



**COLONY**  
BANKCORP, INC.

2017 ANNUAL REPORT

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DEAR

Shareholders,

2017 was a remarkable year for Colony Bankcorp, Inc., the banking industry, and for the U. S. economy, in general. Colony continued to make progress in terms of profitability and credit quality, in particular. Details are summarized below:

**PROFITABILITY:**

Income available to shareholders was \$7.54 million or \$.87 per share in 2017 compared to \$7.18 million or \$.84 per share the prior year, a 5.01% increase. While this increase is positive it does not truly reflect the progress made in 2017. As a result of the Tax Reform Act signed by President Trump on December 22, 2017, FASB accounting standards require public companies to write down deferred tax assets to the new tax rate of 21% compared to the old rate of 35%. Excluding the one-time tax adjustment for Colony Bankcorp, Inc., income available to shareholders would have been \$9.581 million or \$1.11 per share, a 33.4% increase. In addition, return on average assets would have been .80% and return on equity would have been 10.52%.

**NON-PERFORMING ASSETS:**

- Non-Performing assets decreased from \$18.8 million to \$11.8 million, a 37.4% reduction.
- Foreclosed real estate (OREO) decreased from \$6.4 million to \$4.3 million, a 33.9% reduction.
- Net charge offs were \$1,805,785 or .24% of total loans compared to \$742,612 or .10% of total loans in 2016.
- Credit-related expenses declined 62% from \$1.3 million to \$500 thousand.
- Past due loans of 30 days or more decreased from 1.59% to 1.07%.
- Criticized assets to capital and reserves improved from 25.67% to 20.18%.

During 2017 Colony was successful in retiring our TARP preferred securities. These securities peaked at approximately \$34 million in 2014 and the related expense was a significant drag on the company's earnings. With these securities retired, the company's ability to consider strategic opportunities is greatly enhanced. In that regard, during the first quarter 2017, the company reinstated quarterly cash dividends, payable to shareholders, of \$.025 per share. The Board of Directors increased the quarterly dividend payout ratio to \$.05 per share effective March 30, 2018.

Colony management is pursuing several initiatives to improve earnings and operating efficiency. Loans are still our primary product, and with an improving economy, quality loan growth should be attainable. Non-interest income opportunities exist in our payment process contracts as well as other areas. Of particular note related to efficiency, we are closing the Albany/Chehaw office of Colony in May, 2018. While this office achieved some degree of success, the trends indicated our capital could be better deployed elsewhere. Management constantly reassesses the effectiveness of the company's delivery systems to improve efficiency and earnings potential.

The banking industry has now endured the Great Recession and is currently poised to experience better times. For the first time in quite some time, we hear discussion of reduced regulatory oversight from Washington, D. C. While this is mostly just discussion at this point, we believe community banks will see relief in the coming years. In addition, we expect a gradually increasing interest rate environment where depositors will once again be more justly rewarded for their deposits. Last, but not least, the financial health of our borrowers has improved significantly, creating better lending opportunities and reduced credit-related expenses. Overall, the banking environment has improved significantly; thereby improving Colony's earning capacity as well.

Economic trends for Georgia, the Southeast, and the U.S. are quite favorable. Interest rates, while increasing somewhat, remain at historically low levels. Residential construction and mortgage lending have returned to normal volume with reasonable valuations. Of particular note, the Port of Savannah continues to set records in container volume and the positive impact is felt throughout South Georgia and beyond. The impact of the Tax Reform Act is expected to not only boost capital investment, but also increase consumer spending. This in turn should create improved economic opportunities for Colony. In general, our clients are more optimistic about business activity than they have been in some time. Hopefully this optimism is well founded.

The board, management and employees of Colony look forward to 2018 and appreciate your continuing support.



