

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2019

Transition report pursuant to Section 13 or 15(d) of the Exchange Act.
For the transition period from _____ to _____

Commission file number 1-12053

SOUTHWEST GEORGIA FINANCIAL CORPORATION

(Exact Name Of Small Business Issuer as specified in its Charter)

Georgia

58-1392259

(State Or Other Jurisdiction Of
Incorporation Or Organization)

(I.R.S. Employer
Identification No.)

201 FIRST STREET, S.E., MOULTRIE, GEORGIA 31768

Address Of Principal Executive Offices

(229) 985-1120

Registrant's Telephone Number, Including Area Code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.

Class
Common Stock, \$1 Par Value

Outstanding At August 7, 2019
2,545,776

**SOUTHWEST GEORGIA FINANCIAL CORPORATION
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2019**

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SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED BALANCE SHEETS
June 30, 2019 and December 31, 2018

	(Unaudited) June 30, <u>2019</u>	(Audited) December 31, <u>2018</u>
ASSETS		
Cash and due from banks	\$ 13,172,962	\$ 14,050,682
Interest-bearing deposits in other banks	17,448,914	21,448,110
Cash and cash equivalents	<u>30,621,876</u>	<u>35,498,792</u>
Certificates of deposit in other banks	2,977,000	2,732,000
Investment securities available for sale, at fair value	73,712,634	58,313,577
Investment securities held to maturity (fair value approximates \$33,209,979 and \$37,010,327)	32,546,072	36,827,073
Federal Home Loan Bank stock, at cost	<u>1,869,900</u>	<u>1,820,300</u>
Total investment securities	<u>108,128,606</u>	<u>96,960,950</u>
Loans	388,285,673	376,767,688
Less: Unearned income	(17,367)	(17,451)
Allowance for loan losses	<u>(3,465,140)</u>	<u>(3,428,869)</u>
Loans, net	<u>384,803,166</u>	<u>373,321,368</u>
Premises and equipment, net	14,263,995	14,573,974
Foreclosed assets	37,605	127,605
Intangible assets	0	3,907
Bank owned life insurance	6,846,072	6,779,242
Other assets	<u>4,796,508</u>	<u>4,835,329</u>
Total assets	<u>\$ 552,474,828</u>	<u>\$ 534,833,167</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Interest bearing business checking	\$ 31,308,389	\$ 28,070,871
NOW accounts	20,772,381	35,816,115
Money Market	156,449,201	158,730,044
Savings	33,593,374	31,848,588
Certificates of deposit \$250,000 and over	27,257,249	16,264,681
Other time accounts	<u>80,967,174</u>	<u>81,214,376</u>
Total interest-bearing deposits	350,347,768	351,944,675
Noninterest-bearing deposits	<u>117,289,695</u>	<u>103,694,910</u>
Total deposits	<u>467,637,463</u>	<u>455,639,585</u>
Short-term borrowed funds	6,314,286	10,457,143
Long-term debt	27,385,714	21,171,429
Other liabilities	<u>4,078,930</u>	<u>3,946,066</u>
Total liabilities	<u>505,416,393</u>	<u>491,214,223</u>
Stockholders' equity:		
Common stock - \$1 par value, 5,000,000 shares authorized, 2,545,776 shares issued	2,545,776	2,545,776
Capital surplus	18,418,995	18,418,995
Retained earnings	26,757,498	24,841,569
Accumulated other comprehensive loss	<u>(663,834)</u>	<u>(2,187,396)</u>
Total stockholders' equity	<u>47,058,435</u>	<u>43,618,944</u>
Total liabilities and stockholders' equity	<u>\$ 552,474,828</u>	<u>\$ 534,833,167</u>

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF INCOME

	For The Three Months		For The Six Months	
	Ended June 30,		Ended June 30,	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	2019	2018	2019	2018
Interest income:				
Interest and fees on loans	\$ 5,327,565	\$ 4,471,832	\$ 10,448,751	\$ 8,765,072
Interest on taxable securities available for sale	373,062	320,337	707,496	608,983
Interest on taxable securities held to maturity	52,613	25,661	106,671	53,808
Interest on tax exempt securities	225,971	279,079	463,742	570,082
Dividends	21,096	35,548	47,953	67,495
Interest on deposits in other banks	129,677	148,177	300,570	266,005
Interest on certificates of deposit in other banks	17,453	11,693	34,300	23,259
Total interest income	<u>6,147,437</u>	<u>5,292,327</u>	<u>12,109,483</u>	<u>10,354,704</u>
Interest expense:				
Interest on deposits	974,632	481,273	2,024,938	853,747
Interest on federal funds purchased	6	2	12	8
Interest on other short-term borrowings	37,360	117,525	73,346	233,192
Interest on long-term debt	83,163	126,659	192,586	252,492
Total interest expense	<u>1,095,161</u>	<u>725,459</u>	<u>2,290,882</u>	<u>1,339,439</u>
Net interest income	<u>5,052,276</u>	<u>4,566,868</u>	<u>9,818,601</u>	<u>9,015,265</u>
Provision for loan losses	250,390	140,000	366,298	355,500
Net interest income after provision for loan losses	<u>4,801,886</u>	<u>4,426,868</u>	<u>9,452,303</u>	<u>8,659,765</u>
Noninterest income:				
Service charges on deposit accounts	229,841	266,369	467,990	490,959
Income from trust services	55,321	63,018	111,926	121,850
Income from retail brokerage services	87,955	96,793	194,703	185,188
Income from insurance services	456,336	417,177	892,984	805,417
Income from mortgage banking services	0	623	0	1,243
Net gain on sale or disposition of assets	243,830	7,254	244,728	99
Net gain on extinguishment of debt	0	0	143,031	0
Other income	233,983	208,831	488,949	449,713
Total noninterest income	<u>1,307,266</u>	<u>1,060,065</u>	<u>2,544,311</u>	<u>2,054,469</u>
Noninterest expense:				
Salaries and employee benefits	2,584,434	2,388,128	5,080,638	4,729,247
Occupancy expense	319,059	294,644	633,569	584,069
Equipment expense	310,549	187,191	618,569	377,460
Data processing expense	405,260	351,117	808,813	704,908
Amortization of intangible assets	0	3,906	3,907	7,812
Other operating expenses	931,176	906,928	1,820,573	1,723,995
Total noninterest expenses	<u>4,550,478</u>	<u>4,131,914</u>	<u>8,966,069</u>	<u>8,127,491</u>
Income before income taxes	<u>1,558,674</u>	<u>1,355,019</u>	<u>3,030,545</u>	<u>2,586,743</u>
Provision for income taxes	260,462	207,332	503,630	206,689
Net income	<u>\$ 1,298,212</u>	<u>\$ 1,147,687</u>	<u>\$ 2,526,915</u>	<u>\$ 2,380,054</u>
Earnings per share of common stock:				
Net income, basic	<u>\$ 0.51</u>	<u>\$ 0.45</u>	<u>\$ 0.99</u>	<u>\$ 0.93</u>
Net income, diluted	<u>\$ 0.51</u>	<u>\$ 0.45</u>	<u>\$ 0.99</u>	<u>\$ 0.93</u>
Dividends paid per share	<u>\$ 0.12</u>	<u>\$ 0.12</u>	<u>\$ 0.24</u>	<u>\$ 0.23</u>
Weighted average shares outstanding	<u>2,545,776</u>	<u>2,545,776</u>	<u>2,545,776</u>	<u>2,545,351</u>
Diluted average shares outstanding	<u>2,545,776</u>	<u>2,545,776</u>	<u>2,545,776</u>	<u>2,545,351</u>

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Net income	\$ 1,298,212	\$ 1,147,687	\$ 2,526,915	\$ 2,380,054
Other comprehensive income (loss), net of tax:				
Unrealized holding gain (loss) on investment securities available for sale	1,019,990	(297,127)	1,928,559	(1,270,997)
Less: Tax effect	<u>214,198</u>	<u>(62,397)</u>	<u>404,997</u>	<u>(266,910)</u>
Total other comprehensive income (loss), net of tax	<u>805,792</u>	<u>(234,730)</u>	<u>1,523,562</u>	<u>(1,004,087)</u>
Total comprehensive income	<u>\$ 2,104,004</u>	<u>\$ 912,957</u>	<u>\$ 4,050,477</u>	<u>\$ 1,375,967</u>

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
for the three months ended June 30, 2019 and June 30, 2018

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at Mar. 31, 2018	\$ 2,545,776	\$ 18,707,400	\$ 22,471,760	\$ (2,398,975)	\$ -	\$ 41,325,961
Net Income	-	-	1,147,687	-	-	1,147,687
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	(234,731)	-	(234,731)
Cash dividend declared \$.12 per share	-	-	(304,840)	-	-	(304,840)
Retirement of treasury stock	-	-	-	-	-	-
Balance at Jun. 30, 2018	<u>\$ 2,545,776</u>	<u>\$ 18,707,400</u>	<u>\$ 23,314,607</u>	<u>\$ (2,633,706)</u>	<u>\$ -</u>	<u>\$ 41,934,077</u>
Balance at Mar. 31, 2019	\$ 2,545,776	\$ 18,418,995	\$ 25,764,780	\$ (1,469,626)	\$ -	\$ 45,259,925
Net Income	-	-	1,298,212	-	-	1,298,212
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	805,792	-	805,792
Cash dividend declared \$.12 per share	-	-	(305,494)	-	-	(305,494)
Balance at Jun. 30, 2019	<u>\$ 2,545,776</u>	<u>\$ 18,418,995</u>	<u>\$ 26,757,498</u>	<u>\$ (663,834)</u>	<u>\$ -</u>	<u>\$ 47,058,435</u>

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
for the six months ended June 30, 2019 and June 30, 2018

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total Shareholders' Equity
Balance at Dec. 31, 2017	\$ 4,293,835	\$ 31,701,533	\$ 33,020,030	\$ (1,629,619)	\$ (26,242,793)	\$ 41,142,986
Net Income	-	-	2,380,054	-	-	2,380,054
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	(1,004,087)	-	(1,004,087)
Cash dividend declared \$.23 per share	-	-	(584,876)	-	-	(584,876)
Retirement of treasury stock	(1,748,059)	(12,994,133)	(11,500,601)	-	26,242,793	-
Balance at Jun. 30, 2018	<u>\$ 2,545,776</u>	<u>\$ 18,707,400</u>	<u>\$ 23,314,607</u>	<u>\$ (2,633,706)</u>	<u>\$ -</u>	<u>\$ 41,934,077</u>
Balance at Dec. 31, 2018	\$ 2,545,776	\$ 18,418,995	\$ 24,841,569	\$ (2,187,396)	\$ -	\$ 43,618,944
Net Income	-	-	2,526,915	-	-	2,526,915
Comprehensive income (loss):						
Changes in net gain on securities available for sale	-	-	-	1,523,562	-	1,523,562
Cash dividend declared \$.24 per share	-	-	(610,986)	-	-	(610,986)
Balance at Jun. 30, 2019	<u>\$ 2,545,776</u>	<u>\$ 18,418,995</u>	<u>\$ 26,757,498</u>	<u>\$ (663,834)</u>	<u>\$ -</u>	<u>\$ 47,058,435</u>

SOUTHWEST GEORGIA FINANCIAL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Six Months
Ended June 30,

	(Unaudited) 2019	(Unaudited) 2018
Cash flows from operating activities:		
Net income	\$ 2,526,915	\$ 2,380,054
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	366,298	355,500
Depreciation	607,500	474,903
Net amortization of investment securities	140,392	185,548
Income on cash surrender value of bank owned life insurance	(66,830)	(82,239)
Amortization of intangibles	3,907	7,812
Loss on sale/writedown of foreclosed assets	5,850	6,789
Net gain on disposal of fixed assets	(250,578)	(6,888)
Net gain on extinguishment of debt	(143,031)	0
Change in:		
Other assets	(380,247)	282,059
Other liabilities	133,368	(140,255)
Net cash provided by operating activities	2,943,544	3,463,283
Cash flows from investing activities:		
Proceeds from calls, paydowns and maturities of securities HTM	4,257,355	4,070,107
Proceeds from calls, paydowns and maturities of securities AFS	540,971	354,244
Proceeds from Federal Home Loan Bank stock repurchase	840,900	0
Purchase of securities held to maturity	0	(752,889)
Purchase of securities available for sale	(14,128,215)	(6,744,149)
Purchase of Federal Home Loan Bank Stock	(890,500)	(36,600)
Purchase of certificates of deposit in other banks	(245,000)	0
Net change in loans	(11,848,096)	(16,285,700)
Purchase of premises and equipment	(440,881)	(1,931,714)
Proceeds from sales of fixed assets and foreclosed assets	491,655	957,611
Net cash used by investing activities	(21,421,811)	(20,369,090)
Cash flows from financing activities:		
Net change in deposits	11,997,878	18,430,694
Payment of short-term portion of long-term debt	(37,283,601)	0
Payment for early retirement of long-term debt	(11,501,940)	0
Proceeds from issuance of short-term debt	33,214,286	0
Proceeds from issuance of long-term debt	17,785,714	0
Cash dividends paid	(610,986)	(584,876)
Net cash provided by financing activities	13,601,351	17,845,818
Increase (decrease) in cash and cash equivalents	(4,876,916)	940,011
Cash and cash equivalents - beginning of period	35,498,792	35,078,432
Cash and cash equivalents - end of period	\$ 30,621,876	\$ 36,018,443
NONCASH ITEMS:		
Increase in foreclosed properties and decrease in loans	\$ 0	\$ 413,655
Unrealized gain (loss) on securities available for sale	\$ 1,928,559	\$ (1,270,997)
Net reclass between short and long-term debt	\$ 0	\$ 1,500,000
Retirement of treasury stock	\$ 0	\$ 26,242,793
Receivable from sale of guaranteed foreclosed asset	\$ 0	\$ 172,616
Sales of fixed assets through loans	\$ 0	\$ 13,000

SOUTHWEST GEORGIA FINANCIAL CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Basis of Presentation

Southwest Georgia Financial Corporation (the “Corporation”), a bank-holding company organized under the laws of Georgia, provides deposit, lending, and other financial services to businesses and individuals primarily in the Southwest region of Georgia. The Corporation and its subsidiaries are subject to regulation by certain federal and state agencies.

