FIRST FEDERAL BANCORP, MHC

Parent Company for

First Federal Bank

Audited Consolidated Financial Statements

As of December 31, 2018 and 2017 and
For the Years then Ended

(Together with Independent Auditors' Report)

HACKER, JOHNSON & SMITH PA

Fort Lauderdale
Orlando
Tampa

Certified Public Accountants

Independent Auditors' Report

The Board of Directors
First Federal Bancorp, MHC
Lake City, Florida:

We have audited the accompanying consolidated financial statements of First Federal Bancorp, MHC and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of earnings, comprehensive income, equity and cash flows for the years then ended, and the related notes to financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

500 North Westshore Boulevard, Post Office Box 20368, Tampa, Florida 33622-0368, (813) 286-2424
A Registered Public Accounting Firm

Other Matters

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 28, 2019 expressed an unmodified opinion.

HACKER, JOHNSON & SMITH PA
Tampa, Florida
March 28, 2019

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Balance Sheets
(In thousands)

Assets	**At December 31, 2018**	**2017**
Cash and due from banks	$ 40,041	8,443
Interest-earning deposits with banks	103,395	49,367
Total cash and cash equivalents	143,436	57,810
Time deposits	19,521	21,957
Securities available for sale	416,213	461,053
Securities held to maturity at cost (fair value of $95 and $136)	5	88
Loans held for sale, net	101,846	29,037
Loans, net of allowance for loan losses of $5,457 and $5,435	949,965	654,575
Accrued interest receivable	6,952	7,265
Premises and equipment, net	34,707	24,014
Federal Home Loan Bank stock, at cost	2,001	2,893
Foreclosed real estate	2,706	216
Income taxes receivable	1,097	2,335
Cash surrender value of bank-owned life insurance	34,970	28,914
Servicing rights, net	45,817	38,546
Goodwill	28,235	1,728
Other assets	50,739	50,107
Total	$ 1,838,210	1,380,538
Liabilities and Equity		
Liabilities:		
Noninterest-bearing demand deposits	355,273	268,562
Interest checking and money-market deposits	728,955	648,320
Savings deposits	78,111	65,533
Time deposits	380,621	138,006
Total deposits	1,542,960	1,120,421
Federal Home Loan Bank advances	5,000	42,500
Junior Subordinated Debt	5,801	-
Other borrowings	30,100	-
Deferred income taxes	6,326	10,109
Other liabilities	42,826	20,338
Total liabilities	1,633,013	1,193,368
Commitments and contingencies (Notes 7, 13, 18 and 19)		
Equity:		
Retained earnings	205,169	181,879
Accumulated other comprehensive income	28	5,291
Total equity	205,197	187,170
Total	$ 1,838,210	1,380,538

See accompanying Notes to Consolidated Financial Statements.

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Statements of Earnings
(In thousands)

	Year Ended December 31, 2018	2017
Interest income:		
Loans	$ 54,347	32,423
Securities	12,295	12,191
Other	2,026	1,209
Total interest income	68,668	45,823
Interest expense:		
Deposits	8,487	3,884
Junior Subordinated Debt	246	-
Other Borrowings	1,255	836
Total interest expense	9,988	4,720
Net interest income	58,680	41,103
Provision for loan losses	617	1,445
Net interest income after provision for loan losses	58,063	39,658
Noninterest income:		
Loan servicing fees	7,611	7,115
Servicing rights retained from loans sold	5,081	2,793
Mortgage banking revenue	19,525	8,104
Service charges on deposit accounts	3,784	3,566
Other service charges and fees	3,566	2,455
Gain on sale of securities available for sale	2,495	740
Other than temporary impairment of securities	(88)	-
Income from bank-owned life insurance	585	911
Debit card interchange income	3,622	2,949
Other	139	385
Total noninterest income	46,320	29,018
Noninterest expense:		
Salaries and employee benefits	47,681	31,931
Occupancy and equipment	8,633	5,816
Professional fees	2,838	2,848
Other expenses	16,688	11,162
Total noninterest expense	75,840	51,757
Earnings before income taxes	28,543	16,919
Income tax expense (benefit)	5,253	(161)
Net earnings	$ 23,290	17,080

See accompanying Notes to Consolidated Financial Statements.

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income
(In thousands)

	Year Ended December 31, 2018	2017
Net earnings	$ 23,290	17,080
Other comprehensive (loss) income:		
Change in unrealized gain on securities available for sale:		
Unrealized (loss) gain arising during the year	(4,641)	6,243
Reclassification adjustment for realized gains	(2,495)	(740)
Reclassification adjustment for other-than-temporary impairment losses recognized	88	-
Net change in unrealized gain	(7,048)	5,503
Deferred income tax benefit (expense) on above change	1,785	(1,314)
One-time reclassification for newly enacted corporate tax rate	-	(864)
Total other comprehensive (loss) income	(5,263)	3,325
Comprehensive income	$ 18,027	20,405

See accompanying Notes to Consolidated Financial Statements.

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Statements of Equity

Years Ended December 31, 2018 and 2017
(In thousands)

	Retained Earnings	Accumulated Other Compre- hensive Income	Total
Balance at December 31, 2016	$ 165,663	1,102	166,765
Net earnings	17,080	-	17,080
Net change in unrealized gain on securities available for sale, net of income taxes of $1,314 and reclassification of newly enacted corporate tax rate	(864)	4,189	3,325
Balance at December 31, 2017	181,879	5,291	187,170
Net earnings	23,290	-	23,290
Net change in unrealized gain on securities available for sale, net of income taxes of $1,785	-	(5,263)	(5,263)
Balance at December 31, 2018	$ 205,169	28	205,197

See accompanying Notes to Consolidated Financial Statements.

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Statements of Cash Flows
(In thousands)

	Year Ended December 31, 2018	2017
Cash flows from operating activities:		
Net earnings	$ 23,290	17,080
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	617	1,445
Depreciation and amortization	2,010	1,627
Deferred income tax expense (benefit)	676	(1,864)
Net amortization of premiums and discounts on securities	4,419	6,619
Net amortization of deferred loan costs	(1,772)	183
Loss on sale of premise and equipment	27	-
Gain on sale of securities available for sale	(2,495)	(740)
Other than temporary impairment of securities	88	-
Net loss on sale of foreclosed real estate	2	9
Write-down of foreclosed real estate	250	49
Origination of loans held for sale, net	(1,914,014)	(698,350)
Proceeds from sale of loans held for sale and loan securitizations	1,948,727	698,071
Mortgage banking revenue	(19,525)	(8,104)
Income from bank-owned life insurance	(585)	(911)
Decrease (increase) in accrued interest receivable	1,702	(2,362)
Net increase in mortgage servicing rights	(5,137)	(2,723)
Decrease in other assets	14,420	42,535
Decrease in income tax receivable	1,238	243
Increase (decrease) in other liabilities	10,336	(101)
Net cash provided by operating activities	64,274	52,706
Cash flows from investing activities:		
Decrease (increase) in restricted cash	-	83,140
Purchases of securities available for sale	(165,524)	(399,407)
Principal repayments of securities available for sale	53,000	73,395
Maturities and calls of securities available for sale	46,085	9,582
Net proceeds from sales of securities available for sale	132,185	93,844
Principal repayments of securities held to maturity	83	32
Purchase of time deposits	(13,051)	(4,977)
Proceeds from sale of time deposits	12,450	-
Maturities of time deposits	3,037	-
Net decrease (increase) in loans	80,617	(104,755)
Purchases of premises and equipment, net	(2,949)	(5,097)
Proceeds from sale of premise and equipment, net	1,239	-
Proceeds from sale of foreclosed real estate	555	1,172
Redemption of Federal Home Loan Bank stock	892	1,184
Purchase of BOLI	(3,007)	-
Proceeds from BOLI claim	-	784
Business acquisitions, net of cash received	(75,846)	-
Net cash provided by (used in) investing activities	69,766	(251,103)
Cash flows from financing activities:		
(Decrease) increase in deposits	(8,710)	178,092
Decrease in Federal Home Loan Bank advances	(62,200)	(32,500)
Increase in Other Borrowings	22,496	-
Net cash (used in) provided by financing activities	(48,414)	145,592
Net increase (decrease) in cash and cash equivalents	85,626	(52,805)
Cash and cash equivalents at beginning of year	57,810	110,615
Cash and cash equivalents at end of year	$ 143,436	57,810

(continued)

FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

Consolidated Statements of Cash Flows, Continued

(In thousands)

	Year Ended December 31, 2018	2017
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Income taxes	$ 3,747	1,228
Interest	$ 9,743	4,686
Noncash transactions:		
Loans transferred to foreclosed real estate	$ 471	381
Capitalized servicing rights	$ 6,702	4,701
Net change in unrealized gain on securities available for sale, net of taxes	$ (5,263)	(3,325)
One-time reclassification for newly enacted tax rate	$ -	(864)
Noncash assets acquired and liabilities assumed:		
Securities available for sale	$ 29,966	
Loans held for sale	$ 87,887	
Loans, net	$ 375,323	
Accrued interest receivable	$ 1,389	
Premise and equipment	$ 11,020	
Foreclosed real estate	$ 2,826	
Cash surrender value of bank-owned life insurance	$ 2,464	
Servicing rights	$ 2,244	
Goodwill	$ 26,507	
Other assets	$ 17,726	
Deposits	$ 431,249	
Federal Home Loan Bank advances	$ 24,700	
Junior subordinated debt	$ 5,738	
Other borrowings	$ 7,667	
Other liabilities	$ 12,152	

See accompanying Notes to Consolidated Financial Statements.

