TRUXTON TRUST

Dear Shareholder:

2016 was a year of steady progress for Truxton Trust and Truxton Corporation. We experienced record earnings and dividends and demonstrated our ability to deliver consistent earnings growth and high returns on shareholder's capital. We earned over $5.5 million after tax in 2016 and paid out almost $2 million in dividends, generating a 12% return on shareholder's equity for the fourth consecutive year.

Our operating businesses, a private bank and a wealth management firm, each performed well. We believe both continue to thrive because so many of our clients rely on Truxton for sound financial advice, often needing the services of both our bankers and our wealth advisors.

In the private bank, loans grew 12% and ended the year at record levels with a strong pipeline of opportunities. Credit quality remained very strong with below 1% of loans categorized as "non-accrual" at year end. Nashville, our principal banking market, has one of the strongest economies in the nation. Construction and development are occurring at an astonishing pace. We are growing in this environment, but are keenly aware of our need to manage risk, underwrite and price loans with care, and consider the strength of our borrowers and their projects with heightened caution.

Wealth Management revenue grew by 5.5% during the year. We added new client relationships and saw existing relationships grow. We manage assets for our clients, but we do far more. Wealthy families make decisions with long-term consequences and both legal and financial complexity. Unbiased advice from experienced professionals is hard to find. Many families find expert guidance and service at Truxton Trust.

The political and economic environment changed significantly in 2016. Interest rates have begun to rise, a new administration took power in Washington, and tax and regulatory changes are on the horizon. Rising rates should be a small positive for our company though the effects on deposit and loan pricing are difficult to predict after many years near zero. Reductions in corporate taxes and some measure of reduced regulation would be clear advantages to our prospects for earnings, but their form and timing are unpredictable. We manage Truxton to be stable and reasonably profitable across a wide range of economic scenarios, earning superior returns through our relationships and local market knowledge, not by guessing the direction of rates or regulations.

At Truxton, we believe that a stubborn focus on doing the right thing for clients has been the key to our success since we started in 2004.

We strive to serve our clients with the greatest measure of integrity and kindness, and we are humbled that this ambition continues to be rewarded with exceptional financial performance.

Thomas S. Stumb

Chairman of the Board
and Chief Executive Officer

Andrew L. May

President

TRUXTON CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

TRUXTON CORPORATION
Nashville, Tennessee

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

CONTENTS

INDEPENDENT AUDITOR'S REPORT

The Board of Directors
Truxton Corporation
Nashville, Tennessee

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Truxton Corporation, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of net income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the 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 from 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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Truxton Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Franklin, Tennessee
February 22, 2017

TRUXTON CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2016 and 2015
(Dollars in thousands except share and per share amounts)

	2016	2015
ASSETS		
Cash and due from financial institutions	$ 6,547	$ 5,699
Interest bearing deposits in other financial institutions	3,466	17,340
Federal funds sold	295	9,815
Cash and cash equivalents	10,308	32,854
Time deposits in other financial institutions	16,628	19,995
Securities available for sale	78,988	82,482
Gross loans	288,096	257,159
Allowance for loan losses	(2,998)	(2,754)
Net loans	285,098	254,405
Bank owned life insurance	9,304	9,060
Restricted equity securities	2,543	2,527
Premises and equipment, net	817	1,175
Accrued interest receivable	1,261	1,107
Deferred tax asset, net	830	805
Other assets	1,448	1,042
Total assets	$ 407,225	$ 405,452
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest bearing	$ 76,035	$ 75,561
Interest bearing	262,896	263,453
Total deposits	338,931	339,014
Federal Home Loan Bank advances	20,522	22,479
Other liabilities	1,644	1,685
Total liabilities	361,097	363,178
Shareholders' equity		
Preferred stock, $0.10 par value; 5,000,000 shares authorized; no shares issued	-	-
Common stock, $0.10 par value; 40,000,000 shares authorized; 2,649,178 shares issued and outstanding in 2016 and 2,618,964 shares issued and outstanding in 2015	265	262
Additional paid-in capital	26,469	25,928
Retained earnings	19,519	15,919
Accumulated other comprehensive income	(125)	165
Total shareholders' equity	46,128	42,274
Total liabilities and shareholders' equity	$ 407,225	$ 405,452

See accompanying notes to consolidated financial statements.

TRUXTON CORPORATION
CONSOLIDATED STATEMENTS OF NET INCOME
Years ended December 31, 2016 and 2015
(Dollars in thousands except share and per share amounts)

	2016	2015
Non-interest income		
Wealth management services	$ 7,646	$ 7,204
Service charges on deposit accounts	325	278
Gain on sale of securities	85	-
Gain on other real estate sold	-	221
Bank owned life insurance income	244	226
Life insurance death benefit income	-	247
Other	208	149
Total non-interest income	8,508	8,325
Interest income		
Loans, including fees	11,310	10,286
Taxable securities	954	913
Tax-exempt securities	745	730
Interest bearing deposits	287	142
Federal funds sold	21	10
Total interest income	13,317	12,081
Interest expense		
Deposits	1,046	1,006
Short-term borrowings	12	4
Long-term borrowings	266	275
Total interest expense	1,324	1,285
Net interest income	11,993	10,796
Provision for loan losses	248	21
Net interest income after provision for loan losses	11,745	10,775
Total revenue, net	20,253	19,100
Non-interest expense		
Compensation and employee benefits	8,192	7,840
Occupancy	664	655
Furniture and equipment	171	173
Data processing	1,158	929
Wealth management processing fees	523	588
Advertising and public relations	166	150
Professional services	663	525
FDIC insurance assessments	171	194
Other	876	812
Total non-interest expense	12,584	11,866
Income before income taxes	7,669	7,234
Income tax expense	2,164	2,203
Net income	$ 5,505	$ 5,031
Earnings per share:		
Basic	$ 2.09	$ 1.94
Diluted	$ 2.06	$ 1.92

See accompanying notes to consolidated financial statements.

TRUXTON CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2016 and 2015
(Dollars in thousands except share and per share amounts)

	2016	2015
Net income	$ 5,505	$ 5,031
Other comprehensive loss:		
Unrealized gains/losses on securities:		
Unrealized holding loss arising during the period	(386)	(53)
Reclassification adjustment for gains included in net income as gain on sale of securities	(85)	-
Tax effect, income tax expense included in net income related to reclassification adjustments $33 and $0, respectively	181	20
Total other comprehensive loss, net of tax	(290)	(33)
Comprehensive income	$ 5,215	$ 4,998

See accompanying notes to consolidated financial statements.