The accompanying unaudited consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnotes necessary for a fair presentation of financial position, results of operations, and changes in financial position in conformity with generally accepted accounting principles. The interim financial statements furnished reflect all adjustments which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. The interim consolidated financial statements should be read in conjunction with the Corporation’s 2018 Annual Report on Form 10K.

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of Southwest Georgia Financial Corporation (the “Corporation”) and its direct and indirect subsidiaries, including its wholly-owned banking subsidiary, Southwest Georgia Bank (the “Bank”), conform to U.S. generally accepted accounting principles (“GAAP”) and to general practices within the banking industry. The following is a description of the more significant of those policies.

Principles of Consolidation

The consolidated financial statements include the accounts of the Corporation and its direct and indirect subsidiaries. All significant intercompany accounts and transactions have been eliminated in the consolidation.

Nature of Operations

The Corporation offers comprehensive financial services to consumer, business, and governmental entity customers through its banking offices in southwest Georgia. Its primary deposit products are money market, NOW, savings and certificates of deposit, and its primary lending products are consumer and commercial mortgage loans. In addition to conventional banking services, the Corporation provides investment planning and management, trust management, and commercial and individual insurance products. Insurance products and advice are provided by the Bank’s Southwest Georgia Insurance Services Division.

The Corporation’s primary business is providing banking services through the Bank to individuals and businesses principally in the counties of Colquitt, Baker, Worth, Lowndes, Tift and the surrounding counties of southwest Georgia. The Bank operates six branch offices in its trade area. In Valdosta, Georgia, lending services are offered at our Commercial Banking Center at 3520 N Valdosta Road, located next door to the branch. Trust and retail brokerage services are offered at an office building located at 25 2nd Avenue SW in Moultrie.

Use of Estimates

The preparation of 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 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 relate to the determination of the allowance for loan losses and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with these evaluations, management obtains independent appraisals for significant properties.

A substantial portion of the Corporation’s loans are secured by real estate located primarily in Georgia. Accordingly, the ultimate collection of these loans is susceptible to changes in the real estate market conditions of this market area

Cash and Cash Equivalents and Statement of Cash Flows

For purposes of reporting cash flows, the Corporation considers cash and cash equivalents to include all cash on hand, deposit amounts due from banks, interest-bearing deposits in other banks, and federal funds sold. The Corporation maintains its cash balances in several financial institutions. Accounts at the financial institutions

are secured by the Federal Deposit Insurance Corporation (the “FDIC”) up to \$250,000. There were no uninsured deposits at June 30, 2019.

Investment Securities

Investment securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity or trading are classified as available for sale and recorded at fair value with unrealized gains and losses (net of tax effect) reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other-than-temporarily impaired are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation has been calculated primarily using the straight-line method for buildings and building improvements over the assets estimated useful lives. Equipment and furniture are depreciated using the modified accelerated recovery system method over the assets estimated useful lives for financial reporting and income tax purposes for assets purchased on or before December 31, 2003. For assets acquired after 2003, the Corporation used the straight-line method of depreciation. The following estimated useful lives are used for financial statement purposes:

Land improvements	5 – 31 years
Building and improvements	10 – 40 years
Machinery and equipment	5 – 10 years
Computer equipment	3 – 5 years
Office furniture and fixtures	5 – 10 years

All of the Corporation’s leases are operating leases and are not capitalized as assets for financial reporting purposes. Maintenance and repairs are charged to expense and betterments are capitalized.

Long-lived assets are evaluated regularly for other-than-temporary impairment. If circumstances suggest that their value may be impaired and the write-down would be material, an assessment of recoverability is performed prior to any write-down of the asset. Impairment on intangibles is evaluated at each balance sheet date or whenever events or changes in circumstances indicate that the carrying amount should be assessed. Impairment, if any, is recognized through a valuation allowance with a corresponding charge recorded in the income statement.

During second quarter 2019, the Corporation sold a parcel of vacant land in Moultrie, Georgia, for \$387,938 and recorded a gain on the sale in the amount of \$266,224.

Bank Property Held for Sale

In 2016, the Bank's former branch in Pavo, Georgia, was transferred from premises to bank property held for sale and depreciation was discontinued. The property was booked at the lower of cost or market value based on the current appraisal of \$211,500. On November 30, 2018, the Corporation sold this property and recorded a loss in the amount of \$96,750.

Loans and Allowances for Loan Losses

Loans are stated at principal amounts outstanding less unearned income and the allowance for loan losses. Interest income is credited to income based on the principal amount outstanding at the respective rate of interest except for interest on certain installment loans made on a discount basis which is recognized in a manner that results in a level-yield on the principal outstanding.

Accrual of interest income is discontinued on loans when, in the opinion of management, collection of such interest income becomes doubtful. Accrual of interest on such loans is resumed when, in management's judgment, the collection of interest and principal becomes probable.

Fees on loans and costs incurred in origination of most loans are recognized at the time the loan is placed on the books. Because loan fees are not significant, the results on operations are not materially different from the results which would be obtained by accounting for loan fees and costs as amortized over the term of the loan as an adjustment of the yield.

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. 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 commercial and construction 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.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Corporation does not separately identify individual consumer and residential loans for impairment disclosures.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes the collection of the principal is unlikely. The allowance is an amount which management believes will be adequate to absorb estimated losses on existing loans that may become uncollectible based on evaluation of the collectability of loans and prior loss experience. This evaluation takes into consideration such factors as changes in the nature and volume of the loan portfolios, current economic conditions that may affect the borrowers' ability to pay, overall portfolio quality, and review of specific problem loans.

Management believes that the allowance for loan losses is adequate. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based upon changes

in economic conditions. Also, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments of information available to them at the time of their examination.

Foreclosed Assets

In accordance with policy guidelines and regulations, properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the fair market value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. A valuation allowance is established to record market value changes in foreclosed assets. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from foreclosed assets. There was no valuation allowance for foreclosed asset losses at June 30, 2019. Foreclosed assets totaled \$37,605 at June 30, 2019 and \$127,605 at December 31, 2018.

Intangible Assets

Intangible assets are amortized over a determined useful life using the straight-line basis. These assets are evaluated annually as to the recoverability of the carrying value. All intangibles were fully amortized as of June 30, 2019.

Credit Related Financial Instruments

In the ordinary course of business, the Corporation has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded.

Retirement Plans

The Corporation and its direct and indirect subsidiaries have post-retirement plans covering substantially all employees. The Corporation makes annual contributions to the plans in amounts not exceeding the regulatory requirements.

Bank Owned Life Insurance

The Bank owns life insurance policies on a group of employees. Banking laws and regulations allow the Bank to purchase life insurance policies on certain employees in order to help offset the Bank's overall employee compensation costs. The beneficial aspects of these life insurance policies are tax-free earnings and a tax-free death benefit, which are realized by the Bank as the owner of the policies. The cash surrender value of these policies is included as an asset on the balance sheet, and any increases in cash surrender value are recorded as noninterest income on the statement of income. At June 30, 2019, and December 31, 2018, the policies had a value of \$6,846,072 and \$6,779,242, respectively, and were 14.5% and 15.5%, respectively, of shareholders' equity. These values are within regulatory guidelines.

Income Taxes

The Corporation and its direct and indirect subsidiaries file a consolidated income tax return. Each subsidiary computes its income tax expense as if it filed an individual return except that it does not receive any portion of the surtax allocation. Any benefits or disadvantages of the consolidation are absorbed by the parent company. Each subsidiary pays its allocation of federal income taxes to the parent company or receives payment from the parent company to the extent that tax benefits are realized.

The Corporation reports income under the Financial Accounting Standards Board Accounting Standards Codification (“ASC”) Topic 740, Income Taxes, which requires recognition of deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Recognition of deferred tax assets is based on management’s belief that it is more likely than not that the tax benefit associated with certain temporary differences and tax credits will be realized.

The Corporation will recognize a tax position as a benefit only if it is more likely than not that the tax position would be sustained in a tax examination, with an examination being presumed to occur. The amount recognized is the largest amount of a tax benefit that is greater than fifty percent likely of being realized on examination. No benefit is recorded for tax positions that do not meet the more than likely than not test.

The Corporation recognizes penalties related to income tax matters in income tax expense. The Corporation is subject to U.S. federal and Georgia state income tax audit for returns for the tax period ending December 31, 2016 and subsequent years.

Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) includes all changes in shareholders’ equity during a period, except those resulting from transactions with shareholders. Besides net income, other components of the Corporation’s accumulated other comprehensive income (loss) includes the after tax effect of changes in the net unrealized gain/loss on securities available for sale and the unrealized gain/loss on pension plan benefits.

Trust Department

Trust income is included in the accompanying consolidated financial statements on the cash basis in accordance with established industry practices. Reporting of such fees on the accrual basis would have no material effect on reported income.

Advertising Costs

It is the policy of the Corporation to expense advertising costs as they are incurred. The Corporation does not engage in any direct-response advertising and accordingly has no advertising costs reported as assets on its balance sheet. Costs expensed were \$81,036 and \$156,786 for the three and six month periods ended June 30, 2019, respectively.

Recent Market and Regulatory Developments

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum Tier 1 leverage, Tier 1 risk-based capital and Total risk-based capital ratios. In July 2013, the Board of Governors of the Federal Reserve System published the Basel III Capital Rules. These rules establish a comprehensive capital framework applicable to all depository institutions, certain bank holding companies with total consolidated assets below a certain threshold and all savings and loan holding companies except for those that are substantially engaged in insurance underwriting or commercial activities. These rules implement higher minimum capital requirements for banks and certain bank holding companies, include a new common equity Tier 1 capital requirement and establish criteria that instruments must meet to be considered common equity Tier 1 capital, additional Tier 1 capital or Tier 2 capital.

The Basel III Capital Rules became effective for the Bank on January 1, 2015, subject to a phase-in period, but are not applicable to bank holding companies, like the Corporation, with less than \$1 billion in total consolidated assets that meet certain criteria.

The minimum capital level requirements applicable to the Bank under the Basel III Capital Rules are: (i) a common equity Tier 1 risk-based capital ratio of 4.5%; (ii) a Tier 1 risk-based capital ratio of 6% (increased from 4%); (iii) a Total risk-based capital ratio of 8% (unchanged from the rules effective for the year ended December 31, 2014); and (iv) a Tier 1 leverage ratio of 4% for all institutions. Common equity Tier 1 capital will consist of retained earnings and common stock instruments, subject to certain adjustments.

The Basel III Capital Rules set forth changes in the methods of calculating certain risk-weighted assets, which in turn affect the calculation of risk-based ratios. The new risk weightings are more punitive for assets held by banks that are deemed to be of higher risk. These changes were also effective beginning January 1, 2015.

The Basel III Capital Rules also introduce a "capital conservation buffer", which is in addition to each capital ratio and is phased-in over a three-year period beginning in January 2016.

As of June 30, 2019, the Bank is considered to be well-capitalized under the Basel III Capital Rules. There have been no conditions or events since June 30, 2019, that management believes has changed the Bank's status as "well-capitalized." The capital ratios of the Corporation and Bank are presented in Management Discussion and Analysis of the Corporation's Notes to Consolidated Financial Statements.

Adoption of New Accounting Standards

In March 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. The purpose of this ASU is to codify the SEC's guidance issued in Staff Accounting Bulletin 118. The amendments in this update were effective upon issuance. The adoption of ASU 2018-05 had no material impact on the Corporation's consolidated financial statements.

