as part of an asset liability strategy to obtain the most effective long term funding sources.

The slight decrease in long-term FHLB borrowing balances during the year related to the Corporation's 2018 strategy of refinancing maturing FHLB borrowings to lock in funding for a longer period of time but not initiating many new advances. As of December 31, 2018, all the borrowings of FHLB were fixed-rate loans.

To limit the Corporation's exposure and reliance on a single funding source, the Corporation's Asset Liability Policy sets a goal of maintaining the amount of borrowings from the FHLB to 15% of the Corporation's total assets. As of December 31, 2018, the Corporation was well within this policy guideline at 6.0% of asset size with $65.4 million of total FHLB borrowings. The Corporation also has a policy that limits total borrowings from all sources to 150% of the Corporation's capital. As of December 31, 2018, total borrowings from all sources amounted to 71.3% of the Corporation's capital, well under the policy guideline. The Corporation has maintained FHLB borrowings and total borrowings within these guidelines throughout the year.

The Corporation continues to be well under the FHLB maximum borrowing capacity (MBC), which is $399.9 million as of December 31, 2018. The Corporation's two internal policy limits are far more restrictive than the FHLB MBC, which is calculated and set quarterly by FHLB.

Stockholders' Equity

Federal regulatory authorities require banks to meet minimum capital levels. The Corporation maintains capital ratios well above those minimum levels and higher than the peer group average. The risk-weighted capital ratios are calculated by dividing capital by risk-weighted assets. Regulatory guidelines determine risk-weighted assets by assigning assets to a pre-defined risk-weighted category. The calculation of Tier I Capital to Risk-Weighted Assets includes an adjustment to remove the impact of the unrealized holding gains or losses on the Corporation's securities portfolio, adjusted for taxes. The Tier II or Total Capital to Risk-Weighted Assets ratio has the same adjustment but adds back any allowances for loan losses thereby making this ratio higher than the Tier I Capital to Risk-Weighted Assets ratio. The new Common Equity Tier I Capital Ratio could include an adjustment to Tier I Capital for deferred tax items, but there was no adjustment for the Corporation as of December 31, 2018, 2017, or 2016, so the Common Equity Tier I Capital ratio was the same as the Tier I Capital ratio. See Notes I and M to the Consolidated Financial Statements for additional information on capital transactions.

The following table reflects the Corporation's capital ratios compared to regulatory capital requirements for prompt corrective action.

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REGULATORY CAPITAL RATIOS	Capital Ratios			Regulatory Requirements	
	As of Dec. 31, 2018	As of Dec. 31, 2017	As of Dec. 31, 2016	Adequately Capitalized	Well Capitalized
Total Capital to Risk-Weighted Assets	14.3%	15.0%	15.2%	8.0%	10.0%
Tier I Capital to Risk-Weighted Assets	13.2%	13.8%	14.1%	6.0%	8.0%
Common Equity Tier I Capital to Risk-Weighted Assets	13.2%	13.8%	14.1%	4.5%	6.5%
Tier I Capital to Average Assets	10.0%	10.1%	10.2%	4.0%	5.0%

The high level of capital maintained by the Corporation provides a greater degree of financial security and acts as a non-interest bearing source of funds. Conversely, a high level of capital, also referred to as equity, makes it more difficult for the Corporation to improve return on average equity, which is a benchmark of shareholder return. The Corporation's capital is affected by earnings, the payment of dividends, changes in accumulated other comprehensive income or loss, and equity transactions.

Total dividends paid to shareholders during 2018, were $3,282,000, or $1.15 per share, compared to $3,190,000, or $1.12 per share paid to shareholders during 2017. The Corporation uses current earnings and available retained earnings to pay dividends. The Corporation's current capital plan targets Tier I Capital to Average Assets between 10.0% and 12.0%. The Corporation also desires a dividend payout ratio in the range of 35% to 40%. This ratio will vary according to income, but over the long term, management's goal is to maintain a payout ratio within this range. For 2018, the dividend payout ratio was 33.6%. This lower ratio was due to the higher earnings recorded in 2018. The Corporation anticipates that the payout ratio for 2019 will return to the more typical 35% to 40% range.

The amount of unrealized gain or loss on the Corporation's securities portfolio is reflected, net of tax, as an adjustment to capital, as required by U.S. generally accepted accounting principles. This is recorded as accumulated other comprehensive income or loss in the capital section of the Corporation's balance sheet. The change in unrealized holding gain or loss that occurred during 2018 is shown on the Corporation's Consolidated Statements of Comprehensive Income, along with a reclassification adjustment for losses included in the current year's income. The Corporation's Consolidated Statements of Comprehensive Income shows the impact of changes in unrealized gains and losses during the year on the Corporation's net income to arrive at net comprehensive income or loss.

In terms of the Corporation's balance sheets, an unrealized gain increases capital while an unrealized loss reduces capital. This requirement takes the position that, if the Corporation liquidated at the end of each period, the current unrealized gain or loss on the securities portfolio would directly impact the Corporation's capital. As of December 31, 2018, the Corporation showed unrealized losses, net of tax, of $5,678,000, compared to unrealized losses of $3,195,000 as of December 31, 2017. The changes in unrealized gains or losses are due to normal changes in market valuations of the Corporation's securities as a result of interest rate movements.

On July 1, 2008, ENB Financial Corp was formed. The retirement of all treasury shares was required as part of the formation of ENB Financial Corp. As a result, management needed treasury shares to be utilized for the existing Employee Stock Purchase Plan and Dividend Reinvestment Plan. Therefore, on August 14, 2008, the Board authorized a stock buyback plan for the purchase of up to 140,000 shares of common stock for corporate purposes. A total of 133,290 shares were purchased under this plan before it was superseded by a new plan. On June 17, 2015, the Board of Directors of ENB Financial Corp announced the approval of another new plan to purchase, in open market and privately negotiated transactions, up to 140,000 shares of its outstanding common stock. Since formation of this new plan, 55,535 shares of treasury stock have been repurchased. Under both plans, a total of 188,825 shares of treasury stock have been repurchased and 171,800 reissued, with 17,025 treasury shares existing on December 31, 2018. In 2018, the net capital impact of shares being purchased and reissued was not significant with 12,900 shares being purchased and 15,609 shares reissued.

After December 31, 2018, but prior to the filing of this report, the Corporation issued a Form 8-K on February 22, 2019 announcing the Board of Directors authorized a new stock repurchase plan to purchase in open market and privately negotiated transactions, up to 100,000 shares of the Corporation's outstanding common stock This plan supersedes the previous 2015 stock repurchase plan. Management also indicated the intention to use its best efforts to complete this repurchase plan by the end of 2019.

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Management's Discussion and Analysis

Contractual Cash Obligations

The Corporation has a number of contractual obligations that arise from the normal course of business. The following table summarizes the contractual cash obligations of the Corporation as of December 31, 2018, and shows the future periods in which settlement of the obligations is expected. The contractual obligation numbers below do not include accrued interest. Refer to Note O to the Consolidated Financial Statements referenced in the table for additional details regarding these obligations.

CONTRACTUAL OBLIGATIONS

(DOLLARS IN THOUSANDS)

	Less than 1 year $	1-3 years $	4-5 years $	More than 5 years $	Total $
Time deposits (Note F)	57,063	55,417	20,738	—	133,218
Borrowings (Notes G and H)	20,107	30,845	22,304	—	73,256
Operating Leases	194,308	333,366	80,178	80,000	687,852
Total contractual obligations	271,478	419,628	123,220	80,000	894,326

Off-Balance Sheet Arrangements

In the normal course of business, the Corporation typically has off-balance sheet arrangements related to loan funding commitments. These arrangements may impact the Corporation's financial condition and liquidity if they were to be exercised within a short period of time. As discussed in the liquidity section to follow, the Corporation has in place sufficient liquidity alternatives to meet these obligations. The following table presents information on the commitments by the Corporation as of December 31, 2018. For further details regarding off-balance sheet arrangements, refer to Note O to the Consolidated Financial Statements.

OFF-BALANCE SHEET ARRANGEMENTS

(DOLLARS IN THOUSANDS)

	December 31, 2018
	$
Commitments to extend credit:	
Revolving home equity loans	91,207
Construction loans	22,800
Real estate loans	45,000
Business loans	106,341
Consumer loans	1,391
Other	8,493
Standby letters of credit	8,739
Total	283,971

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Recently Issued Accounting Standards

Refer to Note A to the Consolidated Financial Statements for discussion on recently issued accounting standards.

Critical Accounting Policies

The presentation 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 many of the reported amounts and disclosures. Actual results could differ from these estimates.

Allowance for Loan Losses

A material estimate that is particularly susceptible to significant change is the determination of the allowance for loan losses. Management believes that the allowance for loan losses is adequate and reasonable. The Corporation's methodology for determining the allowance for loan losses is described in an earlier section of Management's Discussion and Analysis. Given the very subjective nature of identifying and valuing loan losses, it is likely that well-informed individuals could make materially different assumptions and, therefore, calculate a materially different allowance amount. Management uses available information to recognize losses on loans; however, changes in economic conditions may necessitate revisions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize adjustments to the allowance based on their judgments of information available to them at the time of their examination.

Fair Values of Assets and Liabilities

ASC Topic 820 defines fair value as the price that would be received to sell the financial asset or paid to transfer the financial liability in an orderly transaction between market participants at the measurement date. The degree of management judgment involved in determining the fair value of assets and liabilities is dependent upon the availability of quoted market prices or observable market parameters. For financial instruments that trade actively and have quoted market prices or observable market parameters, there is minimal subjectivity involved in measuring fair value. When observable market prices and parameters are not fully available, management judgment is necessary to estimate fair value. In addition, changes in market conditions may reduce the availability of quoted prices or observable data. See Note R to the Consolidated Financial Statements for a complete discussion and summary of the Corporation’s use of fair valuation of assets and liabilities and the related measurement techniques.

Other than Temporary Impairment of Securities

Securities are evaluated periodically to determine whether a decline in their value is other than temporary. Management utilizes criteria such as the magnitude and duration of the decline, in addition to the reasons underlying the decline, to determine whether the loss in value is other than temporary. The term “other than temporary” is not intended to indicate that the decline is permanent. It indicates that the prospect of a near-term recovery of value is not necessarily favorable or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the security. Once a decline in value is determined to be other than temporary, the value of the security is reduced and a corresponding charge to earnings is recognized.

Deferred Tax Assets

The Corporation uses an estimate of future earnings to support the position that the benefit of deferred tax assets will be realized. If future income should prove non-existent or less than the amount of the deferred tax assets within the tax years to which they may be applied, the asset may not be realized and the Corporation’s net income will be reduced. Deferred tax assets are described further in Note L to the Consolidated Financial Statements.

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Item 7A. Quantitative and Qualitative Disclosures about Market Risk

As a financial institution, the Corporation is subject to four primary market risks:

- Credit risk
- Liquidity risk
- Interest rate risk
- Fair value risk

The Board of Directors has established an Asset Liability Management Committee (ALCO) to measure, monitor, and manage these four primary market risks. The Asset Liability Policy has instituted guidelines for all of these primary risks, as well as other financial performance measurements with target ranges. The Asset Liability goals and guidelines are consistent with the Corporation’s Strategic Plan goals.

For discussion on credit risk, refer to the sections on non-performing assets, allowance for loan losses, Note C, and Note P to the Consolidated Financial Statements.

Liquidity

Liquidity refers to having an adequate supply of cash available to meet business needs. Financial institutions must ensure that there is adequate liquidity to meet a variety of funding needs, at a minimal cost. Minimal cost is an important component of liquidity. If a financial institution is required to take significant action to obtain funding, and is forced to utilize an expensive source, it has not properly planned for its liquidity needs. Funding new loans and covering deposit withdrawals are the primary liquidity needs of the Corporation. The Corporation uses a variety of funding sources to meet liquidity needs, such as:

- Deposits
- Loan repayments
- Maturities and sales of securities
- Borrowings from correspondent and member banks
- Brokered deposits

· Current earnings

One of the measurements used in liquidity planning is the Maturity Gap Analysis. The Maturity Gap Analysis below measures the amount of assets maturing within various time frames versus liabilities maturing in those same periods. These time frames are referred to as gaps and are reported on a cumulative basis. For instance, the one-year gap shows all assets maturing one year or less from a specific date versus the total liabilities maturing in the same time period. The gap is then expressed as a percentage of assets over liabilities. Mismatches between assets and liabilities maturing are identified and assist management in determining potential liquidity issues.

The maturity gap analysis does not include non-interest earning assets and non-interest bearing liabilities, with the exception of non-interest bearing demand deposit accounts. The non-interest bearing demand deposits are considered additional deposit liabilities with a 0.00% interest rate, which acts to lower the overall interest rate paid on total deposits. For purposes of this analysis, items like cash, premises and equipment, bank owned life insurance, and other assets are considered non-interest earning assets and are not included in assets maturing. On the liability side, the only liability not included is other liabilities, which represent open obligations of the Corporation.

It is unlikely that maturing assets would equal maturing liabilities because, on the balance sheet, assets do not equal liabilities. For purposes of this analysis, $1,011.6 million of assets mature in all time frames while $993.8 million of liabilities mature in all time frames, resulting in a 101.8% cumulative maturity gap. So, while a cumulative maturity gap of 100% would indicate that the same amount of assets and liabilities are maturing within the specified period, this is rather unlikely to occur within any time frame, or on a cumulative basis.

Gap ratios have been increasing for the Corporation throughout 2018. The Corporation's assets are moderately long, but the length of the securities portfolio and the loan portfolio is more than offset by the length of the Corporation's core deposit liabilities in conjunction with holding relatively high levels of cash and cash equivalents. Beyond the non-maturity deposits, management is able to utilize the length of wholesale funding instruments to offset the declining length of the CD portfolio as customers invest in shorter terms in anticipation of higher interest rates.

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The size and length of the Corporation’s core deposit liabilities provide the most extension in terms of lengthening the liabilities on the balance sheet. The length of the core deposits is significantly longer than the Corporation’s longest term deposits and wholesale borrowings. The mix of the Corporation’s liabilities alone would be sufficient to offset the Corporation’s longer assets and to maintain gap ratios within management’s guidelines. However, due to the high likelihood that short term interest rates will continue to increase, management prefers to enhance the gap ratio levels by carrying higher levels of cash and cash equivalents. A higher level of cash and cash equivalents is the most effective immediate hedge against both interest rate risk and liquidity risk. The strategy of maintaining higher cash levels to enhance gap ratios is expected to continue until the securities portfolio is materially shorter in duration.

The table below shows the six-month, one-year, three-year, and five-year cumulative gaps as of December 31, 2018, along with the cumulative maturity gap guidelines monitored by management. For the purposes of this analysis, core deposits without a specific maturity date are spread across all time periods based on historical behavior.

MATURITY GAP ANALYSIS

(DOLLARS IN THOUSANDS)

Maturity Gap	Less than 6 months	More than 6 months to 1 year	More than 1 year to 3 years	More than 3 years to 5 years	More than 5 years
	$	$	$	$	$
Assets maturing	88,874	72,205	234,390	207,754	408,344
Liabilities maturing	78,865	50,749	183,220	116,527	564,447
Maturity gap	10,009	21,456	51,170	91,227	(156,103)
Cumulative maturity gap	10,009	31,465	82,635	173,862	17,759
Maturity gap %	112.7%	142.3%	127.9%	178.3%	72.3%
Cumulative maturity gap %	112.7%	124.3%	126.4%	140.5%	101.8%
Cumulative maturity gap % guideline	45% to 155%	60% to 140%	75% to 125%	85% to 115%	

As of December 31, 2018, two cumulative maturity gap ratios were within Corporate Policy guidelines and two were higher than the upper policy guideline. The three-year cumulative gap ratio was 126.4% as of December 31, 2018, compared to an upper guideline of 125% indicating slightly more assets maturing in the 1-3 year time frame than is typical. Likewise, the five-year cumulative gap ratio was 140.5% as of December 31, 2018, compared to an upper guideline of 115%. Given the likelihood of higher rates in the future, these higher gap ratios are not of concern, but management will continue to monitor all gap ratios to ensure proper positioning for future interest rate cycles.

Given the possibility that short term interest rates could increase further in 2019, management's current position is to maintain the cumulative maturity gap percentages within guidelines and even towards the higher end of the guidelines in preparation for the opportunity to invest excess cash in higher-yielding assets throughout the year. However, if interest rates would decline in the near term, maintaining higher gap ratios would result in more assets maturing and repricing to rates lower than the average portfolio rates. This is referred to as repricing risk. Carrying high gap ratios in the current environment brings on an increased level of repricing risk, which impacts the Corporation's interest income and margin. The risk of liabilities repricing to higher interest rates was being moderated through the end of 2018 due to a balance of shorter time deposits beginning to reprice higher, while longer term time deposits were still repricing lower. However, with two time deposit specials implemented in the fourth quarter of 2018, some time deposits began to reprice to higher interest rates and this is likely to continue throughout 2019, resulting in a higher cost of funds and more repricing risk on the liability side.