TRUXTON CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2016 and 2015
(Dollars in thousands except share and per share amounts)

	Shares	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2015	2,569,051	$ 257	$ 25,247	$ 12,450	$ 198	$ 38,152
Exercise of stock options, including tax benefit and net of forfeitures	29,382	3	343	-	-	346
Issuance of restricted shares of common stock, net	20,531	2	(2)	-	-	-
Stock based compensation expense	-	-	340	-	-	340
Cash dividends declared ($0.60 per share)	-	-	-	(1,562)	-	(1,562)
Net income	-	-	-	5,031	-	5,031
Other comprehensive loss	-	-	-	-	(33)	(33)
Balance at December 31, 2015	2,618,964	262	25,928	15,919	165	42,274
Exercise of stock options, including tax benefit and net of forfeitures	8,310	1	136	-	-	137
Issuance of restricted shares of common stock, net	21,904	2	(2)	-	-	-
Stock based compensation expense	-	-	407	-	-	407
Cash dividends declared ($0.72 per share)	-	-	-	(1,905)	-	(1,905)
Net income	-	-	-	5,505	-	5,505
Other comprehensive loss	-	-	-	-	(290)	(290)
Balance at December 31, 2016	2,649,178	$ 265	$ 26,469	$ 19,519	$ (125)	$ 46,128

See accompanying notes to consolidated financial statements.

TRUXTON CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2016 and 2015
(Dollars in thousands except share and per share amounts)

	2016	2015
Cash flows from operating activities		
Net income	$ 5,505	$ 5,031
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	392	359
Net amortization of securities	719	602
Deferred income tax expense (benefit)	156	90
Excess tax benefit from exercise of stock options	-	(107)
Provision for loan losses	248	21
Gain on securities	(85)	-
Gain on sale of other real estate owned	-	(221)
Life insurance death benefit income	-	(247)
Stock based compensation expense	407	340
Bank owned life insurance income	(244)	(226)
Net change in:		
Accrued interest receivable	(148)	(50)
Other assets	(414)	(533)
Other liabilities	(40)	(66)
Net cash from operating activities	6,496	4,993
Cash flows from investing activities		
Net (increase) decrease in time deposits in other financial institutions	3,367	(13,121)
Purchase of bank owned life insurance	-	(1,250)
Proceeds of settlement of life insurance death benefit	-	722
Available for sale securities:		
Purchases	(26,866)	(6,957)
Maturities, calls and paydowns	9,369	9,380
Sales	19,887	-
Net increase in loans	(30,941)	(27,866)
Purchase of restricted equity securities	(16)	(230)
Proceeds from sale of other real estate owned	-	1,117
Capitalized costs of improvements to other real estate owned	-	(255)
Additions of premises and equipment, net	(34)	(834)
Net cash from investing activities	(25,234)	(39,294)
Cash flows from financing activities		
Proceeds from Federal Home Loan Bank advances	(743)	500
Repayments of Federal Home Loan Bank advances	(1,214)	(1,374)
Net increase (decrease) in deposits	(83)	57,184
Proceeds from exercise of stock options, including tax benefit	137	346
Cash dividends paid	(1,905)	(1,562)
Net cash from financing activities	(3,808)	55,094
Net change in cash and cash equivalents	(22,546)	20,793
Cash and cash equivalents at beginning of year	32,854	12,061
Cash and cash equivalents at end of year	$ 10,308	$ 32,854
Supplemental cash flow information:		
Cash paid during year for interest	$ 1,322	$ 1,287
Cash paid during year for income taxes	1,825	2,025

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principals of Consolidation: The consolidated financial statements include Truxton Corporation and its wholly owned subsidiary, Truxton Trust Company, together referred to as “the Corporation.” Intercompany transactions and balances are eliminated in consolidation.

Truxton Trust Company, referred to as “the Bank”, represents substantially all the operations in the consolidated financial statements and it provides a variety of banking, investment management and trust administration services to individuals, businesses and charitable institutions. Its primary deposit products are demand, money market and certificates of deposit and its primary lending products are residential and commercial real estate mortgages, commercial loans and loans to individuals.

Subsequent Events: The Corporation has evaluated subsequent events for recognition and disclosure through February 22, 2017, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided and actual results could differ.

Cash Flows: Cash and cash equivalents include cash, deposits with other financial institutions with maturities under 90 days, and federal funds sold. Net cash flows are reported for customer loan and deposit transactions, premises and equipment, and time deposits in other financial institutions.

Interest-Bearing Deposits in Other Financial Institutions: Interest-bearing deposits in other financial institutions mature within one year and are carried at cost.

Time Deposits in Other Financial Institutions: Time deposits in other financial institutions are carried at cost. These accounts are maintained at several financial institutions and are all within the insurance limits provided by the Federal Deposit Insurance Corporation “FDIC” and have maturities ranging from 2017 to 2022.

Securities: Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value with unrealized holding gains and losses reported in accumulated other comprehensive income (loss), net of tax.

Interest income includes net amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments except for collateralized mortgage obligations and mortgage-backed securities, where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment “OTTI” on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also 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 the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split into two components as follows: 1) OTTI related to credit loss, which must be recognized in the income statement, and 2) OTTI related to other factors, which is recognized in other comprehensive income (loss). The credit loss is defined as the difference between the present value of the cash flows expected to be collected and the amortized cost basis. For equity securities, the entire amount of impairment is recognized through earnings.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the level-yield method without anticipating prepayments.

Interest income is reported on the interest method and includes amortization of net deferred loan fees and costs over the loan term. Interest income on all loans is discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued, but not received, for loans placed on nonaccrual are reversed against interest income. Interest received on such 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.

Concentration of Credit Risk: Most of the Corporation's business activity is with customers located within Nashville, Tennessee. Therefore, the Corporation's exposure to credit risk is significantly affected by changes in the economy in the Nashville, Tennessee metropolitan area.

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and decreased by charge-offs less recoveries. Management estimates the allowance balance required using historical loan loss experience of both the bank and the banking industry, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries if any, are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers loans that are collectively evaluated for impairment and is based on historical loss experience adjusted for current factors.