In March 2018, FASB issued ASU 2018-04, Investment - Debt Securities (Topic 320) and Regulated Operations (Topic 980): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 117 and SEC Release No. 33-9273. The purpose of this ASU is to codify the SEC's guidance issued in Staff Accounting Bulletin 117. The amendments in this update were effective upon issuance. The adoption of ASU 2018-04 had no material impact on the Corporation's consolidated financial statements.

In February 2018, FASB issued ASU 2018-03, Technical Corrections and Improvements to Financial Instruments - Overall (Subtopic 825-10). This Update clarifies certain aspects of the guidance issued in ASU 2016-01 including (i) an entity measuring an equity security using the measurement alternative may make an irrevocable election to change its measurement approach to a fair value method under Topic 820 for that security and any identical or similar investments of the same issuer, (ii) fair value adjustments under the measurement alternative should be as of the date the observable transaction for a similar security occurred, (iii) requiring the remeasurement of the entire value of forward contracts and purchased options when observable transactions occur on the underlying equity securities, (iv) financial liabilities for which the fair value option is elected should follow the guidance in paragraph 825-10-45-5, (v) changes in the fair value of financial liabilities for which the fair value option is elected relating to the instrument-specific credit risk should first be measured in the currency of denomination and then both components of the change in fair value should be remeasured into the reporting entity's functional currency using end-of-period spot rates, and (vi) the prospective transition approach should only be applied for instances in which the measurement alternative is applied. The guidance was effective for interim periods beginning after June 15, 2018 and may be early adopted provided ASU 2016-01 was adopted. The Company adopted the amendments in this ASU effective January 1, 2018. The adoption of ASU 2018-03 had no material impact on the Corporation's consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement – Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 provides guidance on accounting for the effects of the Tax Cuts and Jobs Act, which was enacted in December, 2017. The guidance allows reclassification of the tax effects that were stranded in accumulated other comprehensive income as a result of the tax rate change from accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years beginning after December 15, 2018. The adoption of ASU 2018-02 had no material impact on the Corporation's consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, "Stock Compensation, Scope of Modification Accounting." This ASU clarifies when changes to the terms of conditions of a share-based payment award must be accounted for as modifications. Companies will apply the modification accounting guidance if the value, vesting conditions or classification of the award changes. The new guidance should reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications, as the guidance will allow companies to make certain non-substantive changes to awards without accounting for them as modifications. It does not change the accounting for modifications. ASU No. 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017; early adoption is permitted. The adoption of ASU 2017-09 had no material impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Receivables – Nonrefundable Fees and Other Costs (Topic 310-20): Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for certain callable debt securities held at a premium. The premium on individual callable debt securities shall be amortized to the earliest call date. This guidance does not apply to securities for which prepayments are estimated on a large number of similar loans where prepayments are probable and reasonable estimable. The amendments in this update are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. This update should be adopted on a modified retrospective basis with a cumulative effect adjustment to retained earnings on the date of adoption. The adoption of ASU 2017-08 had no material impact on the Corporation's consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-07, Compensation-Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The updated accounting guidance requires changes to the presentation of the components of net periodic benefit cost on the income statement by requiring service cost to be presented with other employee compensation costs and other components of net periodic pension cost to be presented outside of any subtotal of operating income. This ASU also stipulates that only the service cost component of net benefit cost is eligible for capitalization. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The adoption of ASU 2017-07 had no material impact on the Corporation's consolidated financial statements.

In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805), which provides a new framework for determining whether transactions should be accounted for as acquisitions or disposals of assets or businesses. This ASU is effective for public business entities for annual and interim periods in fiscal years beginning after December 15, 2017. Early adoption will be permitted and should apply it to transactions that have not been reported in financial statements that have been issued or made available for issuance. The adoption of ASU 2017-01 had no material impact on the Corporation's consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (vii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The accounting guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Corporation adopted the amendments in this ASU effective January 1, 2018. The adoption of 2016-01 had no material impact on the Corporation's consolidated financial statements.

In May 2014, the FASB began issuing guidance to change the recognition of revenue from contracts with customers. The last guidance was issued in February 2017. The standards issued during this time are as follows: ASU 2014-09, Revenue from Contracts with Customers (Topic 606), ASU 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, ASU 2016-08 Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net), ASU 2016-10 Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, ASU 2016-11 Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting, ASU 2016-12 Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, ASU 2016-20 Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers, and ASU 2017-05 Other Income - Gains and losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) - Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets. This new guidance, which does not apply to financial instruments, provides that revenue should be recognized for the transfer of goods and

services to customers in an amount equal to the consideration it receives or expects to receive. The guidance also includes expanded disclosure requirements that provide comprehensive information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The Corporation adopted the amendments in this ASU effective January 1, 2018, using the modified retrospective method. Since there was no change to net income upon adoption of the new guidance, a cumulative effect adjustment to opening retained earnings was not necessary. See below for additional information related to revenue generated from contracts with customers.

In 2016, the FASB issued ASU 2016-02 – Leases (Topic 842). ASU 2016-02 amends the existing standards for lease accounting effectively requiring most leases be carried on the balance sheets of the related lessees by requiring them to recognize a right-of-use asset and a corresponding lease liability. ASU 2016-02 includes qualitative and quantitative disclosure requirements intended to provide greater insight into the nature of an entity's leasing activities. The standard must be adopted using a modified retrospective transition with a cumulative-effect adjustment to equity as of the beginning of the period in which it is adopted. ASU 2016-02 is effective for annual reporting periods beginning after December 15, 2018, and interim periods within those annual periods with early adoption permitted. The adoption of ASU No. 2016-02 had no material impact on the Corporation's consolidated financial statements.

Revenue Recognition

On January 1, 2018, the Corporation adopted ASC Topic 606, using the modified retrospective method. Disclosures of revenue from contracts with customers for periods beginning after January 1, 2018, are presented under ASC Topic 606 and have not materially changed from the prior year amounts. Noninterest income, within the scope of this guidance, is recognized as services are transferred to customers in an amount that reflects the considerations expected to be entitled to in exchange for those services. The Corporation's revenue streams that were in scope include service charges on deposit accounts, income from insurance services, income from trust services, Automated Teller Machine ("ATM") surcharge and other noninterest income.

Services Charges on Deposit Accounts - Service charges on deposit accounts primarily consist of monthly maintenance charges, analysis charges and Non-sufficient funds ("NSF") charges. The NSF charges and certain service charges are fixed and the performance obligation is typically satisfied at the time of the related transaction. The consideration for analysis charges and monthly maintenance charges are variable as the fee can be reduced if the customer meets certain qualifying metrics. The Corporation's performance obligations are satisfied either at the time of the transaction or over the course of a month.

Income from Insurance Services – Income from insurance services consists primarily of property and casualty insurance, life, health, and disability insurance. Property and casualty, life, health, and disability insurance includes the brokerage of both personal and commercial coverages. The placement of the policy is completion of the Corporation's performance obligation and revenue is recognized at that time. The Corporation's commission is primarily a percentage of the premium.

Income from Trust Services – Income from Trust services consists of revenue generated from services provided for corporate, pension, and personal trusts, trustee services, and administrative services for employee benefit plans. The Corporation's performance obligation and revenue is recognized once the service has been performed.

ATM Surcharge - ATM surcharge represents revenues earned from certain terminal activity. ATM surcharges primarily consist of charges assessed to our customers for using a non-Bank ATM or a non-Bank customer using our ATM. Such surcharges generally are recognized concurrently with the delivery of services on a daily basis.

Other - Other noninterest income primarily consists of transaction based revenue where the performance obligation is satisfied concurrent with the revenue recognition.

Recent Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, which is essentially the final rule on use of the “CECL” model, or current expected credit losses. Among other things, the amendments in this ASU require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. 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. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with later effective dates for non-SEC registrant public companies and other organizations. Early adoption will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of ASU No. 2016-13 is being reviewed for any material impact on the Corporation’s consolidated financial statements.

NOTE 2

Fair Value Measurements

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. From time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans and foreclosed real estate. Additionally, the Corporation is required to disclose, but not record, the fair value of other financial instruments.

Fair Value Hierarchy:

Under ASC Topic 820, the Corporation groups assets and liabilities at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. These levels are:

- | | |
|---------|--|
| Level 1 | Valuation is based upon quoted prices for identical instruments traded in active markets. |
| Level 2 | Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market. |
| Level 3 | Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include use of option pricing models, discounted cash flow models and similar techniques. |

Following is a description of valuation methodologies used for assets and liabilities which are either recorded or disclosed at fair value.

Cash and Cash Equivalents:

For disclosure purposes for cash and due from banks, interest bearing deposits in other banks and federal funds sold, the carrying amount is a reasonable estimate of fair value.

Certificates of Deposit in Other Banks:

For disclosure purposes for certificates of deposit in other banks, the carrying amount is a reasonable estimate of fair value.

Investment Securities Available for Sale:

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

Investment Securities Held to Maturity:

Investment securities held to maturity are not recorded at fair value on a recurring basis. For disclosure purposes, fair value measurement is based upon quoted prices, if available.

Federal Home Loan Bank Stock:

For disclosure purposes, the carrying value of other investments approximate fair value.

Loans:

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific allocation is established within the allowance for loan losses. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with ASC Topic 310, *Accounting by Creditors for Impairment of a Loan*. The fair value of impaired loans is estimated using one of three methods, including collateral value, market value of similar debt, and discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. In accordance with ASC Topic 820, impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the impaired loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the impaired loan as nonrecurring Level 3.

For disclosure purposes, the fair value of fixed rate loans which are not considered impaired, is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings. For unimpaired variable rate loans, the carrying amount is a reasonable estimate of fair value for disclosure purposes.

Foreclosed Assets:

Other real estate properties are adjusted to fair value upon transfer of the loans to other real estate. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon

independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the other real estate as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation records the other real estate asset as nonrecurring Level 3.

Bank Owned Life Insurance:

For disclosure purposes, for cash surrender value of life insurance, the carrying value is a reasonable estimate of fair value.

Deposits:

For disclosure purposes, the fair value of demand deposits, savings accounts, NOW accounts and money market deposits is the amount payable on demand at the reporting date, while the fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using current rates at which comparable certificates would be issued.

FHLB Advances:

For disclosure purposes, the fair value of the FHLB fixed rate borrowing is estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements.

Commitments to Extend Credit and Standby Letters of Credit:

Because commitments to extend credit and standby letters of credit are made using variable rates and have short maturities, the carrying value and the fair value are immaterial for disclosure.

Assets Recorded at Fair Value on a Recurring Basis:

The table below presents the recorded amount of assets measured at fair value on a recurring basis as of June 30, 2019, and December 31, 2018.

<u>June 30, 2019</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available for sale:				
U.S. government treasury securities	\$4,021,530	\$ 0	\$ 0	\$ 4,021,530
U.S. government agency securities	0	47,678,029	0	47,678,029
State and municipal securities	0	7,528,095	0	7,528,095
Residential mortgage-backed securities	0	14,484,980	0	14,484,980
Total	<u>\$4,021,530</u>	<u>\$ 69,691,104</u>	<u>\$ 0</u>	<u>\$ 73,712,634</u>

<u>December 31, 2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investment securities available for sale:				
U.S. government treasury securities	\$ 954,570	\$ 0	\$ 0	\$ 954,570
U.S. government agency securities	0	45,207,005	0	45,207,005
State and municipal securities	0	7,377,935	0	7,377,935
Residential mortgage-backed securities	0	4,774,067	0	4,774,067
Total	<u>\$ 954,570</u>	<u>\$ 57,359,007</u>	<u>\$ 0</u>	<u>\$ 58,313,577</u>

Assets Recorded at Fair Value on a Nonrecurring Basis:

The Corporation may be required, from time to time, to measure certain assets at fair value on a nonrecurring basis in accordance with GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis are included in the table below as of June 30, 2019, and December 31, 2018.

<u>June 30, 2019</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Foreclosed assets	\$ 0	\$ 0	\$ 37,605	\$ 37,605
Impaired loans	0	0	4,033,151	4,033,151
Total assets at fair value	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 4,070,756</u>	<u>\$ 4,070,756</u>

<u>December 31, 2018</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Foreclosed assets	\$ 0	\$ 0	\$ 127,605	\$ 127,605
Impaired loans	0	0	3,838,151	3,838,151
Total assets at fair value	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 3,965,756</u>	<u>\$ 3,965,756</u>

Foreclosed properties that are included above as measured at fair value on a nonrecurring basis are those properties that resulted from a loan that had been foreclosed and charged down or have been written down subsequent to foreclosure. Foreclosed properties are generally recorded at the appraised value less estimated selling costs in the range of 15 – 20%. Loans that are reported above as being measured at fair value on a nonrecurring basis are generally impaired loans that have been either partially charged off or have specific reserves assigned to them. Nonaccrual impaired loans that are collateral dependent are generally written down to a range of 80 – 85% of appraised value which considers the estimated costs to sell. Specific reserves are established for impaired loans based on appraised value of collateral or discounted cash flows.