Edward P. Loomis, Jr.  
President and  
Chief Executive Officer



Mark H. Massee  
Chairman of the Board

## 2017 KEY PERFORMANCE INDICATORS

Years Ended December 31, 2017 and 2016

Dollar amounts in thousands except per share data	2017	2016	Percent Change
Total Assets	\$1,232,755	\$1,210,442	1.84%
Total Deposits	\$1,067,985	\$1,044,357	2.26%
Loans (Net of Unearned Income)	\$764,788	\$753,922	1.44%
Net Income	\$7,540	\$7,180	5.01%
<b>Per Share Data:</b>			
Basic Earnings	\$0.89	\$0.85	4.71%
Common Book Value/Share	\$10.70	\$9.96	7.43%

## KEY TRENDS

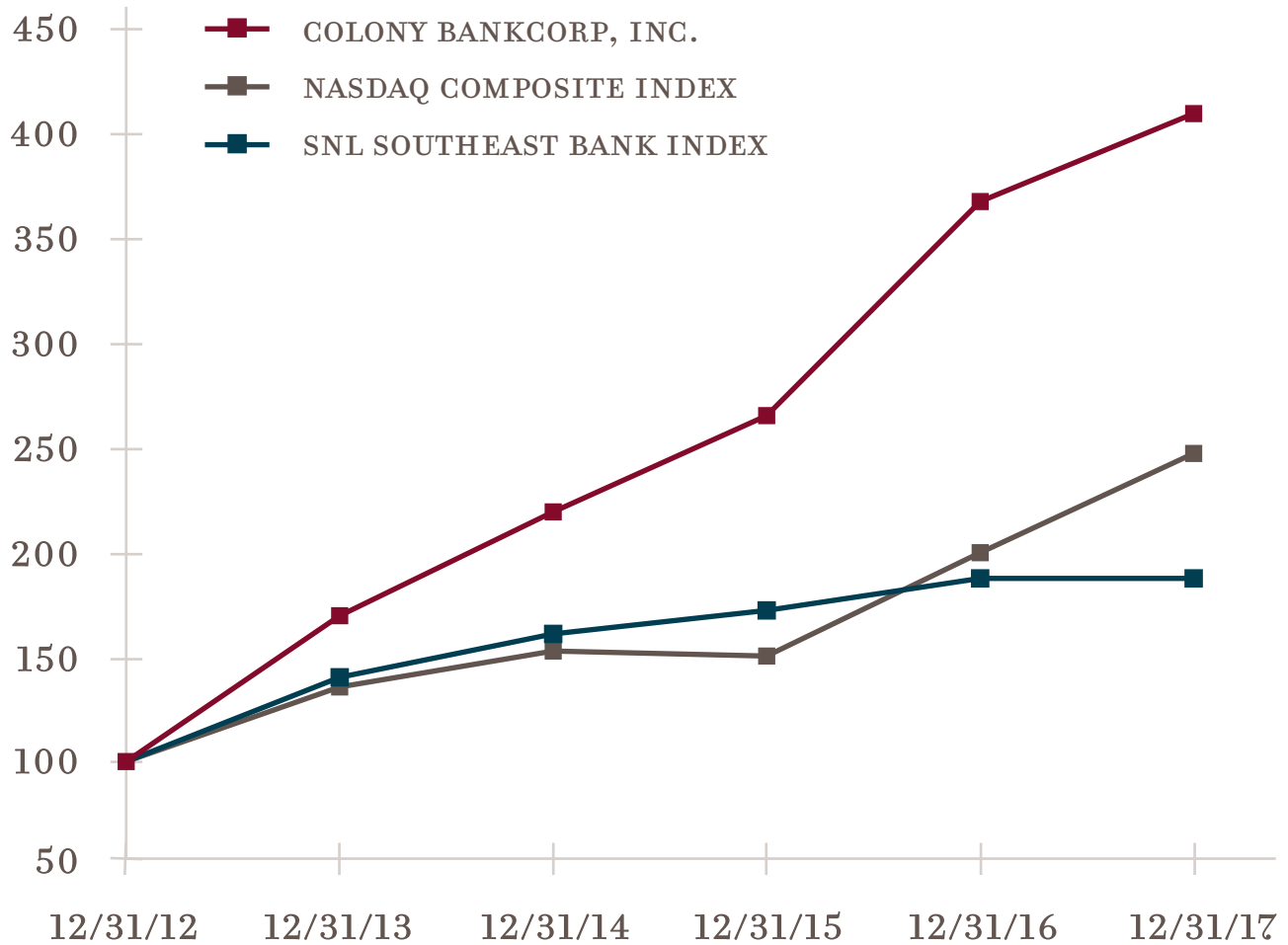
A Historical Comparative

Years Ending	2017	2016	2015	2014	2013
Net Income (in thousands)	\$7,540	\$7,180	\$5,998	\$4,843	\$3,120
Return on Average Shareholders' Equity	8.28%	7.17%	5.90%	5.11%	3.34%
Diluted Earnings Per Share	\$0.87	\$0.84	\$0.71	\$0.57	\$0.37