(1) Organization and Summary of Significant Accounting Policies

Organization. First Federal Bancorp, MHC is a federally-chartered, mutual holding company. The Company through its subsidiary First Federal Bancorp, Inc. (a federal corporation) ("FFBI") owns First Federal Bank, formerly First Federal Bank of Florida (the "Bank" or "First Federal") which serves its customers through 23 branches across Florida and South Carolina. The Bank has three loan production offices located in Florida, Georgia and Wisconsin. Lines of business include a mortgage processing company, wholesale lending, Small Business Administration ("SBA") and U.S. Department of Agriculture ("USDA") lending, warehouse lending, consumer direct lending and manufactured housing lending. The Bank's deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). In April of 2017 the Company established a new subsidiary of the Bank. FFBF Investments, Inc., is a Delaware based company to perform investment management for the Bank. On April 2, 2018 the Company acquired and merged Coastal Banking Co., Inc. ("CBC") into First Federal.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP"). The following summarizes the more significant of these policies and practices:

Subsequent Events. Management has evaluated all significant events occurring subsequent to the balance sheet date through March 28, 2019, which is the date the consolidated financial statements were available to be issued, determining no events require additional disclosure in the consolidated financial statements.

Principles of Consolidation. The consolidated financial statements include the accounts of First Federal Bancorp, MHC and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Estimates. The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in its near term relate to the determination of whether a security is other-than-temporarily impaired, the allowance for loan losses, and the estimated fair value of the tangible assets and identifiable assets acquired, and liabilities assumed.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Acquisition Method of Accounting. The Company accounts for acquisitions using the acquisition method of accounting. The acquisition method of accounting requires the Company to estimate the fair value of the tangible assets and identifiable assets acquired, and liabilities assumed. These estimated fair values are based on available information and current economic conditions at the date of acquisition. Fair value may be obtained from independent appraisers, discounted cash flow present value techniques, management valuation models, quoted prices on national markets or quoted market prices from brokers. These fair value estimates will affect future earnings through the disposition or amortization of the underlying assets and liabilities.

Accounting for business combination under GAAP prohibits "carrying over" valuation allowances, such as the allowance for loan losses. Uncertainties relating to the expected future cash flows is reflected in the fair value measurement of the acquired loans and reflected in the purchase price. The Company will establish loan loss allowances for the acquired loans in periods after the acquisition, but only for losses incurred on these loans due to credit deterioration after acquisition.

Purchase Credit-Impaired Loans. As part of the business acquisition, the Company acquired loans, some of which have shown evidence of credit deterioration since origination. These purchased credit-impaired ("PCI") loans were determined to be credit impaired based on borrower payment history, past due status, loan credit grading, value of underlying collateral and other factors that affect the collectability of contractual cash flows. Under GAAP, purchasers are permitted to individually or collectively aggregate PCI loans into pools. PCI loans acquired in the same fiscal quarter may be assembled into one or more pools with common characteristics. Once pooled, a single composite interest rate is used to determine aggregate expected cash flows for the pool.

As a result of the Company's recent acquisition, the Company has engaged a third party to evaluate 50 PCI loans. The Company estimates the amount and timing of expected cash flows for each individually analyzed loan. Estimated cash flows in excess of the amount paid is recorded as interest income over the remaining life of the loan. On a quarterly basis, the Company will update the amount of loan principal and interest cash flows expected to be collected, incorporating assumptions regarding default rates, loss severities, the amounts and timing of prepayments and other factors that are reflective of current market conditions. Probable decreases in expected loan principal cash flows trigger the recognition of impairment, which is then measured as the present value of the expected principal loss plus any related foregone interest cash flows discounted at the loan's effective interest rate. Impairments that occur after the acquisition date are recognized through the allowance for loan losses; any remaining increases are recognized prospectively as interest income. The impacts of (i) prepayments, (ii) changes in variable interest rates, and (iii) any other changes in the timing of expected cash flows are recognized prospectively as adjustments to interest income. Disposals of loans, which may include sale of loans, receipt of payments in full by the borrower, or foreclosure, result in removal of the loan from the PCI portfolio.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Cash and Cash Equivalents. For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, due from banks and interest-earning deposits with banks, all of which have original maturities of less than ninety days.

The Company may be required under Federal Reserve Board regulations to maintain reserves, generally consisting of cash, interest-bearing deposits with the Federal Reserve Bank or noninterest-earning accounts with qualifying banks, against its transaction accounts. Required reserves were $8.4 million and $2.3 million at December 31, 2018 and 2017, respectively.

Securities. The Company may classify its securities as either trading, held to maturity or available for sale. Trading securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading securities are included immediately in earnings. Held-to-maturity securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale securities consist of securities not classified as trading securities nor as held-to-maturity securities. Unrealized holding gains and unrealized losses, net of tax, on available-for-sale securities are excluded from earnings and reported in accumulated other comprehensive income. Gains and losses on the sale of securities are determined using the specific-identification method. Premiums and discounts on securities available for sale and held to maturity are recognized in interest income using the interest method over the period to maturity.

The Company assesses individual securities in its investment securities portfolio for impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. An investment is impaired if the fair value of the security is less than its carrying value at the financial statement date. When a security is impaired, the Company then determines whether this impairment is temporary or other-than-temporary. In estimating other-than-temporary impairment ("OTTI") losses, management assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in accumulated other comprehensive income. Management utilizes cash flow models to segregate impairments to distinguish between impairment related to credit losses and impairment related to other factors.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Securities, Continued. To assess for OTTI, management considers, among other things, (i) the severity and duration of the impairment; (ii) the ratings of the security; (iii) the overall transaction structure (the Company's position within the structure, the aggregate, near-term financial performance of the underlying collateral, delinquencies, defaults, loss severities, recoveries, prepayments, cumulative loss projections, and discounted cash flows); and (iv) the timing and magnitude of a break in modeled cash flows.

Loans Held for Sale, Net. Mortgage loans originated and intended for sale in the secondary market are carried at fair value in the aggregate. Net unrealized gains and (losses), if any, are recognized through a valuation allowance and are included in earnings.

Loans. Loans are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Loan origination fees are deferred and certain direct origination costs are capitalized. Both are recognized as an adjustment of the yield of the related loan.

The accrual of interest on all portfolio classes is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. Guaranteed loans that are 90+ days past due and accruing are well secured by guarantees from the U.S. Government and are in the process of collection or being rehabilitated to be held for sale. Guarantees cover the principal basis in these loans and interest will be paid by the guarantor through the claim payment date. Loans which are guaranteed through U.S. Government programs that are in the process of foreclosure are placed on nonaccrual as recovery of the contract interest is no longer covered by the guarantee. Generally claims on guaranteed student loans cannot be filed until the loan has been delinquent more than 270 days. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses. The allowance for loan losses is established as losses are estimated to have occurred through a credit for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. There were no changes in the Company's accounting policies or methodology during the years ended December 31, 2018 or 2017.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Allowance for Loan Losses, Continued. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows or the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired and is based on historical loss experience, adjusted for qualitative factors.

The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding two years. This is supplemented by the risks for each portfolio segment. Risk factors impacting loans in each of the portfolio segments include any deterioration of property values, reduced consumer and business spending as a result of unemployment and reduced credit availability and lack of confidence in the economy. The historical experience is adjusted for qualitative factors including, economic conditions, industry specific factors, portfolio and other trends or uncertainties that could affect management's estimate of probable losses.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for all loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral-dependent.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Servicing. Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Prior to 2014, the Company recorded servicing assets based on the lower of cost or market. Beginning in 2014, the Company began recording servicing assets at fair value. With the acquisition of CBC, the Company assumed SBA servicing assets. The Company has chosen to account for these servicing rights under the lower of cost or market method. Servicing assets are evaluated for impairment based upon the fair value of the rights compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. At December 31, 2018 and 2017, all impairment of servicing assets has been recorded.

Premises and Equipment. Land is carried at cost. Building and improvements and furniture and equipment are carried at cost, less accumulated depreciation and amortization computed using the straight-line and accelerated methods over the estimated life of the assets. Interest costs are capitalized in connection with the construction of new banking offices.

Foreclosed Real Estate. Real estate acquired through, or in lieu of, foreclosure, is initially recorded at fair value less selling costs establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the foreclosed real estate is carried at the lower of the new cost basis or fair value less selling costs. Revenue and expenses from operations and changes in the valuation allowance are included in earnings.

Goodwill and Core Deposit Intangibles. Goodwill represents the excess of the acquisition cost over the fair value of the net assets acquired in acquisitions. GAAP requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired. Management has internally evaluated goodwill in accordance with GAAP and determined, based on a qualitative assessment, that it is not more-likely-than-not that the fair value of the reporting unit is less than its carrying value as of December 31, 2018 and 2017 and therefore has determined that there was no impairment of goodwill during the years ended December 31, 2018 and 2017. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings. As of December 31, 2018 and 2017, the Company had goodwill in the amount of $28.2 million and $1.7 million, respectively.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Goodwill and Core Deposit Intangibles, Continued. The core deposit intangibles ("CDI") are intangible assets arising from either branch acquisitions or whole bank acquisitions. CDI are initially measured at fair value and then amortized up to ten years on a straight-line basis using projected decay rates of the underlying core deposits. The principal factors considered when valuing the CDI consist of the following: (1) the rate and maturity structure of the interest bearing liabilities, (2) estimated retention rates for each deposit liability category, (3) the current interest rate environment and (4) estimated noninterest income potential of the acquired relationship. The CDI is evaluated periodically for impairment. As of December 31, 2018 the Company determined the CDI was not impaired.