The carrying amount and estimated fair values of the Corporation's assets and liabilities which are required to be either disclosed or recorded at fair value at June 30, 2019, and December 31, 2018:

<u>June 30, 2019</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
		(Dollars in thousands)			
Assets:					
Cash and cash equivalents	\$ 30,622	\$ 30,622	\$ 0	\$ 0	\$ 30,622
Certificates of deposit in other banks	2,977	2,977	0	0	2,977
Investment securities available for sale	73,713	4,022	69,691	0	73,713
Investment securities held to maturity	32,546	0	33,210	0	33,210
Federal Home Loan Bank stock	1,870	0	1,870	0	1,870
Loans, net	384,803	0	370,382	4,033	374,415
Bank owned life insurance	6,846	0	6,846	0	6,846
Liabilities:					
Deposits	467,637	0	453,638	0	453,638
Federal Home Loan Bank advances	33,700	0	35,222	0	35,222

<u>December 31, 2018</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
		(Dollars in thousands)			
Assets:					
Cash and cash equivalents	\$ 35,499	\$ 35,499	\$ 0	\$ 0	\$ 35,499
Certificates of deposit in other banks	2,732	2,732	0	0	2,732
Investment securities available for sale	58,314	955	57,359	0	58,314
Investment securities held to maturity	36,827	0	37,010	0	37,010
Federal Home Loan Bank stock	1,820	0	1,820	0	1,820
Loans, net	373,321	0	362,373	3,838	366,211
Bank owned life insurance	6,779	0	6,779	0	6,779
Liabilities:					
Deposits	455,640	0	456,245	0	456,245
Federal Home Loan Bank advances	31,629	0	31,591	0	31,591

Limitations:

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial statement element. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

Fair value estimates included herein are based on existing on- and off-balance-sheet financial instruments without attempting to estimate the value of anticipated future business and the fair value of assets and liabilities that are not required to be recorded or disclosed at fair value like premises and equipment. In addition, the tax ramifications related to the realization of the unrealized gains and losses can have a significant effect on fair value estimates and have not been considered in the estimates.

NOTE 3

Investment Securities

Debt securities have been classified in the consolidated balance sheets according to management's intent. The amortized cost of securities as shown in the consolidated balance sheets and their estimated fair values at June 30, 2019, and December 31, 2018, were as follows:

Securities Available For Sale:

<u>June 30, 2019</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
U.S. government treasury securities	\$ 3,966,170	\$ 55,360	\$ 0	\$ 4,021,530
U.S. government agency securities	46,764,074	1,007,002	93,047	47,678,029
State and municipal securities	7,349,504	180,457	1,866	7,528,095
Residential mortgage-backed securities	<u>14,360,334</u>	<u>126,359</u>	<u>1,713</u>	<u>14,484,980</u>
Total debt securities AFS	<u>\$72,440,082</u>	<u>\$ 1,369,178</u>	<u>\$ 96,626</u>	<u>\$73,712,634</u>

<u>December 31, 2018</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
U.S. government treasury securities	\$ 982,044	\$ 0	\$ 27,474	\$ 954,570
U.S. government agency securities	45,823,595	264,567	881,157	45,207,005
State and municipal securities	7,394,278	30,579	46,922	7,377,935
Residential mortgage-backed securities	<u>4,769,668</u>	<u>21,579</u>	<u>17,180</u>	<u>4,774,067</u>
Total debt securities AFS	\$ <u>58,969,585</u>	\$ <u>316,725</u>	\$ <u>972,733</u>	\$ <u>58,313,577</u>

Securities Held to Maturity:

<u>June 30, 2019</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
State and municipal securities	\$26,893,531	\$ 492,712	\$ 11,212	\$27,375,031
Residential mortgage-backed securities	<u>5,652,541</u>	<u>182,407</u>	<u>0</u>	<u>5,834,948</u>
Total securities HTM	\$ <u>32,546,072</u>	\$ <u>675,119</u>	\$ <u>11,212</u>	\$ <u>33,209,979</u>

<u>December 31, 2018</u>	<u>Amortized Cost</u>	<u>Unrealized Gains</u>	<u>Unrealized Losses</u>	<u>Estimated Fair Value</u>
State and municipal securities	\$ 30,582,785	\$ 208,480	\$ 67,434	\$ 30,723,831
Residential mortgage-backed securities	<u>6,244,288</u>	<u>49,490</u>	<u>7,282</u>	<u>6,286,496</u>
Total securities HTM	\$ <u>36,827,073</u>	\$ <u>257,970</u>	\$ <u>74,716</u>	\$ <u>37,010,327</u>

The amortized cost and estimated fair value of securities at June 30, 2019, and December 31, 2018, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without penalties.

June 30, 2019

<u>Available for Sale:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 4,003,638	\$ 4,001,488
After one through five years	35,076,017	35,858,294
After five through ten years	18,933,752	19,302,368
After ten years	<u>14,426,675</u>	<u>14,550,484</u>
Total debt securities AFS	\$ <u>72,440,082</u>	\$ <u>73,712,634</u>

<u>Held to Maturity:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 4,687,048	\$ 4,698,641
After one through five years	12,284,059	12,493,184
After five through ten years	10,638,493	10,894,566
After ten years	<u>4,936,472</u>	<u>5,123,588</u>
Total securities HTM	\$ <u>32,546,072</u>	\$ <u>33,209,979</u>

December 31, 2018

<u>Available for Sale:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 2,147,059	\$ 2,124,645
After one through five years	29,691,474	29,674,236
After five through ten years	21,585,776	20,968,318
After ten years	<u>5,545,276</u>	<u>5,546,378</u>
Total debt securities AFS	\$ <u>58,969,585</u>	\$ <u>58,313,577</u>

<u>Held to Maturity:</u>	<u>Amortized Cost</u>	<u>Estimated Fair Value</u>
Amounts maturing in:		
One year or less	\$ 6,483,464	\$ 6,497,910
After one through five years	12,885,021	12,961,209
After five through ten years	11,035,146	11,097,382
After ten years	<u>6,423,442</u>	<u>6,453,826</u>
Total securities HTM	\$ <u>36,827,073</u>	\$ <u>37,010,327</u>

There were no securities sold during the three and six months ended June 30, 2019, and 2018.

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

June 30, 2019

	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities Available for Sale</u>				
Temporarily impaired debt securities:				
U.S. government treasury securities	\$ 0	\$ 0	\$ 0	\$ 0
U.S. government agency securities	0	0	93,047	9,207,406
State and municipal securities	0	0	1,866	870,691
Residential mortgage-backed securities	<u>0</u>	<u>0</u>	<u>1,713</u>	<u>116,796</u>
Total debt securities available for sale	\$ <u>0</u>	\$ <u>0</u>	\$ <u>96,626</u>	\$ <u>10,194,893</u>
<u>Securities Held to Maturity</u>				
Temporarily impaired debt securities:				
State and municipal securities	\$ 0	\$ 0	\$ 11,212	\$ 1,488,615
Residential mortgage-backed securities	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total securities held to maturity	\$ <u>0</u>	\$ <u>0</u>	\$ <u>11,212</u>	\$ <u>1,488,615</u>

<u>December 31, 2018</u>	<u>Less Than Twelve Months</u>		<u>Twelve Months or More</u>	
	Gross		Gross	
	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>
<u>Securities Available for Sale</u>				
Temporarily impaired debt securities:				
U.S. government treasury securities	\$ 0	\$ 0	\$ 27,474	\$ 954,570
U.S. government agency securities	33,077	6,073,337	848,080	20,015,052
State and municipal securities	3,209	306,792	43,713	1,813,173
Residential mortgage-backed securities	14,199	3,032,237	2,981	129,410
Total debt securities available for sale	\$ <u>50,485</u>	\$ <u>9,412,366</u>	\$ <u>922,248</u>	\$ <u>22,912,205</u>
<u>Securities Held to Maturity</u>				
Temporarily impaired debt securities:				
State and municipal securities	\$ 20,209	\$ 7,359,536	\$ 47,225	\$ 2,782,627
Residential mortgage-backed securities	5,671	879,487	1,611	89,464
Total securities held to maturity	\$ <u>25,880</u>	\$ <u>8,239,023</u>	\$ <u>48,836</u>	\$ <u>2,872,091</u>

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

At June 30, 2019, thirteen debt securities with unrealized losses have depreciated 0.9% from the Corporation's amortized cost basis. These unrealized losses relate principally to current interest rates for similar types of securities. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government, its agencies, or other governments, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. Management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available for sale. Also, no declines in debt securities are deemed to be other-than-temporary.

NOTE 4

Loans and Allowance for Loan Losses

The composition of the Corporation's loan portfolio and the percentage of loans in each category to total loans at June 30, 2019 and December 31, 2018, were as follows:

	<u>June 30, 2019</u>		<u>December 31, 2018</u>	
Commercial, financial and agricultural loans	\$ 91,875,926	23.7%	\$ 88,403,215	23.5%
Real estate:				
Construction loans	22,976,763	5.9%	24,890,536	6.6%
Commercial mortgage loans	133,594,392	34.4%	123,477,369	32.8%
Residential loans	103,129,466	26.6%	103,347,898	27.4%
Agricultural loans	31,145,318	8.0%	31,561,686	8.4%
Consumer & other loans	<u>5,563,808</u>	<u>1.4%</u>	<u>5,086,984</u>	<u>1.3%</u>
Loans outstanding	388,285,673	100.0%	376,767,688	100.0%
Unearned interest and discount	(17,367)		(17,451)	
Allowance for loan losses	(3,465,140)		(3,428,869)	
Net loans	\$ <u>384,803,166</u>		\$ <u>373,321,368</u>	

The Corporation's only significant concentration of credit at June 30, 2019, occurred in real estate loans which totaled \$290,845,939 compared with \$283,277,489 at December 31, 2018. However, this amount was not concentrated in any specific segment within the market or geographic area.

At June 30, 2019, the lendable collateral value of the 1 – 4 family and multifamily mortgage loans that were pledged to FHLB to secure outstanding advances was \$63,566,962. FHLB has a blanket lien on the 1 – 4 family and multifamily portfolios, which totaled \$118,587,401.

The following table shows maturities as well as interest sensitivity of the commercial, financial, agricultural, and construction loan portfolio at June 30, 2019.

	Commercial, Financial, Agricultural and <u>Construction</u>
Distribution of loans which are due:	
In one year or less	\$ 39,222,998
After one year but within five years	56,744,401
After five years	<u>18,885,290</u>
Total	\$ <u>114,852,689</u>

The following table shows, for such loans due after one year, the amounts which have predetermined interest rates and the amounts which have floating or adjustable interest rates at June 30, 2019.

	<u>Loans With Predetermined Rates</u>	<u>Loans With Floating Rates</u>	<u>Total</u>
Commercial, financial, agricultural and construction	\$ <u>74,706,251</u>	\$ <u>923,440</u>	\$ <u>75,629,691</u>

Appraisal Policy

When a loan is first identified as a problem loan, the appraisal is reviewed to determine if the appraised value is still appropriate for the collateral. For the duration that a loan is considered a problem loan, the appraised value of the collateral is monitored on a quarterly basis. If significant changes occur in market conditions or in the condition of the collateral, a new appraisal will be obtained.

Nonaccrual Policy

The Corporation does not accrue interest on any loan (1) that is maintained on a cash basis due to the deteriorated financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been past due for ninety days or more unless the loan is well secured and in the process of collection.

A loan subsequently placed on nonaccrual status may be returned to accrual status if (1) all past due interest and principal is paid with expectations of any remaining contractual principal and interest being repaid or (2) the loan becomes well secured and in the process of collection.

Loans placed on nonaccrual status amounted to \$1,794,349 and \$1,204,861 at June 30, 2019, and December 31, 2018, respectively. There were \$842 past due loans over ninety days and still accruing at June 30, 2019, and none at December 31, 2018. The accrual of interest is discontinued when the loan is placed on nonaccrual. Interest income that would have been recorded on these nonaccrual loans in accordance with their original terms totaled \$27,027 for June 30, 2019, and \$64,015 for December 31, 2018.

The following tables present an age analysis of past due loans still accruing interest and nonaccrual loans segregated by class of loans.