A loan is impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

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.

Commercial and commercial real estate loans are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans are collectively evaluated for impairment and accordingly, they are not separately identified for impairment disclosures.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled debt restructurings are individually evaluated for impairment and included in the separately identified impairment disclosures. Troubled debt restructurings are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Corporation determines the amount of the allowance on the loan in accordance with the accounting policy for the allowance for loan losses individually evaluated as impaired.

The historical loss experience used in management's analysis of the general component for the allowance for loan losses is determined by portfolio segment and is based on the average loss history experienced by the bank and banking industry over the most recent 3 year periods. The Corporation used the loss history of its peers, as it has experienced very few losses on its own during the entire history of the Corporation. Management evaluates 3 years of peer losses in order to align with what management expects normalized probable incurred losses to be for the Corporation. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations.

The following portfolio segments have been identified:

- Commercial loans include loans for commercial, industrial or agricultural purposes to business enterprises that are not secured by real estate. These loans are typically made on the basis of the borrower's ability to repay from the cash flow of the borrower's business and are generally secured by accounts receivable, inventory and equipment. The collateral securing loans may depreciate over time, may be difficult to appraise and may fluctuate in value based on the success of the business.

- Commercial Real Estate loans include loans secured by non-residential real estate and improvements thereon. Often these loans are made to single borrowers or groups of related borrowers, and the repayment of these loans largely depends on the results of operations and management of these properties. Adverse economic conditions may affect the repayment ability of these loans.

- Residential Real Estate loans include loans secured by residential real estate, including single-family and multi-family dwellings. Adverse economic conditions in the Corporation's market area may reduce borrowers' ability to repay these loans and may reduce the collateral securing these loans.

- Construction and Land Development loans include loans to finance the process of improving properties preparatory to erecting new structures or the on-site construction of industrial, commercial, residential or farm buildings. Construction and land development loans also include loans secured by vacant land, except land known to be used or usable for agricultural purposes. Construction loans generally are made for relatively short terms. They generally are more vulnerable to changes in economic conditions. Furthermore, the nature of these loans is such that they are more difficult to evaluate and monitor. The risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property's value upon completion of the project and the estimated cost (including interest) of the project. Periodic site inspections are made on construction loans.

- Consumer loans include loans to individuals for household, family and other personal expenditures that are not secured by real estate.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Bank Owned Life Insurance: The Bank has purchased life insurance policies on certain key employees. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or other amounts due that are probable at settlement.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales, when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Corporation, 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 the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Premises and Equipment: Premises and equipment are stated at cost less accumulated depreciation. Leasehold improvements are amortized using the straight-line method over the shorter of the lease terms or the useful lives. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from three to five years.

Restricted Equity Securities: The Bank is a member of the Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) systems. Members are required to own a certain amount of stock based on the level of borrowings and on their level of equity and may invest in additional amounts. FHLB and FRB stock are carried at cost, classified as restricted equity securities and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Prepaid Long-term Compensation: The Corporation paid retention bonuses in cash to certain key employees. These cash bonuses are considered long-term compensation to be earned over a 36 to 60 month requisite service period. The amount of the contracts is earned pro rata by the employees and expensed pro rata by the Corporation over the contractual term of the agreements. In the event that the employee leaves during the life of the contract, the employee is obligated to repay the unearned amount. Prepaid long-term compensation amounts of $283 and $245 were included in other assets as of December 31, 2016 and 2015.

Long-term Assets: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are recorded at fair value.

Assets Under Management: Assets held in fiduciary or agency capacities are not included in the consolidated balance sheets since such items are not assets of the Corporation.

Wealth Management Services Income Recognition: Income from Wealth Management Services is calculated by multiplying each investment management account's market value, determined on a specific date each month, by a static or tiered percentage, according to the investment management agreement. The income resulting from Wealth Management Services accounts is recognized monthly.

Derivatives: The Corporation has entered into derivative contracts designated as a hedge of fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value hedge"). For a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item, are recognized in current earning as fair values change. Changes in fair values of derivatives that are not highly effective in hedging the changes in fair value of the hedged item are recognized immediately in current earnings. Net cash settlements on derivatives that qualify for hedge accounting are recorded in interest income or interest expense, based on the item being hedged.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Corporation formally documents the relationship between derivatives and hedged items, as well as the risk-management objective and the strategy for undertaking hedge transactions at the inception of the hedging relationship. This documentation includes linking fair value hedge's to specific assets and liabilities on the balance sheet. The Corporation also formally assesses, both at the hedges inception and on an ongoing basis, whether the derivative instruments that are used are highly effective in offsetting changes in fair values of hedged items. The Corporation discontinues hedge accounting when it determines that the derivative is no longer effective in offsetting changes in fair value of the hedged item, the derivative is settled or terminates, or the treatment of the derivative as a hedge is no longer appropriate or intended. When hedge accounting is discontinued, subsequent changes in fair value of the derivative are recorded as non-interest income.

<u>Stock-Based Compensation</u>: Compensation cost is recognized for stock options and restricted stock awards issued to employees and directors, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Corporation's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized, on a straight-line basis over the requisite service period for the entire award generally defined as the vesting period.

<u>Retirement Plans</u>: Employee 401(k) benefit plan expense is the amount of matching contributions for the period.

<u>Comprehensive Income</u>: Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as separate components of shareholders' equity.

<u>Income Taxes</u>: Income tax expense or benefit is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Corporation recognizes interest and/or penalties related to income tax matters in income tax expense.

<u>Earnings Per Share</u>: Basic earnings per share available to common shareholders is computed by dividing net income adjusted for income allocated to participating securities by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under stock options.

(Dollars in thousands except share and per share amounts)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loss Contingencies: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe that there now are such matters that will have a material effect on the financial statements.

Restrictions on Cash: Cash on hand or on deposit with the Federal Reserve Bank is required to meet regulatory reserve and clearing requirements.

Dividend Restriction: Banking regulations require maintaining certain capital levels and may limit the dividends paid by the Bank to the Corporation or by the Corporation to shareholders.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Off Balance Sheet Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit issued to meet customer financing needs. The face amount for these items represents the exposure to loss before considering customer collateral or ability to repay. Such financial instruments are recorded as loans when they are funded.