It is likely that, should market interest rates rise in 2019, customer behavior patterns will change and deposits will be more rate sensitive with a greater portion potentially leaving the Corporation. These maturity gaps are closely monitored along with additional liquidity measurements discussed below. Management believes the probability of future Federal Reserve rate increases has diminished, driven by concerns of slower economic growth. This could signal a pause or end to the current rising rate cycle. Therefore, management no longer sees a need to maintain longer gap ratios above target ranges. It is expected that the one to three year and the three-year to five-year gap ratios will decline in 2019. These longer gap ratios can be improved by investing in assets longer than five years and growing time deposits between one and five years. If short term rates do stabilize and then begin to decline in

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late 2019, management would need to accelerate this strategy and work to bring down the maturity gap levels to protect against assets repricing to lower levels.

In addition to the cumulative maturity gap analysis discussed above, management utilizes a number of other important liquidity measurements that management believes have advantages over, and give better clarity to, the Corporation's present and projected liquidity. The following is a listing of the Corporation's other liquidity measurements, along with a short definition, that are evaluated periodically in an effort to monitor and mitigate liquidity risk:

- Core Deposit Ratio – Core deposits as a percentage of assets
- Funding Concentration Analysis – Alternative funding sources outside of core deposits as a percentage of assets
- Short-term Funds Availability – Readily available short-term funds as a percentage of assets
- Securities Portfolio Liquidity – Cash flows maturing in one year or less as a percentage of assets and securities
- Readily Available Unencumbered Securities and Cash – Unencumbered securities as a percentage of the securities portfolio and as a percentage of total assets
- Borrowing Limits – Internal borrowing limits in terms of both FHLB and total borrowings
- Three, Six, and Twelve-month Projected Sources and Uses of Funds – Net projected liquidity surplus/shortage shown for each period

These measurements are designed to prevent undue reliance on outside sources of funding and ensure a steady stream of liquidity is available should events occur that would cause a sudden decrease in deposits or large increase in loans or both, which would in turn draw significantly from the Corporation's available liquidity sources.

As of December 31, 2018, the Corporation was within guidelines for all of the above measurements except the securities portfolio liquidity as a percentage of assets. The policy calls for the Corporation to maintain securities portfolio cash flows maturing in one year or less between 4% and 8% of total assets. As of December 31, 2018, these cash flows represented 3.6% of total assets, which is under the lower guideline. When factoring in available overnight cash, the Corporation's securities portfolio liquidity represented 4.8% of total assets which is also slightly below the lower target of 6%.

Throughout 2018 it was important for the Corporation to be prepared for a continued rates-up environment with more liquidity available so funds could be reinvested in higher yielding assets. Now moving into 2019, it appears the Federal Reserve is pausing on increasing short-term rates as it gauges whether the economy will continue growing or slow down. Management had been carrying an average of approximately $30 million to $40 million of cash and cash equivalents on a daily basis throughout most of 2018. Management anticipates carrying this higher level of cash again throughout most of 2019, until it is better determined which direction short term rates will go.

The Corporation’s liquidity measurements are tracked and reported quarterly by management to both observe trends and ensure the measurements stay within desired ranges. Management is confident that a sufficient amount of internal and external liquidity exists to provide for significant unanticipated liquidity needs.

Interest Rate Risk and Fair Value Risk

Identifying the interest rate risk of the Corporation’s interest earning assets and interest bearing liabilities is essential to managing net interest margin and net interest income. In addition to the impact on earnings, management is also concerned about how much the value of the Corporation’s assets might fall or rise given an increasing or decreasing interest rate environment. Interest rate sensitivity analysis (IRSA) measures the impact of a change in interest rates on the net interest income and net interest margin of the Corporation, while net portfolio value (NPV) analysis measures the change in the Corporation’s capital fair value, given interest rate fluctuations. Therefore, the two primary approaches to measuring the impact of interest rate changes on the Corporation’s earnings and fair value are referred to as:

- Changes in net interest income
- Changes in net portfolio value

The Corporation’s asset liability model is able to perform dynamic forecasting based on a wide range of assumptions provided. The model is flexible and can be used for many types of financial projections. The Corporation uses financial modeling to forecast balance sheet growth and earnings. The results obtained through the use of forecasting models are based on a variety of factors. Both earnings and balance sheet forecasts make use of maturity and repricing schedules to determine the changes to the Corporation's balance sheet over the course of time. Additionally, there are many assumptions that factor into the results. These assumptions include, but are not limited to:

- Projected interest rates
- Timing of interest rate changes
- Slope of the U.S. Treasury curve
- Spreads available on securities over the U.S. Treasury curve
- Prepayment speeds on loans held and mortgage-backed securities
- Anticipated calls on securities with call options
- Deposit and loan balance fluctuations
- Competitive pressures affecting loan and deposit rates
- Economic conditions
- Consumer reaction to interest rate changes

For the interest rate sensitivity analysis and net portfolio value analysis shown below, results are based on a static balance sheet reflecting no projected growth from balances as of December 31, 2018, and December 31, 2017. While it is unlikely that the balance sheet will not grow at all, management considers a static analysis of this sort to be the most conservative and most accurate means to evaluate fair value and future interest rate risk. Management does run expected growth scenarios through the asset liability model to most accurately predict future financial performance. This is done separately and apart from the static balance sheet approach discussed above to test fair value and future interest rate risk. The static balance sheet approach is used to reduce the number of variables in calculating the model's accuracy in predicting future net interest income. It is appropriate to pull out various balance sheet growth scenarios, which could be utilized to compensate for a declining margin. By testing the model using a base model assuming no growth, this variable is eliminated and management can focus on predicted net interest income based on the current existing balance sheet.

As a result of the many assumptions, this information should not be relied upon to predict future results. Additionally, both of the analyses shown below do not consider any action that management could take to minimize or offset the negative effect of changes in interest rates. These tools are used to assist management in identifying possible areas of risk in order to address them before a greater risk is posed.

Changes in Net Interest Income

The changes in net interest income reflect how much the Corporation's net interest income would be expected to increase or decrease given a change in market interest rates. The changes in net interest income shown are measured over a one-year time horizon and assume an immediate rate change on the rate sensitive assets and liabilities. This is considered the more important measure of interest rate sensitivity due to the immediate effect that rate changes may have on the overall performance of the Corporation. The following table takes into consideration when financial instruments would most likely reprice and the duration of the pricing change. It is important to emphasize that the information shown in the table is an estimate based on hypothetical changes in market interest rates. In 2018 management moved back to projecting for up to 300 basis points of upward rate movement, while projecting down rate scenarios to -150 basis points. This was due to the nine (9) Federal Reserve rate increases that have occurred since December of 2015.

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CHANGES IN NET INTEREST INCOME

	2018 Percentage Change	2017 Percentage Change	Policy Guidelines %
400 basis point rise	—	14.2	(20.0)
300 basis point rise	7.4	9.6	(15.0)
200 basis point rise	3.9	5.2	(10.0)
100 basis point rise	1.3	1.7	(5.0)
Base rate scenario	—	—	—
50 basis point decline	(1.1)	(2.0)	(2.5)
100 basis point decline	(3.4)	(5.1)	(5.0)
150 basis point decline	(6.7)	—	(7.5)

This table shows the effect of an immediate interest rate shock over a one-year period on the Corporation's net interest income. Base rate is the Prime rate.

The above analysis shows a slightly negative impact to the Corporation's net interest income in all down-rate scenarios. All up-rate scenarios show a positive impact. In the current rate environment, the amount of the Corporation's assets repricing higher will be fairly large due to the amount of cash and variable rate loans that will reprice immediately when Prime increases. These instruments will generally reprice up the full amount of the Federal Reserve's rate increase. This is not the case on the liability side where it is typical for management to react slowly in increasing deposit rates. Even when deposit rates are increased, they are typically increased at a fraction of the increase in the Federal Funds rate. In the current environment, if interest rates rise, it is expected that deposit rates will move upward, but more slowly than asset rates. In the event that rates would go lower, the Corporation would have exposure to all maturing fixed-rate loans and securities that would reprice lower while most of the Corporation's interest-bearing deposits could not be repriced any lower. The analysis above focuses on immediate rate movements, referred to as rate shocks, and measured over the course of one year. The Corporation's model also has the ability to measure changes to net interest income given interest rate changes that occur more slowly over time. This type of modeling is referred to as "interest rate ramps," where a set change in rates occurs over a period of time. If rates were to move upward slowly over the course of the next six months, the results are very close to the results using a rate shock.

In all rates-up scenarios, modeled net interest income increases, with more significant increases after rates have increased at least 200 basis points. All rates-up scenarios show slightly less benefit compared to the results as of December 31, 2017. When rates do go up, most assets with the ability to reprice off a key benchmark rate will generally reprice by the full amount of the Federal Reserve's rate movement while liabilities will lag and reprice by a much smaller amount, i.e. only a proportion of the asset rate increases. But that proportion is expected to be slightly higher than in past rate cycles. Financial industry studies have revealed that financial institutions are benefiting from a larger level of deposit balances as a result of the historically long and very low interest rate cycle. This is often referred to as a surge of deposits with concern being that these deposits could leave banks once the overnight Federal Funds rate reaches higher levels. This began to occur to some degree in 2018 and banks generally became more competitive as interest rates rose in order to retain these deposits as other competition re-enters the marketplace and is able to attract these funds. Management has built more deposit sensitivity into the current model to reflect this ongoing anticipated impact. Importantly, management's analysis continues to show that the Corporation should benefit when rates rise by achieving a larger increase in income associated with repricing assets than increased expense paid on repricing liabilities.

Additionally, the analysis shows that the Corporation's net interest income would decrease if rates did decline. This results from several types of deposit products' current offering rates being near the floor for pricing. For instance, savings accounts had an interest rate of 0.05% as of December 31, 2018. Management is only able to reduce the rate to zero; therefore, any reduction in the savings rate only benefits earnings to the magnitude of a 5-basis point rate decline. Meanwhile, if the Federal Reserve did decrease the overnight rate by 25 basis points, most of the Corporation's commercial Prime-based loans would decrease by the full 25 basis points, causing a net reduction to net interest income. It is likely that, given any downward rate movement, management would act to help minimize the reduction in loan rates to limit the reduction in net interest income. Management could hold off on reducing fixed rates on loans but would need to allow Prime-based loans to price off their contract terms. In this manner, management influences customer behavior and encourages more variable rate loans, which would act to decrease

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the Corporation's net interest income given lower interest rates and increase net interest income given higher interest rates.

The assumptions and analysis of interest rate risk are based on historical experience during varied economic cycles. Management believes these assumptions to be appropriate; however, actual results could vary significantly. Management uses this analysis to identify trends in interest rate sensitivity and determine if action is necessary to mitigate asset liability risk.

Change in Net Portfolio Value

The change in NPV gives a long-term view of the exposure to changes in interest rates. The NPV is calculated by discounting the future cash flows to the present value based on current market rates. The NPV is the mathematical equivalent of the present value of assets minus the present value of liabilities.

The table below indicates the changes in the Corporation's NPV as of December 31, 2018 and December 31, 2017. As part of the Asset Liability Policy, the Board of Directors has established risk measurement guidelines to protect the Corporation against decreases in the net portfolio value and net interest income in the event of the interest rate changes described below.

As of December 31, 2018, the Corporation was within guidelines for all up-rate scenarios but was outside of guidelines for the three down-rate scenarios. The positive impact of higher rates on both loans and securities was up slightly from December 31, 2017, due to more favorable modeling of deposits to higher rates. On the liability side of the Corporation's balance sheet, the value of non-interest bearing deposit accounts only becomes more and more valuable as interest rates rise, which is reflected in NPV as a decrease in liabilities. These deposits have always been highly favorable in a rising rate environment as these balances are more valuable to the Corporation, representing a decrease in liabilities as interest rates rise. The non-interest bearing demand deposit accounts and low-interest bearing checking, NOW, and money market accounts also provide more benefit to the Corporation when interest rates rise and the difference between the overnight funding costs compared to the average interest bearing core deposit rates are greater. As interest rates increase, the discount rate used to value the Corporation's interest bearing accounts increases, causing a lower net present value. This improves the modeling of the Corporation's fair value risk as the liability amounts decrease, causing the net present value or fair value of the Corporation's balance sheet to increase.

CHANGES IN NET PORTFOLIO VALUE

	2018 Percentage Change	2017 Percentage Change	Policy Guidelines %
400 basis point rise	—	9.8	(20.0)
300 basis point rise	14.5	12.7	(15.0)
200 basis point rise	15.4	13.4	(10.0)
100 basis point rise	11.6	10.1	(5.0)
Base rate scenario	—	—	—
50 basis point decline	(9.4)	(11.3)	(7.5)
100 basis point decline	(24.7)	(28.3)	(15.0)
150 basis point decline	(37.2)	—	(22.5)

This table shows the effect of an immediate interest rate shock on the net portfolio value of the Corporation's assets and liabilities. Base rate is the Prime rate.

The results as of December 31, 2018, indicate that the Corporation's net portfolio value would experience valuation

gains in all up-rate scenarios with a gain of 11.6% in the rates-up 100 basis point scenario, and gains of 15.4% and 14.5%, in the rates-up 200 and 300 basis point scenarios, respectively. A valuation gain indicates that the value of the Corporation's assets is declining at a slower pace than the decrease in the value of the Corporation's liabilities. Even though the Corporation has some longer-term assets such as residential mortgages and municipal securities which show declines in value as interest rates increase further, the large balances of core deposits more than offsets this fair value exposure of the longer-term assets. As the composition of the balance sheet changes throughout 2019, it is likely that the fair value analysis will show less in the rates-up scenarios particularly if the mix of deposits changes throughout the year. With potentially higher Treasury rates and a different mix of deposits or loans, fair value could experience more volatility. Based on past decay rate studies on the Corporation's core deposits, management does not expect a material decline in core deposit accounts, including the non-interest bearing accounts, if short term interest rates do increase further. The Corporation's core deposits have been stable through a number of rate cycles. While the changes in net portfolio value show exposure in the down-rate scenarios that is outside of policy guidelines, it is management's belief that the more likely scenario is rates-up and our balance sheet is well-positioned for that scenario. Conintual monitoring of all interest rate scenarios will be essential throughout 2019.

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ENB FINANCIAL CORP

Item 8. Financial Statements and Supplementary Data

The following audited consolidated financial statements are set forth in this Annual Report of Form 10-K on the following pages:

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of ENB Financial Corp

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of ENB Financial Corp and subsidiary (the "Company") as of December 31, 2018 and 2017; the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2018; and the related notes to the consolidated financial statements (collectively, the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 25, 2019, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company, in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks.

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Basis for Opinion (Continued)

Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company’s auditor since 2005.

Cranberry Township, Pennsylvania

March 25, 2019

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of ENB Financial Corp

Opinion on Internal Control over Financial Reporting

We have audited ENB Financial Corp and subsidiary (the "Company")'s internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework,* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the two years in the period ended December 31, 2018, of the Company, and our report dated March 25, 2019, expressed an unqualified opinion.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting in the accompanying Management's

Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company, in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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Definition and Limitations of Internal Control over Financial Reporting

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

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

Cranberry Township, Pennsylvania

March 25, 2019

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ENB FINANCIAL CORP

CONSOLIDATED BALANCE SHEETS

(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	December 31, 2018 $	December 31, 2017 $
ASSETS		
Cash and due from banks	26,675	21,867
Interest-bearing deposits in other banks	14,690	31,206
Total cash and cash equivalents	41,365	53,073
Securities available for sale (at fair value)	294,065	314,077
Equity securities available for sale (at fair value)	5,934	5,584
Loans held for sale	1,429	2,892
Loans (net of unearned income)	694,073	597,553
Less: Allowance for loan losses	8,666	8,240
Net loans	685,407	589,313
Premises and equipment	25,551	25,687
Regulatory stock	6,348	5,794
Bank owned life insurance	28,085	27,814
Other assets	9,658	9,388
Total assets	1,097,842	1,033,622
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Noninterest-bearing	369,081	314,917
Interest-bearing	550,653	551,560
Total deposits	919,734	866,477
Short-term borrowings	7,870	—
Long-term debt	65,386	65,850

Other liabilities	2,050	1,536
Total liabilities	995,040	933,863
Stockholders' equity:		
Common stock, par value $0.20;		
Shares: Authorized 12,000,000		
Issued 2,869,557 and Outstanding 2,852,532 as of 12/31/18		
Issued 2,869,557 and Outstanding 2,849,823 as of 12/31/17	574	574
Capital surplus	4,435	4,415
Retained earnings	104,067	98,629
Accumulated other comprehensive loss net of tax	(5,678)	(3,195)
Less: Treasury stock cost on 17,025 shares as of 12/31/18		
19,734 shares as of 12/31/17	(596)	(664)
Total stockholders' equity	102,802	99,759
Total liabilities and stockholders' equity	1,097,842	1,033,622

See Notes to the Consolidated Financial Statements

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ENB FINANCIAL CORP

CONSOLIDATED STATEMENTS OF INCOME

(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	Year Ended December 31,	
	2018	2017
	$	$
Interest and dividend income:		
Interest and fees on loans	27,966	24,253
Interest on securities available for sale		
Taxable	4,704	3,841
Tax-exempt	2,861	4,248
Interest on deposits at other banks	392	388
Dividend income	575	387
Total interest and dividend income	36,498	33,117
Interest expense:		
Interest on deposits	2,067	1,929
Interest on borrowings	1,307	1,010
Total interest expense	3,374	2,939
Net interest income	33,124	30,178
Provision for loan losses	660	940
Net interest income after provision for loan losses	32,464	29,238
Other income:		
Trust and investment services income	1,959	1,776
Service fees	2,929	2,669
Commissions	2,596	2,303
Gains (losses) on debt securities, net	(286)	618
Gains (losses) on equity securities, net	(5)	57
Gains on sale of mortgages	1,602	1,715
Earnings on bank-owned life insurance	1,638	688
Other income	604	495
Total other income	11,037	10,321