Age Analysis of Past Due Loans						
As of June 30, 2019						
	30-89 Days Past Due	Greater than 90 Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
Commercial, financial and agricultural loans	\$1,067,816	\$ 842	\$1,068,658	\$ 7,204	\$ 90,800,064	\$ 91,875,926
Real estate:						
Construction loans	91,289	0	91,289	185,238	22,700,236	22,976,763
Commercial mortgage loans	36,998	0	36,998	750,001	132,807,393	133,594,392
Residential loans	534,965	0	534,965	851,906	101,742,595	103,129,466
Agricultural loans	301,144	0	301,144	0	30,844,174	31,145,318
Consumer & other loans	15,094	0	15,094	0	5,548,714	5,563,808
Total loans	<u>\$2,047,306</u>	<u>\$ 842</u>	<u>\$2,048,148</u>	<u>\$1,794,349</u>	<u>\$384,443,176</u>	<u>\$388,285,673</u>
Age Analysis of Past Due Loans						
As of December 31, 2018						
	30-89 Days Past Due	Greater than 90 Days	Total Past Due Loans	Nonaccrual Loans	Current Loans	Total Loans
Commercial, financial and agricultural loans	\$ 247,397	\$ 0	\$ 247,397	\$ 36,157	\$ 88,119,661	\$ 88,403,215
Real estate:						
Construction loans	0	0	0	0	24,890,536	24,890,536
Commercial mortgage loans	0	0	0	1,022,550	122,454,819	123,477,369
Residential loans	1,560,913	0	1,560,913	146,154	101,640,831	103,347,898
Agricultural loans	321,319	0	321,319	0	31,240,367	31,561,686
Consumer & other loans	36,654	0	36,654	0	5,050,330	5,086,984
Total loans	<u>\$ 2,166,283</u>	<u>\$ 0</u>	<u>\$ 2,166,283</u>	<u>\$ 1,204,861</u>	<u>\$ 373,396,544</u>	<u>\$ 376,767,688</u>

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. 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 commercial and construction 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.

At June 30, 2019, and December 31, 2018, impaired loans amounted to \$4,760,022 and \$4,356,381, respectively. A reserve amount of \$726,871 and \$518,230 was recorded in the allowance for loan losses for these impaired loans as of June 30, 2019, and December 31, 2018, respectively.

The following tables present impaired loans, segregated by class of loans as of June 30, 2019, and December 31, 2018:

	Unpaid Principal Balance	Recorded Investment			Related Allowance	Year-to-date Average Recorded Investment	Interest Income Received During Impairment
		With No Allowance	With Allowance	Total			
<u>June 30, 2019</u>							
Commercial, financial and agricultural loans	\$1,299,434	\$ 113,251	\$1,099,529	\$1,212,780	\$ 433,815	\$ 587,074	\$ 19,703
Real estate:							
Construction loans	395,314	274,514	0	274,514	0	274,514	8,685
Commercial mortgage loans	1,653,696	255,248	948,097	1,203,345	46,865	1,045,411	21,738
Residential loans	2,055,845	925,655	1,130,190	2,055,845	245,169	1,353,530	50,357
Agricultural loans	0	0	0	0	0	0	0
Consumer & other loans	13,538	0	13,538	13,538	1,022	13,538	489
Total loans	<u>\$5,417,827</u>	<u>\$1,568,668</u>	<u>\$3,191,354</u>	<u>\$4,760,022</u>	<u>\$726,871</u>	<u>\$ 3,274,067</u>	<u>\$100,972</u>
							Interest
						Year-to-date	Income
						Average	Received
						Recorded	During
						Investment	Impairment
<u>December 31, 2018</u>							
Commercial, financial and agricultural loans	\$ 184,899	\$ 87,525	\$ 568,816	\$ 656,341	\$ 276,392	\$ 370,038	\$ 52,411
Real estate:							
Construction loans	402,234	281,434	0	281,434	0	281,434	25,364
Commercial mortgage loans	1,787,305	1,277,611	333,892	1,611,503	51,854	1,544,299	45,403
Residential loans	1,801,002	1,027,647	752,443	1,780,090	188,368	1,594,390	127,806
Agricultural loans	12,526	12,526	0	12,526	0	12,526	5,530
Consumer & other loans	0	0	14,487	14,487	1,616	14,487	820
Total loans	<u>\$4,187,966</u>	<u>\$2,686,743</u>	<u>\$1,669,638</u>	<u>\$4,356,381</u>	<u>\$518,230</u>	<u>\$3,817,174</u>	<u>\$257,334</u>

At June 30, 2018, the year-to-date average recorded investment of impaired loans was \$4,434,451 and the interest income received during impairment was \$125,729.

At June 30, 2019, and December 31, 2018, included in impaired loans were \$3,834 and \$7,458, respectively, of troubled debt restructurings.

Troubled Debt Restructurings (TDR)

Loans are considered to have been modified in a troubled debt restructuring, or TDR, when due to a borrower's financial difficulty the Corporation makes certain concessions to the borrower that it would not otherwise consider for new debt with similar risk characteristics. Modifications may include interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral. Each potential loan modification is reviewed individually and the terms of the loan are modified to meet the borrower's specific circumstances at a point in time. Not all loan modifications are TDRs. However, performance prior to the modification, or significant events that coincide

with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period.

Loan modifications are reviewed and recommended by the Corporation's senior credit officer, who determines whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether the loan is classified as a TDR include:

- Interest rate reductions – Occur when the stated interest rate is reduced to a nonmarket rate or a rate the borrower would not be able to obtain elsewhere under similar circumstances.
- Amortization or maturity date changes – Result when the amortization period of the loan is extended beyond what is considered a normal amortization period for loans of similar type with similar collateral.
- Principal reductions – Arise when the Corporation charges off a portion of the principal that is not fully collateralized and collectability is uncertain; however, this portion of principal may be recovered in the future under certain circumstances.

The following tables present the amount of troubled debt restructuring by loan class, classified separately as accrual and nonaccrual at June 30, 2019, and December 31, 2018, as well as those currently paying under restructured terms and those that have defaulted under restructured terms as of June 30, 2019, and December 31, 2018. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 30 or more days past due.

	June 30, 2019					
	<u>Accruing</u>	<u>Non-accruing</u>	<u>#</u>	<u>Under restructured terms</u>		
				<u>Current</u>	<u>#</u>	<u>Default</u>
Commercial, financial, and agricultural loans	\$ 3,834	\$ 0	1	\$ 3,834	0	\$ 0
Real estate:						
Construction loans	0	0	0	0	0	0
Commercial mortgage loans	0	0	0	0	0	0
Residential loans	0	0	0	0	0	0
Agricultural loans	0	0	0	0	0	0
Consumer & other loans	0	0	0	0	0	0
Total TDR's	<u>\$ 3,834</u>	<u>\$ 0</u>	<u>1</u>	<u>\$ 3,834</u>	<u>0</u>	<u>\$ 0</u>

	December 31, 2018					
	<u>Accruing</u>	<u>Non-accruing</u>	<u>#</u>	<u>Under restructured terms</u>		
				<u>Current</u>	<u>#</u>	<u>Default</u>
Commercial, financial, and agricultural loans	\$ 5,570	\$ 0	1	\$ 5,570	0	\$ 0
Real estate:						
Construction loans	0	0	0	0	0	0
Commercial mortgage loans	0	0	0	0	0	0
Residential loans	1,888	0	1	1,888	0	0
Agricultural loans	0	0	0	0	0	0
Consumer & other loans	0	0	0	0	0	0
Total TDR's	<u>\$ 7,458</u>	<u>\$ 0</u>	<u>2</u>	<u>\$ 7,458</u>	<u>0</u>	<u>\$ 0</u>

The following table presents the amount of troubled debt restructurings by types of concessions made, classified separately as accrual and non-accrual at June 30, 2019, and December 31, 2018.

Type of concession:	June 30, 2019				December 31, 2018			
	Accruing		Nonaccruing		Accruing		Nonaccruing	
	#	Balance	#	Balance	#	Balance	#	Balance
Payment modification	0	\$ 0	0	\$ 0	0	\$ 0	0	\$ 0
Rate reduction	0	0	0	0	0	0	0	0
Rate reduction, payment modification	1	3,834	0	0	1	1,888	0	0
Forbearance of interest	0	0	0	0	1	5,570	0	0
Total	1	\$ 3,834	0	\$ 0	2	\$ 7,458	0	\$ 0

As of June 30, 2019, and December 31, 2018, the Corporation had a balance of \$3,834 and \$7,458, respectively, in troubled debt restructurings. The Corporation had no charge-offs on such loans at June 30, 2019, and December 31, 2018. The Corporation had \$3,834 in the allowance for loan losses allocated to such troubled debt restructurings at June 30, 2019, and no balance allocated at December 31, 2018. The Corporation had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of June 30, 2019.

Credit Risk Monitoring and Loan Grading

The Corporation employs several means to monitor the risk in the loan portfolio including volume and severity of loan delinquencies, nonaccrual loans, internal grading of loans, historical loss experience and economic conditions.

Loans are subject to an internal risk-grading system which indicates the risk and acceptability of that loan. The loan grades used by the Corporation are for internal risk identification purposes and do not directly correlate to regulatory classification categories or any financial reporting definitions.

The general characteristics of the risk grades are as follows:

Grade 1 – Exceptional – Loans graded 1 are characterized as having a very high credit quality, exhibit minimum risk to the Corporation and have low administrative cost. These loans are usually secured by highly liquid and marketable collateral and a strong primary and secondary source of repayment is available.

Grade 2 – Above Average – Loans graded 2 are basically sound credits secured by sound assets and/or backed by the financial strength of borrowers of integrity with a history of satisfactory payments of credit obligations.

Grade 3 – Acceptable – Loans graded 3 are secured by sound assets of sufficient value and/or supported by the sufficient financial strength of the borrower. The borrower will have experience in their business area or employed a reasonable amount of time at their current employment. The borrower will have a sound primary source of repayment, and preferably a secondary source, which will allow repayment in a prompt and reasonable period of time.

Grade 4 – Fair – Loans graded 4 are those which exhibit some weakness or downward trend in financial condition and although the repayment history is satisfactory, it requires supervision by bank personnel. The borrower may have little experience in their business area or employed only a short amount of time at their current employment. The loan may be secured by good collateral; however, it may require close supervision as to value and/or quality and may not have sufficient liquidation value to completely cover the loan.

Grade 5a – Watch – Loans graded 5a contain a discernible weakness; however, the weakness is not sufficiently pronounced so as to cause concern for the possible loss of interest or principal. Loans in this category may exhibit outward signs of stress, such as slowness in financial disclosures or recent payments. However, such signs are not of long duration or of sufficient severity that default appears imminent. Loans in this category are not so deficient as to cause alarm, but do require close monitoring for further deterioration and possible downgrade.

Grade 5b – Other Assets Especially Mentioned (OAEM) – Loans graded 5b may otherwise be classified more severely except that the loan is well secured by properly margined collateral, it is generally performing in accordance with the original contract or modification thereof and such performance has seasoned for a period of 90 days, or the ultimate collection of all principal and interest is reasonably expected. Loans in this grade are unsupported by sufficient evidence of the borrower’s sound net worth or repayment capacity or may be subject to third party action that would cause concern for future prompt repayment.

Grade 6 – Substandard – Loans graded 6 contain clearly pronounced credit weaknesses that are below acceptable credit standards for the Corporation. Such weaknesses may be due to either collateral deficiencies or inherent financial weakness of the borrower, but in either case represents less than acceptable credit risk. Loans in this grade are unsupported by sufficient evidence of the borrower’s sound net worth, repayment capacity or acceptable collateral.

Grade 7 – Doubtful – Loans graded 7 have such pronounced credit weaknesses that the Corporation is clearly exposed to a significant degree of potential loss of principal or interest. These loan generally have a defined weakness which jeopardizes the ultimate repayment of the debt.

Grade 8 – Loss – Loans graded 8 are of such deteriorated credit quality that repayment of principal and interest can no longer be considered. These loans are of such little value that their continuance as an active bank asset is not warranted. As of June 30, 2019, all Grade 8 loans have been charged-off.