NOTE 2 - SECURITIES

The following table summarizes the amortized cost and fair value of the available for sale securities portfolio at December 31, 2016 and 2015 and the corresponding amounts of gross unrealized gains and losses recognized in accumulated other comprehensive income (loss):

2016	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
Corporate bonds	$ 10,042	$ 40	$ (65)	$ 10,017
State and political subdivisions	25,559	329	(298)	25,590
Collateralized mortgage obligations	7,591	31	(76)	7,546
Mortgage-backed securities: residential	18,941	17	(231)	18,727
Mortgage-backed securities: commercial	17,058	124	(74)	17,108
Total available for sale	$ 79,191	$ 541	$ (744)	$ 78,988

(Dollars in thousands except share and per share amounts)

NOTE 2 – SECURITIES (Continued)

2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available for sale				
U.S. government sponsored entities and agencies	$ 4,802	$ -	$ (77)	$ 4,725
Corporate bonds	6,550	13	(82)	6,481
State and political subdivisions	25,847	707	(57)	26,497
Collateralized mortgage obligations	9,237	35	(225)	9,047
Mortgage-backed securities: residential	17,522	53	(193)	17,382
Mortgage-backed securities: commercial	18,256	155	(61)	18,350
Total available for sale	$ 82,214	$ 963	$ (695)	$ 82,482

There were no sales of available for sale securities during the year ending December 31, 2015. Sales of available for sale securities were as follows for the year ending December 31, 2016:

Proceeds	$ 19,887
Gross gains	180
Gross losses	(95)

Securities pledged at year-end 2016 and 2015 had carry value of $8,036 and $5,095, and were pledged to secure public deposits. The Corporation had no holdings of securities of any one issuer, other than the U.S. government sponsored entities and agencies, in an amount greater than 10% of shareholders' equity.

The amortized cost and fair value of the investment securities portfolio are shown by contractual maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

	December 31, 2016	
	Amortized Cost	Fair Value
Within one year	$ 500	$ 503
One to five years	10,286	10,275
Five to ten years	14,785	14,888
Beyond ten years	10,030	9,941
Collateralized mortgage obligations	7,591	7,546
Mortgage-backed securities: residential	18,941	18,727
Mortgage-backed securities: commercial	17,058	17,108
Total	$ 79,191	$ 78,988

(Dollars in thousands except share and per share amounts)

NOTE 2 – SECURITIES (Continued)

The following table summarizes the investment securities with unrealized losses at December 31, 2016 and 2015 aggregated by major security type and length of time in a continuous unrealized loss position:

	Less than 12 Months		12 Months or More		Total	
December 31, 2016	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Available for sale						
Corporate bonds	$ 5,802	$ (60)	$ 680	$ (5)	$ 6,482	$ (65)
State and political subdivisions	10,988	(298)	-	-	10,988	(298)
Collateralized mortgage obligation	5,595	(76)	-	-	5,595	(76)
Mortgage-backed securities: residential	15,790	(215)	1,547	(16)	17,337	(231)
Mortgage-backed securities: commercial	5,689	(71)	1,507	(3)	7,196	(74)
Total available for sale	$ 43,864	$ (720)	$ 3,734	$ (24)	$ 47,598	$ (744)
December 31, 2015						
Available for sale						
U.S. government sponsored entities and agencies	$ 1,730	$ (22)	$ 2,995	$ (55)	$ 4,725	$ (77)
Corporate bonds	4,032	(48)	1,436	(34)	5,468	(82)
State and political subdivisions	2,878	(35)	1,565	(22)	4,443	(57)
Collateralized mortgage obligation	2,601	(21)	4,960	(204)	7,561	(225)
Mortgage-backed securities: residential	7,483	(84)	4,299	(109)	11,782	(193)
Mortgage-backed securities: commercial	4,248	(22)	2,595	(39)	6,843	(61)
Total available for sale	$ 22,972	$ (232)	$ 17,850	$ (463)	$ 40,822	$ (695)

Unrealized losses on securities have not been recognized into income because the issuers are of high credit quality, management does not intend to sell and it is more likely than not that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to changes in market interest rates instead of credit quality. The fair value is expected to recover as the securities approach their maturity dates and/or market rates change. As a result, the Corporation does not consider these securities to be other-than-temporarily impaired at December 31, 2016.

Restricted equity securities consist of securities which are restricted as to transferability. These securities are recorded at cost. Restricted equity securities consist of the following at December 31, 2016 and 2015:

	2016	2015
Federal Home Loan Bank stock	$ 1,852	$ 1,852
Federal Reserve Bank stock	691	675
	$ 2,543	$ 2,527

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS

Loans at year end were as follows:

	2016	2015
Commercial	$ 28,721	$ 26,293
Commercial real estate	107,033	76,759
Residential real estate:		
Closed-end	61,551	61,782
Open-end	40,816	46,651
Construction and land development:		
Owner occupied	3,301	4,339
Development	19,429	18,160
Consumer	27,380	23,243
Subtotal	288,231	257,227
Net deferred loan fees	(135)	(68)
Gross loans	$ 288,096	$ 257,159

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

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

December 31, 2016	Commercial	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 183	$ 998	$ 1,138	$ 270	$ 165	$ -	$ 2,754
Provision (credit) for loan losses	22	319	(199)	17	89	-	248
Loans charged-off	-	-	(5)	-	-	-	(5)
Recoveries	-	-	1	-	-	-	1
Total ending allowance balance	$ 205	$ 1,317	$ 935	$ 287	$ 254	$ -	$ 2,998

December 31, 2015	Commercial	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Consumer	Unallocated	Total
Allowance for loan losses:							
Beginning balance	$ 290	$ 745	$ 1,238	$ 123	$ 94	$ 243	$ 2,733
Provision (credit) for loan losses	(107)	253	(100)	147	71	(243)	21
Loans charged-off	-	-	-	-	-	-	-
Recoveries	-	-	-	-	-	-	-
Total ending allowance balance	$ 183	$ 998	$ 1,138	$ 270	$ 165	$ -	$ 2,754

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016 and 2015. The recorded investment amounts do not include accrued and unpaid interest or any net deferred loan fees or costs due to immateriality.