RETURN ON AVERAGE ASSETS		NET INTEREST MARGIN	
2017	2016	2017	2016
0.63%	0.62%	3.46%	3.51%

# FINANCIAL Summary

# Performance TOTAL RETURN



Index	PERIOD ENDING					
	12/31/12	12/31/13	12/31/14	12/31/15	12/31/16	12/31/17
Colony Bankcorp, Inc.	100.00	169.44	218.89	264.72	366.67	408.55
NASDAQ Composite Index	100.00	140.12	160.78	171.97	187.22	242.71
SNL Southeast Bank Index	100.00	135.52	152.63	150.24	199.45	246.72

Source: S&P Global Market Intelligence © 2017

# BOARD OF *Directors*

**Edward P. Loomis, Jr.**

*President/CEO*  
Colony Bankcorp, Inc.  
Fitzgerald, Georgia

**Mark H. Massee**

*Chairman*  
Colony Bankcorp, Inc.  
*President*  
Massee Builders, Inc.  
Fitzgerald, Georgia

**Michael Frederick (Freddie)  
Dwozan, Jr.**

*Vice Chairman*  
Colony Bankcorp, Inc.  
*President/CEO/Owner*  
Medical Center Prescription Shop  
Eastman, Georgia

**Terry L. Hester**

*EVP/Chief Financial Officer*  
Colony Bankcorp, Inc.  
Fitzgerald, Georgia

**Jonathan W.R. Ross**

*President*  
Ross Construction Co., Inc.  
Tifton, Georgia

**Scott L. Downing**

*President*  
SDI Investments  
Fitzgerald, Georgia

# *Executive* OFFICERS

**Edward P. Loomis, Jr**

*President/CEO*

**Terry L. Hester**

*EVP/Chief Financial Officer*

**J. Stan Cook**

*EVP/Chief Operating Officer*

**Edward L. Bagwell, III**

*EVP/Chief Credit Officer*

**Lee A. Northcutt**

*EVP/Regional Executive Officer*

**M. Edward Hoyle, Jr.**

*EVP/Regional Executive Officer*

# MARKET Presidents

**Jeffery Alton**

*Market President*  
Thomaston

**Bill Marsh**

*Market President*  
Tifton

**Phil Franklin**

*Market President*  
Albany/Leesburg/Chehaw

**Kirk Scott**

*Market President*  
Warner Robins/Centerville

**Jon Butler**

*Market President*  
Eastman/Soperton

**Scott Miller**

*Market President*  
Douglas/Broxtown

**John Gandy**

*Market President*  
Moultrie

**Eddie Smith**

*Market President*  
Valdosta

**Chip Carroll**

*Market President*  
Quitman

**Johnny Bryan**

*Market President*  
Sylvester

**Drew Hulsey**

*Market President*  
Savannah/Statesboro

**Mark Turner**

*Market President*  
Fitzgerald

**Bob Evans**

*Market President*  
Cordele

**John Roberts**

*Market President*  
Columbus

**Andy Johnson**

*Market President*  
Ashburn

**Nic Worthy**

*Market President*  
Rochelle

EVEN MORE  
WAYS TO

*Serve You*

VISIT OUR TWO NEWEST LOCATIONS.