Operating expenses:

Salaries and employee benefits	20,240	19,340
Occupancy	2,475	2,413
Equipment	1,129	1,166
Advertising & marketing	773	698
Computer software & data processing	2,341	2,210
Shares tax	901	859
Professional services	1,974	1,673
Other expense	2,613	2,518
Total operating expenses	32,446	30,877
Income before income taxes	11,055	8,682
Provision for federal income taxes	1,306	2,338
Net income	9,749	6,344
Earnings per share of common stock	3.42	2.23
Cash dividends paid per share	1.15	1.12
Weighted average shares outstanding	2,854,369	2,849,084

See Notes to the Consolidated Financial Statements

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ENB FINANCIAL CORP

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(DOLLARS IN THOUSANDS)

	Year Ended December 31,	
	2018	2017
	$	$
Net income	9,749	6,344
Other comprehensive income (loss), net of tax:		
Net change in unrealized gains:		
Securities available for sale not other-than-temporarily impaired:		
Unrealized gains (losses) arising during the period	(2,631)	3,235
Income tax effect	556	(1,100)
	(2,075)	2,135
(Gains)/losses recognized in earnings	286	(675)
Income tax effect	(60)	230
	226	(445)
Other comprehensive income (loss), net of tax	(1,849)	1,690
Comprehensive Income	7,900	8,034

See Notes to the Consolidated Financial Statements

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ENB FINANCIAL CORP

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(DOLLARS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

	Common Stock $	Capital Surplus $	Retained Earnings $	Accumulated Other Comprehensive Income (Loss) $	Treasury Stock $	Total Stockholders' Equity $
Balances, December 31, 2016	574	4,403	95,475	(4,885)	(628)	94,939
Net income	—	—	6,344	—	—	6,344
Other comprehensive income net of tax	—	—	—	1,690	—	1,690
Treasury stock purchased - 16,500 shares	—	—	—	—	(568)	(568)
Treasury stock issued - 15,941 shares	—	12	—	—	532	544
Cash dividends paid, $1.12 per share	—	—	(3,190)	—	—	(3,190)
Balances, December 31, 2017	574	4,415	98,629	(3,195)	(664)	99,759
Net income	—	—	9,749	—	—	9,749
Other comprehensive loss net of tax	—	—	—	(1,849)	—	(1,849)
Change in accounting principal for adoption of ASU 2017-08			(1,663)			(1,663)
Reclassification of certain income tax effects from accumulated other comprehensive loss	—	—	634	(634)	—	—
Treasury stock purchased - 12,900 shares	—	—	—	—	(463)	(463)
Treasury stock issued - 15,609 shares	—	20	—	—	531	551
Cash dividends paid, $1.15 per share	—	—	(3,282)	—	—	(3,282)
Balances, December 31, 2018	574	4,435	104,067	(5,678)	(596)	102,802

See Notes to the Consolidated Financial Statements

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ENB FINANCIAL CORP

CONSOLIDATED STATEMENTS OF CASH FLOWS

(DOLLARS IN THOUSANDS)	Year Ended December 31,	
	2018	2017
	$	$
Cash flows from operating activities:		
Net income	9,749	6,344
Adjustments to reconcile net income to net cash provided by operating activities:		
Net amortization of securities premiums and discounts and loan fees	3,936	3,892
Decrease (increase) in interest receivable	(70)	66
Increase (decrease) in interest payable	12	1
Provision for loan losses	660	940
(Gains) losses on securities transactions, net	291	(675)
Gains on sale of mortgages	(1,602)	(1,715)
Loans originated for sale	(43,450)	(42,847)
Proceeds from sales of loans	46,515	44,222
Earnings on bank-owned life insurance	(1,638)	(688)
Depreciation of premises and equipment and amortization of software	1,618	1,624
Net decrease (increase) in deferred income tax	1,352	1,496
Other assets and other liabilities, net	(616)	(1,310)
Net cash provided by operating activities	16,757	11,350
Cash flows from investing activities:		
Securities:		
Proceeds from maturities, calls, and repayments	16,255	21,864
Proceeds from sales	57,932	80,642
Purchases	(62,222)	(114,269)
Purchase of regulatory bank stock	(1,952)	(2,920)
Redemptions of regulatory bank stock	1,398	2,498
Purchase of bank-owned life insurance	—	(2,439)
Proceeds from bank-owned life insurance	1,364	—
Net increase in loans	(97,288)	(26,693)
Purchases of premises and equipment, net	(1,320)	(4,510)
Purchase of computer software	(101)	(118)
Net cash used for investing activities	(85,934)	(45,945)
Cash flows from financing activities:		
Net increase in demand, NOW, and savings accounts	69,448	61,181
Net decrease in time deposits	(16,191)	(12,195)
Net increase (decrease) in short-term borrowings	7,870	(8,329)
Proceeds from long-term debt	14,161	19,593
Repayments of long-term debt	(14,625)	(15,000)
Dividends paid	(3,282)	(3,190)
Proceeds from sale of treasury stock	551	544

Treasury stock purchased	(463)	(568)
Net cash provided by financing activities	57,469	42,036
(Decrease) Increase in cash and cash equivalents	(11,708)	7,441
Cash and cash equivalents at beginning of period	53,073	45,632
Cash and cash equivalents at end of period	41,365	53,073
Supplemental disclosures of cash flow information:		
Interest paid	3,362	2,938
Income taxes paid	375	1,725
Supplemental disclosure of non-cash investing and financing activities:		
Fair value adjustments for securities available for sale	2,345	(2,560)

See Notes to the Consolidated Financial Statements

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ENB FINANCIAL CORP
Notes to Consolidated Financial Statements

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

ENB Financial Corp, through its wholly owned subsidiary, Ephrata National Bank, provides financial services to Northern Lancaster County and surrounding communities. ENB Financial Corp, a bank holding company, was formed on July 1, 2008, to become the parent company of Ephrata National Bank, which existed as a stand-alone national bank since its formation on April 11, 1881. The Corporation’s wholly owned subsidiary, Ephrata National Bank, offers a full array of banking services including loan and deposit products for both personal and commercial customers, as well as trust and investment services, through twelve full-service office locations.

Basis of Presentation

The consolidated financial statements of ENB Financial Corp and its subsidiary, Ephrata National Bank, (collectively “the Corporation”) conform to U.S. generally accepted accounting principles (GAAP). The preparation of these statements requires that management make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Material estimates of the Corporation, including the allowance for loan losses, the fair market value of financial instruments, and deferred tax assets or liabilities, are evaluated regularly by management. Actual results could differ from the reported estimates given different conditions or assumptions.

The accounting and reporting policies followed by the Corporation conform with U.S. GAAP and to general practices within the banking industry. All significant intercompany transactions have been eliminated in consolidation. The following is a summary of the more significant policies.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents are identified as cash and due from banks and include cash on hand, collection items, amounts due from banks, and interest bearing deposits in other banks with maturities of less than 90 days.

Securities Available for Sale

The Corporation classifies its entire portfolio of debt and equity securities as available for sale securities, which the Corporation reports at fair value. Any unrealized valuation gains or losses in the portfolio are reported as a separate component of stockholders' equity, net of deferred income taxes. The constant yield method is used for the amortization of premiums and the accretion of discounts for all of the Corporation's securities with the exception of collateralized mortgage obligations (CMOs) and mortgage backed securities (MBS). The constant yield method maintains a stable yield on the instrument through its maturity. For CMOs and MBS, a two-step/proration method is used for amortization and accretion. The first step is a proration based on the current pay down. This component ensures that the book price stays level with par. The second step amortizes or accretes the remaining premium or discount to the calculated final amortization or accretion date based on the current three-month constant prepayment rates. Net gains or losses realized on sales or calls of securities are reported as gains or losses on security transactions during the year of sale, using the specific identification method.

Other Than Temporary Impairment ("OTTI")

Management monitors all of the Corporation's securities for OTTI on a monthly basis and determines whether any impairment should be recorded. A number of factors are considered in determining whether a security is impaired, including, but not limited to, the following:

- Percentage of unrealized losses,
- Period of time the security has had unrealized losses,
- Type of security,
- Maturity date of the instrument if a debt instrument,
- The intent to sell the security or whether it is more likely than not that the Corporation would be required to sell the security before its anticipated recovery in market value,
- Amount of projected credit losses based on current cash flow analysis, default and severity rates, and
- Market dynamics impacting the market for and liquidity of the security.

Management will more closely evaluate those securities that have unrealized losses of 10% or more and have had unrealized losses for more than twelve months. If management determines that the declines in value of the security are not temporary, or if management does not have the ability to hold the security until maturity, which is the case with equity securities, then management will record impairment on the security. For equity securities, typically the amount of impairment is the difference between the security's book value and current fair market value determined by obtaining independent market pricing. For debt securities evaluated for impairment, management will determine what portion of the unrealized valuation loss is attributed to projected or known loss of principal, and what portion is attributed to market pricing not reflective of the true value of the security, based on current cash flow analysis. Management will generally record impairment equivalent to the projected or known loss of principal, known as the credit loss. The other portion of the fair market value loss is attributed to market factors and it is management's opinion that these fair value losses are temporary and not permanent. All impairment is recorded as a loss on securities and is included in the Corporation's Consolidated Statements of Income.

Loans Held for Investment

Loans receivable, that management has the intent and ability to hold for the foreseeable future, or until maturity or payoff, generally are reported at the outstanding principal balances, reduced by any charge-offs and net of any deferred loan origination fees or costs. Net loan origination fees and costs are deferred and recognized as an adjustment of yield over the contractual life of the loan.

Interest accrues daily on outstanding loan balances. Generally, the accrual of interest discontinues when the ability to collect the loan becomes doubtful or when a loan becomes more than 90 days past due as to principal and interest. These loans are referred to as non-accrual loans. Management may elect to continue the accrual of interest based on the expectation of future payments and/or the sufficiency of the underlying collateral.

Loans Held for Sale

Loans originated and intended for sale on the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income. In general, fixed-rate residential mortgage loans originated by the Corporation and held for sale are carried in the aggregate at the lower of cost or market. The Corporation originates loans for immediate sale with servicing retained and servicing released to several investors. However, the vast majority of the sold mortgages are sold to the Federal Home Loan Bank of Pittsburgh (FHLB) and Fannie Mae, with servicing retained. As a result, the Corporation has a growing portfolio of mortgages that are serviced on behalf of FHLB and Fannie Mae. In addition, the Corporation originates FHA, VA, and USDA mortgages which are originated for immediate sale to various investors on a service-released basis.

Allowance for Loan Losses

The allowance for loan losses is maintained at a level considered by management to be adequate to provide for known and inherent risks in the loan portfolio at the Consolidated Balance Sheets dates. The monthly provision or credit for loan losses is an expense or a reduction of expense which increases or decreases the allowance, and charge-offs, net of recoveries, decrease the allowance. The Corporation performs ongoing credit reviews of the loan portfolio and considers current economic conditions, historical loan loss experience, and other factors in determining the adequacy of the reserve balance. Loans determined to be uncollectible are charged to the allowance during the period in which such determination is made.

In calculating the allowance, management will begin by compiling the balance of loans by credit quality for each loan segment in order that allocations can be made in aggregate based on historic losses and qualitative factors. Prior to calculating these aggregate allocations, management will individually evaluate commercial and commercial real estate loans for impairment. A loan is impaired when it is probable that a creditor will be unable to collect all principal and interest due according to the contractual terms of the loan agreement. All other loan types such as residential mortgages, home equity loans and lines of credit, and all other consumer loans, are not individually evaluated for impairment and are therefore allocated for in aggregate. These loans are considered to be large groups of smaller-balance homogenous loans and are measured for impairment collectively. Loans that experience insignificant payment delays, which are defined as 90 days or less, generally are not classified as impaired. Management determines the significance of payment delays on a case-by-case basis, taking into consideration all circumstances concerning the loan, the creditworthiness and payment history of the borrower, the length of the payment delay, and the amount of shortfall in relation to the principal and interest owed.

For loans deemed to be impaired, management will provide a specific allocation. This loan balance is then subtracted from the total loan balances being allocated for in the aggregate. The remaining balances, along with the full loan balances for the other loan types are then multiplied by an adjusted loss ratio, which is the sum of both the historical loss ratio and a qualitative factor adjustment. Generally both the historical loss ratio and the qualitative factor adjustment will increase as the credit rating of the loan deteriorates. The credit ratings begin with unclassified loans, which represent the best internal credit rating, also referred to as a “pass” credit and then continue with declining grades of special mention, substandard, doubtful, and loss. Special mention loans are no longer deemed to be a “pass” credit and require additional management attention. They are essentially placed on “watched” status and attempts are made to improve the credit to an unclassified status. If the credit would deteriorate further it would then be a substandard credit, which for regulatory purposes, is deemed to be a classified loan. Doubtful and loss credit grades represent further credit deterioration and are also considered classified loans.

For each loan type, all of these credit rating categories are broken out with adjusted loss ratios. The loan balance is then multiplied by the adjusted loss ratio to produce the required allowance. The allowances are totaled and added to any specific allocations on impaired loans to arrive at the total allowance for loan losses for the Corporation.

Management tracks and assigns a historical loss percentage for each loan rating category within each loan type. A rolling three-year historical loss ratio, calculated on a quarterly basis, with a 60%, 30%, and 10% weighting for the past three years is used. In this manner the historical loss percentage is heavily weighted to the current loss environment, but has sufficient weighting assigned to prior periods to avoid unnecessary volatile fluctuations based on just one period’s data.

Management currently utilizes nine qualitative factors that are adjusted based on changes in the lending environment and economic conditions. The qualitative factors include the following:

- levels of and trends in delinquencies, non-accruals, and charge-offs,
- trends in the nature and volume of the loan portfolio,
- changes in lending policies and procedures,
- experience, ability, and depth of lending personnel and management oversight,
- national and local economic trends,
- concentrations of credit,
- external factors such as competition, legal, and regulatory requirements,
- changes in the quality of loan review and Board oversight,
- changes in the value of underlying collateral.

The number of qualitative factors can change. Factors can be added for new risks or taken away if the risk no longer applies. Each loan type will have its own risk profile and management will evaluate and adjust each qualitative factor for each loan type quarterly, if necessary. For example, if one area of the loan portfolio is experiencing sharp increases in growth, it is likely the qualitative factor for trends in the loan portfolio would be increased for that loan type. As levels of delinquencies and non-accrual loans decline for any segment of the loan portfolio it is likely that factor would be reduced.

In terms of the Corporation's loan portfolio, the commercial and industrial loans and commercial real estate loans are deemed to have more risk than the consumer real estate loans and other consumer loans in the portfolio. The commercial loans not secured by real estate are highly dependent on their financial condition and therefore are more dependent on economic conditions. The commercial loans secured by real estate are also dependent on economic conditions but generally have stronger forms of collateral. Commercial real estate lending is highly impacted by the value of collateral so these commercial loans carry a higher qualitative factor for changes in collateral value. While the Corporation's CRE loans have performed well historically, other commercial loans and commercial mortgage loans have historically been responsible for the majority of the Corporation's delinquencies, non-accrual loans, and charge-offs, so both of these categories carry higher qualitative factors than consumer real estate loans and other consumer loans. Of particular focus currently is the dairy component of the Corporation's agricultural loans. The decline in milk prices continues to put financial pressure on these operations and management has increased qualitative factors over the year to reflect this. The Corporation has historically experienced very low levels of consumer real estate and consumer loan charge-offs so these qualitative factors are set lower than the commercial real estate and commercial and industrial loans.

Impaired and Non-Accrual Loans

The definition of "impaired loans" is not the same as the definition of "non-accrual loans," although the two categories overlap. Generally, a non-accrual loan will always be considered impaired due to payment delinquency or uncertain collection, but there are cases where an impaired loan is not considered non-accrual. The primary factors considered by management in determining impairment include payment status and collateral value, but could also include debt service coverage, financial health of the business, and other external factors that could impact the ability of the borrower to fully repay the loan. The amount of impairment for these types of loans is determined by the difference between the present value of the expected cash flows related to the loan using the original interest rate and its recorded value or, as a practical expedient in the case of collateral-dependent loans, the difference between the fair value of the collateral and the recorded amount of the loan. When foreclosure is probable, impairment is measured based on the fair value of the collateral on a discounted basis, relative to the loan amount.

Management will place a business or commercial loan on non-accrual status when it is determined that the loan is impaired, or when the loan is 90 days past due. These customers will generally be placed on non-accrual status at the end of each quarter. Consumer loans over 90 days delinquent are generally charged off, or in the case of residential real estate loans the Corporation will seek to bring the customer current or pursue foreclosure options. When the borrower is on non-accrual, the Corporation will reverse any accrued interest on the books and will discontinue recognizing any interest income until the borrower is placed back on accrual status or fully pays off the loan balance plus any accrued interest. Payments received by the customer while the loan is on non-accrual are fully applied against principal. The Corporation maintains records of the full amount of interest that is owed by the borrower. A non-accrual loan will generally only be placed back on accrual status after the borrower has become current and has demonstrated six consecutive months of non-delinquency.