December 31, 2016	Commercial	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Consumer	Unallocated	Total
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ 10	$ -	$ -	$ -	$ 10
Collectively evaluated for impairment	205	1,317	925	287	254	-	2,988
Total ending allowance balance	$ 205	$ 1,317	$ 935	$ 287	$ 254	$ -	$ 2,998
Loans:							
Individually evaluated for impairment	$ -	$ 787	$ 357	$ -	$ -	$ -	$ 1,144
Collectively evaluated for impairment	28,721	106,246	102,010	22,730	27,380	-	287,087
Total ending loans balance	$ 28,721	$ 107,033	$ 102,367	$ 22,730	$ 27,380	$ -	$ 288,231
December 31, 2015							
Ending allowance balance attributable to loans:							
Individually evaluated for impairment	$ -	$ -	$ 17	$ -	$ -	$ -	$ 17
Collectively evaluated for impairment	183	998	1,121	270	165	-	2,737
Total ending allowance balance	$ 183	$ 998	$ 1,138	$ 270	$ 165	$ -	$ 2,754
Loans:							
Individually evaluated for impairment	$ -	$ -	$ 305	$ -	$ -	$ -	$ 305
Collectively evaluated for impairment	26,293	76,759	108,128	22,499	23,243	-	256,922
Total ending loans balance	$ 26,293	$ 76,759	$ 108,433	$ 22,499	$ 23,243	$ -	$ 257,227

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

As of December 31, 2015, the Corporation had no troubled debt restructurings. As of December 31, 2016, the Corporation has a recorded investment in troubled debt restructurings of $990. The Corporation has allocated no specific reserves for those loans at December 31, 2015 and 2016.

The modifications in terms associated with troubled debt restructurings that occurred in 2016 included the reduction of near-term interest and/or principal payments as a concession to borrowers experiencing financial stress. These loans are well secured by residential and commercial real estate.

The troubled debt restructurings described above had no impact on the allowance for loan losses or charge offs during the year ending December 31, 2016

	Number Of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
December 31, 2016			
Troubled debt restructurings:			
Commercial	2	$ 787	$ 787
Residential real estate:			
Closed-end	2	203	203
Total	4	$ 990	$ 990

There were no loans that were modified as troubled debt restructurings for which there was a payment default within twelve months following the modification during the years ended December 31, 2016 and 2015.

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the years ended December 31, 2016 and 2015:

	Unpaid Principal Balance	Recorded Investment	Allowance for Loan Losses Allocated	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
December 31, 2016						
With no related allowance recorded:						
Commercial real estate:	$ 787	$ 787	$ -	$ 787	$ 36	$ 36
Residential real estate:						
Closed-end	203	203	-	205	10	10
With an allowance recorded:						
Residential real estate:						
Closed-end	154	154	10	173	5	5
Total	$ 1,144	$ 1,144	$ 10	$ 1,165	$ 51	$ 51
December 31, 2015						
With no related allowance recorded:						
Residential real estate:						
Closed-end	$ 288	$ 288	$ -	$ 298	$ 25	$ 25
With an allowance recorded:						
Residential real estate:						
Closed-end	17	17	17	18	2	2
Total	$ 305	$ 305	$ 17	$ 316	$ 27	$ 27

For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

There were no loans past due over 90 days and still accruing as of December 31, 2016. There were $5 closed-end residential real estate loans past due over 90 days and still accruing as of December 31, 2015.

There were $787 commercial loans on non-accrual as of December 31, 2016 and $0 loans on non-accrual as of December 31, 2015.

The following table presents the aging of the recorded investment in past due loans as of December 31, 2016 and 2015 by class of loans:

December 31, 2016	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial	$ -	$ -	$ -	$ -	$ 28,721	$ 28,721
Commercial real estate	-	-	-	-	107,033	107,033
Residential real estate:						
Closed-end	8	-	-	8	61,543	61,551
Open-end	-	-	-	-	40,816	40,816
Construction and land Development:						
Owner occupied	-	-	-	-	3,301	3,301
Development	-	-	-	-	19,429	19,429
Consumer	-	-	-	-	27,380	27,380
Total	$ 8	$ -	$ -	$ 8	$ 288,223	$ 288,231

December 31, 2015	30 - 59 Days Past Due	60 - 89 Days Past Due	Greater than 89 Days Past Due	Total Past Due	Loans Not Past Due	Total
Commercial	$ -	$ -	$ -	$ -	$ 26,293	$ 26,293
Commercial real estate	-	-	-	-	76,759	76,759
Residential real estate:						
Closed-end	139	11	5	155	61,627	61,782
Open-end	355	-	-	355	46,296	46,651
Construction and land Development:						
Owner occupied	-	-	-	-	4,339	4,339
Development	-	-	-	-	18,160	18,160
Consumer	-	-	-	-	23,243	23,243
Total	$ 494	$ 11	$ 5	$ 510	$ 256,717	$ 257,227

Credit Quality Indicators:

The Corporation 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 Corporation periodically analyzes loans individually by classifying the loans as to credit risk. The Corporation uses the following definitions for risk ratings:

(Dollars in thousands except share and per share amounts)

NOTE 3 - LOANS (Continued)

Special Mention. Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

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

Doubtful. Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans. As of December 31, 2016 and 2015, based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Doubtful
December 31, 2016				
Commercial	$ 27,934	$ -	$ 787	$ -
Commercial real estate	107,033	-	-	-
Residential real estate:				
Closed-end	61,551	-	-	-
Open-end	38,727	2,089	-	-
Construction and land development:				
Owner occupied	3,301	-	-	-
Development	19,429	-	-	-
Consumer	27,380	-	-	-
Total	$ 285,355	$ 2,089	$ 787	$ -
December 31, 2015				
Commercial	$ 26,293	$ -	$ -	$ -
Commercial real estate	76,759	-	-	-
Residential real estate:				
Closed-end	61,495	-	287	-
Open-end	44,561	2,090	-	-
Construction and land development:				
Owner occupied	4,339	-	-	-
Development	18,160	-	-	-
Consumer	23,243	-	-	-
Total	$ 254,850	$ 2,090	$ 287	$ -

(Dollars in thousands except share and per share amounts)

NOTE 4 - PREMISES AND EQUIPMENT

Year-end premises and equipment were as follows:

	2016	2015
Leasehold improvements	$ 915	$ 915
Furniture, fixtures and equipment	857	833
Computer software	1,075	1,064
	2,847	2,812
Less: Accumulated depreciation and amortization	2,030	1,637
Net premises and equipment	$ 817	$ 1,175

Depreciation and amortization expense totaled $392 and $359 for 2016 and 2015, respectively.