Asset acquired through acquisitions included intangible assets consisting of CDI are as follows (dollars in thousands):

Acquisition	Core Deposit Intangible Acquired	Period of Amortization	Amortization Recognized in 2018	Amortization Recognized in 2017	Remaining Core Deposit Intangible at December 31, 2018	Remaining Core Deposit Intangible at December 31, 2017
CBC Bank..........................	$ 6,453	69 months	$ 732	-	$ 5,721	-

The CDI was included in other assets in accompanying consolidated balance sheets.

The future expected amortization of CDI with determinable useful lives as of December 31, 2018 is as follows (in thousands):

Year Ending December 31,		Amount
2019	....	$ 1,257
2020	....	1,257
2021	....	1,257
2022	....	1,257
2023	....	693
		$ 5,721

Junior Subordinated Debt. With the acquisition of CBC the Company assumed two Trust Preferred Securities. Coastal Banking Company Statutory Trust I ("Trust I") is a non-consolidated subsidiary issued in May 2004 with a maturity date of July 23, 2034. The debenture balance of $3,093,000 was valued at $2,584,835 at acquisition date. The debenture carries a floating rate equal to the 3-month LIBOR plus 2.75%, adjusted at acquisition date quarterly. Coastal Banking Company Statutory Trust II ("Trust II") is a non-consolidated subsidiary issued in June 2006 with a maturity date of September 30, 2036. The debentures balance of $4,124,000 was valued at $2,935,914 at acquisition date. The debenture carries a floating rate equal to the 3-month LIBOR plus 1.60%, adjusted quarterly.

All of the common securities of Trust I and Trust II are owned by the Company.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Transfer of Financial Assets. Transfers of financial assets or a participating interest in an entire financial asset 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. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

Mortgage Banking Revenue. Mortgage banking revenue includes gains on the sale of loans originated for sale, gains on the sale of loans originated for securitization by third parties and the fair market value adjustment on loans held for sale at fair value. The Company recognizes mortgage banking revenue from mortgage loans originated and securitized in the consolidated statements of earnings upon sale of the loans.

Income Taxes. There are two components of income taxes: current and deferred. Current income taxes reflect taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income taxes result from changes in deferred tax assets and liabilities between periods.

Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. As of December 31, 2018, management is not aware of any uncertain tax positions that would have a material effect on the Company's consolidated financial statements.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Income Taxes, Continued The Company recognizes interest and penalties on income taxes if any as a component of income tax expense.

The Holding Companies and the Bank file consolidated income tax returns. Income taxes are allocated proportionately to the Holding Company and the Bank as though separate income tax returns were filed.

Off-Balance-Sheet Financial Instruments. In the ordinary course of business the Company has entered into off-balance-sheet financial instruments consisting of unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Derivative Financial Instruments. Derivative financial instruments are recognized as assets or liabilities in the accompanying consolidated balance sheets and measured at fair value.

Rate-Lock Commitments and Forward Loan Sale Contracts. The Company enters into commitments to originate loans whereby the interest-rate on the loan is determined prior to funding (rate-lock commitments). Rate-lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Accordingly, such commitments, along with any related fees received from potential borrowers, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, the difference between current levels of interest rates and the committed rates is also considered.

The Company utilizes forward loan sale contracts to mitigate the interest-rate risk inherent in the Company's mortgage loan pipeline or rate-lock commitments and held-for-sale portfolio. Forward loan sale contracts are contracts for future delivery of mortgage loans. The Company agrees to deliver on a specified future date, a specified amount of loans, at a specified price or yield. However, the contract may allow for cash settlement. The credit risk inherent to the Company arises from the potential inability of counterparties to meet the terms of their contracts. In the event of nonacceptance by the counterparty, the Company would be subject to the credit risk of the loans retained. Such contracts are accounted for as derivatives and, along with related fees paid to investors, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in mortgage banking revenue. Fair value is based on the estimated amounts that the Company would receive or pay to terminate the commitment at the reporting date.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Fair Value Measurements. Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets and liabilities measured at fair value:

Securities Available for Sale. Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations, U.S. Government agency bonds, corporate bonds, municipal bonds, and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Securities classified within Level 3 include certain residual interests in securitizations and other less liquid securities.

Derivatives. Exchange-traded derivatives that are valued using quoted prices are classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the derivative positions are valued by the investment banker using their models and are classified within Level 2 of the valuation hierarchy. Derivatives that are valued based upon models with significant unobservable market parameters and that are normally traded less actively or have trade activity that is one way are classified within Level 3 of the valuation hierarchy and are also valued by the Company's investment banker. Such derivatives are rate-lock commitments or forward sale contracts.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Fair Value Measurements, Continued.

Impaired Loans. The Company's impaired loans are normally collateral dependent and, as such, are carried at the lower of the Company's net recorded investment in the loan or the estimated fair value of the collateral less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans is classified as Level 3.

Loans Held for Sale, Net. Loans held for sale, net primarily consist of loans that are valued based on traded market prices of similar assets, a Level 2 measurement.

Foreclosed Real Estate. The Company's foreclosed real estate is recorded at the lower of cost or fair value less estimated selling costs. Estimates of fair values are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current economic conditions in the area the property is located in assessing estimates of fair value. Accordingly, the fair values estimates for foreclosed real estate are classified as Level 3.

Assets Acquired and Liabilities Assumed. The estimated fair values of the investment securities classified as available for sale were calculated utilizing Level 2 inputs. The Company reviewed the data and assumptions used in pricing the securities by its third party provider to ensure the highest level of significant inputs are derived from market observable data.

Servicing Rights. The fair value of servicing rights is based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness. Servicing rights were valued using Level 3 inputs.

Fair Values of Financial Instruments. The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

Cash and Cash Equivalents. The carrying amounts of cash approximate fair value.

Time Deposits. The carrying amounts of time deposits approximate fair value.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Fair Values of Financial Instruments, Continued.

Securities. Fair values for securities held to maturity and available for sale are based on the framework for measuring fair value.

Loans Held for Sale, Net. The fair value of loans held for sale, net is based on the framework for measuring fair value.

Loans. For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed-rate mortgage loans (for example, fixed-rate one-to-four family residential) and consumer loans are estimated by discounting the estimated future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities. Fair values for impaired loans are based on the framework for measuring fair value.

Accrued Interest Receivable. The carrying amount of accrued interest receivable approximates its fair value.

Federal Home Loan Bank Stock. The stock is not publicly traded and the estimated fair value is based on its redemption value.

Servicing Rights. The fair value of residential mortgage servicing rights is based on the framework for measuring fair value.

Deposits. The fair value estimated for demand deposits (e.g., interest and noninterest-bearing NOW accounts, passbook savings, and money-market accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregate expected monthly time deposit maturities.

Accrued Interest Payable. The carrying amount of accrued interest payable approximates its fair value.

Federal Home Loan Bank ("FHLB") Advances. The fair value of FHLB Advances is estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowings.

Junior Subordinated Debt and Other Borrowings. The fair value of the Junior Subordinated Debt and other borrowings is estimated using discounted cash flow analysis based on current rates of similar debt.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Fair Values of Financial Instruments, Continued.

Derivative Financial Instruments. The fair value of derivative financial instruments is based on the framework for measuring fair value.

Off-Balance Sheet Instruments. Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

Comprehensive Income. GAAP requires that recognized revenue, expenses, gains and losses be included in earnings. Although certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities, are reported as a separate component of the equity section of the consolidated balance sheet, such items, are components of comprehensive income.

Reclassifications. Certain amounts in the 2017 consolidated financial statements have been reclassified to conform to the 2018 presentation.

Recent Pronouncements. In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.* The ASU requires equity investments to be measured at fair value with changes in fair values recognized in net earnings**,** public entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purpose, simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment and eliminates the requirement to disclose fair values, the methods and significant assumptions used to estimate the fair value of financial instruments, measured at amortized cost. The ASU also clarifies that the Company should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale debt securities in combination with the Company's other deferred tax assets. The ASU is effective for fiscal years beginning after December 15, 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued. In February 2016, the FASB issued ASU No. 2016-02, *Lease (Topic 842)* which will require lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with a term of more than twelve months. Consistent with current GAAP, the recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. The new ASU will require both types of leases to be recognized on the consolidated balance sheets. The ASU also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the consolidated financial statements. The ASU is effective for fiscal years and interim periods within those fiscal years, beginning after December 15, 2018. The Company estimates that the effect of the ASU will increase assets and liabilities by $1 million.

In June 2016, the FASB issued Accounting Standards Update ("ASU") No. 2016-13 *Financial Instruments-Credit Losses (Topic 326).* The ASU requires the Company to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. The Company will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other consolidated financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the consolidated financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Early adoption is permitted. The Company is in the process of determining the effect of the ASU on its consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, *Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. The ASU shortens the amortization period for certain callable debt securities held at a premium, the ASU requires the premium to be amortized to the earliest call date. No accounting change is required for securities held at a discount. The ASU is effective for pubic business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company has early adopted this ASU and did not have a material impact on the Company's consolidated financial statements.