The following tables present internal loan grading by class of loans as of June 30, 2019, and December 31, 2018:

	Commercial, Financial, and Agricultural	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Agricultural Real Estate	Consumer and Other	Total
<u>June 30, 2019</u>							
Rating:							
Grade 1- Exceptional	\$ 1,543,294	\$ 0	\$ 0	\$ 22,420	\$ 0	\$ 236,636	\$ 1,802,350
Grade 2- Above Avg.	25,350	0	0	0	0	38,618	63,968
Grade 3- Acceptable	24,747,422	2,879,744	29,292,207	26,036,145	16,574,101	1,952,560	101,482,179
Grade 4- Fair	63,975,074	19,696,504	99,705,018	70,431,427	14,571,217	3,317,528	271,696,768
Grade 5a- Watch	1,391,027	274,515	1,472,301	2,788,321	0	15,647	5,941,811
Grade 5b- OAEM	3,807	0	2,476,833	456,629	0	2,819	2,940,088
Grade 6- Substandard	0	126,000	648,033	3,340,491	0	0	4,114,524
Grade 7- Doubtful	<u>189,952</u>	<u>0</u>	<u>0</u>	<u>54,033</u>	<u>0</u>	<u>0</u>	<u>243,985</u>
Total loans	<u>\$91,875,926</u>	<u>\$22,976,763</u>	<u>\$133,594,392</u>	<u>\$103,129,466</u>	<u>\$31,145,318</u>	<u>\$5,563,808</u>	<u>\$388,285,673</u>

<u>December 31, 2018</u>	Commercial, Financial, and <u>Agricultural</u>	Construction <u>Real Estate</u>	Commercial <u>Real Estate</u>	Residential <u>Real Estate</u>	Agricultural <u>Real Estate</u>	Consumer and Other	<u>Total</u>
Rating:							
Grade 1- Exceptional	\$ 1,237,602	\$ 0	\$ 0	\$ 22,905	\$ 0	\$ 210,045	\$ 1,470,552
Grade 2- Above Avg.	0	0	0	0	0	43,711	43,711
Grade 3- Acceptable	23,821,846	1,860,003	30,398,565	25,839,646	16,863,356	1,151,239	99,934,655
Grade 4- Fair	58,753,931	22,749,099	88,122,957	73,114,310	14,698,330	3,657,108	261,095,735
Grade 5a- Watch	473,616	0	2,411,710	722,441	0	6,206	3,613,973
Grade 5b- OAEM	3,079,098	0	446,841	1,299,587	0	2,168	4,827,694
Grade 6- Substandard	787,309	281,434	2,097,296	2,349,009	0	16,507	5,531,555
Grade 7- Doubtful	<u>249,813</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>249,813</u>
Total loans	<u>\$88,403,215</u>	<u>\$24,890,536</u>	<u>\$123,477,369</u>	<u>\$103,347,898</u>	<u>\$31,561,686</u>	<u>\$5,086,984</u>	<u>\$376,767,688</u>

Allowance for Loan Losses Methodology

The allowance for loan losses (ALL) is determined by a calculation based on segmenting the loans into the following categories: (1) impaired loans and nonaccrual loans, (2) loans with a credit risk rating of 5b, 6, 7 or 8, (3) other outstanding loans, and (4) other commitments to lend. In addition, unallocated general reserves are estimated based on migration and economic analysis of the loan portfolio.

The ALL is calculated by the addition of the estimated loss derived from each of the above categories. The impaired loans and nonaccrual loans are analyzed on an individual basis to determine if the future collateral value is sufficient to support the outstanding debt of the loan. If an estimated loss is calculated, it is included in the estimated ALL until it is charged to the loan loss reserve. The calculation for loan risk graded 5b, 6, 7 or 8, other outstanding loans and other commitments to lend is based on assigning an estimated loss factor based on a twelve quarter rolling historical weighted average net loss rate. The estimated requirement for unallocated general reserves from migration and economic analysis is determined by considering (1) trends in asset quality, (2) level and trends in charge-off experience, (3) macroeconomic trends and conditions, (4) microeconomic trends and conditions and (5) risk profile of lending activities. Within each of these categories, a risk factor percentage from a rating of excessive, high, moderate or low will be determined by management and applied to the loan portfolio. By adding the estimated value from the migration and economic analysis to the estimated reserve from the loan portfolio, a total estimated loss reserves is obtained. This amount is then compared to the actual amount in the loan loss reserve.

The calculation of ALL is performed on a monthly basis and is presented to the Loan Committee and the Board of Directors.

The following table details activity in the ALL and loans evaluated for impairment by class of loans for the three and six month period ended June 30, 2019. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories. The annualized net charge-offs to average loans outstanding ratio was 0.17% for the six months ended June 30, 2019, compared with 0.13% at December 31, 2018.

Three months ended June 30, 2019:

<u>June 30, 2019</u>	<u>Commercial, Financial, and Agricultural</u>	<u>Construction Real Estate</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Agricultural Real Estate</u>	<u>Consumer and Other</u>	<u>Total</u>
<u>Allowance for loan losses:</u>							
Beginning balance, March 31, 2019	\$ 503,322	\$ 1,043,027	\$ 1,077,669	\$ 458,871	\$ 76,880	\$ 207,158	\$ 3,366,927
Charge-offs	102,217	0	89,853	0	0	6,778	198,848
Recoveries	9,484	0	0	35,940	0	1,247	46,671
Net charge-offs	92,733	0	89,853	(35,940)	0	5,531	152,177
Provisions charged to operations	122,964	0	138,429	(15,848)	0	4,845	250,390
Balance at end of period, June 30, 2019	<u>\$ 533,553</u>	<u>\$ 1,043,027</u>	<u>\$ 1,126,245</u>	<u>\$ 478,963</u>	<u>\$ 76,880</u>	<u>\$ 206,472</u>	<u>\$ 3,465,140</u>

Six months ended June 30, 2019:

<u>June 30, 2019</u>	<u>Commercial, Financial, and Agricultural</u>	<u>Construction Real Estate</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Agricultural Real Estate</u>	<u>Consumer and Other</u>	<u>Total</u>
<u>Allowance for loan losses:</u>							
Beginning balance, December 31, 2018	\$ 402,251	\$ 1,043,027	\$ 1,210,302	\$ 458,871	\$ 108,878	\$ 205,540	\$ 3,428,869
Charge-offs	102,217	0	274,549	0	0	6,778	383,544
Recoveries	12,180	0	3,368	35,940	0	2,029	53,517
Net charge-offs	90,037	0	271,181	(35,940)	0	4,749	330,027
Provisions charged to operations	221,339	0	187,124	(15,848)	(31,998)	5,681	366,298
Balance at end of period, June 30, 2019	<u>\$ 533,553</u>	<u>\$ 1,043,027</u>	<u>\$ 1,126,245</u>	<u>\$ 478,963</u>	<u>\$ 76,880</u>	<u>\$ 206,472</u>	<u>\$ 3,465,140</u>

Ending balance - Individually evaluated for impairment	\$ 433,815	\$ 0	\$ 46,865	\$ 245,169	\$ 0	\$ 1,022	\$ 726,871
Collectively evaluated for impairment	99,738	1,043,027	1,079,380	233,794	76,880	205,450	2,738,269
Balance at end of period	<u>\$ 533,553</u>	<u>\$ 1,043,027</u>	<u>\$ 1,126,245</u>	<u>\$ 478,963</u>	<u>\$ 76,880</u>	<u>\$ 206,472</u>	<u>\$ 3,465,140</u>

Loans :

Ending balance - Individually evaluated for impairment	\$ 1,212,780	\$ 274,514	\$ 1,203,345	\$ 2,055,845	\$ 0	\$ 13,538	\$ 4,760,022
Collectively evaluated for impairment	90,663,146	22,702,249	132,391,047	101,073,621	31,145,318	5,550,270	383,525,651
Balance at end of period	<u>\$91,875,926</u>	<u>\$22,976,763</u>	<u>\$133,594,392</u>	<u>\$103,129,466</u>	<u>\$31,145,318</u>	<u>\$5,563,808</u>	<u>\$388,285,673</u>

At June 30, 2019, of the \$4,760,022 loans that were individually evaluated for impairment, all \$4,760,022 were deemed impaired.

The following table details activity in the ALL and loans evaluated for impairment by class of loans for the year ended December 31, 2018.

<u>December 31, 2018</u> <u>Allowance for loan</u> <u>losses:</u>	Commercial, Financial, and <u>Agricultural</u>	Construction <u>Real Estate</u>	Commercial <u>Real Estate</u>	Residential <u>Real Estate</u>	Agricultural <u>Real Estate</u>	Consumer and Other	<u>Total</u>
Beginning balance, December 31, 2017	\$ 324,260	\$ 1,043,083	\$ 1,056,595	\$ 416,474	\$ 11,560	\$ 191,660	\$ 3,043,632
Charge-offs	548,460	783	43,349	6,909	0	6,844	606,345
Recoveries	<u>12,025</u>	<u>0</u>	<u>590</u>	<u>0</u>	<u>147,252</u>	<u>2,215</u>	<u>162,082</u>
Net charge-offs	536,435	783	42,759	6,909	(147,252)	4,629	444,263
Provisions charged to operations	<u>614,426</u>	<u>727</u>	<u>196,466</u>	<u>49,306</u>	<u>(49,934)</u>	<u>18,509</u>	<u>829,500</u>
Balance at end of period, December 31, 2018	<u>\$ 402,251</u>	<u>\$ 1,043,027</u>	<u>\$ 1,210,302</u>	<u>\$ 458,871</u>	<u>\$ 108,878</u>	<u>\$ 205,540</u>	<u>\$ 3,428,869</u>
Ending balance - Individually evaluated for impairment	\$ 276,392	\$ 0	\$ 51,854	\$ 188,368	\$ 0	\$ 1,616	\$ 518,230
Collectively evaluated for impairment	<u>125,859</u>	<u>1,043,027</u>	<u>1,158,448</u>	<u>270,503</u>	<u>108,878</u>	<u>203,924</u>	<u>2,910,639</u>
Balance at end of period	<u>\$ 402,251</u>	<u>\$ 1,043,027</u>	<u>\$ 1,210,302</u>	<u>\$ 458,871</u>	<u>\$ 108,878</u>	<u>\$ 205,540</u>	<u>\$ 3,428,869</u>
<u>Loans :</u>							
Ending balance - Individually evaluated for impairment	\$ 656,341	\$ 281,434	\$ 1,611,503	\$ 1,929,214	\$ 12,526	\$ 14,487	\$ 4,505,505
Collectively evaluated for impairment	<u>87,746,874</u>	<u>24,609,102</u>	<u>121,865,866</u>	<u>101,418,684</u>	<u>31,549,160</u>	<u>5,072,497</u>	<u>372,262,183</u>
Balance at end of period	<u>\$88,403,215</u>	<u>\$24,890,536</u>	<u>\$123,477,369</u>	<u>\$103,347,898</u>	<u>\$31,561,686</u>	<u>\$5,086,984</u>	<u>\$376,767,688</u>

At December 31, 2018, of the \$4,505,505 loans that were individually evaluated for impairment, only \$4,356,381 were deemed impaired.

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

Forward-Looking Statements

In addition to historical information, this Form 10-Q report contains forward-looking statements within the meaning of the federal securities laws. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical fact, and can be identified by the use of forward-looking terminology such as “believes”, “expects”, “may”, “will”, “could”, “should”, “projects”, “plans”, “goal”, “targets”, “potential”, “estimates”, “pro forma”, “seeks”, “intends”, or “anticipates” or the negative thereof or comparable terminology. Forward-looking statements include discussions of strategy, financial projections, guidance and estimates (including their underlying assumptions), statements regarding plans, objectives, expectations or consequences of various transactions, and statements about the future performance, operations, products and services of the Corporation and its subsidiaries. We caution our shareholders and other readers not to place undue reliance on such statements.

The Corporation cautions that there are various factors that could cause actual results to differ materially from the anticipated results or other expectations expressed in any forward-looking statements; accordingly, there can be no assurance that such indicated results will be realized. These factors include risks related to:

- the conditions in the banking system, financial markets, and general economic conditions;
- the Corporation’s ability to maintain profitability;
- the Corporation’s ability to raise capital;
- the Corporation’s ability to maintain liquidity or access other sources of funding;
- changes in the cost and availability of funding;
- the Corporation’s construction and land development loans;
- asset quality;
- the adequacy of the allowance for loan losses;
- technology difficulties or failures;
- the Corporation’s ability to execute its business strategy;
- the loss of key personnel;
- competition from financial institutions and other financial service providers;
- changes in technology;
- the impact of the Dodd-Frank Act and related regulations and other changes in financial services laws and regulations or failures to comply with such laws and regulations;
- changes in regulatory capital and other requirements;
- changes in monetary policy;
- losses due to fraudulent and negligent conduct of customers, third party service providers or employees;
- the costs and effects of litigation, examinations, investigations, or similar matters, or adverse facts and developments related thereto;
- possible regulatory or judicial proceedings, board resolutions, informal memorandums of understanding or formal enforcement actions imposed by regulators;
- the Corporation’s reliance on third parties to provide key components of our business infrastructure and services required to operate our business;
- acquisitions or dispositions of assets or internal restructuring that may be pursued by the Corporation;
- deteriorating conditions in the stock market, the public debt market and other capital markets;

- changes in or application of environmental and other laws and regulations to which the Corporation is subject;
- political, legal and local economic conditions and developments;
- the Corporation's lack of geographic diversification;
- changes in commodity prices and interest rates;
- the Corporation's accounting and reporting policies;
- the Corporation's ability to maintain effective internal controls over financial reporting and disclosure controls and procedure;
- a cybersecurity incident involving the misappropriation, loss or unauthorized disclosure or use of confidential information of our customers; and
- weather, natural disasters and other catastrophic events and other factors discussed in the Corporation's other filings with the SEC.

The foregoing list of factors is not exclusive, and readers are cautioned not to place undue reliance on any forward-looking statements. The Corporation undertakes no obligation to update or revise any forward-looking statements. Additional information with respect to factors that may cause results to differ materially from those contemplated by such forward-looking statements is included in the Corporation's current and subsequent filings with the SEC.

Overview

The Corporation is a full-service community bank holding company headquartered in Moultrie, Georgia. The community of Moultrie has been served by the Bank since 1928. We provide comprehensive financial services to consumer, business and governmental customers, which, in addition to conventional banking products, include a full range of trust, retail brokerage and insurance services. Our primary market area incorporates Colquitt County, where we are headquartered, as well as Baker, Worth, Lowndes, and Tift Counties, each contiguous with Colquitt County, and the surrounding counties of southwest Georgia. We have six full service banking facilities each with a deposit automation teller machine, and nine In-Lobby teller machines throughout the six branches.