Allowance for Off-Balance Sheet Extensions of Credit

The Corporation maintains an allowance for off-balance sheet extensions of credit, which would include any unadvanced amount on lines of credit and any letters of credit provided to borrowers. The allowance is carried as a liability and is included in other liabilities on the Corporation's Consolidated Balance Sheets. The liability was $333,000 as of December 31, 2018, and $317,000 as of December 31, 2017. As the unadvanced portion of lines of credit increases, this provision will increase.

Management follows the same methodology as the allowance for loan losses when calculating the allowance for off-balance sheet extensions of credit, with the exception of multiplying the unadvanced total by a high/low balance variance to arrive at the expected unadvanced portion that could be drawn upon at any time, or the amount at risk. The unadvanced amounts for each loan segment are broken down by credit classification. A historical loss ratio and qualitative factor are calculated for each credit classification by loan type. The historical loss ratio and qualitative factor are combined to produce an adjusted loss ratio, which is multiplied by the amount at risk for each credit classification within each loan segment to arrive at an allocation. The allocations are summed to arrive at the total allowance for off-balance sheet extensions of credit.

Other Real Estate Owned (OREO)

OREO represents properties acquired through customer loan defaults. These properties are recorded at the lower of cost or fair value less projected disposal costs at acquisition date. Fair value is determined by current appraisals. Costs associated with holding OREO are charged to operational expense. OREO is a component of other assets on the Corporation's Consolidated Balance Sheets. The Corporation had no OREO as of December 31, 2018, or December 31, 2017.

Mortgage Servicing Rights (MSRs)

The Corporation has agreements for the express purpose of selling residential mortgage loans on the secondary market, referred to as mortgage servicing rights. The Corporation maintains all servicing rights for loans currently sold through FHLB and Fannie Mae. The Corporation had $905,000 of MSRs as of December 31, 2018, compared to $661,000 as of December 31, 2017. Management expects MSRs to continue to grow as a result of the expanded mortgage program. The value of newly originated MSRs is determined by estimating the life of the mortgage and how long the Corporation will have access to the servicing income stream to determine the relative fair value. The Corporation utilizes a third party that calculates the MSR valuation on a quarterly basis. A longer estimated life would increase the MSR while a shorter estimated life would decrease the value of the asset. Management records the MSR value based on this reporting. Ultimately the value of the MSRs would be at what level a willing buyer and seller would exchange the MSRs. MSRs are amortized in proportion to the estimated servicing income over the estimated life of the servicing portfolio. Impairment is evaluated based on the fair value of the rights, portfolio interest rates, and prepayment characteristics. MSRs are a component of other assets on the Consolidated Balance Sheets.

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ENB FINANCIAL CORP
Notes to Consolidated Financial Statements

The following chart provides the activity of the Corportation's mortgage servicing rights for the years ended December 31, 2018 and 2017.

MORTGAGE SERVICING RIGHTS

(DOLLARS IN THOUSANDS)

	December 31,	
	2018	2017
	$	$
Beginning Balance	661	410
Additions	315	290
Amortization	(52)	(27)
Disposals	(19)	(12)
Ending Balance	905	661

Premises and Equipment

Land is carried at cost. Premises and equipment are carried at cost, less accumulated depreciation. Book depreciation is computed using straight-line methods over the estimated useful lives of generally fifteen to thirty-nine years for buildings and improvements and four to ten years for furniture and equipment. Maintenance and repairs of property and equipment are charged to operational expense as incurred, while major improvements are capitalized. Net gains or losses upon disposition are included in other income or operational expense, as applicable.

Transfer of Assets

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

Bank-Owned Life Insurance (BOLI)

BOLI is carried by the Corporation at the cash surrender value of the underlying policies. Income earned on the policies is based on any increase in cash surrender value less the cost of the insurance, which varies according to age and health of the insured. The life insurance policies owned by the Corporation had a cash surrender value of $28,085,000 and $27,814,000 as of December 31, 2018, and 2017, respectively. The increase in BOLI cash surrender value was primarily due to normal appreciation of existing policies as a result of returns exceeding expenses.

Advertising Costs

The Corporation expenses advertising costs as incurred. Advertising costs for the years ended December 31, 2018 and 2017 were $773,000 and $698,000, respectively.

Income Taxes

An asset and liability approach is followed for financial accounting and reporting for income taxes. Accordingly, a net deferred tax asset or liability is recorded in the consolidated financial statements for the tax effects of temporary differences, which are items of income and expense reported in different periods for income tax and financial reporting purposes. Deferred tax expense is determined by the change in the assets or liabilities related to deferred income taxes. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Earnings per Share

The Corporation currently maintains a simple capital structure with no stock option plans that would have a dilutive effect on earnings per share. Earnings per share are calculated by dividing net income by the weighted-average number of shares outstanding for the periods.

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Comprehensive Income

The Corporation is required to present comprehensive income in a full set of general-purpose consolidated financial statements for all periods presented. Other comprehensive income (loss) consists of unrealized holding gains and losses on the available for sale securities portfolio.

Segment Disclosure

U.S. generally accepted accounting principles establish standards for the manner in which public business enterprises report information about segments in the annual financial statements and requires that those enterprises report selected information about operating segments in interim financial reports issued to shareholders. It also establishes standards for related disclosures regarding financial products and services, geographic areas, and major customers. The Corporation has only one operating segment consisting of its banking and fiduciary operations.

Pension Plans

The Corporation provides an optional 401(k) plan, in which employees may elect to defer pre-tax salary dollars, subject to the maximum annual Internal Revenue Service contribution amounts. The Corporation will match 50% of employee contributions up to 5%, limiting the match to 2.5%.

As part of the 401(k) Plan, the Corporation also has a noncontributory Profit Sharing Plan which covers substantially all employees. The Corporation provides a 3% Non-Elective contribution to all employees and contributes a 2% Elective Contribution to all employees aged 21 or older who work 1,000 or greater hours in a calendar year and have completed at least one full year of employment.

Trust Assets and Income

Assets held by ENB’s Money Management Group in a fiduciary or agency capacity for customers are not included in the Corporation’s Consolidated Balance Sheets since these items are not assets of the Corporation. In accordance with banking industry practice, trust income is recognized on a cash basis; as such income does not differ significantly from amounts that would be recognized on an accrual basis. Trust income is reported in the Corporation’s Consolidated Statements of Income under other income.

Reclassification of Comparative Amounts

Certain comparative amounts for the prior year have been reclassified to conform to current-year classifications. Such reclassifications had no material effect on net income or stockholders' equity.

Change in Accounting Principle

Revenue from Contracts with Customers

The Company records revenue from contracts with customers in accordance with Accounting Standards Topic 606, *Revenue from Contracts with Customers (Topic 606).* Under Topic 606, the Corporation must identify contracts with customers, identify the performance obligations in the contract, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize revenue when the Corporation satisfies a performance obligation. Significant revenue has not been recognized in the current reporting period that results from performance obligations satisfied in previous periods.

The Corporation's primary sources of revenue are derived from interest and dividends earned on loans, investment securities, and other financial instruments that are not within the scope of Topic 606. The Corporation has evaluated the nature of its contracts with customers and determined that further disaggregation of revenue from contracts with customers into more granular categories beyond what is presented in the Consolidated Statements of Income was not necessary. The Corporation generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers.

Financial Instruments

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This Update applies to all entities that hold financial assets or owe financial liabilities and is intended to provide more useful information on the recognition, measurement, presentation, and disclosure of financial instruments. Among other things, this Update (a) requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (b) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; (c) eliminates the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities; (d) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (e) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (f) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; and (g) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets.

ASU 2016-01 was effective for the Corporation on January 1, 2018, and resulted in separate classification of equity securities previously included in available for sale securities on the consolidated balance sheets with changes in the fair value of the equity securities captured in the consolidated statements of income. See Note B – Securities for disclosures related to equity securities. Adoption of the standard also resulted in the use of an exit price rather than an entrance price to determine the fair value of loans not measured at fair value on a non-recurring basis in the consolidated balance sheets. See Note R – Fair Value Presentation for further information regarding the valuation of these loans.

Nonrefundable Fees and Other Costs

In March 2017, the FASB issued ASU 2017-08, *Receivables – Nonrefundable Fees and Other Costs (Subtopic 310-20).* The amendments in this Update shorten the amortization period for certain callable debt securities held at a premium. Specifically, the amendments require the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. The Corporation elected to early adopt the Update effective January 1, 2018. Upon adoption, the Corporation made a one-time cumulative effect adjustment through retained earnings of $1.7 million. The net effect was a decrease to retained earnings.

Reporting Comprehensive Income

In February 2018, the FASB issued ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220)*, to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. Consequently, the amendments eliminate the stranded tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users.

Upon adoption in February 2018, the Corporation made a one-time cumulative effect adjustment through retained earnings of $634,000. The net effect was an increase to retained earnings.

Recently Issued Accounting Standards

ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 will, among other things, require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 does not significantly change lease accounting requirements applicable to lessors; however, certain changes were made to align, where necessary, lessor accounting with the lessee accounting model and *ASC Topic 606, "Revenue from Contracts with Customers*." ASU 2016-02 will be effective for us on January 1, 2019 and initially required transition using a modified retrospective approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In July 2018, the FASB issued ASU 2018-11, *"Leases (Topic 842) - Targeted Improvements,"* which, among other things, provides an additional transition method that would allow entities to not apply the guidance in ASU 2016-02 in the comparative periods presented in the financial statements and instead recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. In December 2018, the FASB also issued *ASU 2018-20, "Leases (Topic 842) - Narrow-Scope Improvements for Lessors,"* which provides for certain policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. Upon adoption of

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ASU 2016-02, ASU 2018-11 and ASU 2018-20 on January 1, 2019, the Corporation expects to recognize right-of-use assets and related lease liabilities of approximately $1,000,000.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*, which changes the impairment model for most financial assets. This Update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. The underlying premise of the Update is that financial assets measured at amortized cost should be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The allowance for credit losses should reflect management’s current estimate of credit losses that are expected to occur over the remaining life of a financial asset. The income statement will be effected for the measurement of credit losses for newly recognized financial assets, as well as the expected increases or decreases of expected credit losses that have taken place during the period. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted for annual and interim periods beginning after December 15, 2018. With certain exceptions, transition to the new requirements will be through a cumulative effect adjustment to opening retained earnings as of the beginning of the first reporting period in which the guidance is adopted. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective, but cannot yet determine the magnitude of any such one-time adjustment or the overall impact of the new guidance on the consolidated financial statements.

In February 2018, the FASB issued ASU 2018-03, *Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10)*, to clarify certain aspects of the guidance issued in ASU 2016-01. (1) An entity measuring an equity security using the measurement alternative may change its measurement approach to a fair value method in accordance with Topic 820, *Fair Value Measurement*, through an irrevocable election that would apply to that security and all identical or similar investments of the same issuer. Once an entity makes this election, the entity should measure all future purchases of identical or similar investments of the same issuer using a fair value method in accordance with Topic 820. (2) Adjustments made under the measurement alternative are intended to reflect the fair value of the security as of the date that the observable transaction for a similar security took place. (3) Remeasuring the entire value of forward contracts and purchased options is required when observable transactions occur on the underlying equity securities. (4) When the fair value option is elected for a financial liability, the guidance in paragraph 825-10- 45-5 should be applied, regardless of whether the fair value option was elected under either Subtopic 815-15, *Derivatives and Hedging—Embedded Derivatives*, or 825-10, *Financial Instruments—Overall*. (5) Financial liabilities for which the fair value option is elected, the amount of change in fair value that relates to the instrument specific credit risk should first be measured in the currency of denomination when presented separately from the total change in fair value of the financial liability. Then, both components of the change in the fair value of the liability should be remeasured into the functional currency of the reporting entity using end-of-period spot rates. (6) The prospective transition approach for equity securities without a readily determinable fair value in the amendments in Update 2016-01 is meant only for instances in which the measurement alternative is applied. An insurance entity subject to the guidance in Topic 944, *Financial Services— Insurance*, should apply a prospective transition method when applying the amendments related to equity securities without readily determinable fair values.

An insurance entity should apply the selected prospective transition method consistently to the entity's entire population of equity securities for which the measurement alternative is elected. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years beginning after June 15, 2018. Public business entities with fiscal years beginning between December 15, 2017, and June 15, 2018, are not required to adopt these amendments until the interim period beginning after June 15, 2018, and public business entities with fiscal years beginning between June 15, 2018, and December 15, 2018, are not required to adopt these amendments before adopting the amendments in Update 2016-01. For all other entities, the effective date is the same as the effective date in Update 2016-01. All entities may early adopt these amendments for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years, as long as they have adopted Update 2016-01. This Update is not expected to have a significant impact on the Corporation's financial statements.

ASU 2018-04, *Investments – Debt Securities (Topic 320)* and *Regulated Operations (Topic 980) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273,* ASU 2018-04 supersedes various SEC paragraphs and adds an SEC paragraph pursuant to the issuance of Staff Accounting Bulletin No. 117.

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ASU 2018-05, *Income Taxes (Topic 740) - Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin (SAB) No. 118,* ASU 2018-05 amends the Accounting Standards Codification to incorporate various SEC paragraphs pursuant to the issuance of SAB 118. SAB 118 addresses the application of generally accepted accounting principles in situations when a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the Tax Cuts and Jobs Act. See Note L - Income Taxes.

In May 2018, the FASB issued ASU 2018-06, *Codification Improvements to Topic 942, Financial Services – Depository and Lending*, which supersedes outdated guidance related to the Office of the Comptroller of the Currency (OCC)'s Banking Circular 202, *Accounting for Net Deferred Tax Charges* (Circular 202), because that guidance has been rescinded by the OCC and no longer is relevant.

In July 2018, the FASB issued ASU 2018-09, *Codification Improvements*, represents changes to clarify, correct errors in, or make minor improvements to the Codification. The amendments make the Codification easier to understand and easier to apply by eliminating inconsistencies and providing clarifications. The transition and effective date guidance is based on the facts and circumstances of each amendment. Some of the amendments do not require transition guidance and will be effective upon issuance of this ASU. However, many of the amendments in this ASU do have transition guidance with effective dates for annual periods beginning after December 15, 2018, for public business entities. This Update is not expected to have a significant impact on the Corporation's financial statements.

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes the Disclosure Requirements for Fair Value Measurements*. The Update removes the requirement to disclose the amount of and reasons for transfers between Level I and Level II of the fair value hierarchy; the policy for timing of transfers between levels; and the valuation processes for Level III fair value measurements. The Update requires disclosure of changes in unrealized gains and losses for the period included in other comprehensive income (loss) for recurring Level III fair value measurements held at the end of the reporting period and the range and weighted average of significant unobservable inputs used to develop Level III fair value measurements. This Update is effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. This Update is not expected to have a significant impact on the Corporation's financial statements.

In November, 2018, the FASB issued ASU 2018-18, *Collaborative Arrangements (Topic 808)*, which made the following targeted improvements to generally accepted accounting principles (GAAP) for collaborative arrangements (1) clarified that certain transactions between collaborative arrangement participants should be accounted for as revenue under Topic 606 when the collaborative arrangement participant is a customer in the context of a unit of account, (2) add unit-of-account guidance in Topic 808 to align with the guidance in Topic 606 (that is, a distinct good or service) when an entity is assessing whether the collaborative arrangement or a part of the arrangement is within the scope of Topic 606, and (3) require that in a transaction with a collaborative arrangement participant that is not directly related to sales to third parties, presenting the transaction together with revenue recognized under Topic 606 is precluded if the collaborative arrangement participant is not a customer. For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. This Update is not expected to have a significant impact on the Corporation's financial statements.

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NOTE B - SECURITIES

(DOLLARS IN THOUSANDS)

The amortized cost and fair value of debt securities held at December 31, 2018, and 2017, are as follows:

	Amortized Cost $	Gross Unrealized Gains $	Gross Unrealized Losses $	Fair Value $
December 31, 2018				
U.S. government agencies	31,025	5	(910)	30,120
U.S. agency mortgage-backed securities	46,363	2	(1,726)	44,639
U.S. agency collateralized mortgage obligations	55,182	74	(1,166)	54,090
Asset-backed securities	11,440	—	(41)	11,399
Corporate bonds	61,085	—	(1,893)	59,192
Obligations of states and political subdivisions	96,157	69	(1,601)	94,625
Total securities available for sale	301,252	150	(7,337)	294,065
December 31, 2017				
U.S. government agencies	35,101	—	(749)	34,352
U.S. agency mortgage-backed securities	52,981	8	(916)	52,073
U.S. agency collateralized mortgage obligations	55,493	46	(898)	54,641
Corporate bonds	61,334	24	(589)	60,769
Obligations of states and political subdivisions	114,047	242	(2,047)	112,242
Total securities available for sale	318,956	320	(5,199)	314,077

The amortized cost and fair value of debt securities available for sale at December 31, 2018, by contractual maturity, are shown below. Actual maturities may differ from contractual maturities due to certain call or prepayment provisions.