(continued)

(1) Organization and Summary of Significant Accounting Policies, Continued

Recent Pronouncements, Continued. In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*. The ASU provides a screen to determine when an integrated set of assets and activities (a "set") is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. If the screen is not met, the ASU (1) requires that to be considered a business, a set must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output and (2) remove the evaluation of whether a market participant could replace missing elements. The amendments provide a framework to assist entities in evaluating whether both an input and a substantive process are present. The framework includes two sets of criteria to consider that depend on whether a set has outputs. Although outputs are not required for a set to be a business, outputs generally are a key element of a business. The ASU was effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815) Targeted Improvements to Accounting for Hedge Activities*. The ASU better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the ASU expands and refines hedge accounting for both nonfinancial and financial risk components and aligns the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The ASU is effective for fiscal years beginning after December 15, 2018. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

(2) Business Combinations

Acquisition of Coastal Banking Company, Inc. and Subsidiaries. On April 2, 2018, pursuant to an Agreement and Plan of Merger entered into November 7, 2017, the Company completed its acquisition of Coastal Banking Company, Inc. (CBC) and its wholly-owned subsidiary CBC National Bank. At the effective time of the Merger, the Company paid $21.50 per share in cash for each CBC common share and stock option outstanding in a transaction valued at $86.8 million. The Company acquired these assets and liabilities to expand its market presence in the Florida, Georgia, and South Carolina area. The Company also gained residential, SBA, and USDA lending offices across Florida and multiple states. The Company incurred approximately $1million in merger and acquisition related expenses in the 2018 results of operations.

(continued)

(2) Business Combinations, Continued

The following table summarizes the fair value of assets acquired and liabilities assumed on the date of acquisition, April 2, 2018:

	Coastal Banking Co. Inc.
Cash and cash equivalents	$ 10,046
Securities available for sale	29,966
Loans held for sale	87,887
Loans	375,323
Accrued interest receivable	1,389
Premise and Equipment	11,020
Foreclosed real estate	2,826
Cash surrender value of bank-owned life insurance	2,464
Servicing rights	2,244
Goodwill	26,507
Other assets	17,726
Total Assets Acquired	567,398
Deposits	431,249
Federal Home Loan Bank Advances	24,700
Junior Subordinated Debt	5,738
Other Borrowings	7,667
Other liabilities	12,152
Total Liabilities Assumed	481,506
Net assets acquired	$ 85,892

(continued)

(2) Business Combinations, Continued

Results of operations for CBC prior to the acquisition date are not included in the consolidated statement of earnings for the year ended December 31, 2018. The following table presents financial information regarding the former CBC operations excluded from the consolidated statement of operations prior to the date of acquisition:

	Actual from January 1, 2018 Through April 1, 2018
Net interest income	$ 5,518
Noninterest income	5,512
Net earnings	1,357

The following table presents unaudited pro forma information as if the acquisition of CBC had occurred on January 1, 2017. The table does not consider the effect of expense savings created by the merger other than to exclude merger related expenses.

	Unaudited pro forma information Year Ended December 31,	
	2018	2017
Net interest income	$ 64,198	62,402
Noninterest income	51,034	50,358
Net earnings	24,647	24,072

The tables above have been prepared for comparative purposes only and are not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect the Company's estimate of any revenue enhancing opportunities nor anticipated cost savings as a result of the integration and consolidation of the acquisition.

(continued)

(3) Securities

Securities have been classified according to management's intention. The carrying amounts of securities and their fair value are summarized as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale:				
At December 31, 2018:				
U.S. Treasury	$ 46,465	-	(15)	46,450
U.S Government agency bonds	729	-	(18)	711
Municipal securities	140,466	1,791	(560)	141,697
Collateralized mortgage obligations	76,022	594	(736)	75,880
SBA pool securities	78,741	80	(539)	78,282
Asset-backed securities	19,105	20	-	19,125
Mortgage-backed securities	54,649	86	(667)	54,068
	$ 416,177	2,571	(2,535)	416,213
At December 31, 2017:				
U.S. Government agency bonds	$ 1,027	-	(24)	1,003
Corporate bonds	4,500	157	-	4,657
Municipal securities	212,551	5,804	(132)	218,223
Collateralized mortgage obligations	111,243	2,130	(736)	112,637
SBA pool securities	87,057	326	(95)	87,288
Asset-backed securities	15,420	81	-	15,501
Mortgage-backed securities	22,171	28	(455)	21,744
	$ 453,969	8,526	(1,442)	461,053
Securities Held to Maturity:				
At December 31, 2018				
Corporate bonds	$ 5	90	-	95
At December 31, 2017				
Corporate bonds	$ 88	48	-	136

(continued)

(3) Securities, Continued

The following summarizes sales of securities (in thousands):

	Year Ended December 31, 2018	2017
Proceeds	$ 132,185	93,844
Gross gains	2,921	996
Gross losses	(426)	(256)
Net gain	$ 2,495	740

The scheduled maturities of securities at December 31, 2018 are as follows (in thousands):

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due before one year	$ 46,946	46,951	-	-
Due after one year through five years	15,353	16,055	-	-
Due after five years through ten years	124,632	125,141	-	-
Due after ten years	729	711	5	95
Collateralized mortgage obligations	76,022	75,880	-	-
SBA pool securities	78,741	78,282	-	-
Asset-backed securities	19,105	19,125		
Mortgage-backed securities	54,649	54,068	-	-
	$ 416,177	416,213	5	95

At December 31, 2018 and 2017, the Company pledged, as collateral for state and municipal deposits, securities with a carrying value of $147,096,000 and $109,148,000, respectively.

(continued)

(3) Securities, Continued

The Company's securities available for sale with gross unrealized losses aggregated by investment category and length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2018:				
U.S. Treasury bonds	$ (15)	46,450	-	-
U.S. Government agency bonds	-	-	(18)	711
Municipal securities	(289)	45,255	(271)	16,295
Collateralized mortgage obligations	(168)	18,261	(568)	30,101
SBA pool securities	(357)	62,406	(182)	6,770
Mortgage-backed securities	(92)	23,561	(575)	13,391
Total	$ (921)	195,933	(1,614)	67,268
December 31, 2017:				
U.S. Government agency bonds	$ -	-	(24)	1,003
Municipal securities	(40)	11,932	(92)	8,136
Collateralized mortgage obligations	(456)	48,710	(280)	17,517
SBA pool securities	(36)	20,479	(59)	4,548
Mortgage-backed securities	(116)	10,362	(339)	6,752
Total	$ (648)	91,483	(794)	37,956

At December 31, 2018 and 2017 the unrealized losses on 84 and 55 investment securities available for sale, respectively, were caused by market conditions. It is expected that the securities would not be settled at a price less than the par value of the investments. Because the decline in fair value is attributable to changes in market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

(continued)

(3) Securities, Continued

The Company invests in residential Collateralized Mortgage Obligations ("CMO's") included in securities available for sale and corporate bonds held to maturity. Quarterly, management stress tests all CMO's and corporate bonds via a third party resource that takes into account housing price appreciation (depreciation), interest rates, expected loss trends, both nationally and in geographic areas represented by the CMO and future cash flows of the corporate bonds. These stress tests are done, where data is available, at the individual loan level, opposed to using averages from services such as Bloomberg. If these stress tests indicate, on a present value basis, the Company will not receive the contracted cash flows; the Company makes an other-than-temporary impairment charge through the consolidated statements of earnings. Based on the lack of an active market and the results of the Company's continuing valuation of the underlying collateral and cash flows of these securities, these securities have been deemed as other-than-temporarily impaired. Based on current accounting policies, the portion of losses deemed as credit losses is charged against earnings and the portion deemed as noncredit losses is included in other comprehensive (loss) income. As of December 31, 2018, the Company's management does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell the securities for liquidity or other reasons.

The following tables provide various information regarding the Company's securities deemed other-than-temporarily impaired (in thousands):

	Year Ended December 31,			
	2018		2017	
	Impairment Losses	Fair Value	Impairment Losses	Fair Value
Securities Available for Sale-				
Collateralized mortgage obligations	$ 88	630	-	706
Securities Held to Maturity-				
Corporate bonds	$ -	95	-	136

The Company will continue to evaluate the investment ratings in the securities portfolio, severity in pricing declines, market price quotes along with timing and receipt of amounts contractually due. Based upon these and other factors, the securities portfolio may experience further impairment.

(continued)

(4) Loans

The segments and classes of loans are summarized as follows (in thousands):

	At December 31, 2018	At December 31, 2017
Real estate mortgage loans:		
Commercial real estate	$ 322,642	156,821
Residential real estate	221,886	110,193
Construction and land	76,237	41,310
Total real estate mortgage loans	620,765	308,324
Commercial loans:		
Warehouse lines of credit	132,906	148,325
Other commercial	66,961	52,040
Total commercial loans	199,867	200,365
Consumer loans	144,616	152,577
Subtotal	965,248	661,266
Deduct (add):		
Allowance for loan losses	5,457	5,435
Loan discount	11,460	1,321
Net deferred loan origination fees (costs)	(1,634)	(65)
Loans, net	$ 949,965	654,575

(continued)

(4) Loans, Continued

An analysis of the change in the allowance for loan losses follows (in thousands):

	Real Estate Mortgage Loans	Commercial Loans	Consumer Loans	Total
Year Ended December 31, 2018:				
Beginning balance	$ 2,984	893	1,558	5,435
Provision for loan losses	349	24	244	617
Charge-offs	(337)	(2)	(601)	(940)
Recoveries	193	2	150	345
Ending balance	$ 3,189	917	1,351	5,457
Year Ended December 31, 2017:				
Beginning balance	$ 2,593	1,114	1,090	4,797
Provision (credit) for loan losses	512	(190)	1,123	1,445
Charge-offs	(330)	(38)	(832)	(1,200)
Recoveries	209	7	177	393
Ending balance	$ 2,984	893	1,558	5,435
At December 31, 2018:				
Balance in allowance for loan losses:				
Individually evaluated for impairment	$ 218	-	-	218
Loans acquired	-	-	-	-
Loans acquired with deteriorated credit quality	14	3	-	17
Collectively evaluated for impairment	2,957	914	1,351	5,222
Ending balance	$ 3,189	917	1,351	5,457
Recorded investment:				
Individually evaluated for impairment	$ 5,217	6	60	5,283
Loans acquired	268,298	7,983	16,121	292,402
Loans acquired with deteriorated credit quality	17,634	2,035	-	19,669
Collectively evaluated for impairment	329,616	189,843	128,435	647,894
Ending balance	$ 620,765	199,867	144,616	965,248
At December 31, 2017:				
Balance in allowance for loan losses:				
Individually evaluated for impairment	$ 95	1	-	96
Collectively evaluated for impairment	2,889	892	1,558	5,339
Total ending allowance balance	$ 2,984	893	1,558	5,435
Recorded investment:				
Individually evaluated for impairment	$ 6,917	2	111	7,030
Collectively evaluated for impairment	301,407	200,363	152,466	654,236
Total ending loan balance	$ 308,324	200,365	152,577	661,266