Our strategy is to:

- maintain the diversity of our revenue, including both interest and noninterest income through a broad base of business;
- strengthen our sales and marketing efforts while developing our employees to provide the best possible service to our customers;
- expand our market share where opportunity exists; and
- grow outside of our current geographic market either through de-novo branching or acquisitions into areas proximate to our current market area.

We believe that investing in sales and marketing in our markets and geographic expansion will provide us with a competitive advantage. To that end, about seven years ago, we began expanding geographically in Valdosta, Georgia, with two full-service banking centers, and added a commercial banking center in August 2014. Continuing to expand our geographic footprint, a loan production office was opened in the neighboring community of Tifton, Georgia, in January 2016. The loan production office was closed upon completion of a new full-service banking center in Tifton, Georgia, that was opened in August 2018. We focus on our customers and believe that our strategic positioning, strong balance sheet and capital levels position us to sustain our franchise, capture market share and build customer loyalty.

The Corporation's profitability, like most financial institutions, is dependent to a large extent upon net interest income, which is the difference between the interest received on earning assets and the interest paid on interest-bearing liabilities. The Corporation's earning assets are primarily loans, securities, and short-term interest-bearing deposits with banks, and the interest-bearing liabilities are principally customer deposits and borrowings. Net interest income is highly sensitive to fluctuations in interest rates. To address interest rate fluctuations, we manage our balance sheet in an effort to diminish the impact should interest rates suddenly change.

Broadening our revenue sources helps to reduce the risk and exposure of our financial results to the impact of changes in interest rates, which are outside of our control. Sources of noninterest income include our insurance agency, fees on customer accounts, and trust and retail brokerage services through our Wealth Strategies division. In the second quarter 2019, noninterest income, at 17.5% of the Corporation's total revenue, increased mostly due to a net gain on the sale and disposition of fixed assets in the second quarter 2019.

Our profitability is also impacted by operating expenses such as salaries, employee benefits, occupancy, and income taxes. Our lending activities are significantly influenced by regional and local factors such as changes in population, competition among lenders, interest rate conditions and prevailing market rates on competing uses of funds and investments, customer preferences and levels of personal income and savings in the Corporation's primary market area.

The Corporation's nonperforming assets were \$1.83 million at the end of June 30, 2019, up from \$1.33 million at December 31, 2018, primarily due to an increase of \$589 thousand in nonaccrual loans and up \$75 thousand when compared with the second quarter 2018 due to nonaccrual loans increasing \$74 thousand.

Critical Accounting Policies

In the course of the Corporation's normal business activity, management must select and apply many accounting policies and methodologies that lead to the financial results presented in the consolidated financial statements of the Corporation. Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy because of the uncertainty and subjectivity inherent in estimating the levels of allowance needed to cover probable credit losses within the loan portfolio and the material effect that these estimates have on the Corporation's results of operations. We believe that the allowance for loan losses as of June 30, 2019, is adequate; however, under adverse conditions or assumptions, future additions to the allowance may be necessary. There have been no significant changes in the methods or assumptions used in our accounting policies that would have resulted in material estimates and assumptions changes. Note 1 to the Consolidated Financial Statements provides a description of our significant accounting policies and contributes to the understanding of how our financial performance is reported.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity management involves the ability to meet the cash flow requirements of customers who may be either depositors wanting to withdraw their funds or borrowers needing assurance that sufficient funds will be available to meet their credit needs. In the ordinary course of business, the Corporation's cash flows are generated from interest and fee income as well as from loan repayments and the maturity or sale of other earning assets. In addition, liquidity is continuously provided through the acquisition of new deposits and borrowings or the rollover of maturing deposits and borrowings. The Corporation strives to maintain an adequate liquidity position by managing the balances and maturities of interest-earning assets and interest-earning liabilities so its short-term investments balance, at any given time, will adequately cover any reasonably anticipated immediate need for funds. Additionally, the Bank maintains relationships with correspondent banks that could provide funds on short notice, if needed.

The liquidity and capital resources of the Corporation are monitored on a periodic basis by state and Federal regulatory authorities. As determined under guidelines established by these regulatory authorities, the Bank's liquidity ratios at June 30, 2019, were considered satisfactory. At that date, the Bank's short-term investments were adequate to cover any reasonably anticipated immediate need for funds. We are not aware of any known trends, events, or uncertainties that will have or that are reasonably likely to have a material adverse effect on the Corporation's liquidity or operations. At June 30, 2019, the Corporation's and the Bank's risk-based capital ratios were considered adequate based on guidelines established by regulatory authorities. During the six months ended June 30, 2019, total capital increased \$3.439 million to \$47.1 million and increased \$5.12 million from the same period last year. Also, the Corporation continues to maintain a healthy level of capital adequacy as measured by its equity-to-asset ratio of 8.52% as of June 30, 2019, and average equity-to-average asset ratio for the second quarter ending June 30, 2019, of 8.45%. The Corporation is not aware of any events or trends likely to result in a material change in capital resources other than the effects of normal operations on the retention of net earnings. Also, the Corporation's management is not aware of any current recommendations by the regulatory authorities which, if they were implemented, would have a material effect on the Corporation's capital resources.

RESULTS OF OPERATIONS

The Corporation's results of operations are determined by its ability to effectively manage interest income and expense, to minimize loan and investment losses, to generate noninterest income and to control noninterest expense. Since interest rates are determined by market forces and economic conditions beyond the control of the Corporation, the ability to generate net interest income is dependent upon the Bank's ability to obtain an adequate spread between the rate earned on interest-earning assets and the rate paid on interest-bearing liabilities. Thus, the key performance measure for net interest income is the interest margin or net yield, which is taxable-equivalent net interest income divided by average earning assets.

Performance Summary

The Corporation's net income after taxes for the three-month period ending June 30, 2019, was \$1.3 million, up \$150 thousand from net income of \$1.1 million for the second quarter of 2018. Net interest income grew 11% to \$5.1 million due primarily to a \$45.8 million growth in average loans and an increase in noninterest income of \$247 thousand. These increases were partially offset by increases in noninterest expense of \$419 thousand and provision for loan loss of \$110 thousand.

On a per share basis, net income for the second quarter was \$.51 per share compared with \$.45 per share for the same quarter in 2018. The weighted average common diluted shares outstanding for the second quarter remained flat compared to the same quarter in 2018 at 2.546 million. In the first quarter of 2018, the Corporation retired its treasury stock. The number of treasury shares retired was 1,748,059.

We measure our performance on selected key ratios, which are provided for the previous five quarterly periods.

	2nd Qtr 2019	1st Qtr 2019	4th Qtr 2018	3rd Qtr 2018	2nd Qtr 2018
Return on average total assets	0.95%	0.91%	0.85%	0.90%	0.91%
Return on average total equity	11.27%	11.06%	10.48%	10.74%	11.00%
Average shareholders' equity to					
Average total assets	8.45%	8.19%	8.09%	8.36%	8.28%
Net interest margin (tax equivalent)	4.06%	3.82%	3.94%	4.08%	3.96%

Comparison of Statements of Income for the Quarter

Total interest income increased \$855 thousand to \$6.1 million for the three months ended June 30, 2019, compared with the same period in 2018, reflecting an increase in interest income and fees on loans of \$856 thousand. Interest on deposits in other banks decreased \$19 thousand and certificates of deposit in other banks increased \$6 thousand, respectively, when compared with the second quarter of 2018. Also, interest income and dividends from investment securities increased \$12 thousand compared with the same period last year.

Total interest expense increased \$370 thousand, or 51%, to \$1.1 million in the second quarter of 2019 compared with the same period in 2018. Interest paid on deposits increased \$493 thousand, or 103%, during the second quarter of 2019 due to a 32 basis point increase in rate paid on interest-bearing deposits as well as an \$60.2 million increase in average interest-bearing deposit volume compared with the second quarter of 2018. Total interest on borrowings decreased \$124 thousand compared with the same quarter in 2018 due to a \$28.1 million lower average volume of Federal Home Loan Bank Advances.

The primary source of revenue for the Corporation is net interest income, which is the difference between total interest income on earning assets and interest expense on interest-bearing sources of funds. Net interest income improved to \$5.1 million for the second quarter of 2019 compared with \$4.6 million in net interest income in the 2018 second quarter. Net interest income after provision for loan losses for the second quarter of 2019 was \$4.8 million compared with \$4.4 million for the same period in 2018 as the second quarter provision for loan losses was up \$110 thousand to \$250 thousand in 2019. The Corporation's net interest margin was 4.06% for the second quarter of 2019, up 10 basis points from the same period last year. The higher net interest margin was primarily related to the 25 basis point increase in rates received on loans.

Noninterest income, at 17.5% of the Corporation's total revenue for the quarter, was \$1.3 million for the second quarter, up \$247 thousand compared with the same period in 2018. The increase in noninterest income was primarily the result of a \$244 thousand gain on the sale and disposition of fixed assets. Also contributing to the increase was a \$39 thousand increase in income from insurance services and a \$25 thousand increase in other income. Partially offsetting these increases, service charges on deposit accounts, income from retail brokerage services, and income from trust services decreased by \$36 thousand, \$9 thousand, and \$8 thousand, respectively, compared with the second quarter last year.

Noninterest expense was \$4.6 million for the second quarter of 2019, an increase of \$419 thousand when compared with the second quarter of 2018. The largest component of noninterest expense, salaries and employee benefits, increased \$196 thousand to \$2.6 million for the second quarter of 2019 as hourly wages increased and management made a number strategic hires to support the Corporation. Equipment, data processing, and other expenses increased \$123 thousand, \$54 thousand, and \$24 thousand, respectively. The increase in equipment are due to an increase in depreciation expense and maintenance on new equipment purchased to support technological advances. Also contributing to the increase is occupancy expense which increased \$24 thousand when compared to second quarter 2018.

Comparison of Statements of Income for the Six-month Period

Total interest income for the first six months of 2019 increased \$1.8 million to \$12.1 million when compared with the same period in 2018, due primarily to a \$1.7 million increase in interest income and fees on loans as average loans increased \$45.8 million compared with the first half of 2018. Interest income on deposits and certificates of deposit in other banks also increased \$35 thousand and \$11 thousand, respectively, compared to the same period last year. Interest income and dividends from investment securities increased by \$25 thousand when compared with the first six months of last year.

Total interest expense for the six-month period ended June 30, 2019, increased \$951 thousand, or 71%, to \$2.3 million compared with the same period in 2018. Interest paid on interest-bearing deposits increased \$1,171 thousand compared with the first six months of 2018. Interest expense on total borrowings decreased \$220 thousand for the first six months of 2019 due to \$25.2 million lower average Federal Home Loan Bank advances compared with the same period last year.

Net interest income for the first six months of 2019 was 9% higher at \$9.8 million compared with \$9.0 million for the same period in 2018. Net interest income after provision for loan losses was \$9.5 million compared with \$8.7 million for the same period in 2018. The provision for loan losses was \$366 thousand in the first six months of 2019, up from \$356 thousand for the same period of 2018 due to steady loan growth. Net interest margin was 3.98% for the first half of 2019, relatively flat from 3.97% for the same period last year. As mentioned for the quarter, a 40 basis point increase in average rate paid on interest bearing liabilities and the impact of the decreased tax equivalency adjustment on tax free investments contributed to the shift in net interest margin.

For the first half of 2019, noninterest income was \$2.5 million, up \$490 thousand compared with the same period in 2018. The increase was primarily attributed to a \$245 thousand gain on the sale and disposition of fixed assets, and a net gain on extinguishment of debt of \$143 thousand. Also, income from insurance services, other income, and retail brokerage services increased \$88 thousand, \$39 thousand, and \$10 thousand, respectively, compared with the first half of 2018. Partially offsetting these increases, service charges on deposit accounts and income from trust services decreased \$23 thousand and \$10 thousand respectively.

Noninterest expense increased \$839 thousand for the first six months of 2019 compared with the same period last year mainly attributed to an increase of \$351 thousand in salary and employee benefits related to the same categories mentioned above in the quarterly comparison. Equipment expense, data processing expense, other operating expenses, and occupancy expense, also increased \$241 thousand, \$104 thousand, \$97 thousand, and \$50 thousand, respectively, compared with the first half of last year. Partially offsetting the increase, amortization of intangible assets decreased \$4 thousand due to the intangible asset on the book being fully amortized.

Comparison of Financial Condition Statements

At June 30, 2019, total assets were \$552.5 million, a \$17.6 million increase from December 31, 2018. Interest-bearing deposits in other banks decreased \$4.0 million and total loans increased \$11.5 million which was primarily funded by an increase in total deposits of \$12 million at June 30, 2019, mostly in noninterest-bearing deposit accounts and time deposits.