## Savannah



241 Drayton Street  
Savannah, GA 31401  
(912) 454-2479

### LOBBY HOURS:

9:00 am - 5:00 pm Monday - Friday  
Closed Saturday - Sunday

## Tifton



104 2nd St W  
Tifton, GA 31794  
(229) 386-2265

### LOBBY HOURS:

9:00 am - 4:00 pm Monday - Thursday  
9:00 am - 6:00 pm Friday  
Closed Saturday - Sunday

### DRIVE-THRU HOURS:

8:30 am - 4:00 pm Monday - Thursday  
8:30 am - 6:00 pm Friday  
8:30 am - 12:00 pm Saturday  
Closed Sunday



McNAIR, McLEMORE, MIDDLEBROOKS & Co., LLC

CERTIFIED PUBLIC ACCOUNTANTS

389 Mulberry Street • Post Office Box One • Macon, GA 31202

Telephone (478) 746-6277 • Facsimile (478) 743-6858

*mmmcpa.com*

March 15, 2018

**REPORT OF INDEPENDENT  
REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders  
Colony Bankcorp, Inc.

**Opinions on the Financial Statements and Internal Control Over Financial Reporting**

We have audited the accompanying consolidated balance sheets of Colony Bankcorp, Inc. and subsidiary (the Company) as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively, the financial statements). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

**Basis for Opinions**

The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included under Item 9A, Controls and Procedures, in the Company's Annual Report on Form 10-K. Our responsibility is to express an opinion on the Company's financial statements and an opinion on the company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the financial statements included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

### **Definition and Limitations of Internal Control Over Financial Reporting**

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

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

*McNair, McLemore, Middlebrooks & Co., LLC*

McNAIR, McLEMORE, MIDDLEBROOKS & CO., LLC

We have served as the Company's auditor since 1995.

Macon, Georgia

March 15, 2018

**COLONY BANKCORP, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31**

**ASSETS**

	<b>2017</b>	<b>2016</b>
<b>Cash and Cash Equivalents</b>		
Cash and Due from Banks	<b>\$ 23,145,136</b>	<b>\$ 28,822,104</b>
<b>Interest-Bearing Deposits</b>	<b>34,667,715</b>	<b>46,344,859</b>
<b>Investment Securities</b>		
Available for Sale, at Fair Value	<b>354,246,904</b>	<b>323,657,870</b>
<b>Federal Home Loan Bank Stock, at Cost</b>	<b>3,042,900</b>	<b>3,010,000</b>
<b>Loans</b>	<b>765,283,855</b>	<b>754,283,563</b>
Allowance for Loan Losses	<b>(7,507,508)</b>	<b>(8,923,293)</b>
Unearned Interest and Fees	<b>(495,500)</b>	<b>(361,042)</b>
	<b>757,280,847</b>	<b>744,999,228</b>
<b>Premises and Equipment</b>	<b>27,639,430</b>	<b>27,969,260</b>
<b>Other Real Estate (Net of Allowance of \$1,451,492 and \$1,878,127 in 2017 and 2016, Respectively)</b>	<b>4,256,469</b>	<b>6,439,226</b>
<b>Other Intangible Assets</b>	<b>44,766</b>	<b>80,515</b>
<b>Other Assets</b>	<b>28,431,150</b>	<b>29,118,555</b>
<b>Total Assets</b>	<b>\$1,232,755,317</b>	<b>\$1,210,441,617</b>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS  
DECEMBER 31**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

	2017	2016
<b>Deposits</b>		
Noninterest-Bearing	\$ 190,927,928	\$ 159,058,633
Interest-Bearing	877,057,477	885,297,895
	<b>1,067,985,405</b>	1,044,356,528
<b>Borrowed Money</b>		
Subordinated Debentures	24,229,000	24,229,000
Other Borrowed Money	47,500,000	46,000,000
	<b>71,729,000</b>	70,229,000
<b>Other Liabilities</b>	<b>2,718,249</b>	2,468,356
 <b>Commitments and Contingencies</b>		
 <b>Stockholders' Equity</b>		
Preferred Stock, Stated Value \$1,000; 10,000,000 Shares Authorized, 0 and 9,360 Shares Issued and Outstanding as of December 31, 2017 and 2016	-	9,360,000
Common Stock, Par Value \$1; 20,000,000 Shares Authorized, 8,439,258 Shares Issued and Outstanding as of December 31, 2017 and 2016	<b>8,439,258</b>	8,439,258
Paid-In Capital	<b>29,145,094</b>	29,145,094
Retained Earnings	<b>59,230,260</b>	51,465,521
Accumulated Other Comprehensive Loss, Net of Tax	<b>(6,491,949)</b>	(5,022,140)
	<b>90,322,663</b>	93,387,733
 <b>Total Liabilities and Stockholders' Equity</b>	<b>\$1,232,755,317</b>	\$1,210,441,617