The Corporation's main office facility is subject to a six-year lease, terminating June 1, 2018. The lease agreement includes one renewal option of three years. The Corporation's second office facility is subject to a two year lease, terminating on June 1, 2018. The lease agreement includes one renewal option of two years. Total rent expense for 2016 and 2015 was $397 and $388.

Rent commitments for office facilities under non-cancelable operating leases were as follows, before considering renewal options that are present.

2017	$ 401
2018	166

The Corporation had operating leases for property and equipment that have non-cancelable lease commitments as follows:

2017	$ 63
2018	64
2019	42
2020	25
2021	3

These leases have terms of three or five years and resulted in lease expense of $111 and $116 for the years ending December 31, 2016 and 2015.

NOTE 5 - DEPOSITS

Scheduled maturities of time deposits, included in interest bearing deposits, for the next five years were as follows:

2017	$ 13,243
2018	3,631
2019	777
2020	763
2021	754

Time deposits that meet or exceed the FDIC Insurance limit of $250 at December 31, 2016 and 2015 were $8,040 and $1,278.

(Dollars in thousands except share and per share amounts)

NOTE 6 - FEDERAL HOME LOAN BANK ADVANCES

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

For 2016, interest rates ranged from .64% to 1.77%, averaging 1.24% with maturities between January 6, 2017 and June 1, 2028.	$ 20,522
For 2015, interest rates ranged from 0.59% to 1.77%, averaging 1.1369% with maturities between January 22, 2015 and June 1, 2028.	$ 22,479

The advances are subject to penalties if repaid before scheduled payments are due. The Bank's outstanding borrowings from the FHLB are secured by a blanket pledge agreement of 150% of 1-4 family loans, first lien mortgage loans. The Bank has approximately $44,481 of 1-4 family, first mortgage loans and $26,651 of home equity mortgage loans available to pledge under the blanket pledge arrangement dated March 16, 2006. Based on the collateral and the Corporation's holdings of FHLB Stock, the Bank is eligible to borrow additional advances of approximately $47,795 as of December 31, 2016.

Payments over the next five years are as follows:

2017	$ 8,381
2018	2,195
2019	3,084
2020	2,985
2021	2,647
Thereafter	1,230

NOTE 7 - INCOME TAXES

Income tax expense was as follows:

	2016	2015
Current expense		
Federal	$ 1,978	$ 1,938
State	30	175
Total current	2,008	2,113
Deferred expense (benefit)		
Federal	131	90
State	25	-
Total deferred	156	90
Total	$ 2,164	$ 2,203

(Dollars in thousands except share and per share amounts)

NOTE 7 - INCOME TAXES (Continued)

Effective tax rates differ from federal statutory rate of 34% applied to income before income taxes due to the following:

	2016	2015
Federal statutory rate times financial statement income	$ 2,607	$ 2,460
Effect of:		
State taxes, net of federal benefit	36	116
Tax exempt interest income	(273)	(271)
Bank owned life insurance income	(83)	(160)
Captive insurance premiums and disallowances	(135)	-
Other, net	12	58
Total income tax expense	$ 2,164	$ 2,203

Year-end deferred tax assets and liabilities were due to the following:

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$ 1,115	$ 1,021
Organizational and start-up expenditures	6	7
Loan origination income	139	122
Accrued bonus	391	515
Net unrealized loss on available for sale securities	78	-
Other	51	42
Total deferred tax assets	1,780	1,707
Deferred tax liabilities:		
Prepaid expenses	(269)	(119)
Stock based compensation expense	(378)	(302)
Net unrealized gain on available for sale securities	-	(103)
Restricted equity stock dividends	(10)	(10)
Loan origination expenses	(87)	(96)
Depreciation	(206)	(272)
Total deferred tax liabilities	(950)	(902)
Deferred tax asset, net	$ 830	$ 805

The Corporation does not have any uncertain tax positions and does not have any interest and penalties recorded or accrued in the consolidated financial statements for the years ended December 31, 2016 and 2015. The Corporation and its subsidiary are subject to U.S. federal income tax as well as income tax of the state of Tennessee. The Corporation is no longer subject to examination by taxing authorities for years before 2013.

NOTE 8 - RELATED PARTY TRANSACTIONS

Loans to principal officers, directors and their affiliates at December 31, 2016 and 2015 totaled $5,548 and $5,766, respectively.

Deposits from principal officers, directors and their affiliates at December 31, 2016 and 2015 totaled $1,354 and $1,664, respectively.

Wealth management fees earned from assets under management for principal officers, directors and their affiliates at December 31, 2016 and 2015 totaled $311 and $343, respectively.

NOTE 9 - REGULATORY CAPITAL MATTERS

Banks and bank holding companies are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance of all the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under the Basel III rules, the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2016, the Bank met all capital adequacy requirements to which it is subject. Bank holding companies under $1 billion in assets are not required to report regulatory capital ratios.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At December 31, 2016 and 2015, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

(Dollars in thousands except share and per share amounts)

NOTE 9 - REGULATORY CAPITAL MATTERS (Continued)

Actual and required capital amounts and ratios for the Bank are presented below as of December 31, 2016 and 2015.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
2016						
Total Capital to risk weighted assets	$ 45,937	14.80%	$ 24,839	8.00%	$ 31,049	10.00%
Tier 1 (Core) Capital to risk weighted assets	42,939	13.83%	18,629	6.00%	24,839	8.00%
Common Tier 1 (CET1)	42,939	13.83%	13,972	4.50%	20,182	6.50%
Tier 1 (Core) Capital to average assets	42,939	10.50%	16,357	4.00%	20,447	5.00%
2015						
Total Capital to risk weighted assets	$ 42,058	15.28%	$ 22,021	8.00%	$ 27,526	10.00%
Tier 1 (Core) Capital to risk weighted assets	39,305	14.28%	16,516	6.00%	22,021	8.00%
Common Tier 1 (CET1)	39,305	14.28%	12,387	4.50%	17,892	6.50%
Tier 1 (Core) Capital to average assets	39,305	9.67%	16,253	4.00%	20,316	5.00%

Dividend Restrictions - The Corporation’s principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year's net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2017, the Bank could, without prior approval, declare dividends of approximately $6,715 plus any 2017 net profits retained to date of declaration.