CONTRACTUAL MATURITY OF DEBT SECURITIES

(DOLLARS IN THOUSANDS)

	Amortized Cost	Fair Value
	$	$
Due in one year or less	14,908	14,549
Due after one year through five years	140,318	136,151
Due after five years through ten years	33,962	33,144
Due after ten years	112,064	110,221
Total debt securities	301,252	294,065

Securities available for sale with a par value of $58,668,000 and $64,580,000 at December 31, 2018 and 2017, respectively, were pledged or restricted for public funds, borrowings, or other purposes as required by law. The fair market value of these pledged securities was $58,914,000 at December 31, 2018, and $66,157,000 at December 31, 2017.

Proceeds from active sales of debt securities available for sale, along with the associated gross realized gains and gross realized losses, are shown below. Realized gains and losses are computed on the basis of specific identification.

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PROCEEDS FROM SALES OF SECURITIES AVAILABLE FOR SALE

(DOLLARS IN THOUSANDS)

	Securities Available for Sale	
	2018	2017
	$	$
Proceeds from sales	57,660	80,508
Gross realized gains	130	889
Gross realized losses	416	271

Information pertaining to securities with gross unrealized losses at December 31, 2018, and December 31, 2017, aggregated by investment category and length of time that individual securities have been in a continuous loss position follows:

TEMPORARY IMPAIRMENTS OF SECURITIES

(DOLLARS IN THOUSANDS)

	Less than 12 months		More than 12 months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	$	$	$	$	$	$
As of December 31, 2018						
U.S. government agencies	—	—	28,116	(910)	28,116	(910)
U.S. agency mortgage-backed securities	—	—	42,041	(1,726)	42,041	(1,726)
U.S. agency collateralized mortgage obligations	8,055	(85)	40,735	(1,081)	48,790	(1,166)
Asset-backed securities	5,563	(41)	—	—	5,563	(41)
Corporate bonds	20,228	(455)	38,964	(1,438)	59,192	(1,893)
Obligations of states & political subdivisions	12,367	(104)	68,982	(1,497)	81,349	(1,601)
Total temporarily impaired securities	46,213	(685)	218,838	(6,652)	265,051	(7,337)

As of December 31, 2017						
U.S. government agencies	9,941	(59)	24,411	(690)	34,352	(749)
U.S. agency mortgage-backed securities	10,326	(78)	37,123	(838)	47,449	(916)
U.S. agency collateralized mortgage obligations	29,551	(280)	20,980	(618)	50,531	(898)
Corporate bonds	38,543	(282)	15,019	(307)	53,562	(589)
Obligations of states & political subdivisions	15,188	(142)	68,278	(1,905)	83,466	(2,047)
Total temporarily impaired securities	103,549	(841)	165,811	(4,358)	269,360	(5,199)

In the debt security portfolio, there are 181 positions carrying unrealized losses as of December 31, 2018. There were no instruments considered to be other-than-temporarily impaired at December 31, 2018.

The Corporation evaluates both equity and fixed income positions for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic and market concerns warrant such evaluation. Equity investments are bank stocks held by the Corporation with no maturity date, whereas the fixed income positions are bonds held by the Corporation with fixed maturity dates. U.S. generally accepted accounting principles provide for the bifurcation of OTTI into two categories: (a) the amount of the total OTTI related to a decrease in cash flows expected to be collected from the debt security (the credit loss), which is recognized in earnings, and (b) the amount of total OTTI related to all other factors, which is recognized, net of taxes, as a component of accumulated other comprehensive income (loss).

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Equity Securities

The following tables summarizes the amortized cost, gross unrealized gains and losses, and fair value of equity securities held at December 31, 2018 and December 31, 2017.

(DOLLARS IN THOUSANDS)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	$	$	$	$
December 31, 2018				
CRA-qualified mutual funds	5,410	—	—	5,410
Bank stocks	591	—	(67)	524
Total equity securities	6,001	—	(67)	5,934

(DOLLARS IN THOUSANDS)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	$	$	$	$
December 31, 2017				
CRA-qualified mutual funds	5,280	—	—	5,280
Bank stocks	268	36	—	304
Total equity securities	5,548	36	—	5,584

As of January 1, 2018, the Corporation adopted ASU 2016-01, resulting in the reclassification of equity securities from available-for-sale.

The following table presents the net gains and losses on the Corporation's equity investments recognized in earnings during the year ended December 31, 2018, and the portion of unrealized gains and losses for the periods that relates to equity investments held as of December 31, 2018.

NET GAINS AND LOSSES ON EQUITY INVESTMENTS RECOGNIZED IN EARNINGS

(DOLLARS IN THOUSANDS)

	Year Ended December 31, 2018 $
Net gains (losses) recognized in equity securities during the period	(5)
Less: Net gains (losses) realized on the sale of equity securities during the period	53
Unrealized gains (losses) recognized in equity securities held at reporting date	(58)

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NOTE C - LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table presents the Corporation's loan portfolio by category of loans for 2018 and 2017.

LOAN PORTFOLIO

(DOLLARS IN THOUSANDS)

	December 31,	
	2018	2017
	$	$
Commercial real estate		
Commercial mortgages	101,419	90,072
Agriculture mortgages	165,926	152,050
Construction	18,092	18,670
Total commercial real estate	285,437	260,792
Consumer real estate (a)		
1-4 family residential mortgages	219,037	176,971
Home equity loans	10,271	11,181
Home equity lines of credit	64,413	61,104
Total consumer real estate	293,721	249,256
Commercial and industrial		
Commercial and industrial	61,043	41,426
Tax-free loans	22,567	20,722
Agriculture loans	20,512	18,794
Total commercial and industrial	104,122	80,942
Consumer	9,197	5,320
Gross loans prior to deferred costs and allowance for loan losses	692,477	596,310
Deferred loan costs, net	1,596	1,243
Allowance for loan losses	(8,666)	(8,240)
Total net loans	685,407	589,313

(a) Real estate loans serviced for others, which are not included in the Consolidated Balance Sheets, totaled $126,916,000 and $98,262,000 as of December 31, 2018, and 2017, respectively.

The Corporation grades commercial credits differently than consumer credits. The following tables represent all of the Corporation’s commercial credit exposures by internally assigned grades as of December 31, 2018 and 2017. The grading analysis estimates the capability of the borrower to repay the contractual obligations under the loan agreements as scheduled or at all. The Corporation's internal commercial credit risk grading system is based on experiences with similarly graded loans.

The Corporation's internally assigned grades for commercial credits are as follows:

- Pass – loans which are protected by the current net worth and paying capacity of the obligor or by the value of the underlying collateral.
- Special Mention – loans where a potential weakness or risk exists, which could cause a more serious problem if not corrected.
- Substandard – loans that have a well-defined weakness based on objective evidence and characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected.
- Doubtful – loans classified as doubtful have all the weaknesses inherent in a substandard asset. In addition, these weaknesses make collection or liquidation in full highly questionable and improbable, based on existing circumstances.
- Loss – loans classified as a loss are considered uncollectible, or of such value that continuance as an asset is not warranted.

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COMMERCIAL CREDIT EXPOSURE

CREDIT RISK PROFILE BY INTERNALLY ASSIGNED GRADE

(DOLLARS IN THOUSANDS)

December 31, 2018	Commercial Mortgages	Agriculture Mortgages	Construction	Commercial and Industrial	Tax-free Loans	Agriculture Loans	Total
	$	$	$	$	$	$	$
Grade:							
Pass	99,013	154,132	17,567	59,348	22,367	19,487	371,914
Special Mention	176	3,478	525	518	200	453	5,350
Substandard	2,230	8,316	—	1,177	—	572	12,295
Doubtful	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—
Total	101,419	165,926	18,092	61,043	22,567	20,512	389,559

COMMERCIAL CREDIT EXPOSURE

CREDIT RISK PROFILE BY INTERNALLY ASSIGNED GRADE

(DOLLARS IN THOUSANDS)

December 31, 2017	Commercial Mortgages	Agriculture Mortgages	Construction	Commercial and Industrial	Tax-free Loans	Agriculture Loans	Total
	$	$	$	$	$	$	$
Grade:							
Pass	86,259	143,037	17,670	37,947	20,514	17,798	323,225
Special Mention	160	3,873	—	1,015	208	270	5,526
Substandard	3,653	5,140	1,000	2,464	—	726	12,983
Doubtful	—	—	—	—	—	—	—
Loss	—	—	—	—	—	—	—
Total	90,072	152,050	18,670	41,426	20,722	18,794	341,734

For consumer loans, the Corporation evaluates credit quality based on whether the loan is considered performing or non-performing. A consumer loan is considered non-performing when it is over 90 days past due. Management will generally charge off consumer loans more than 120 days past due for closed end loans and over 180 days for open-end consumer loans. The following table presents the balances of consumer loans by classes of the loan portfolio based on payment performance as of December 31, 2018 and 2017:

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CONSUMER CREDIT EXPOSURE

CREDIT RISK PROFILE BY PAYMENT PERFORMANCE

(DOLLARS IN THOUSANDS)

December 31, 2018	1-4 Family Residential Mortgages	Home Equity Loans	Home Equity Lines of Credit	Consumer	Total
Payment performance:	$	$	$	$	$
Performing	218,641	10,271	64,413	9,196	302,521
Non-performing	396	—	—	1	397
Total	219,037	10,271	64,413	9,197	302,918

CONSUMER CREDIT EXPOSURE

CREDIT RISK PROFILE BY PAYMENT PERFORMANCE

(DOLLARS IN THOUSANDS)

December 31, 2017	1-4 Family Residential Mortgages	Home Equity Loans	Home Equity Lines of Credit	Consumer	Total
Payment performance:	$	$	$	$	$
Performing	176,576	11,181	61,074	5,305	254,136
Non-performing	395	—	30	15	440
Total	176,971	11,181	61,104	5,320	254,576

The following tables present an age analysis of the Corporation's past due loans, segregated by loan portfolio class, as of December 31, 2018 and 2017:

AGING OF LOANS RECEIVABLE

(DOLLARS IN THOUSANDS)

December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable > 90 Days and Accruing
	$	$	$	$	$	$	$
Commercial real estate							
Commercial mortgages	—	—	237	237	101,182	101,419	—
Agriculture mortgages	326	—	816	1,142	164,784	165,926	—
Construction	—	—	—	—	18,092	18,092	—
Consumer real estate							
1-4 family residential mortgages	455	201	396	1,052	217,985	219,037	396
Home equity loans	62	35	—	97	10,174	10,271	—
Home equity lines of credit	95	—	—	95	64,318	64,413	—
Commercial and industrial							
Commercial and industrial	24	—	—	24	61,019	61,043	—
Tax-free loans	—	—	—	—	22,567	22,567	—
Agriculture loans	118	—	—	118	20,394	20,512	—
Consumer	10	15	1	26	9,171	9,197	1
Total	1,090	251	1,450	2,791	689,686	692,477	397

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AGING OF LOANS RECEIVABLE

(DOLLARS IN THOUSANDS)

December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans Receivable	Loans Receivable > 90 Days and Accruing
	$	$	$	$	$	$	$
Commercial real estate							
Commercial mortgages	—	—	372	372	89,700	90,072	—
Agriculture mortgages	—	—	—	—	152,050	152,050	—
Construction	—	—	—	—	18,670	18,670	—
Consumer real estate							
1-4 family residential mortgages	533	248	395	1,176	175,795	176,971	395
Home equity loans	40	—	—	40	11,141	11,181	—
Home equity lines of credit	—	—	30	30	61,074	61,104	30
Commercial and industrial							
Commercial and industrial	65	109	—	174	41,252	41,426	—
Tax-free loans	—	—	—	—	20,722	20,722	—
Agriculture loans	—	—	—	—	18,794	18,794	—
Consumer	8	3	15	26	5,294	5,320	15
Total	646	360	812	1,818	594,492	596,310	440

As of December 31, 2018, and 2017, all of the Corporation’s loans on non-accrual status were also considered impaired. Interest income on loans would have increased by approximately $47,000 and $24,000 during 2018 and 2017, respectively, if these loans had performed in accordance with their original terms.

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The following table presents non-accrual loans by classes of the loan portfolio as of December 31:

NON-ACCRUAL LOANS BY LOAN CLASS

(DOLLARS IN THOUSANDS)

	2018	2017
	$	$
Commercial real estate		
Commercial mortgages	1,017	393
Agriculture mortgages	816	—
Construction	—	—
Consumer real estate		
1-4 family residential mortgages	—	—
Home equity loans	—	—
Home equity lines of credit	—	—
Commercial and industrial		
Commercial and industrial	—	—
Tax-free loans	—	—
Agriculture loans	—	—
Consumer	—	—
Total	1,833	393

During 2018, there were no loan modifications made causing a loan to be considered a troubled debt restructuring (TDR). During 2017, there was one loan modification made causing a loan to be considered a TDR. A TDR is a loan where management has granted a concession to a borrower that is experiencing financial difficulty. A concession is generally defined as more favorable payment or credit terms granted to a borrower in an effort to improve the likelihood of the lender collecting principal in its entirety. Concessions usually are in the form of interest only for a period of time, or a lower interest rate offered in an effort to enable the borrower to continue to make normally scheduled payments. The loan classified as a TDR during 2017 was an agricultural loan with a principal balance at December 31, 2017, of $245,000. The concession granted to the borrower was an interest-only period initially running for three months to March 31, 2017. However, in April 2017, that deferral period was extended for an additional three months, causing management to classify the loan as a TDR. The concession period ended June 30, 2017. Subsequent to June 30, 2017, the borrower resumed normal principal and interest payments as of July 2017. The loan was later paid off in July of 2018 when the balance was down to $209,000.

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The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2018:

IMPAIRED LOAN ANALYSIS

(DOLLARS IN THOUSANDS)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	$	$	$	$	$
With no related allowance recorded:					
Commercial real estate					
Commercial mortgages	370	901	—	396	—
Agriculture mortgages	1,692	1,692	—	1,063	45
Construction	—	—	—	—	—
Total commercial real estate	2,062	2,593	—	1,459	45
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	—	—	—	—	—
Total commercial and industrial	—	—	—	—	—
Total with no related allowance	2,062	2,593	—	1,459	45
With an allowance recorded:					
Commercial real estate					
Commercial mortgages	647	694	132	484	—
Agriculture mortgages	—	—	—	—	—
Construction	—	—	—	—	—
Total commercial real estate	647	694	132	484	—
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	—	—	—	124	6
Total commercial and industrial	—	—	—	124	6

Total with a related allowance	647	694	132	608	6
Total by loan class:					
Commercial real estate					
Commercial mortgages	1,017	1,595	132	880	—
Agriculture mortgages	1,692	1,692	—	1,063	45
Construction	—	—	—	—	—
Total commercial real estate	2,709	3,287	132	1,943	45
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	—	—	—	124	6
Total commercial and industrial	—	—	—	124	6
Total	2,709	3,287	132	2,067	51

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The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2017:

IMPAIRED LOAN ANALYSIS

(DOLLARS IN THOUSANDS)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
	$	$	$	$	$
With no related allowance recorded:					
Commercial real estate					
Commercial mortgages	393	690	—	585	4
Agriculture mortgages	1,174	1,174	—	1,210	54
Construction	—	—	—	—	—
Total commercial real estate	1,567	1,864	—	1,795	58
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	245	245	—	163	7
Total commercial and industrial	245	245	—	163	7
Total with no related allowance	1,812	2,109	—	1,958	65
With an allowance recorded:					
Commercial real estate					
Commercial mortgages	—	—	—	—	—
Agriculture mortgages	—	—	—	—	—
Construction	—	—	—	—	—
Total commercial real estate	—	—	—	—	—
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	—	—	—	—	—
Total commercial and industrial	—	—	—	—	—

Total with a related allowance	—	—	—	—	—
Total by loan class:					
Commercial real estate					
Commercial mortgages	393	690	—	585	4
Agriculture mortgages	1,174	1,174	—	1,210	54
Construction	—	—	—	—	—
Total commercial real estate	1,567	1,864	—	1,795	58
Commercial and industrial					
Commercial and industrial	—	—	—	—	—
Tax-free loans	—	—	—	—	—
Agriculture loans	245	245	—	163	7
Total commercial and industrial	245	245	—	163	7
Total	1,812	2,109	—	1,958	65

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The following table details activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2018:

ALLOWANCE FOR CREDIT LOSSES AND RECORDED INVESTMENT IN LOANS RECEIVABLE

(DOLLARS IN THOUSANDS)

	Commercial Real Estate	Consumer Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
	$	$	$	$	$	$
Allowance for credit losses:						
Beginning balance	3,863	2,052	1,829	98	398	8,240
Charge-offs	(223)	(20)	(110)	(27)	—	(380)
Recoveries	72	—	66	8	—	146
Provision (credit)	584	376	(357)	24	33	660
Ending balance	4,296	2,408	1,428	103	431	8,666
Ending balance: individually evaluated for impairment	132	—	—	—	—	132
Ending balance: collectively evaluated for impairment	4,164	2,408	1,428	103	431	8,534
Loans receivable:						
Ending balance	285,437	293,721	104,122	9,197		692,477
Ending balance: individually evaluated for impairment	2,709	—	—	—		2,709
Ending balance: collectively evaluated for impairment	282,728	293,721	104,122	9,197		689,768

The dollar amount of the allowance increased for all loan segments except commercial and industrial since December 31, 2017. Loan growth and higher charge-off amounts resulted in higher allowance balances. The higher charge-offs in 2018 increased the historical loss adjustments in the commercial real estate and consumer real estate pools causing the associated allowance to increase in those areas. The decline in allowance allocated to the commercial and industrial segment was due to a change in the allowance calculation that occurred in early 2018. Prior to 2018, the business loan pool, included in commercial and industrial, had a large special adjustment factor for potential impairment. The loss rate for this pool also declined from December 31, 2017, to December 31, 2018.