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Interest Income</b>			
Loans, Including Fees	\$38,613,540	\$38,942,503	\$39,716,269
Federal Funds Sold	3	-	14,561
Deposits with Other Banks	232,397	124,459	79,735
Investment Securities			
U.S. Government Agencies	6,717,827	5,263,741	4,235,207
State, County and Municipal	115,097	127,379	107,638
Corporate	87,387	-	-
Dividends on Other Investments	150,172	131,007	122,070
	<u>45,916,423</u>	<u>44,589,089</u>	<u>44,275,480</u>
<b>Interest Expense</b>			
Deposits	4,758,073	4,781,228	4,856,673
Federal Funds Purchased	2,639	581	26
Borrowed Money	2,112,017	1,701,522	1,712,548
	<u>6,872,729</u>	<u>6,483,331</u>	<u>6,569,247</u>
<b>Net Interest Income</b>	<u>39,043,694</u>	<u>38,105,758</u>	<u>37,706,233</u>
Provision for Loan Losses	390,000	1,062,000	865,500
<b>Net Interest Income After Provision for Loan Losses</b>	<u>38,653,694</u>	<u>37,043,758</u>	<u>36,840,733</u>
<b>Noninterest Income</b>			
Service Charges on Deposits	4,466,997	4,307,214	4,268,438
Other Service Charges, Commissions and Fees	3,040,262	2,802,651	2,627,157
Mortgage Fee Income	858,658	681,806	527,187
Securities Gains (Losses)	-	385,223	(11,466)
Other	1,368,648	1,376,860	1,633,205
	<u>9,734,565</u>	<u>9,553,754</u>	<u>9,044,521</u>
<b>Noninterest Expenses</b>			
Salaries and Employee Benefits	19,222,594	18,482,693	17,589,631
Occupancy and Equipment	3,947,941	3,970,244	3,989,347
Directors' Fees	298,100	348,755	358,291
Legal and Professional Fees	893,938	791,563	737,731
Foreclosed Property	363,519	1,143,518	1,682,783
FDIC Assessment	386,823	603,654	899,302
Advertising	349,722	609,892	624,844
Software	1,192,025	1,112,065	992,593
Telephone	813,592	737,063	710,038
ATM/Card Processing	1,467,411	1,136,122	1,061,262
Other	4,924,163	5,137,400	5,078,932
	<u>33,859,828</u>	<u>34,072,969</u>	<u>33,724,754</u>
<b>Income Before Income Taxes</b>	<u>14,528,431</u>	<u>12,524,543</u>	<u>12,160,500</u>
Income Taxes	6,777,453	3,851,333	3,787,803
<b>Net Income</b>	<u>7,750,978</u>	<u>8,673,210</u>	<u>8,372,697</u>
Preferred Stock Dividends	210,600	1,493,310	2,375,010
<b>Net Income Available to Common Stockholders</b>	<u>\$ 7,540,378</u>	<u>\$ 7,179,900</u>	<u>\$ 5,997,687</u>
<b>Net Income Per Share of Common Stock</b>			
Basic	<u>\$ 0.89</u>	<u>\$ 0.85</u>	<u>\$ 0.71</u>
Diluted	<u>\$ 0.87</u>	<u>\$ 0.84</u>	<u>\$ 0.71</u>
<b>Cash Dividends Declared Per Share of Common Stock</b>	<u>\$ 0.10</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
<b>Weighted Average Shares Outstanding, Basic</b>	<u>8,439,258</u>	<u>8,439,258</u>	<u>8,439,258</u>
<b>Weighted Average Shares Outstanding, Diluted</b>	<u>8,633,581</u>	<u>8,513,295</u>	<u>8,458,461</u>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
**FOR THE YEARS ENDED DECEMBER 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Net Income</b>	<b><u>\$ 7,750,978</u></b>	<b><u>\$ 8,673,210</u></b>	<b><u>\$ 8,372,697</u></b>
<b>Other Comprehensive Income (Loss)</b>			
Gains (Losses) on Securities Arising During the Year	<b>(608,355)</b>	(505,367)	610,689
Tax Effect	<b>206,841</b>	171,825	(207,634)
Realized (Gains) Losses on Sale of AFS Securities	-	(385,223)	11,466
Tax Effect	<u>-</u>	<u>130,976</u>	<u>(3,898)</u>
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<b><u>(401,514)</u></b>	<b><u>(587,789)</u></b>	<b><u>410,623</u></b>
<b>Comprehensive Income</b>	<b><u><u>\$ 7,349,464</u></u></b>	<b><u><u>\$ 8,085,421</u></u></b>	<b><u><u>\$ 8,783,320</u></u></b>