(continued)

(4) Loans, Continued

The Company has divided the loan portfolio into three portfolio segments, each with different risk characteristics and methodologies for assessing risk. All loans are underwritten based upon standards set forth in the policies approved by the Company's Board of Directors. The portfolio segments identified by the Company are as follows:

Real Estate Mortgage Loans. Real estate mortgage loans are typically segmented into three classes: Commercial real estate, Residential real estate and Construction and Land. Commercial real estate loans are secured by the subject property and are approved based on standards that include, among other factors, loan to value limits, cash flow coverage and general creditworthiness of the obligors. Residential real estate loans are underwritten based on repayment capacity and source, value of the underlying property, credit history and stability. Construction loans to borrowers are to finance the construction of owner occupied and lease properties. These loans are categorized as construction loans during the construction period, later converting to commercial or residential real estate loans after the construction is complete and amortization of the loan begins. Construction loans are approved based on an analysis of the borrower and guarantor, the viability of the project and on an acceptable percentage of the appraised value of the property securing the loan. Construction loan funds are disbursed periodically based on the percentage of construction completed. The Company carefully monitors these loans with on-site inspections and requires the receipt of lien waivers on funds advanced. Construction loans are typically secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely on the value of the underlying property, the Company considers the market conditions and feasibility of proposed projects, the financial condition and reputation of the borrower and guarantors, the amount of the borrower's equity in the project, independent appraisals, costs estimates and pre-construction sale information. The Company also makes loans on occasion for the purchase of land for future development by the borrower. Land loans are extended for the future development for either commercial or residential use by the borrower. The Company carefully analyzes the intended use of the property and the viability thereof.

Commercial Loans. Commercial loans are segmented into two classes: warehouse lines of credit and other commercial loans. Warehouse lending provides a line of credit to mortgage bankers throughout the United States who use the lines to fund 1-4 family residential lending for sale within 90 days into the secondary market. Other commercial loans are primarily underwritten on the basis of the borrowers' ability to service such debt from income. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. As a general practice, the Company takes as collateral a security interest in mortgage loans, any available equipment, or other chattel, although loans may also be made on an unsecured basis. Collateralized working capital loans typically are secured by short-term assets whereas long-term loans are primarily secured by long-term assets.

(continued)

(4) Loans, Continued

Consumer Loans. Consumer loans and are extended for various purposes, including purchases of automobiles, recreational vehicles, and boats. The Company also offers lines of credit, personal loans, and deposit account collateralized loans. Consumer loans include guaranteed student loans purchased at approximately 99% of principal balance outstanding and the principal balance of such loans is approximately 98% guaranteed by the U.S. Department of Education. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Loans to consumers are extended after a credit evaluation, including the creditworthiness of the borrower(s), the purpose of the credit, and the secondary source of repayment. Consumer loans are made at fixed and variable interest rates and may be made on terms of up to ten years. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

The following summarizes the loan credit quality (in thousands):

	Real Estate Mortgage Loans					
	Commercial Real Estate	Residential Real Estate	Construction and Land	Commercial Loans	Consumer Loans	Total
Credit Risk Profile by Internally Assigned Grade:						
At December 31, 2018:						
Grade:						
Pass	$ 295,584	218,501	76,163	197,513	144,061	931,822
Special mention	15,829	404	-	1,979	280	18,492
Substandard	11,229	2,981	74	375	275	14,934
Total	$ 322,642	221,886	76,237	199,867	144,616	965,248
At December 31, 2017:						
Grade:						
Pass	$ 131,195	106,370	40,286	199,531	151,855	629,237
Special mention	17,760	119	-	805	95	18,779
Substandard	7,866	3,704	1,024	29	627	13,250
Total	$ 156,821	110,193	41,310	200,365	152,577	661,266

(continued)

(4) Loans, Continued

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis includes nonhomogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on at least an annual basis.

Loans excluded from the review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of a deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as to special mention, substandard or even charged-off. The Company uses the following definitions for risk ratings:

Pass – A Pass loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary.

Special Mention – A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or the Company's credit position at some future date. Special Mention loans are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

Substandard – A Substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful – A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss – A loan classified Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

(continued)

(4) Loans, Continued

An analysis of past-due loans is as follows (in thousands):

	Accruing Loans						
	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Past Due	Current	Nonaccrual Loans	Total Loans
At December 31, 2018:							
Real estate mortgage loans:							
Commercial real estate	$ 2,702	682	-	3,384	317,346	1,912	322,642
Residential real estate[(2)]	3,986	1,430	28,513	33,929	186,944	1,013	221,886
Construction and land	671	-	-	671	75,473	93	76,237
Commercial loans	98	95	-	193	199,457	217	199,867
Consumer loans [(1)]	1,472	364	1,952	3,788	140,768	60	144,616
Total	$ 8,929	2,571	30,465	41,965	919,988	3,295	965,248
At December 31, 2017:							
Real estate mortgage loans:							
Commercial real estate	$ 165	23	-	188	156,082	551	156,821
Residential real estate[(2)]	3,325	1,536	31,617	36,478	72,024	1,691	110,193
Construction and land	2,052	-	-	2,052	38,603	655	41,310
Commercial loans	446	25	-	471	199,892	2	200,365
Consumer loans [(1)]	1,725	1,140	1,857	4,722	147,759	96	152,577
Total	$ 7,713	2,724	33,474	43,911	614,360	2,995	661,266

(1) At December 31, 2018 and 2017, guaranteed student loans were $11.4 million and $13.5 million, respectively. Guaranteed student loans of $1.5 million and $1.4 million at December 31, 2018 and 2017 that are 90+ days past due and accruing are well secured by guarantees from the U.S. Government and are in the process of collection. Guarantees cover the principal basis in these loans and interest will be paid by the guarantor through the claim payment date. Generally claims on guaranteed student loans cannot be filed until the loan has been delinquent more than 270 days. As of December 31, 2018 and 2017, there were $193,000 and $135,000, respectively, of student loans 270+ days past due and accruing. At December 31, 2018 and 2017, FHA Title I loans were $55.5 million and $48.8 million, respectively. FHA Title I loans of $488,000 and $450,000 at December 31, 2018 and 2017, respectively, that are 90+ days past due and accruing are well secured by guarantees from the U.S Government and are in the process of collection.

(2) Guaranteed loans in the process of collection or being rehabilitated to be held for sale were $31.3 million and $38.1 million at December 31, 2018 and 2017, respectively.

(continued)

(4) Loans, Continued

The following summarizes the amount of impaired loans (in thousands):

	With No Related Allowance Recorded		With an Allowance Recorded			Total		
	Recorded Investment	Unpaid Contractual Principal Balance	Recorded Investment	Unpaid Contractual Principal Balance	Related Allowance	Recorded Investment	Unpaid Contractual Principal Balance	Related Allowance
December 31, 2018:								
Real estate mortgage loans:								
Commercial real estate	$ 1,959	2,234	520	763	218	2,479	2,997	218
Residential real estate	2,664	3,297	-	-	-	2,664	3,297	-
Construction and land	74	168	-	-	-	74	168	-
Commercial loans	6	6	-	-	-	6	6	-
Consumer loans	60	61	-	-	-	60	61	-
	$ 4,763	5,766	520	763	218	5,283	6,529	218
December 31, 2017:								
Real estate mortgage loans:								
Commercial real estate	$ 2,264	2,619	399	444	95	2,663	3,063	95
Residential real estate	3,599	4,267	-	-	-	3,599	4,267	-
Construction and land	655	828	-	-	-	655	828	-
Commercial loans	-	-	2	7	1	2	7	1
Consumer loans	111	118	-	-	-	111	118	-
	$ 6,629	7,832	401	451	96	7,030	8,283	96

The average net investment in impaired loans and interest income recognized and received on impaired loans are as follows (in thousands):

	Average Recorded Investment	Interest Income Recognized	Interest Income Received
Year Ended December 31, 2018:			
Real estate mortgage loans:			
Commercial real estate	$ 2,742	115	168
Residential real estate	3,278	87	214
Construction and land	388	-	3
Commercial loans	3	-	1
Consumer loans	80	3	10
	$ 6,491	205	396
Year Ended December 31, 2017:			
Real estate mortgage loans:			
Commercial real estate	$ 4,051	141	235
Residential real estate	3,482	110	236
Construction and land	1,635	6	111
Commercial loans	66	-	5
Consumer loans	126	4	9
	$ 9,360	261	596

(continued)

(4) Loans, Continued

Troubled debt restructurings ("TDR") during the years ended December 31, 2018 and 2017 are as follows (dollars in thousands):

	2018			2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Troubled Debt Restructurings:						
Real estate mortgage loans:						
Commercial real estate:						
Modified amortization..........	-	$ -	$ -	2	$ 60	$ 60
Modified interest rate, principal and amortization	-	-	-	3	311	263
Residential real estate:						
Modified amortization..........	6	395	408	1	47	49
Modified interest rate, principal and amortization	-	-	-	3	222	171
Consumer loans:						
Modified amortization..........	2	105	105	-	-	-
	8	$ 500	$ 513	9	$ 640	543

The allowance for loan losses on all classes or loans that have been restructured and are considered TDRs is included in the Company's specific reserve. The specific reserve is determined on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral-dependent. TDR's that have subsequently defaulted are considered collateral-dependent. There were no TDRs modified during the years ended December 31, 2018 or 2017 that subsequently defaulted during the same year.