The Corporation's allowance allocation is still overweighted toward commercial real estate loans due to the higher historical losses experienced. Approximately 50% of the allowance is dedicated to this sector that comprises 41% of total loan balances. This compares to 28% of the allowance being allocated to the consumer real estate sector which comprises 42% of all loan balances. Losses on consumer real estate has traditionally been lower than commercial loans. The commercial and industrial sector has 17% of the allowance allocated and comprises a similar 15% of loan balances. Commercial and industrial historical losses have generally been lower than commercial real estate but higher than consumer real estate, based on loan balances outstanding. The December 31, 2018 ending balance of the allowance was up $426,000, or 5.2%, from December 31, 2017, and the allowance as a percentage of total loans was down from 1.38% as of December 31, 2017, to 1.25% as of December 31, 2018.

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The following table details activity in the allowance for loan losses by portfolio segment for the year ended December 31, 2017:

ALLOWANCE FOR CREDIT LOSSES AND RECORDED INVESTMENT IN LOANS RECEIVABLE

(DOLLARS IN THOUSANDS)

	Commercial Real Estate	Consumer Real Estate	Commercial and Industrial	Consumer	Unallocated	Total
	$	$	$	$	$	$
Allowance for credit losses:						
Beginning balance	3,795	1,652	1,552	82	481	7,562
Charge-offs	(200)	—	(89)	(28)	—	(317)
Recoveries	—	20	24	11	—	55
Provision (credit)	268	380	342	33	(83)	940
Ending balance	3,863	2,052	1,829	98	398	8,240
Ending balance: individually evaluated for impairment	—	—	—	—	—	—
Ending balance: collectively evaluated for impairment	3,863	2,052	1,829	98	398	8,240
Loans receivable:						
Ending balance	260,792	249,256	80,942	5,320		596,310
Ending balance: individually evaluated for impairment	1,567	—	245	—		1,812
Ending balance: collectively evaluated for impairment	259,225	249,256	80,697	5,320		594,498

The dollar amount of the allowance increased for all loan segments from December 31, 2016 to December 31, 2017. Loan growth and higher charge-off amounts resulted in higher allowance balances but delinquencies, non-performing loans, and classified loans were all down from prior years' levels. The higher charge-offs in 2017 increased the historical loss adjustments in the commercial real estate and commercial and industrial pools causing the associated allowance to increase in those areas. The primary reason for the increase in allowance in the consumer real estate segment was due to a significant 16.6% increase in loan balances as well as increases in some qualititative factors related to this segment. The December 31, 2017 ending balance of the allowance was up $678,000, or 9.0%, from December 31, 2016, and the allowance as a percentage of total loans was up from 1.32% as of December 31, 2016, to 1.38% as of December 31, 2017.

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NOTE D – PREMISES AND EQUIPMENT

(DOLLARS IN THOUSANDS)

The major classes of the Corporation's premises and equipment and accumulated depreciation are as follows:

	December 31,	
	2018	2017
	$	$
Land	5,043	5,043
Buildings and improvements	29,302	26,424
Furniture and equipment	14,592	13,510
Construction in process	133	2,773
Total	49,070	47,750
Less accumulated depreciation	(23,519)	(22,063)
Premises and equipment	25,551	25,687

Depreciation expense, which is included in operating expenses, amounted to $1,456,000 for 2018, and $1,391,000 for 2017. The construction in process category represents expenditures for ongoing projects. When construction is completed, these amounts will be reclassified into buildings and improvements, and/or furniture and equipment. Depreciation only begins when the project or asset is placed into service. As of December 31, 2018, the construction in process consists primarily of costs associated with various small projects whereas the balance outstanding at December 31, 2017, was primarily related to the the building of the permanent branch office in Strasburg, PA which was opened for business in January of 2018.

NOTE E – REGULATORY STOCK

The Bank is a member of the Federal Home Loan Bank (FHLB) of Pittsburgh, which is one of 12 regional Federal Home Loan Banks. Each FHLB serves as a reserve or central bank for its members within its assigned region. As a member, the Bank is required to purchase and maintain stock in the FHLB in an amount equal to 0.10% of its asset value plus an additional 4% of its outstanding advances from the FHLB and mortgage partnership finance loans sold to the FHLB. At December 31, 2018, the Bank held $6,160,000 in stock of the FHLB compared to $5,606,000 as of December 31, 2017.

The FHLB repurchases excess capital stock on a quarterly basis and pays a quarterly dividend on stock held by the Corporation. The FHLB's quarterly dividend yield was 6.75% annualized on activity stock and 3.50% annualized on membership stock as of December 31, 2018. Most of the Corporation's dividend is based on the activity stock, which is based on the amount of borrowings and mortgage activity with FHLB. The Corporation will continue to monitor the financial condition of the FHLB quarterly to assess its ability to continue to regularly repurchase excess capital stock and pay a quarterly dividend.

The Corporation also owned $151,000 of Federal Reserve Bank stock and $37,000 of Atlantic Community Bancshares, Inc. stock, the Bank Holding Company of ACBB, as of December 31, 2018 and December 31, 2017.

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NOTE F – DEPOSITS

(DOLLARS IN THOUSANDS)

Deposits by major classifications are summarized as follows:

	December 31,	
	2018	2017
	$	$
Non-interest bearing demand	369,081	314,917
Interest-bearing demand	20,104	20,230
NOW accounts	89,072	86,758
Money market deposit accounts	108,594	105,994
Savings accounts	199,665	189,169
Time deposits under $250,000	127,300	143,073
Time deposits of $250,000 or more	5,918	6,336
Total deposits	919,734	866,477

At December 31, 2018, the scheduled maturities of time deposits are as follows:

2019	57,063
2020	31,771
2021	23,646
2022	11,234
2023	9,504
Total	133,218

NOTE G – SHORT TERM BORROWINGS

(DOLLARS IN THOUSANDS)

Short-term borrowings consist of Federal funds purchased that mature one business day from the transaction date, overnight borrowings from the Federal Reserve Discount Window, and FHLB advances with a term of less than one year.

A summary of short-term borrowings is as follows for the years ended December 31, 2018 and 2017:

	2018 $	2017 $
Total short-term borrowings outstanding at year end	7,870	—
Average interest rate at year end	2.60%	—
Maximum outstanding at any month end	17,322	28,674
Average amount outstanding for the year	5,332	7,331
Weighted-average interest rate for the year	1.88%	0.75%

As of December 31, 2018, the Corporation had approved unsecured Federal funds lines of $32 million. The Corporation also has the ability to borrow through the FRB Discount Window. The amount of borrowing available through the Discount Window was $25.8 million as of December 31, 2018. For further information on borrowings from the FHLB see Note H.

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NOTE H – OTHER BORROWED FUNDS

(DOLLARS IN THOUSANDS)

Maturities of other borrowings at December 31, 2018, and 2017, are summarized as follows:

	December 31, 2018		2017	
	Amount $	Weighted-Average Rate %	Amount $	Weighted-Average Rate %
FHLB fixed rate loans				
2018	—	—	14,625	1.25
2019	12,237	1.53	12,237	1.53
2020	16,340	1.85	10,677	1.59
2021	14,505	1.72	14,505	1.72
2022	15,804	1.84	13,806	1.72
2023	6,500	2.93	—	—
Total other borrowings	65,386	1.87	65,850	1.56

All of the Corporation's long term borrowed funds were through the FHLB of Pittsburgh as of December 31, 2018 and 2017. As a member of the FHLB of Pittsburgh, the Corporation has access to significant credit facilities. Borrowings from FHLB are secured with a blanket security agreement and the required investment in FHLB member bank stock. As part of the security agreement, the Corporation maintains unencumbered qualifying assets (principally 1-4 family residential mortgage loans) in an amount at least as much as the advances from the FHLB. Additionally, all of the Corporation's FHLB stock is pledged to secure these advances.

The Corporation had an FHLB maximum borrowing capacity of $399.9 million as of December 31, 2018, with remaining borrowing capacity of $334.5 million. The borrowing arrangement with the FHLB is subject to annual renewal. The maximum borrowing capacity is recalculated quarterly.

NOTE I – CAPITAL TRANSACTIONS

Subsequent to December 31, 2018, but prior to the filing of this Form 10-K Report, on February 21, 2019, the Corporation announced a new stock repurchase program to repurchase, in open market and privately negotiated transactions, up to 100,000 shares of the Corportation's outstanding common stock. Prior to February 21, 2019, the Corporation was repurchasing shares of common stock under a previous stock repurchase program announced on June 17, 2015, authorizing the repurchase of up to 140,000 shares of the Corporation's outstanding common stock in open market and privately negotiated transactions. Under the 2015 plan, through February 20, 2019, management repurchased a total of 64,935 shares at a weighted average cost per share of $34.24. As of December 31, 2018, a total of 55,535 shares were repurchased under the 2015 plan at a weighted average cost of $34.10 per share. Shares repurchased under both plans were held as treasury shares to be utilized in connection with the Corporation's three stock purchase plans.

Currently, the following three stock purchase plans are in place:

- a nondiscriminatory employee stock purchase plan (ESPP), which allows employees to purchase shares at a 10% discount from the stock's fair market value at the end of each quarter,
- a dividend reinvestment plan (DRP), and;
- a directors' stock purchase plan (DSPP).

The ESPP was started in 2001 and is the largest of the three plans. There were 8,269 shares issued through the ESPP in 2018 with 108,921 shares issued since existence. The DRP was started in 2005 and has grown to nearly as large as the ESPP with 6,327 shares issued in 2018 and 97,764 total shares issued since existence. Lastly, the DSPP was started in 2010 as an additional option for board compensation. This plan is limited to outside directors. Only 1,013 shares were issued in connection with this plan in 2018 and 17,249 since existence. In 2017, there were 8,162 shares issued through the ESPP, 6,368 shares issued through the DRP, and 1,411 shares issued through the DSPP.

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The plans are beneficial to the Corporation as all reissued shares increase capital and since dividends are paid out in the form of additional shares, the plans act as a source of funds. The total amount of shares issued from Treasury for these plans collectively in 2018 and 2017 was 15,609 and 15,941, respectively. As of December 31, 2018, the Corporation held 17,025 treasury shares, at a weighted-average cost of $35.04 per share, with a cost basis of $596,000.

NOTE J – RETIREMENT PLANS

The Corporation provides an optional 401(k) plan, in which employees may elect to defer pre-tax or after-tax salary dollars, subject to the maximum annual Internal Revenue Service contribution amounts. The contribution maximum for 2018 was $18,500 and for 2017 was $18,000, for persons under age 50, and for persons over age 50 was $24,500 in 2018 and $24,000 in 2017. The Corporation matches employee contributions into the 401(k) plan at a rate of 50% on the first 5.0% of employee contributions. The Corporation's cost for this 401(k) match was $345,000 and $316,000 for 2018 and 2017, respectively.

Effective January 1, 2016, the Corporation consolidated its Money Purchase Pension Plan and 401(k) Savings Plan. In the process of the consolidation the Money Purchase Pension feature was discontinued and replaced with a Non-Elective Safe Harbor feature and a Non-Elective Employer Contribution feature. Under the new plan, the Corporation provides a Non-Elective Safe Harbor Contribution equal to 3% of all employees' compensation for the year. Additionally, the Corporation has chosen to contribute a Non-Elective Employer Contribution of 2% annually to all employees aged 21 or older who work 1,000 or greater hours in a calendar year and have met the eligibility requirements of the plan. In year 2015, the Corporation provided 5% of all employee compensation in the Money Purchase Pension Plan for qualifying employees. The qualification for the Non-Elective Employer Contribution under the new 401(k) Savings Plan mirrors the requirements of the Money Purchase Pension Plan. Effective January 1, 2016, the balance of the Money Purchase Pension Plan was transferred into the new 401(k) Savings Plan.

For purposes of the new 401(k) Savings Plan and the former Money Purchase Pension Plan, covered compensation was limited to $275,000 in 2018 and $270,000 in 2017. Total expenses of the plan were $620,000 and $704,000, for 2018 and 2017, respectively. The Corporation's new 401(k) Savings Plan is fully funded as all obligations are funded monthly.

Employees who have met the eligibility requirements of the new plan have the potential to receive employer contributions of 7.5% of their compensation. Employees that contributed at least 5% of their compensation into the new 401(k) Savings Plan will continue to receive an employer matching contribution of 2.5% of their compensation.

Employees who met the eligibility requirements under the new 401(k) Savings Plan will receive a Non-Elective Safe Harbor Contribution of 3% of their compensation and may receive a Non-Elective Employer Contribution of 2% of their compensation.

NOTE K - DEFERRED COMPENSATION

Prior to 1999, directors of the Corporation had the ability to defer their directors' fees into a directors' deferred compensation plan. Directors electing to defer their compensation signed a contract that allowed the Corporation to take out a life insurance policy on the director designed to fund the future deferred compensation obligation, which is paid out over a ten-year period at retirement age. A contract and life insurance policy was taken out for each period of pay deferred. The amount of deferred compensation to be paid to each director was actuarially determined based on the amount of life insurance the annual directors' fees were able to purchase. This amount varies for each director depending on age, general health, and the number of years until the director is entitled to begin receiving payments. The Corporation is the owner and beneficiary of all life insurance policies on the directors.

At the time the directors' pay was deferred, the Corporation used the amount of the annual directors' fees to pay the premiums on the life insurance policies. The Corporation could continue to pay premiums after the deferment period, or could allow the policies to fund annual premiums through loans against the policy's cash surrender value. The Corporation has continued to pay the premiums on the life insurance policies and no loans exist on the policies.

The life insurance policies had an aggregate face amount of $3,409,000 for December 31, 2018, and December 31, 2017. The death benefits totaled $6,691,000 at December 31, 2018, and $6,680,000 at December 31, 2017. The cash surrender value of the above policies totaled $4,873,000 and $4,775,000 as of December 31, 2018, and 2017, respectively. The net present value of the vested portion of deferred payments totaled $0 at December 31, 2018, and $130,000 at December 31, 2017. The interest rate used to discount these obligations was 4.50% for 2018 and 2017.

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These net present value amounts are included in other liabilities on the Corporation's Consolidated Balance Sheets. Total charges to expense for deferred compensation amounted to $2,000 for 2018, and $9,000 for 2017, and are included in other operating expenses in the Consolidated Statements of Income.

NOTE L - INCOME TAXES

Federal income tax expense as reported differs from the amount computed by applying the statutory Federal income tax rate to income before taxes. A reconciliation of the differences by amount and percent is as follows:

FEDERAL INCOME TAX SUMMARY

(DOLLARS IN THOUSANDS)	Year Ended December 31,			
	2018		2017	
	$	%	$	%
Income tax at statutory rate	2,322	21.0	2,952	34.0
Tax-exempt interest income	(743)	(6.7)	(1,620)	(18.7)
Non-deductible interest expense	47	0.4	72	0.8
Bank-owned life insurance	(344)	(3.1)	(234)	(2.7)
Other	24	0.2	37	0.4
Change in corporate tax rate	—	—	1,131	13.1
Income tax expense	1,306	11.8	2,338	26.9

The ability to realize the benefit of deferred tax assets is dependent upon a number of factors, including the generation of future taxable income, the ability to carry back losses to recover taxes paid in previous years, the ability to offset capital losses with capital gains, the reversal of deferred tax liabilities, and certain tax planning strategies.

As a result of The Tax Cuts and Jobs Act, enacted on December 22, 2017, the Corporate Alternative Minimum Tax (AMT) has been repealed. Therefore, all AMT tax credits previously carried forward have now been transferred to Federal income tax receivable to utilize against any corporate Federal income tax amounts payable. As of December 31, 2017, the Corporation had $1,158,000 of AMT credits that could be carried forward. The AMT credits previously had an unlimited carry-forward period. No valuation was established for these deferred tax assets in view of the Corporation's ability to carry forward tax credits to future years, coupled with the anticipated future taxable income as evidenced by the Corporation's earnings potential. Additionally, this asset's value was not impacted by the change in the Corporate tax rate described below. The Corporation is expected to fully realize the $1,158,000 of AMT credits in the 2018 and 2019 tax years.

U.S. generally accepted accounting principles prescribe a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority that would have full knowledge of all relevant information. A tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be derecognized in the first subsequent financial reporting period in which that threshold is no longer met.

There is currently no liability for uncertain tax positions and no known unrecognized tax benefits. The Corporation recognizes, when applicable, interest and penalties related to unrecognized tax benefits in the provision for income taxes in the Consolidated Statements of Income. With few exceptions, the Corporation is no longer subject to U.S. federal, state, or local income tax examinations by tax authorities for years before 2015.