NOTE 10 - OFF-BALANCE SHEET ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, and letters of credit, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others as long as conditions established in the contract are met. In addition, these agreements usually have expiration dates, and the commitments may expire without being used.

Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at the exercise of the commitment. The majority of the Corporation’s commitments to extend credit have maturities of less than one year and reflect the prevailing market interest rates at the time of the commitment.

The contractual amount of financial instruments with off-balance sheet risk was as follows at December 31:

	2016	2015
Letters of Credit	$ 3,397	$ 7,671
Unused Lines of Credit	68,501	59,529

(Dollars in thousands except share and per share amounts)

NOTE 11 - STOCK BASED COMPENSATION PLAN

Total stock based compensation expense in 2016 and 2015 was $407 and $340, respectively. Related to the 2016 and 2015 restricted stock grants, some employees made an election, in accordance with Section 83(b) of the Internal Revenue Code, to have the fair value of the awards taxable immediately. In connection with the election, the Corporation allowed the employees to forfeit shares to cover the related personal tax obligation. During 2016 employees forfeited 4,652 shares with a fair value of $116. During 2015 employees forfeited 4,389 shares with a fair value of $104. These amounts were recorded in salaries and employee benefits on the Corporation's consolidated statements of income in 2016 and 2015.

The Corporation's 2008 Equity Incentive Plan as modified in 2015 provides for the grant of stock options, restricted stock and other equity based incentives up to 900,000 shares. As of December 31, 2016, the Corporation had issued grants totaling 710,515 shares under the 2008 Equity Incentive Plan and its predecessor, the 2004 Employee Share Option Plan.

Stock Option Grants

Option awards are granted with an exercise price equal to the market price of the Corporation's common stock at the date of grant. Option awards have vesting periods of one to six years and have 10-year contractual terms. The Corporation uses newly-issued shares to satisfy share option exercises.

The fair value of each option award is estimated on the date of grant using a closed form option valuation (Black-Scholes) model that uses the assumptions noted in the table below. Expected volatilities are based on historical trading of the shares of Truxton Corporation common stock for 2016 and 2015. The expected term of options granted is based on historical data and represents the period of time that options granted are expected to be outstanding taking into account that the options are not transferable. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of the grant.

During 2016, the Corporation issued non-qualified and incentive stock options to outside directors and certain employees for the purchase of 7,824 shares and 6,000 shares of common stock, respectively. During 2015, the Corporation issued non-qualified and incentive stock options to outside directors and certain employees for the purchase of 20,480 shares and 2,000 shares of common stock, respectively. The fair value of options granted in 2016 and 2015 was determined using the following assumptions as of grant date:

	2016	2015
Risk-free interest rate	2.15%	2.37%
Expected term	6 years	10 years
Expected stock price volatility	20.55%	9.16%
Dividend yield	2.50%	2.50%

(Dollars in thousands except share and per share amounts)

NOTE 11 - STOCK BASED COMPENSATION PLAN (Continued)

A summary of the stock option activity for 2016 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at beginning of year	137,280	$ 18.43	8.1	
Granted	13,824	26.55		
Forfeited	-	-		
Exercised	8,310	16.48		
Outstanding at end of year	142,794	19.33	7.3	$ 1,238
Vested or expected to vest	142,794	19.33	7.3	1,238
Exercisable at end of year	80,978	18.10	6.8	801

Information related to stock options during each year follows:

	2016	2015
Intrinsic value of options exercised	$ 96	$ 465
Cash received from option exercises	137	239
Tax benefit realized from option exercises	-	107
Weighted average fair value of options granted	4.90	2.02

There was a total of $71 in unrecognized compensation cost related to non-vested stock options granted under the Plan as of December 31, 2016. The cost is expected to be recognized over a weighted-average period of 1.6 years.

Restricted Stock Grants

In 2016 and 2015, the Corporation issued 26,556 and 24,920 restricted shares of common stock. Compensation expense is recognized over the vesting period of the awards based on the value of the stock at issue date. The fair value of the stock was determined by current stock trade activity. These shares vest in 20% increments through 2019.

A summary of the changes in the Corporation's non-vested shares for the year follows:

Non-vested shares	Shares	Weighted-Average Grant-Date Fair Value
Non-vested at January 1, 2016	61,171	$ 16.63
Granted	26,556	24.57
Vested	(21,276)	14.61
Forfeited	(4,652)	24.90
Non-vested at December 31, 2016	61,799	$ 20.11

As of December 31, 2016, there was $975 of total unrecognized compensation cost related to non-vested restricted shares granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2.2 years.

(Dollars in thousands except share and per share amounts)

NOTE 12 - DERIVATIVES

The Corporation utilizes interest rate swap agreements as part of its asset liability management strategy to help manage its interest rate risk position. The notional amount of the interest rate swaps does not represent amounts exchanged by the parties. The amount exchanged is determined by reference to the notional amount and the other terms of the individual interest rate swap agreements.

Fair Value Hedge

The following table reflects the fair value hedges included in the Consolidated Statements of Net Income as of December 31:

Interest rate contracts	Location	2016	2015
Change in fair value on interest rate swaps hedging loans	Loan interest income	$ 426	$ 36
Change in fair value on loans – hedged item	Loan interest income	$ (382)	$ (45)

The following table reflects the fair value hedges included in the Consolidated Balance Sheets as of December 31:

	2016		2015	
Included in other assets:	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate swaps related to loans	$ 12,312	$ 462	$ 5,108	$ 36

NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Corporation used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available "Level 1". For securities where quoted prices are not available, fair values are calculated using a matrix pricing model, which is based on market prices of similar securities "Level 2". Matrix pricing is a mathematical technique commonly used to price debt securities that are not actively traded, which values debt securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities' relationship to other benchmark securities.

(Dollars in thousands except share and per share amounts)

NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Derivatives: The fair value of the derivatives is based on valuation models using observable market data as of the measurement date (Level 2). Our derivatives are traded in an over-the-counter market where quoted market prices are not always available. Therefore, the fair values of derivatives are determined using quantitative models that utilize multiple market inputs. The inputs will vary based on the type of derivative, prepayment rates, and volatility factors to value the position. The majority of the market inputs is actively quoted and can be validated through external sources, including brokers, market transactions and third-party pricing services.