Total loans increased \$11.5 million to \$388.3 million at June 30, 2019, compared with \$376.8 million at December 31, 2018. The Corporation continues to be conservative in its lending practices in order to maintain a quality loan portfolio. Loans, a major use of funds, represented 70.3% of total assets at June 30, 2019.

Investment securities, interest-bearing deposits in other banks, and certificates of deposit in other banks represented 23.3% of total assets at June 30, 2019. Compared with December 31, 2018, interest-bearing deposits in other banks decreased \$4.0 million, investment securities increased \$11.2 million, and certificates of deposit increased \$245 thousand, respectively. This resulted in an overall increase in investments of \$7.4 million since December 31, 2018.

Deposits increased to \$467.6 million at the end of the second quarter of 2019, up \$12 million from the end of 2018. The increase was primarily in noninterest-bearing accounts of \$13.6 million, total certificates of deposit accounts of \$10.7 million, interest bearing business checking account of \$3.2 million, and savings accounts of \$1.7 million. NOW accounts and money market accounts decreased \$15.0 million and \$2.3 million, respectively, compared with December 31, 2018. At June 30, 2019, total deposits represented 84.6% of total assets.

Total debt increased \$2.1 million when compared with the year-end 2018. Short-term borrowed funds consist of Federal Home Loan Bank advances of \$5.3 million and \$1 million in borrowings from First National Bankers Bank as of June 30, 2019, compared with \$10.5 million at December 31, 2018. Of the short term borrowings, \$3.8 million are short-term portions of long-term principal reducing Federal Home Loan Bank advances. The Corporation will repay the Federal Home Loan Bank long-term advances as scheduled. The following table shows the major contractual obligations for the Corporation.

Long-term debt consists of the following:

	June 30, <u>2019</u>	December 31, <u>2018</u>	June 30, <u>2018</u>
Advance from FHLB with a 1.259% fixed rate of interest maturing September 30, 2020 (principal reducing hybrid advance with principal reductions of \$1.6 million).	\$ 1,600,000	\$ 1,600,000	\$ 3,200,000
Advance from FHLB with a 1.9425% fixed rate of interest maturing December 16, 2022 (principal reducing hybrid advance with principal reductions of \$857 thousand annually). (Extinguished early)	0	2,571,429	3,428,571
Advance from FHLB with a 1.419% fixed rate of interest maturing August 30, 2023 (principal reducing hybrid advance with principal reductions of \$857 thousand annually). (Extinguished early)	0	0	4,285,715
Advance from FHLB with a 1.60% fixed rate of interest maturing July 10, 2019.	0	0	1,500,000
Advance from FHLB with a 1.80% fixed rate of interest maturing July 10, 2020.	2,000,000	2,000,000	2,000,000
Advance from FHLB with a 1.925% fixed rate of interest maturing September 28, 2022 (principal reducing hybrid advance with principal reductions of \$2.0 million annually). (Extinguished early)	0	6,000,000	8,000,000
Advance from FHLB with a 2.337% fixed rate of interest maturing December 5, 2024 (principal reducing hybrid advance with principal reductions of \$857 thousand annually). (Extinguished early)	0	0	5,142,857
Advance from FHLB with a 3.018% fixed rate of interest maturing September 17, 2021. (Extinguished early)	0	3,000,000	0
Advance from FHLB with a 3.192% fixed rate of interest maturing September 20, 2023.	3,000,000	3,000,000	0
Advance from FHLB with a 3.4% fixed rate of interest maturing September 20, 2025.	3,000,000	3,000,000	0
Advance from FHLB with a 1.836% fixed rate of interest maturing June 24, 2021.	5,000,000	0	0
Advance from FHLB with a 1.9505% fixed rate of interest maturing June 26, 2024 (principal reducing hybrid advance with principal reductions of \$1.0 million annually).	4,000,000	0	0
Advance from FHLB with a 2.027% fixed rate of interest maturing June 26, 2026 (principal reducing hybrid advance with principal reductions of \$714 thousand annually).	4,285,714	0	0
Advance from FHLB with a 2.117% fixed rate of interest maturing June 26, 2029 (principal reducing hybrid advance with principal reductions of \$500 thousand annually).	4,500,000	0	0
Total long-term debt	<u>\$27,385,714</u>	<u>\$21,171,429</u>	<u>\$27,557,143</u>

The allowance for loan losses represents a reserve for potential losses in the loan portfolio. The adequacy of the allowance for loan losses is evaluated monthly based on a review of all significant loans, with a particular emphasis on nonaccruing, past due, and other loans that management believes require attention.

Other factors used in determining the adequacy of the reserve are management’s judgment about factors affecting loan quality and their assumptions about the local and national economy. The allowance for loan losses was 0.89% of total loans outstanding at June 30, 2019, compared with 0.91% at December 31, 2018, and 0.92% at June 30, 2018. In the 2019 second quarter, net charge-offs were \$152 thousand compared with net charge-offs of \$118 thousand in the second quarter of 2018. Management considers the allowance for loan losses as of June 30, 2019, adequate to cover potential losses in the loan portfolio. For more information about loans, see Part I, Item 1, “Note 4 – Loans and Allowance for Loan Losses.”

Nonperforming assets were \$1.8 million, or 0.33% of total assets, in the second quarter of 2019, up from \$1.3 million, or 0.25% of total assets, at the end of 2018, and down from \$1.8 million, or 0.35% of total assets in the same period last year. Nonaccrual loans were \$1,794 thousand in the second quarter of 2019 mostly concentrated in two commercial customer relationships totaling \$994 thousand.

Off-Balance Sheet Arrangements

In the normal course of business, we are a party to financial instruments with off-balance-sheet risk to meet the financing needs of our customers and reduce risk exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit in the form of loans or through letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the financial statements. Since many of the commitments to extend credit and standby letters of credit are expected to expire without being drawn upon, the contractual or notional amounts do not represent future cash requirements.

Financial instruments whose contract amounts represent credit risk (dollars in thousands):	June 30, 2019	December 31, 2018
Commitments to extend credit	\$ <u>35,549</u>	\$ <u>39,418</u>
Standby letters of credit and financial guarantees	\$ <u>3,780</u>	\$ <u>4,343</u>

The Corporation does not have any special purpose entities or off-balance sheet financing arrangements.

Capital Resources and Dividends

The Corporation considers a solid capital foundation as essential to continued strength and growth as well as return to our shareholders. Risk-based capital requirements and rules became effective January 1, 2015, with some conditions that phased in through January 2019. These requirements and rules increase the minimum capital ratios, add a new ratio (CET1), and designate a standardized approach for risk-weighting assets.

As of June 30, 2019, the Corporation met the definition under Basel III of a small bank holding company and, therefore, was exempt from the new consolidated risk-based and leverage capital adequacy guidelines for bank holding companies.

Total risk-based capital for the Corporation and the Bank are composed of CET1, additional Tier 1 capital, and Tier 2 capital. CET 1 capital includes common stock plus related surplus and retained earnings less intangible assets. Additional Tier 1 capital is currently the same as the CET1. Tier 2 capital consists of allowances for possible loan and lease losses, subject to limitations. The Tier 1 leverage ratio is based on average assets. Our

total risk-based capital ratio now stands at 12.84%, which is 2.8 percent in excess of the regulatory standard for “well-capitalized”. See Footnote 1, Summary of Significant Accounting Policies, Recent Market and Regulatory Developments section, elsewhere in this report for further discussion on Basel III and capital requirements.

The Corporation’s and the Bank’s risk-based capital ratios as of June 30, 2019, are shown in the following table.

Risk-Based Capital Ratios	<u>Risk Based Capital Ratios</u>			<u>Basel III Regulatory Guidelines</u>
	Southwest Georgia Financial Corporation ⁽¹⁾	Southwest Georgia Bank	For Well Capitalized	Required Minimum Capital
Common Equity Tier 1 capital	11.95%	11.67%	6.50%	7.00%
Tier 1 capital	11.95%	11.67%	8.00%	8.50%
Total risk-based capital	12.84%	12.56%	10.00%	10.50%
Tier 1 leverage ratio	8.58%	8.39%	5.00%	4.00%

(1)Corporation meets the requirements of the exemption as a small bank holding company.

In June 2019, the Corporation paid a quarterly cash dividend of \$0.12 per common share. A cash dividend of \$0.12 per common share was also paid in March 2019, December 2018, September 2018, and June 2018. A cash dividend of \$0.11 per common share was paid in March 2018. The Board of Directors will continue to assess conditions for future dividend payments.

Interest Rate Sensitivity

The Corporation’s most important element of asset/liability management is the monitoring of its sensitivity and exposure to interest rate movements which is the Corporation’s primary market risk. We have no foreign currency exchange rate risk, commodity price risk, or any other material market risk. The Corporation has no trading investment portfolio, nor do we have any interest rate swaps or other derivative instruments.

Our primary source of earnings, net interest income, can fluctuate with significant interest rate movements. To lessen the impact of these movements, we seek to maximize net interest income while remaining within prudent ranges of risk by practicing sound interest rate sensitivity management. We attempt to accomplish this objective by structuring the balance sheet so that the differences in repricing opportunities between assets and liabilities are minimized. Interest rate sensitivity refers to the responsiveness of earning assets and interest-bearing liabilities to changes in market interest rates. The Corporation’s interest rate risk management is carried out by the Asset/Liability Management Committee which operates under policies and guidelines established by the Bank’s Board of Directors. The principal objective of asset/liability management is to manage the levels of interest-sensitive assets and liabilities to minimize net interest income fluctuations in times of fluctuating market interest rates. To effectively measure and manage interest rate risk, the Corporation uses computer simulations that determine the impact on net interest income of numerous interest rate scenarios, balance sheet trends and strategies. These simulations cover the following financial instruments: short-term financial instruments, investment securities, loans, deposits, and borrowings. These simulations incorporate assumptions about balance sheet dynamics, such as loan and deposit growth and pricing, changes in funding mix, and asset and liability repricing and maturity characteristics. Simulations are run under various interest rate scenarios to determine the impact on net income and capital. From these computer simulations, interest rate risk is quantified and appropriate strategies are developed and implemented. The Corporation also maintains an investment portfolio which receives monthly cash flows from mortgage-backed securities principal payments, and staggered

maturities and provides flexibility over time in managing exposure to changes in interest rates. Any imbalances in the repricing opportunities at any point in time constitute a financial institution's interest rate sensitivity.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Corporation's management, including the Chief Executive Officer and Principal Financial Officer, supervised and participated in an evaluation of the effectiveness of the Corporation's disclosure controls and procedures (as defined in federal securities rules) as of the end of the period covered by this report. Based on, and as of the date of, that evaluation, the Corporation's Chief Executive Officer and Principal Financial Officer have concluded that the Corporation's disclosure controls and procedures were effective in accumulating and communicating information to management, including the Chief Executive Officer and Principal Financial Officer, as appropriate to allow timely decisions regarding required disclosures of that information under the SEC's rules and forms and that the Corporation's disclosure controls and procedures are designed to ensure that the information required to be disclosed in reports that are filed or submitted by the Corporation under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Management's Annual Report on Internal Control over Financial Reporting

The Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting. Management's assessment of the effectiveness of the Corporation's internal control over financial reporting as of June 30, 2019, was included in Item 8 of the form 10K, dated December 31, 2018, under the heading "Management's Report on Internal Control Over Financial Reporting".

The annual report form 10K, dated December 31, 2018, does not include an attestation report of the Corporation's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Corporation's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permits the Corporation to provide only management's report in the annual report.

Changes in Internal Control over Financial Reporting

No changes were made to the Corporation's internal control over financial reporting during this quarter that materially affected or could reasonably likely to materially affect the Corporation's internal controls over financial reporting.

PART II. - OTHER INFORMATION

ITEM 6. EXHIBITS

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| Exhibit 31.1 | Section 302 Certification of Periodic Financial Report by Chief Executive Officer. |
| Exhibit 31.2 | Section 302 Certification of Periodic Financial Report by Principal Financial Officer. |
| Exhibit 32.1 | Section 906 Certification of Periodic Financial Report by Chief Executive Officer. |
| Exhibit 32.2 | Section 906 Certification of Periodic Financial Report by Principal Financial Officer. |
| Exhibit 101 | Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2019, is formatted in XBRL interactive data files: (i) Consolidated Balance Sheets at June 30, 2019, and December 31, 2018; (ii) Consolidated Statements of Income for the three and six months ended June 30, 2019, and 2018; (iii) Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2019, and 2018; (iv) Consolidated Statement of Changes in Shareholders' Equity for the three and six months ended July 30, 2019 and 2018; (v) Consolidated Statements of Cash Flows for the six months ended June 30, 2019 and 2018; and (vi) Notes to Consolidated Financial Statements. |

* As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SOUTHWEST GEORGIA FINANCIAL CORPORATION

/s/Karen T. Boyd

BY: KAREN T. BOYD

SENIOR VICE PRESIDENT AND TREASURER

Date: May 14, 2019