The Tax Cuts and Jobs Act, enacted on December 22, 2017, lowered the Corporation’s federal income tax rate from 34% to 21% effective January 1, 2018. As a result, the carrying value of net deferred tax assets was reduced which increased income tax expense by $1,131,000 in 2017.

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Significant components of income tax expense are as follows:

(DOLLARS IN THOUSANDS)	Year Ended December 31, 2018	2017
	$	$
Current tax expense	(46)	842
Deferred tax expense (benefit)	1,352	365
Change in corporate tax rate	—	1,131
Income tax expense	1,306	2,338

Components of the Corporation's net deferred tax position are as follows:

(DOLLARS IN THOUSANDS)	December 31, 2018	2017
	$	$
Deferred tax assets		
Allowance for loan losses	1,820	2,802
Net unrealized holding losses on securities available for sale	1,523	1,016
Deferred compensation reserve	—	44
Tax credit carryforward	—	1,158
Allowance for off-balance sheet extensions of credit	70	108
Interest on non-accrual loans	7	174
Other	53	11
Total deferred tax assets	3,473	5,313
Deferred tax liabilities		
Premises and equipment	(1,006)	(2,670)
Discount on investment securities	(2)	—
Other	(198)	(161)
Total deferred tax liabilities	(1,206)	(2,831)
Net deferred tax assets	2,267	2,482

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NOTE M – REGULATORY MATTERS AND RESTRICTIONS

The Corporation and the Bank are subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation's consolidated financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Corporation and the Bank 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. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. The quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth below) of tier I capital to average assets, and common equity tier I capital, tier I capital, and total capital to risk-weighted assets.

As of December 31, 2018 and 2017, the Corporation and Bank were categorized as "well capitalized" under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category. The following chart details the Corporation's and the Bank's capital levels as of December 31, 2018 and December 31, 2017, compared to regulatory levels.

CAPITAL LEVELS (DOLLARS IN THOUSANDS)	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	$	%	$	%	$	%
As of December 31, 2018						
Total Capital to Risk-Weighted Assets						
Consolidated	117,479	14.3	73,947	8.0	82,163	10.0
Bank.	115,988	14.1	65,680	8.0	82,100	10.0
Tier I Capital to Risk-Weighted Assets						

Consolidated	108,480	13.2	49,298	6.0	73,947	8.0
Bank	106,989	13.0	49,260	6.0	65,680	8.0
Common Equity Tier I Capital to Risk-Weighted Assets						
Consolidated.	108,480	13.2	36,973	4.5	53,406	6.5
Bank	106,989	13.0	36,945	4.5	53,365	6.5
Tier I Capital to Average Assets						
Consolidated	108,480	10.0	43,519	4.0	54,398	5.0
Bank	106,989	9.8	43,519	4.0	54,398	5.0
As of December 31, 2017						
Total Capital to Risk-Weighted Assets						
Consolidated	111,512	15.0	59,525	8.0	74,406	10.0
Bank	109,961	14.8	59,502	8.0	74,378	10.0
Tier I Capital to Risk-Weighted Assets						
Consolidated	102,955	13.8	44,644	6.0	59,525	8.0
Bank	101,404	13.6	44,627	6.0	59,502	8.0
Common Equity Tier I Capital to Risk-Weighted Assets						
Consolidated	102,955	13.8	33,483	4.5	48,364	6.5
Bank	101,404	13.6	33,470	4.5	48,346	6.5
Tier I Capital to Average Assets						
Consolidated	102,955	10.1	40,971	4.0	51,214	5.0
Bank	101,404	9.9	40,971	4.0	51,214	5.0

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In addition to the capital guidelines, certain laws restrict the amount of dividends paid to stockholders in any given year. The approval of the OCC shall be required if the total of all dividends declared by the Corporation in any year shall exceed the total of its net profits for that year combined with retained net profits of the preceding two years. Under this restriction, the Corporation could declare dividends in 2018, without the approval of the OCC, of approximately $9.8 million, plus an additional amount equal to the Corporation's net profits for 2019, up to the date of any such dividend declaration.

NOTE N – TRANSACTIONS WITH DIRECTORS AND OFFICERS

The following table presents activity in the amounts due from directors, executive officers, immediate family, and affiliated companies. These transactions are made on the same terms and conditions, including interest rates and collateral requirements as those prevailing at the time for comparable transactions with others. An analysis of the activity with respect to such aggregate loans to related parties is shown below.

LOANS TO INSIDERS

(DOLLARS IN THOUSANDS)

	Actual $
Balance, January 1, 2017	4,453
Advances	3,358
Repayments	(2,142)
Balance, December 31, 2017	5,669
Balance, January 1, 2018	5,669
Advances	2,935
Repayments	(3,435)
Balance, December 31, 2018	5,169

Deposits from the insiders totaled $3,102,000 as of December 31, 2018, and $4,034,000 as of December 31, 2017.

NOTE O - COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Corporation makes various commitments that are not reflected in the accompanying consolidated financial statements. These are commonly referred to as off-balance sheet commitments and include firm commitments to extend credit, unused lines of credit, and open letters of credit. On December 31, 2018, firm loan commitments totaled approximately $40.0 million; unused lines of credit totaled $235.3 million; and open letters of credit totaled $8.7 million. The sum of these commitments, $284.0 million, represents total exposure to credit loss in the event of nonperformance by customers with respect to these financial instruments; however the vast majority of these commitments are typically not drawn upon. The same credit policies for on-balance sheet instruments apply for making commitments and conditional obligations and the actual credit losses that could arise from the exercise of these commitments is expected to compare favorably with the loan loss experience on the loan portfolio taken as a whole. Commitments to extend credit on December 31, 2017, totaled $270.5 million, representing firm loan commitments of $45.0 million, unused lines of credit of $214.2 million, and open letters of credit totaling $11.3 million.

Firm commitments to extend credit and unused lines of credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Each customer’s creditworthiness is evaluated on an individual basis. The amount of collateral obtained, if deemed necessary by the extension of credit, is based on management’s credit evaluation of the customer. These commitments are supported by various types of collateral, where it is determined that collateral is required.

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Open letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. Most guarantees expire within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. While various assets of the customer act as collateral for these letters of credit, real estate is the primary collateral held for these potential obligations.

NOTE P - FINANCIAL INSTRUMENTS WITH CONCENTRATIONS OF CREDIT RISK

The Corporation determines concentrations of credit risk by reviewing loans by borrower, geographical area, and loan purpose. The amount of credit extended to a single borrower or group of borrowers is capped by the legal lending limit, which is defined as 15% of the Bank's risk-based capital, less the allowance for loan losses. The Corporation's lending policy further restricts the amount to 75% of the legal lending limit. As of December 31, 2018, the Corporation's legal lending limit was $17,398,000, and the Corporation's lending policy limit was $13,049,000. This compared to a legal lending limit of $16,494,000, and lending policy limit of $12,371,000 as of December 31, 2017. As of December 31, 2018 and 2017, no lending relationships exceeded the Corporation's internal lending policy limit.

Geographically, the primary lending area for the Corporation encompasses Lancaster, Lebanon, and Berks counties of Pennsylvania, with the vast majority of the loans made in Lancaster County. The ability of debtors to honor their loan agreements is impacted by the health of the local economy. The Corporation's immediate market area benefits from a diverse economy, which has resulted in a diverse loan portfolio. As a community bank, the largest amount of loans outstanding consists of personal mortgages, residential rental loans, and personal loans secured by real estate. Beyond personal lending, the Corporation's business and commercial lending includes loans for agricultural, construction, specialized manufacturing, service industries, many types of small businesses, and loans to governmental units and non-profit entities.

Management evaluates concentrations of credit based on loan purpose on a quarterly basis. The Corporation's greatest concentration of loans by purpose is residential real estate, which comprises $293.7 million, or 42.4%, of the $692.5 million gross loans outstanding as of December 31, 2018. This compares to $249.3 million, or 41.8%, of the $596.3 million of gross loans outstanding as of December 31, 2017. Residential real estate consists of first mortgages and home equity loans. A concentration in commercial real estate of 41.2%, or $285.4 million, also exists; however, within that category there is not a concentration by specific industry type.

The Corporation remains focused on agricultural purpose loans, of which the vast majority are real estate secured. Agricultural mortgages made up 24.0% of gross loans as of December 31, 2018, compared to 25.5% as of December 31, 2017; however these agricultural mortgages are spread over several broader types of agricultural purpose loans. More specifically within these larger purpose categories, management monitors on a quarterly basis the largest concentrations of non-consumer credit based on the North American Industrial Classification System (NAICS). As of December 31, 2018, the largest specific industry type categories were dairy cattle and milk production loans of $85.5 million, or 12.3% of gross loans, residential real estate investment loans of $53.2 million, or 7.7% of gross loans, and non-residential real estate investment loans with a balance of $42.1 million, or 6.1% of gross loans.

Outside of consumer and commercial real estate, including agricultural mortgages, the third largest component of the Corporation's loans consist of commercial and industrial loans. These loans are generally secured by personal guarantees, inventory, or pledges of municipalities. Out of the $104.1 million of loans designated as commercial and industrial for the Uniform Bank Performance Reports, the largest concentration within that area is $22.6 million of loans to political subdivisions, which account for 3.3% of gross loans outstanding. For the Corporation, these loans consisted of tax-free loans to local municipalities.

To evaluate risk for the securities portfolio, the Corporation reviews both geographical concentration and credit ratings. The largest geographical concentrations as of December 31, 2018, were obligations of states and political subdivisions located in the states of Pennsylvania, Illinois, and Texas. Based on fair market value, the Corporation held $24.2 million of obligations issued by municipalities within the state of Pennsylvania, which is 25.6% of the municipal portfolio, and 8.2% of total debt securities. The Corporation held $18.5 million of obligations issued by municipalities within the state of Illinois, which is 19.5% of the municipal portfolio, and 6.3% of total debt securities. The Corporation also held $17.0 million of obligations of states and political subdivisions issued by municipalities located within the state of Texas, which is 17.9% of the municipal portfolio, and 5.8% of total debt

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securities. Internal policy requires municipal bonds purchased to be rated at least A3 by Moody's and/or A- by Standard & Poor's (S&P) at the time of purchase. As of December 31, 2018, no municipal bonds were below the A3/A- credit ratings the Corporation requires at the time of purchase.

The Corporation held $61.1 million of corporate bonds based on amortized cost as of December 31, 2018. As a total, the $61.1 million represents 20.0% of the Corporation's total debt securities. Management has a policy limit for corporate holdings at 55% of total regulatory capital and 20% of the securities portfolio. The Corporation was under the capital policy limit but at the portoflio policy limit as of December 31, 2018. Management believes shorter corporate bonds currently provide better structure and return than government agencies and mortgage backed securities and CMOs. To limit the Corporation's credit exposure to any one issuer, the policy limits investment to $3 million of par value per company. Out of the $61.1 million of total corporate securities, $40.0 million is domestic and $21.1 million is foreign-issued debt. None of the Corporation's foreign corporate debt originates from the European countries that have struggled with the sovereign debt crisis, namely Portugal, Italy, Ireland, Greece, and Spain. Most of the Corporation's foreign-issued debt is from the United Kingdom, Australia, and Switzerland.

Within the corporate bond segment of the portfolio, management has preferred to invest in the banking, brokerage, and finance industry, where management is more comfortable analyzing and evaluating the credit risk of these firms. As a result, based on amortized cost, $43.2 million, or 70.7%, of the corporate bonds held are invested in national or foreign banks, bank holding companies, brokerage firms, or finance companies. In this broader finance-related group, management has selectively pursued foreign bank-issued debt where there is governmental ownership of the bank, and/or implied backing driven by the heavy reliance on these banks for the nation's financial system. Out of the total $43.2 million of financial and brokerage-related corporate issues, $22.0 million is domestic and $21.2 million is foreign. All of the $21.2 million of foreign financial-related corporate paper is in the form of foreign bank-issued debt. Out of the $22.0 million of domestic financial-related debt, $13.1 million is in bank debt and $8.9 million is in brokerage.

The remaining $17.9 million of non-financial related corporate paper consists of $5.1 million in energy companies, $4.1 million in insurance companies, $2.5 million in consumer goods, $2.1 million in real estate companies, $2.1 million in healthcare, and $2.0 million in biotechnology.

By internal policy, at time of purchase, all corporate bonds must carry a credit rating of at least A3 by Moody's or A- by S&P, and at all times corporate bonds are to be investment grade, which is defined as Baa3 for Moody's and BBB- for S&P, or above. As of December 31, 2018, all of the Corporation's corporate bonds carried at least one single A credit rating of A3 by Moody's or A- by S&P, and all were considered investment grade.

NOTE Q - FAIR VALUE MEASUREMENTS

U.S. generally accepted accounting principles establish a hierarchal disclosure framework associated with the level of observable pricing utilized in measuring assets and liabilities at fair value. The three broad levels defined by the hierarchy are as follows:

Level I:	Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
Level II:	Pricing inputs are other than the quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these assets and liabilities includes items for which quoted prices are available but traded less frequently and items that are fair-valued using other financial instruments, the parameters of which can be directly observed.
Level III:	Assets and liabilities that have little to no observable pricing as of the reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgement or estimation.

This hierarchy requires the use of observable market data when available.

The following tables provide the fair market value for assets required to be measured and reported at fair value on a recurring basis on the Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017, by level within the fair value hierarchy. As required by U.S. generally accepted accounting principles, financial assets and

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liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

ASSETS REPORTED AT FAIR VALUE ON A RECURRING BASIS

(DOLLARS IN THOUSANDS)

	December 31, 2018			
	Level I	Level II	Level III	Total
	$	$	$	$
U.S. government agencies	—	30,120	—	30,120
U.S. agency mortgage-backed securities	—	44,639	—	44,639
U. S. agency collateralized mortgage obligations	—	54,090	—	54,090
Asset-backed securities	—	11,399	—	11,399
Corporate bonds	—	59,192	—	59,192
Obligations of states and political subdivisions	—	94,625	—	94,625
Marketable equity securities	5,934	—	—	5,934
Total securities	5,934	294,065	—	299,999

On December 31, 2018, the Corporation held no securities valued using level III inputs. All of the Corporation’s debt instruments were valued using level II inputs, where quoted prices are available and observable but not necessarily quotes on identical securities traded in active markets on a daily basis. The Corporation’s CRA fund investments and bank stocks are fair valued utilizing level I inputs because the funds have their own quoted prices in an active market. As of December 31, 2018, the CRA fund investments had a $5,410,000 book and market value and the bank stocks had a book value of $591,000 and a market value of $524,000.

Financial instruments are considered level III when their values are determined using pricing models, discounted cash flow methodologies, or similar techniques, and at least one significant model assumption or input is unobservable. In addition to these unobservable inputs, the valuation models for level III financial instruments typically also rely on a number of inputs that are readily observable either directly or indirectly. Level III financial instruments also include those for which the determination of fair value requires significant management judgment or estimation.

ASSETS REPORTED AT FAIR VALUE ON A RECURRING BASIS

(DOLLARS IN THOUSANDS)

	December 31, 2017			
	Level I	Level II	Level III	Total
	$	$	$	$
U.S. government agencies	—	34,352	—	34,352
U.S. agency mortgage-backed securities	—	52,073	—	52,073
U. S. agency collateralized mortgage obligations	—	54,641	—	54,641
Corporate bonds	—	60,769	—	60,769
Obligations of states and political subdivisions	—	112,242	—	112,242
Marketable equity securities	5,584	—	—	5,584
Total securities	5,584	314,077	—	319,661

On December 31, 2017, the Corporation held no securities valued using level III inputs. All of the Corporation's debt instruments were valued using level II inputs, where quoted prices are available and observable but not necessarily quotes on identical securities traded in active markets on a daily basis. The Corporation's CRA fund investments and bank stocks are fair valued utilizing level I inputs because the funds have their own quoted prices in an active market. As of December 31, 2017, the CRA fund investments had a $5,280,000 book and market value and the bank stocks had a book value of $267,000 and a market value of $303,000.

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The following table provides the fair value for each class of assets required to be measured and reported at fair value on a nonrecurring basis on the Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017, by level within the fair value hierarchy:

ASSETS MEASURED ON A NONRECURRING BASIS

(DOLLARS IN THOUSANDS)

	December 31, 2018			
	Level I	Level II	Level III	Total
	$	$	$	$
Assets:				
Impaired Loans	—	—	2,577	2,577
Total	—	—	2,577	2,577

	December 31, 2017			
	Level I	Level II	Level III	Total
	$	$	$	$
Assets:				
Impaired Loans	—	—	1,812	1,812
Total	—	—	1,812	1,812

The Corporation had a total of $2,709,000 of impaired loans as of December 31, 2018, with $132,000 of specific allocation against these loans. As of December 31, 2017, the Corporation had a total of $1,812,000 of impaired loans with no specific allocation against these loans. The value of impaired loans is generally determined through independent appraisals of the underlying collateral.