(continued)

(4) Loans, Continued

Net Deferred Loan Origination Fees (Costs). The following is an analysis of the change in the net deferred loan origination fees (costs) (in thousands):

	Year Ended December 31, 2018	2017
Beginning balance	$ (65)	8
Deferred loan origination fees	2,200	396
Capitalized direct underwriting costs	(3,031)	(652)
Net amortization	(738)	183
Ending balance	$(1,634)	(65)

Concentrations of Credit Risk. The Company grants the majority of its loans to borrowers throughout the Florida counties of Baker, Bay, Columbia, Duval, Holmes, Jackson, Marion, Nassau, and Suwanee. With the acquisition of CBC, the Company has added concentrations in the Atlanta, Georgia and Beaufort, South Carolina areas. Although the Company has a diversified loan portfolio, a significant portion of its borrowers' ability to honor their contracts is dependent upon the economy in these areas. The Company does not have significant concentrations to any one industry or customer other than warehouse lines of credit.

(5) Purchase Credit Impaired Loans ("PCI")

The carrying amounts as of the acquisition date of PCI loans acquired are detailed in the following table (in thousands):

	During Year Ending December 31, 2018
Contractual principal at acquisition	$ 25,772
Nonaccretable difference	(4,271)
Cash flows expected to be collected at acquisition	21,501
Accretable yield adjustment	(961)
Total carrying amount of PCI loans	$ 20,540

The carrying amount of PCI loans at December 31, 2018 was $15,345.

(continued)

(6) Loan Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans are summarized as follows (in thousands):

	At December 31, 2018	At December 31, 2017
Mortgage loan portfolios serviced for:		
Government agencies:		
FHLB	$ 6,366	7,092
FHLMC	2,771,739	2,715,406
GNMA	1,213,782	1,151,730
FNMA	92,011	53,029
All other	224,533	199,292
	$ 4,308,431	4,126,549

Custodial escrow balances maintained in connection with loans serviced for others were $28,204,000 and $23,913,000 at December 31, 2018 and 2017, respectively. The escrow balances are included in noninterest-bearing demand deposits in the accompanying consolidated balance sheets.

(continued)

(6) Loan Servicing, Continued

The following summarizes servicing rights activity, along with the aggregate activity in related valuation allowances (in thousands):

	Year Ended December 31, 2018	2017
Beginning balance	$ 38,845	36,052
Additions from loans originated and sold	6,702	4,701
Acquired from CBC	2,244	-
Amortization	(1,621)	(1,908)
Ending balance	46,170	38,845
Allowance	(334)	(248)
Discount	(19)	(51)
Servicing rights, net	$ 45,817	38,546
Allowance for impairment beginning balance	248	178
Additions	155	101
Reductions	(69)	(31)
Allowance for impairment ending balance	$ 334	248

During the year ended December 31, 2018, the fair value of mortgage servicing rights was determined using discount rates ranging from 9.00% to 11.50% for all loans serviced and constant prepayment rates (CPR) ranging from 7.26% to 20.85%, depending on the stratification of the specific rights. For the year ended December 31, 2017, the discount rates ranged from 9.50% to 13.25% with CPRs ranging from 8.12% to 28.62%.

As a result of the acquisition of CBC, the Company acquired a portfolio of Small Business Administration loans. During the year ended December 31, 2018, the fair value of servicing rights was determined using discount rates ranging from 9.29% to 23.10% for all loans serviced and constant prepayment rates (CPR) ranging from 6.34% to 15.65%, depending on the stratification of the specific rights.

(continued)

(6) Loan Servicing, Continued

The following is a summary of Service Rights by accounting method (in thousands):

	At Ended December 31,			
	2018		2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Service Rights, at fair market value	$ 35,581	35,581	28,879	28,879
Service Rights, at lower of cost or market value	10,236	14,903	9,667	13,777
Total	$ 45,817	50,484	38,546	42,656

Loan servicing and servicing rights income has been recognized as follows (in thousands):

	Year Ended December 31,	
	2018	2017
Servicing fees received from investors net of servicing expense	$ 7,611	7,115
Servicing rights additions from loans originated and sold	6,702	4,701
Less amortization of servicing rights	(1,621)	(1,908)
	5,081	2,793
Income from servicing and rights	$ 12,692	9,908

(continued)

(7) Premises and Equipment

The components of premises and equipment are summarized as follows (in thousands):

	At December 31, 2018	2017
Land	$ 10,114	6,170
Buildings and improvements	29,621	20,537
Furniture and equipment	19,780	15,984
Total, at cost	59,515	42,691
Less accumulated depreciation and amortization	24,808	18,677
Premises and equipment, net	$ 34,707	24,014

The Company leases office space for its operations under noncancellable leases which expire in 2019 and 2024. Rent expense was $988,000 and $388,000 for the years ended December 31, 2018 and 2017, respectively. Future minimum rental commitments under these leases are $542,000 in 2019, $108,000 in 2020, $30,000 in 2021, $13,000 in 2022, $13,000 in 2023 and $3,000 in 2024.

(8) Deposits and Economic Dependence

The aggregate amount of time deposits with a denomination of over $250,000 was approximately $68.0 million and $31.2 million at December 31, 2018 and 2017, respectively.

A schedule of maturities of time deposits at December 31, 2018 is as follows (in thousands):

Year Ending December 31,	
2019	$ 296,498
2020	39,635
2021	31,363
2022	8,086
2023 and thereafter	5,039
	$ 380,621

In the ordinary course of business, the Company accepts deposits from various governmental agencies and public institutions. The aggregate amount of these deposits was approximately $272.9 million and $247.9 million at December 31, 2018 and 2017, respectively.

(continued)

(9) Related Parties

The Company enters into transactions in the ordinary course of business with officers and directors of the Company and their affiliates (related parties). The following summarizes these transactions (in thousands):

	December 31, 2018	December 31, 2017
Deposits	$ 4,757	4,439
Loans	$ 5,675	6,721

(10) Federal Home Loan Bank Advances

There were $5 million in outstanding advances at December 31, 2018. One advance of $2.5 million is a fixed rate credit maturing on July 24, 2020 at a rate of 1.98%. The other advance of $2.5 million is a fixed rate credit maturing on July 24, 2019 with a current rate of 1.70%. Advances outstanding at December 31, 2017 were $42.5 million. The collateral agreement with the FHLB includes a blanket lien covering qualifying loans such as first mortgage, one-to-four family residential loans, and home equity lines of credit owned by the Company with a carrying value of $192.5 million at December 31, 2018. In addition, the Company may pledge additional marketable securities as collateral where the qualifying loans are insufficient. At December 31, 2018, securities with a fair value of $28 million were pledged as collateral for FHLB advances. At December 31, 2018, the Company had available credit if additional collateral were pledged of $448 million.

(11) Other Borrowings

The Company has issued $30,000,000 face value of subordinated debt (the "Subordinated Debt") due December 27, 2028. The Subordinated Debt bears a fixed annual interest rate of 6.125% until December 27, 2023, at which time the rate will become an annual floating rate equal to three-month LIBOR, determined quarterly, plus 326.7 basis points. Interest is payable in arrears on March 31, June 30, September 30 and December 31, of each year through the maturity date, unless redeemed. The Company may, at its option, beginning December 27, 2023, and on any scheduled interest payment date thereafter, redeem the Subordinated Debt, in whole or in part, at 100% of the principal amount of the Subordinate Debt plus any accrued and unpaid interest. The Subordinated Debt was structured to comply with certain regulatory requirements which provide for qualification as Tier 2 Capital. The Subordinated Debt is subject to certain affirmative and negative covenants and at December 31, 2018, the Company was in compliance with the covenants.

The Company also has a line of credit at a financial institution that would allow the Company to borrow up to $10 million. The agreement requires that the Company maintain a $100,000 balance which is the amount outstanding at December 31, 2018.

(continued)

(12) Income Taxes

Allocation of Federal and state income taxes between current and deferred portions is as follows (in thousands):

	Year Ended December 31, 2018	2017
Current:		
Federal	$ 3,341	1,336
State	1,236	367
Total current	4,577	1,703
Deferred:		
Federal	529	(2,245)
State	147	381
Total deferred	676	(1,864)
Income tax expense (benefit)	$ 5,253	(161)

The effective income tax rate differs from the statutory Federal income tax rate for the following reasons (dollars in thousands):

	Year Ended December 31, 2018		2017	
	Amount	%	Amount	%
Income taxes at statutory Federal rate	$ 5,975	21.0%	$ 5,922	35.0%
Increase (decrease) in taxes resulting from:				
State taxes, net of Federal tax benefit	1,093	3.8	487	2.9
Income from bank-owned life insurance	(123)	(0.4)	(319)	(1.9)
Reduction in federal income tax rate	-	-	(4,097)	(24.2)
Tax-exempt interest income	(1,186)	(4.2)	(1,996)	(11.8)
Other	(506)	(1.8)	(158)	(0.1)
Total	$ 5,253	18.4%	$ (161)	(0.1)%

(continued)

(12) Income Taxes, Continued

The components of the net deferred tax liability is as follows (in thousands):

	At December 31,	
	2018	**2017**
Deferred tax assets:		
Allowance for loan losses	$ 1,383	1,377
Deferred compensation	1,980	1,605
Nonaccrual interest income	342	63
Impaired securities	78	78
Accrued expenses	761	319
Fair market value adjustment	1,661	-
Other	367	37
Total deferred tax assets	6,572	3,479
Deferred tax liabilities:		
Purchase accounting on FDIC-assisted transactions	-	(51)
Deferred loan costs	(889)	(289)
Mortgage servicing rights	(11,258)	(9,448)
Unrealized gain in securities available for sale	(8)	(1,793)
Depreciation	(238)	(1,003)
Prepaid expenses	(505)	(288)
Other	-	(716)
Total deferred tax liabilities	(12,898)	(13,588)
Net deferred tax liability	$ (6,326)	(10,109)

The Company files consolidated income tax returns in the U.S. federal jurisdiction and the State of Florida, Wisconsin, Georgia, Illinois, Indiana, Maryland, North Carolina, South Carolina, Tennessee, Michigan, Ohio and Delaware. The Company is no longer subject to U.S. federal, or state and local income tax examinations by taxing authorities for years before 2015.