Assets and liabilities measured at fair value on a recurring basis are summarized below:

		Fair Value Measurements at Using:	
December 31, 2016	Carrying Value	Quoted Prices In Active Markets for Identical Assets "Level 1"	Significant Other Observable Inputs "Level 2"
Financial assets:			
Investment securities available for sale			
Corporate bonds	$ 10,017	$ -	$ 10,017
State and political subdivisions	25,590	-	25,590
Collateralized mortgage obligations	7,546	-	7,546
Mortgage backed securities: residential	18,727	-	18,727
Mortgage backed securities: commercial	17,108	-	17,108
Total investment securities available for sale	$ 78,988	$ -	$ 78,988
Derivatives – Interest Rate Swap	$ 462	$ -	$ 462

		Fair Value Measurements at Using:	
December 31, 2015	Carrying Value	Quoted Prices In Active Markets for Identical Assets "Level 1"	Significant Other Observable Inputs "Level 2"
Financial assets:			
Investment securities available for sale			
U.S. government sponsored entities and agencies	$ 4,725	$ -	$ 4,725
Corporate bonds	6,481	-	6,481
State and political subdivisions	26,497	-	26,497
Collateralized mortgage obligations	9,047	-	9,047
Mortgage backed securities: residential	17,382	-	17,382
Mortgage backed securities: commercial	18,350	-	18,350
Total investment securities available for sale	$ 82,482	$ -	$ 82,482
Derivatives – Interest Rate Swap	$ 36	$ -	$ 36

There were no transfers between Level 1 and Level 2 during 2016 or 2015.

(Dollars in thousands except share and per share amounts)

NOTE 13 - FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

The carrying amounts and estimated fair values of financial instruments, at December 31, 2016 and December 31, 2015 are as follows:

		Fair Value Measurements Using:			
December 31, 2016	Carrying Value	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	$ 10,308	$ 10,308	$ -	$ -	$ 10,308
Time deposits in other financial institutions	16,628	-	16,682	-	16,628
Securities available-for-sale	78,988	-	78,988	-	78,988
Restricted equity securities	2,543	N/A	N/A	N/A	N/A
Loans, net	285,098	-	-	284,653	284,653
Accrued interest receivable	1,262	-	439	823	1,262
Financial liabilities					
Deposits	$ 338,931	$ -	$ 338,757	$ -	$ 338,757
Federal Home Loan Bank advances	20,522	-	20,089	-	20,089
Accrued interest payable	8	8	-	-	8
December 31, 2015					
Financial assets					
Cash and cash equivalents	$ 32,854	$ 32,854	$ -	$ -	$ 32,854
Time deposits in other financial institutions	19,995	-	19,995	-	19,995
Securities available-for-sale	82,482	-	82,482	-	82,482
Restricted equity securities	2,527	N/A	N/A	N/A	N/A
Loans, net	254,405	-	-	254,474	254,474
Accrued interest receivable	1,107	-	430	677	1,107
Financial liabilities					
Deposits	$ 339,014	$ -	$ 338,914	$ -	$ 338,914
Federal Home Loan Bank advances	22,479	-	21,978	-	21,978
Accrued interest payable	6	-	6	-	6

The methods and assumptions, not previously presented, used to estimate fair values are described as follows:

The carrying amount of cash and cash equivalents approximates fair values and are classified as Level 1. Time deposits in other financial institutions have infrequent repricing or repricing limits and their fair value is based on discounted cash flows using current market rates applied to the estimated life and are classified as Level 2. It is not practical to determine the fair value of restricted equity securities due to the restrictions placed on its transferability. For variable rate loans, that reprice frequently and with no significant change in credit risk, fair values are based on carrying values resulting in a Level 3 classification. Fair values for other loans are estimated using discounted cash flows, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality resulting in a Level 3 classification. Impaired loans are valued at the lower of cost or fair value as described previously. The methods utilized to estimate the fair value of loans do not necessarily represent an exit price. The fair values disclosed for demand deposits are by definition, equal to the amount payable on demand at the reporting date resulting in a Level 2 classification. Fair values for fixed rate certificates of deposit are estimated using a discounted cash flows calculation that applies interest rates currently being offered on certificates to a schedule of aggregated expected monthly maturities on time deposits resulting in a Level 2 classification. The fair values of the Bank's Federal Home Loan Bank advances are estimated using discounted cash flows based on the current borrowing rates for similar types of borrowing arrangements resulting in a Level 2 classification. The carrying amounts of accrued interest approximate fair value resulting in Level 2 or 3 classifications.

(Dollars in thousands except share and per share amounts)

NOTE 14 - OTHER BENEFIT PLANS

The Corporation has a 401(k) benefit plan that covers all employees who meet certain eligibility requirements and choose to participate in the plan. The plan allows employee contributions up to the federal limits, which are matched 100% for the first 3% of compensation contributed and then 50% of the next 2% of compensation contributed beginning on the first day of the calendar quarter following the employee's one year anniversary. The 401(k) benefit plan expense for 2016 and 2015 was $196 and $165, respectively.

NOTE 15 – EARNINGS PER SHARE

Basic earnings per share available to common shareholders is computed by dividing net income adjusted for income allocated to participating securities by the weighted average number of common shares outstanding during the period. All outstanding unvested share-based payment awards that contain rights to non-forfeitable dividends are considered participating securities for this calculation. Diluted earnings per share available to common shareholders reflects the potential dilution that could occur if stock options to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in the earnings of the entity. The factors used in the earnings per share computation follows:

	2016	2015
Basic		
Net income	$ 5,505	$ 5,031
Less: Undistributed income allocated to participating securities	135	101
Net earnings allocated to common stock	$ 5,370	$ 4,930
Weighted common shares outstanding including participating securities	2,637,214	2,589,642
Less: Participating securities	64,856	51,851
Weighted average shares	2,572,358	2,537,791
Basic earnings per share	$ 2.09	$ 1.94
Diluted earnings allocated to common stock	$ 5,370	$ 4,930
Weighted average shares	2,572,358	2,537,791
Add: Diluted effects of assumed exercises of stock options and warrants	39,058	33,785
Average shares and dilutive potential common shares	2,611,416	2,571,576
Dilutive earnings per share	$ 2.06	$ 1.92

At year-end 2016, there were 13,824 stock options that were not considered in computing diluted earnings per common share for 2016, because they were antidilutive. At year-end 2015, there were 22,480 stock options that were not considered in computing diluted earnings per common share for 2015, because they were antidilutive.