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The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis for which the Corporation has utilized level III inputs to determine fair value:

QUANTITATIVE INFORMATION ABOUT LEVEL III FAIR VALUE MEASUREMENTS

(DOLLARS IN THOUSANDS)

	December 31, 2018			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Avg)
Impaired loans	2,577	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -20% (-20%)
			Liquidation expenses (2)	0% to -10% (-10%)

	December 31, 2017			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Avg)
Impaired loans	1,812	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -20% (-20%)
			Liquidation expenses (2)	0% to -10% (-10%)

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

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

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NOTE R - DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The following tables provide the carrying amount for each class of assets and liabilities and the fair value for certain financial instruments that are not required to be measured or reported at fair value on the Corporation's Consolidated Balance Sheets as of December 31, 2018 and December 31, 2017:

FINANCIAL INSTRUMENTS NOT REQUIRED TO BE MEASURED OR REPORTED AT FAIR VALUE

(DOLLARS IN THOUSANDS)

	December 31, 2018				
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
	$	$	$	$	$
Financial Assets:					
Cash and Cash equivalents	41,365	41,365	41,365	—	—
Regulatory Stock	6,348	6,348	6,348	—	—
Loans held for sale	1,429	1,429	1,429	—	—
Loans, net of allowance	685,407	687,844	—	—	687,844
Mortgage servicing assets	905	997	—	—	997
Accrued interest recievable	3,754	3,754	3,754	—	—
Bank owned life insurance	28,085	28,085	28,085	—	—
Financial Liabilities:					
Demand deposits	369,081	369,081	369,081	—	—
Interest-bearing demand deposits	20,104	20,104	20,104	—	—
NOW accounts	89,072	89,072	89,072	—	—
Money market deposit accounts	108,594	108,594	108,594	—	—
Savings accounts	199,665	199,665	199,665	—	—
Time deposits	133,218	132,351	—	—	132,351
Total deposits	919,734	918,867	786,516	—	132,351

Short-term borrowings	7,870	7,870	7,870	—	—
Long-term debt	65,386	65,286	—	—	65,286
Accrued interest payable	397	397	397	—	—

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FINANCIAL INSTRUMENTS NOT REQUIRED TO BE MEASURED OR REPORTED AT FAIR VALUE

(DOLLARS IN THOUSANDS)

	December 31, 2017				
	Carrying Amount	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
	$	$	$	$	$
Financial Assets:					
Cash and cash equivalents	53,073	53,073	53,073	—	—
Regulatory stock	5,794	5,794	5,794	—	—
Loans held for sale	2,892	2,892	2,892	—	—
Loans, net of allowance	589,313	590,415	—	—	590,415
Mortgage servicing assets	661	751	—	—	751
Accrued interest receivable	3,684	3,684	3,684	—	—
Bank owned life insurance	27,814	27,814	27,814	—	—
Financial Liabilities:					
Demand deposits	314,917	314,917	314,917	—	—
Interest-bearing demand deposits	20,230	20,230	20,230	—	—
NOW accounts	86,758	86,758	86,758	—	—
Money market deposit accounts	105,994	105,994	105,994	—	—
Savings accounts	189,169	189,169	189,169	—	—
Time deposits	149,409	150,165	—	—	150,165
Total deposits	866,477	867,233	717,068	—	150,165
Long-term debt	65,850	65,850	—	—	65,850
Accrued interest payable	385	385	385	—	—

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NOTE S – ACCUMULATED OTHER COMPREHENSIVE LOSS

The activity in accumulated other comprehensive loss for the years ended December 31, 2018 and 2017 is as follows:

ACCUMULATED OTHER COMPRENHENSIVE LOSS (1) (2)

(DOLLARS IN THOUSANDS)

	Unrealized Gains(Losses) on Securities Available-for-Sale
	$
Balance at January 1, 2018	(3,195)
Other comprehensive loss before reclassifications	(2,075)
Amount reclassified from accumulated other comprehensive loss	226
Reclassification of certain income tax effects from accumulated other comprehensive income (loss)	(634)
Period change	(2,483)
Balance at December 31, 2018	(5,678)
Balance at January 1, 2017	(4,885)
Other comprehensive income before reclassification	2,135
Amount reclassified from accumulated other comprehensive loss	(445)
Period change	1,690
Balance at December 31,2017	(3,195)

(1) All amounts are net of tax. Related income tax expense or benefits is calculated using a Federal income tax rate of 21%.

(2) Amounts in parentheses indicate debits.

DETAILS ABOUT ACCUMULATED OTHER COMPREHENSIVE LOSS COMPONENTS (1)

(DOLLARS IN THOUSANDS)

	Amount Reclassified from Accumulated Other Comprehensive (Loss) For the Year Ended December 31,		
	2018 $	2017 $	Affected Line Item in the Consolidated Statements of Income
Securities available-for sale:			
Net securities (losses) gains reclassified into earnings	(286)	675	Gains (loses) on securities transactions, net
Related income tax expense	60	(230)	Provision for federal income taxes
Net effect on accumulated other comprehensive loss for the period	(226)	445	
Total reclassifications for the period	(226)	445	

(1) Amounts in parentheses indicate debits.

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NOTE T – CONDENSED PARENT ONLY DATA

Condensed Balance Sheets (Parent Company Only)

(DOLLARS IN THOUSANDS)	December 31,	
	2018	2017
	$	$
Assets		
Cash	861	1,187
Equity securities	524	304
Equity in bank subsidiary	101,311	98,184
Other assets	106	84
Total assets	102,802	99,759
Stockholders' Equity		
Common stock	574	574
Capital surplus	4,435	4,415
Retained earnings	104,067	98,629
Accumulated other comprehensive loss, net of tax	(5,678)	(3,195)
Treasury stock	(596)	(664)
Total stockholders' equity	102,802	99,759

Condensed Statements of Comprehensive Income

(DOLLARS IN THOUSANDS)	Year Ended December 31,	
	2018	2017
	$	$
Income		
Dividend income - investment securities	13	10
Gains (losses) on securities transactions	(5)	57
Dividend income	3,282	3,190
Undistributed earnings of bank subsidiary	6,614	3,228
Total income	9,904	6,485
Expense		
Shareholder expenses	132	120
Other expenses	23	21
Total expense	155	141

Net Income	9,749	6,344
Comprehensive Income	7,900	8,034

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Condensed Statements of Cash Flows

(DOLLARS IN THOUSANDS)

	Year Ended December 31,	
	2018	2017
Cash Flows from Operating Activities:	$	$
Net Income	9,749	6,344
Equity in undistributed earnings of subsidiaries	(6,614)	(3,228)
Gains on securities transactions, net	5	(57)
Net change in other assets	(1)	(30)
Net cash provided by operating activities	3,139	3,029
Cash Flows from Investing Activities:		
Proceeds from sales of equity securities	277	150
Purchases of equity securities	(548)	(134)
Net cash provided by (used for) investing activities	(271)	16
Cash Flows from Financing Activities:		
Proceeds from issuance of treasury stock	551	544
Payment to repurchase common stock	(463)	(568)
Dividends paid	(3,282)	(3,190)
Net cash used for financing activities	(3,194)	(3,214)
Cash and Cash Equivalents:		
Net change in cash and cash equivalents	(326)	(169)
Cash and cash equivalents at beginning of period	1,187	1,356
Cash and cash equivalents at end of period	861	1,187

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Notes to Consolidated Financial Statements

The unaudited quarterly results of operations for the years ended 2018 and 2017, are as follows:

NOTE U - SUMMARY OF QUARTERLY FINANCIAL DATA (UNAUDITED)

(DOLLARS IN THOUSANDS, EXCEPT PER SHARE DATA)

	2018			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
	$	$	$	$
Interest income	8,524	8,897	9,348	9,729
Interest expense	774	842	872	886
Net interest income	7,750	8,055	8,476	8,843
Less provision for loan losses	190	90	190	190
Net interest income after provision for loan losses	7,560	7,965	8,286	8,653
Other income	3,380	2,628	2,787	2,242
Operating expenses:				
Salaries and employee benefits	4,960	5,221	5,197	4,862
Occupancy and equipment expenses	951	893	920	840
Other operating expenses	1,973	2,053	1,954	2,622
Total operating expenses	7,884	8,167	8,071	8,324
Income before income taxes	3,056	2,426	3,002	2,571
Provision for Federal income taxes	235	300	425	346
Net income	2,821	2,126	2,577	2,225
FINANCIAL RATIOS				
Per share data:				
Net income	0.99	0.74	0.90	0.78
Cash dividends paid	0.28	0.29	0.29	0.29

	2017			
	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
	$	$	$	$
Interest income	7,982	8,213	8,444	8,478

Interest expense	702	731	754	752
Net interest income	7,280	7,482	7,690	7,726
Less provision for loan losses	90	120	240	490
Net interest income after provision for loan losses	7,190	7,362	7,450	7,236
Other income	2,412	2,512	2,622	2,775
Operating expenses:				
Salaries and employee benefits	4,719	4,811	4,840	4,970
Occupancy and equipment expenses	881	902	923	873
Other operating expenses	1,918	2,002	1,884	2,154
Total operating expenses	7,518	7,715	7,647	7,997
Income before income taxes	2,084	2,159	2,425	2,014
Provision for Federal income taxes	257	287	391	1,403
Net income	1,827	1,872	2,034	611
FINANCIAL RATIOS				
Per share data:				
Net income	0.64	0.66	0.71	0.21
Cash dividends paid	0.28	0.28	0.28	0.28

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Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures.

Management carried out an evaluation, under the supervision and with the participation of the Chief Executive Officer and Treasurer (Principal Financial Officer), of the effectiveness of the design and the operation of the Corporation's disclosure controls and procedures (as such term as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2018, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer along with the Treasurer (Principal Financial Officer) concluded that the Corporation's disclosure controls and procedures as of December 31, 2018, are effective in timely alerting them to material information relating to the Corporation required to be in the Corporation's periodic filings under the Exchange Act.

(b) Changes in Internal Controls.

There have been no changes in the Corporation's internal controls over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Corporation's internal control over financial reporting.

(c) Report on Management's Assessment of Internal Control over Financial Reporting

The Corporation is responsible for the preparation, integrity, and fair presentation of the financial statements included in this annual report. The financial statements and notes included in this annual report have been prepared in conformity with United States generally accepted accounting principles and necessarily include some amounts that are based on management's best estimates and judgments.

Management of the Corporation is responsible for establishing and maintaining effective internal control over financial reporting that is designed to produce reliable financial statements in conformity with United States generally accepted accounting principles. The system of internal control over financial reporting as it relates to the financial statements is evaluated for effectiveness by management and tested for reliability through a program of internal audits. Actions are taken to correct potential deficiencies as they are identified. Any system of internal control, no matter how well designed, has inherent limitations, including the possibility that a control can be circumvented or overridden and misstatements due to error or fraud may occur and not be detected. Also, because of changes in conditions, internal control effectiveness may vary over time. Accordingly, even an effective system of internal control will provide only reasonable assurance with respect to financial statement preparation.

Management assessed the Corporation’s system of internal control over financial reporting as of December 31, 2018, in relation to criteria for effective internal control over financial reporting as described in "Internal Control - Integrated Framework," issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concludes that, as of December 31, 2018, its system of internal control over financial reporting is effective and meets the criteria of the "Internal Control – Integrated Framework.”

This annual report does not include an attestation report of the Corporation’s registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by the Corporation’s registered public accounting firm pursuant to a provision of the Dodd-Frank Act which eliminates such requirement for smaller reporting companies, as defined in SEC regulations.

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/s/ Aaron L. Groff, Jr.	/s/ Scott E. Lied
Aaron L. Groff, Jr.	Scott E. Lied
Chairman of the Board,	Treasurer
Chief Executive Officer and President	(Principal Financial Officer)

Ephrata, PA

March 29, 2019

Item 9B. Other Information

None

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Part III

Item 10. Directors, Executive Officers, and Corporate Governance

The information required by this Item, relating to directors, executive officers, and control persons is set forth under the captions, “Election of Directors,” “Information and Qualifications of Nominees for Director and Continuing Directors,” “Meetings and Committees of the Board of Directors – Audit Committee,” “Executive Officers,” “Audit Committee Report,” and “Section 16(a) Beneficial Ownership Reporting Compliance,” of the Corporation’s definitive Proxy Statement to be used in connection with the Annual Meeting of Shareholders, to be held on May 7, 2019, which is incorporated herein by reference.

The Corporation has adopted a Code of Ethics that applies to directors, officers, and employees of the Corporation and the Bank. The Code of Ethics is attached as Exhibit 14 to this Form 10-K.

There were no material changes to the procedures by which security holders may recommend nominees to the Corporation’s Board of Directors during the fourth quarter of 2018.

Item 11. Executive Compensation

The information required by this Item, relating to executive compensation, is set forth under the caption, “Summary Compensation Table” of the Corporation’s definitive Proxy Statement to be used in connection with the Annual Meeting of Shareholders, to be held on May 7, 2019, which is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item, related to beneficial ownership of the Corporation’s common stock, is set forth under the caption, “Share Ownership” of the Corporation’s definitive Proxy Statement to be used in connection with the Annual Meeting of Shareholders to be held on May 7, 2019, which is incorporated herein by reference.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item related to transactions with management and others, certain business relationships, and indebtedness of management, is set forth under the caption, “Transactions with Related Persons,” and “Governance of the Company” of the Corporation’s definitive Proxy Statement to be used in connection with the Annual Meeting of Shareholders to be held on May 7, 2019, which is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item related to fees and the audit committees’ pre-approved policies are set forth under the caption, “Audit Committee Report” of the Corporation’s definitive Proxy Statement to be used in connection with the Annual Meeting of Shareholders to be held on May 7, 2019, which is incorporated herein by reference.

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Part IV

Item 15. Exhibits and Financial Statement Schedules

(a) 1. Financial Statements.

The following financial statements are included by reference in Part II, Item 8 hereof:

- Report of Independent Registered Accounting Firm
- Consolidated Balance Sheets
- Consolidated Statements of Income
- Consolidated Statements of Comprehensive Income
- Consolidated Statements of Changes in Stockholders' Equity
- Consolidated Statements of Cash Flows
- Notes to Consolidated Financial Statements

2. The financial statement schedules required by this Item are omitted because the information is either inapplicable, not required, or is shown in the respective consolidated financial statements or the notes thereto.

3. The Exhibits filed herewith or incorporated by reference as a part of this Annual Report, are set forth in (b), below.

(b) EXHIBITS

3 (i) Articles of Incorporation of the Registrant, as amended. (Incorporated herein by reference to Exhibit 3(i) of the Corporation's Form 10-Q filed with the SEC on August 11, 2016.)

3 (ii) Bylaws of the Registrant, as amended. (Incorporated herein by reference to Exhibit 3.2 of the Corporation's Form 8-K filed with the SEC on January 15, 2010.)

10.1

Form of Deferred Income Agreement. (Incorporated herein by reference to Exhibit 10.1 of the Corporation's Form 10-Q, filed with the SEC on August 13, 2008.)

10.2 2011 Employee Stock Purchase Plan (incorporated herein by reference to Exhibit 10.2 of the Corporation's Annual Report on Form 10-K for the year ended December 31, 2011, filed with the SEC on March 29, 2012.)

10.3 2010 Non-Employee Directors' Stock Plan (Incorporated herein by reference to Exhibit 10 of the Corporation's Form S-8 filed with the SEC on June 4, 2010.)

14 Code of Ethics Policy of Registrant as amended March 11, 2009. (Incorporated herein by reference to Exhibit 14 of the Corporation's Form 10-K filed with the SEC on March 12, 2009.)

21 Subsidiaries of the Registrant

23 Consent of Independent Registered Public Accounting Firm

31.1 Section 302 Chief Executive Officer Certification (Required by Rule 13a-14(a)/15a-14(a)).

31.2 Section 302 Principal Financial Officer Certification (Required by Rule 13a-14(a)/15a-14(a)).

32.1 Section 1350 Chief Executive Officer Certification (Required by Rule 13a-14(b)).

32.2 Section 1350 Principal Financial Officer Certification (Required by Rule 13a-14(b)).

101 Interactive Data File

(c) NOT APPLICABLE.

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Item 16. Form 10-K Summary

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

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By: /s/ Aaron L. Groff, Jr.
Aaron L. Groff, Jr., Chairman of the Board,
Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Aaron L. Groff, Jr. (Aaron L. Groff, Jr.)	Chairman of the Board, Chief Executive Officer and President	March 29, 2019
/s/ Scott E. Lied (Scott E. Lied)	Treasurer (Principal Financial Officer)	March 29, 2019
/s/ Joshua E. Hoffman (Joshua E. Hoffman)	Director	March 29, 2019
/s/ Willis R. Lefever (Willis R. Lefever)	Director	March 29, 2019
/s/ Donald Z. Musser (Donald Z. Musser)	Director	March 29, 2019

/s/ Susan Young Nicholas (Susan Young Nicholas)	Director	March 29, 2019
/s/ Dr. Brian K. Reed (Dr. Brian K. Reed)	Director	March 29, 2019
/s/ Mark C. Wagner (Mark C. Wagner)	Director	March 29, 2019
/s/ Judith A. Weaver (Judith A. Weaver)	Director	March 29, 2019
/s/ Paul W. Wenger (Paul W. Wenger)	Director	March 29, 2019
/s/ Paul M. Zimmerman, Jr. (Paul M. Zimmerman, Jr.)	Director	March 29, 2019

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