On December 22, 2017, the "Tax Cuts and Jobs Act of 2017," or the Tax Act, was signed into law. The Tax Act, among other things, reduced the maximum statutory federal corporate income tax rate from 35% to 21% effective January 1, 2018. As a result of the enactment of the Tax Act, the Company revalued its net deferred tax liability. This revaluation resulted in a reduction to the income tax provision of $4.1 million.

(continued)

(13) Off-Balance-Sheet Financial Instruments

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments reflect the extent of involvement the Company has in these financial instruments.

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

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed-expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. All outstanding letters of credit expire in the next twelve months. The Company has in some cases obtained guarantees securing these agreements.

A summary of the amounts of the Company's off-balance-sheet financial instruments at December 31, 2018 follows (in thousands):

	Contract Amount
Unused lines of credit	$ 35,501
Undisbursed loans in process	$ 67,186
Commitments to extend credit	$ 56,193
Standby letters of credit	$ 1,342

(continued)

(14) Derivative Financial Instruments

Rate-Lock Commitments. The total outstanding rate-lock commitments at December 31, 2018 and 2017 were approximately $158.3 million and $62.9 million, respectively. The fair value of rate-lock commitments at December 31, 2018 and 2017 were $1.8 million and $1.1 million, respectively, and are included in other assets in the accompanying consolidated balance sheets.

Forward Loan Sale Contracts. The notional amounts of forward loan sale contracts outstanding at December 31, 2018 and 2017 were $67.5 million and $78.7 million, respectively. The fair value of forward loan sale commitments were $584,000 and $93,000 at December 31, 2018 and 2017, respectively, are included in other liabilities and other assets, respectively, in the accompanying consolidated balance sheets.

(15) Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows (in thousands):

	At December 31,			
	2018		2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 143,436	143,436	57,810	57,810
Time deposits	19,521	19,521	21,957	21,957
Securities available for sale	416,213	416,213	461,053	461,053
Securities held to maturity	5	95	88	136
Loans held for sale, net	101,846	101,846	29,037	29,037
Loans	949,965	957,052	654,575	658,944
Accrued interest receivable	6,952	6,952	7,265	7,265
Federal Home Loan Bank stock	2,001	2,001	2,893	2,893
Servicing rights	45,817	50,484	38,546	42,656
Rate-lock commitments	1,834	1,834	1,085	1,085
Forward loan sale contracts	-	-	32	32
Financial liabilities:				
Deposits	1,542,960	1,540,875	1,120,421	1,119,010
Accrued interest payable	293	293	40	40
Federal Home Loan Bank advances	5,000	4,959	42,500	42,495
Other borrowings	35,901	35,605	-	-
Rate-lock commitments	-	-	2	2
Forward loan sale contracts	584	584	125	125
Off-balance-sheet financial instruments	-	-	-	-

(continued)

(16) Regulatory Matters

During the year ended December 31, 2018, the Federal Reserve Bank raised the threshold from $1 billion to $3 billion in total consolidated assets to be considered a small banking holding company. As a result of this change the Company is excluded from consolidated capital requirements. The Bank is subject to various regulatory capital requirements including the Basel III framework ("Basel III") administered by the banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Under Basel II, the Bank became subject to the capital conservation buffer rules which place limitations on distributions, including dividend payments, and certain discretionary bonus payments to executive officers. In order to avoid these limitations, a bank must hold a capital conservation buffer above its minimum risk-based capital requirements. As of December 31, 2018 and 2017, the Bank's capital conservation buffer exceeds the minimum requirement of 1.875% and 1.25%, respectively. The conservation buffer increased to the required amount of 2.50% on January 1, 2019.

As of December 31, 2018 and 2017, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier I risk-based, and Tier I leverage percentages as set forth in the table. There are no conditions or events since that notification that management believes have changed the institution's category.

(continued)

(16) Regulatory Matters, Continued

	Actual		For Capital Adequacy Purposes		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	%	Amount	%	Amount	%
As of December 31, 2018:						
Common equity tier 1 capital ratio	$ 190,847	18.34%	$ 46,830	4.50%	$ 67,643	6.50%
Tier I capital ratio	190,847	18.34	62,439	6.00	83,253	8.00
Total capital ratio	198,924	19.12	83,253	8.00	104,066	10.00
Tier 1 leverage ratio	190,847	10.77	70,865	4.00	88,581	5.00
As of December 31, 2017:						
Common equity tier 1 capital ratio	164,305	20.13	36,730	4.50	53,050	6.50
Tier I capital ratio	164,305	20.13	48,970	6.00	65,300	8.00
Total capital ratio	170,555	20.90	65,290	8.00	81,620	10.00
Tier 1 leverage ratio	164,305	11.34	57,977	4.00	72,471	5.00

(17) Profit Sharing Plan

The Company sponsors a Section 401(k) profit sharing plan (the "Plan") which is available to all employees electing to participate after meeting certain length-of-service requirements. The Company's contributions to the Plan are discretionary and are determined annually. Expenses relating to the Company's contributions to the Plan, included in the accompanying consolidated financial statements, were $3,075,000 and $1,546,000 for the years ended December 31, 2018 and 2017, respectively.

(continued)

(18) Deferred Compensation Plans

General. The Company has established several deferred compensation and other non-qualified benefit programs for selected key managers. The individual programs have different program features and are based on reaching certain performance goals. All of these plans are unfunded programs recorded only on the books of the Company as liabilities and subject to the claims of creditors in the event of bankruptcy or receivership. The plans include two Discretionary Non-Contributory Money Purchase Plans, as well as a Longevity Reward and Retention Plan, and a Death Benefit program. All of the plans require vesting periods, and if not met, the unvested balances forfeit back to the Company. All programs provide immediate vesting in the event of in-service death or disability.

Discretionary Non-Contributory Money Purchase Plans. One plan (Plan A) is a program where the Company makes a contribution to the plan for selected key managers. A portion of the balance is paid out annually based on a formula after the first six years. These funds are not credited with any interest or earnings. The contributions and manager participation are determined solely in the discretion of the Company. The other plan (Plan B) is similar except that the money is converted to units and earns a return each year. The units are a means to compound the returns. In the event the Company was to have publicly traded stock, the units would be priced at the public stock price. The plan is funded via mandatory reductions from the employees earned incentive compensation, in an amount determined by the Company. The second plan also has limited immediate vesting in change of control situations. A portion of the balance is paid out every five years based on a formula. Both plans have a 20 year vesting.

Death Benefit Plan. The Company provides a program where selected key managers who meet vesting and other requirements share in a death benefit provided by a life insurance policy owned by the Company on the life of the employee. The amount of the benefit varies and is subject to reduction based upon the Company recovering the reported cash surrender values of the policies as described in the contract with the employee.

Longevity and Retention Plan. The Company has established an employment contract to reward longevity and promote manager retention. This benefit is payable due to death or disability of a participant, or for separation of service and change of control. Participation is determined by the Board of Directors.

At December 31, 2018 and 2017, $4.0 million and $3.6 million respectively, was accrued in total under all of these plans. During the years ended December 31, 2018 and 2017, $412,000 and $458,000, respectively, was expensed in total under all of these plans.

(continued)

(19) Contingencies

Various legal claims also arise from time to time in the normal course of business which, in the opinion of management of the Company, will not have a material effect on the Company's consolidated financial statements.

(20) Fair Value Measurements

Assets and (liabilities) measured at fair value on a recurring basis are summarized below (in thousands):

	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At December 31, 2018:				
Available-for-Sale Securities:				
U.S. Treasury bonds	$ 46,450	-	46,450	-
U.S. Government agency bonds	711	-	711	-
Municipal securities	141,697	-	141,697	-
Collateralized mortgage obligations	75,880	-	75,880	-
SBA pool securities	78,282	-	78,282	-
Asset-backed securities	19,125		19,125	
Mortgage-backed securities	54,068	-	54,068	-
Total	$ 416,213	-	416,213	-
Loans held for sale, net	$ 101,846	-	101,846	-
Rate-lock commitments, net	$ 1,834	-	-	1,834
Forward loan sale contracts, net	$ (584)	-	-	(584)
Servicing rights at fair market value	$ 35,581	-	-	35,581

(continued)

(20) Fair Value Measurements, Continued

	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
At December 31, 2017:				
Available-for-Sale Securities:				
U.S. Government agency bonds	$ 1,003	-	1,003	-
Corporate bonds	4,657	-	4,657	-
Municipal securities	218,223	-	218,223	-
Collateralized mortgage obligations	112,637	-	112,637	-
SBA pool securities	87,288	-	87,288	-
Asset-backed securities	15,501	-	15,501	-
Mortgage-backed securities	21,744	-	21,744	-
Total	$ 461,053	-	461,053	-
Loans held for sale, net	$ 29,037	-	29,037	-
Rate-lock commitments, net	$ 1,083	-	-	1,083
Forward loan sale contracts, net	$ 93	-	-	93
Servicing rights at fair market value	$ 28,879	-	-	28,879

(continued)

(20) Fair Value Measurements, Continued

Acquired assets and assumed liabilities measured at fair value are as follows (in thousands):

	Fair Value	Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses	Losses Recorded During the Year
Cash and cash equivalents……………….	$ 10,046	10,046	-	-	-	-
Securities available for sale……………..	29,966	-	29,966	-	-	-
Loans held for sale………………………	87,887	-	-	87,887	-	-
Loans, net……………………………….	375,323	-	-	375,323	-	-
Accrued interest receivable………………	1,389	-	-	1,389	-	-
Premise and Equipment………………….	11,020	-	-	11,020	-	-
Foreclosed real estate…………………….	2,826	-	-	2,826	-	-
Cash surrender value of bank-owned life insurance………………………………	2,464	-	-	2,464	-	-
Servicing rights………………………….	2,244	-	-	2,244	-	-
Goodwill………………………………...	26,507	-	-	26,507	-	-
Other assets………………………………	17,726	-	-	17,726	-	-
Deposits………………………………….	431,249	-	-	431,249	-	-
Federal Home Loan Bank Advances…….	24,700	-	-	24,700	-	-
Junior Subordinated Debt……………….	5,738	-	-	5,738	-	-
Other Borrowings…………………………	7,667	-	-	7,667	-	-
Other Liabilities………………………….	12,152	-	-	12,152	-	-

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

	Year Ended December 31,					
	2018			2017		
	Rate-Lock Commitments Net	Forward Loan Sale Contracts Net	MSR at FMV	Rate-lock Commitments Net	Forward Loan Sale Contracts Net	MSR at FMV
Balance at beginning of year...	$ 1,083	(93)	28,879	1,382	168	24,178
Total gains or losses (realized / unrealized) – purchases, issuances and net settlements	751	(491)	6,702	(299)	(261)	4,701
Balance at end of year……..	$ 1,834	(584)	35,581	1,083	(93)	28,879

(continued)

(20) Fair Value Measurements, Continued

Gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in earnings for Level 3 assets are as follows (in thousands):

	Classification of Gains and Losses (Realized/ Unrealized) Included in Earnings Year Ended December 31,	
	2018 Net Derivatives	2017 Net Derivatives
Mortgage-banking revenue	$ 260	(560)
Servicing rights retained from loans sold	$ 6,702	4,701

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below (in thousands):

		At Year End				(Recoveries) Losses Recorded In Earnings For the Year Ended
	Fair Value	Level 1	Level 2	Level 3	Total (recov-eries) Losses	
At December 31, 2018:						
Impaired loans:						
Commercial real estate	$ 781	-	-	781	724	338
Residential real estate	635	-	-	635	265	15
Construction	74	-	-	74	94	16
Consumer loans	365	-	-	365	262	74
Total	$ 1,855	-	-	1,855	1,345	443
Foreclosed real estate	$ 2,706	-	-	2,706	-	-
Mortgage servicing rights at lower of cost or market	$ 14,903	-	-	14,903	(87)	(87)
At December 31, 2017:						
Impaired loans:						
Commercial real estate	$ 944	-	-	944	445	47
Residential real estate	727	-	-	727	340	21
Commercial	2	-	-	2	5	5
Construction	382	-	-	382	165	165
Consumer loans	259	-	-	259	252	28
Total	$ 2,314	-	-	2,314	1,207	266
Foreclosed real estate	$ 216	-	-	216	-	-
Mortgage servicing rights at lower of cost or market	$ 13,777	-	-	13,777	70	70

(continued)

(21) Consolidating Financial Statements

Consolidating Balance Sheet

At December 31, 2018
(In thousands)

	First Federal Bancorp, MHC	First Federal Bancorp, Inc. Consolidation: First Federal Bancorp, Inc.	First Federal Bancorp, Inc. Consolidation: First Federal Bank of Florida Consolidated	First Federal Bancorp, Inc. Consolidation: Consolidating Entries Debit (Credit)	First Federal Bancorp, Inc. Consolidation: Consolidated	Consolidating Entries Debit (Credit)	Consolidated
Assets							
Cash and due from banks	$ 10	4,395	39,318	(3,672)	40,041	(10)[(a)]	40,041
Interest-bearing deposits	-	-	103,395	-	103,395	-	103,395
Time deposits	-	-	19,521	-	19,521	-	19,521
Securities	-	711	415,507	-	416,218	-	416,218
Investment in subsidiaries	205,187	235,603	-	(235,603)	-	(205,187)[(b)]	-
Loans, net	-	-	1,051,811	-	1,051,811	-	1,051,811
Accrued interest receivable	-	3	6,949	-	6,952	-	6,952
Premises and equipment, net	-	-	34,707	-	34,707	-	34,707
Federal Home Loan Bank stock, at cost	-	-	2,001	-	2,001	-	2,001
Foreclosed real estate	-	-	2,706	-	2,706	-	2,706
Income taxes receivable	-	780	317	-	1,097	-	1,097
Cash surrender value of bank-owned life insurance	-	-	34,970	-	34,970	-	34,970
Servicing rights, net	-	-	45,817	-	45,817	-	45,817
Goodwill	-	-	28,235	-	28,235	-	28,235
Other assets	-	93	50,646	-	50,739	-	50,739
Total assets	$ 205,197	241,585	1,835,900	(239,275)	1,838,210	(205,197)	1,838,210
Liabilities, Capital Stock and Retained Earnings and Accumulated Other Comprehensive Income							
Liabilities:							
Deposits	-	-	1,546,642	(3,672)	1,542,970	(10)[(a)]	1,542,960
Federal Home Loan Bank Advances			5,000	-	5,000	-	5,000
Junior Subordinated Debt	-	5,801	-	-	5,801	-	5,801
Other Borrowings	-	30,100	-	-	30,100	-	30,100
Deferred income taxes	-	147	6,179	-	6,326	-	6,326
Other liabilities	-	350	42,476	-	42,826	-	42,826
Total liabilities	-	36,398	1,600,297	(3,672)	1,633,023	(10)	1,633,013
Capital stock	-	-	1	(1)	-	-	-
Retained earnings and accumulated other comprehensive income	205,197	205,187	235,602	(235,602)	205,187	(205,187)[(b)]	205,197
Total liabilities, capital stock and retained earnings and accumulated other comprehensive income	$ 205,197	241,585	1,835,900	(239,275)	1,838,210	(205,197)	1,838,210

(continued)

(a) Elimination of intercompany accounts.
(b) Elimination of investment in subsidiaries.

(21) Consolidating Financial Statements, Continued

Consolidating Statement of Earnings

Year Ended December 31, 2018
(In thousands)

	First Federal Bancorp, MHC	First Federal Bancorp, Inc. Consolidation: First Federal Bancorp, Inc.	First Federal Bancorp, Inc. Consolidation: First Federal Bank of Florida Consolidated	First Federal Bancorp, Inc. Consolidation: Consolidating Entries Debit (Credit)	First Federal Bancorp, Inc. Consolidation: Consolidated	Consolidating Entries Debit (Credit)	Consolidated
Interest income:							
Loans	$ -	-	54,347	-	54,347	-	54,347
Securities	-	11	12,284	-	12,295	-	12,295
Other	-	17	2,009	-	2,026	-	2,026
Total interest income	-	28	68,640	-	68,668	-	68,668
Interest expense:							
Deposits	-	-	8,487	-	8,487	-	8,487
Borrowings	-	341	1,160	-	1,501	-	1,501
Total interest expense	-	341	9,647	-	9,988	-	9,988
Net interest income	-	(313)	58,993	-	58,680	-	58,680
Provision for loan losses	-	-	617	-	617	-	617
Net interest income after provision for loan losses	-	(313)	58,376	-	58,063	-	58,063
Noninterest income:							
Loan servicing fees	-	-	7,611	-	7,611	-	7,611
Servicing rights retained from loans sold	-	-	5,081	-	5,081	-	5,081
Mortgage banking revenue	-	-	19,525	-	19,525	-	19,525
Service charges on deposit accounts	-	-	3,784	-	3,784	-	3,784
Other service charges and fees	-	-	3,566	-	3,566	-	3,566
Gain on sale of securities available for sale	-	-	2,495	-	2,495	-	2,495
OTTI on securities available for sale	-	-	(88)	-	(88)	-	(88)
Income from bank-owned life insurance	-	-	585	-	585	-	585
Debit card interchange income	-	-	3,622	-	3,622	-	3,622
Other	23,290	24,292	175	(24,328)[(a)]	139	(23,290)[(a)]	139
Total noninterest income	23,290	24,292	46,356	(24,328)	46,320	(23,290)	46,320
Noninterest expenses:							
Salaries and employee benefits	-	9	47,681	(9)	47,681	-	47,681
Occupancy and equipment	-	2	8,633	(2)	8,633	-	8,633
Professional fees	-	25	2,838	(25)	2,838	-	2,838
Other	-	792	15,896	-	16,688	-	16,688
Total noninterest expenses	-	828	75,048	(36)	75,840	-	75,840
Earnings before income taxes	23,290	23,151	29,684	(24,292)	28,543	(23,290)	28,543
Income tax	-	(139)	5,392	-	5,253	-	5,253
Net earnings	$ 23,290	23,290	24,292	(24,292)	23,290	(23,290)	23,290

(a) Elimination of income of subsidiaries.