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2017, 2016 AND 2015**

	Preferred Shares Issued	Preferred Stock	Common Shares Issued	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
<b>Balance, December 31, 2014</b>	28,000	\$28,000,000	8,439,258	\$8,439,258	\$29,145,094	\$38,287,934	\$ (4,844,974)	\$99,027,312
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							410,623	410,623
Dividends on Preferred Shares	(9,979)	(9,979,000)				(2,375,010)		(2,375,010)
Redemption of Preferred Stock								(9,979,000)
Net Income						8,372,697		8,372,697
<b>Balance, December 31, 2015</b>	18,021	\$18,021,000	8,439,258	\$8,439,258	\$29,145,094	\$44,285,621	\$ (4,434,351)	\$95,456,622
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							(587,789)	(587,789)
Dividends on Preferred Shares	(8,661)	(8,661,000)				(1,493,310)		(1,493,310)
Redemption of Preferred Stock								(8,661,000)
Net Income						8,673,210		8,673,210
<b>Balance, December 31, 2016</b>	9,360	\$ 9,360,000	8,439,258	\$ 8,439,258	\$29,145,094	\$51,465,521	\$ (5,022,140)	\$93,387,733
Change in Net Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects							(401,514)	(401,514)
Dividends on Common Shares						(843,934)		(843,934)
Dividends on Preferred Shares						(210,600)		(210,600)
T CJ Act Reclassification						1,068,295	(1,068,295)	-
Redemption of Preferred Stock	(9,360)	(9,360,000)						(9,360,000)
Net Income						7,750,978		7,750,978
<b>Balance, December 31, 2017</b>	-	\$ -	8,439,258	\$8,439,258	\$ 29,145,094	\$59,230,260	\$ (6,491,949)	\$90,322,663

See accompanying notes which are an integral part of these financial statements.

**COLONY BANKCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Cash Flows from Operating Activities</b>			
Net Income	\$ 7,750,978	\$ 8,673,210	\$ 8,372,697
Adjustments to Reconcile Net Income to Net Cash Provided from Operating Activities			
Depreciation	1,647,813	1,574,249	1,657,229
Amortization and Accretion	1,413,362	1,609,339	1,797,152
Provision for Loan Losses	390,000	1,062,000	865,500
Deferred Income Taxes	2,833,958	222,120	625,436
Securities (Gains) Losses	-	(385,223)	11,466
(Gain) Loss on Sale of Premises and Equipment	(10,735)	80,329	11,047
Loss on Sale of Other Real Estate and Repossessions	(208,329)	160,682	600,663
Provision for Losses on Other Real Estate	333,767	501,736	453,148
Increase in Cash Surrender Value of Life Insurance	(1,669,424)	(589,408)	(299,010)
<b>Change In</b>			
Interest Receivable	(90,204)	176,766	(354,274)
Prepaid Expenses	139,382	(372,380)	278,637
Interest Payable	21,188	(46,284)	32,253
Accrued Expenses and Accounts Payable	361,005	(252,617)	(202,343)
Other	(367,626)	973,972	217,686
	<u>12,545,135</u>	<u>13,388,491</u>	<u>14,067,287</u>
<b>Cash Flows from Investing Activities</b>			
Interest-Bearing Deposits in Other Banks	11,677,144	(7,729,560)	(17,409,260)
Purchase of Investment Securities			
Available for Sale	(87,160,178)	(109,634,793)	(102,336,227)
Proceeds from Sale of Investment Securities			
Available for Sale	-	25,209,851	28,273,634
Proceeds from Maturities, Calls and Paydowns of Investment Securities			
Available for Sale	54,587,986	54,868,726	51,423,541
Held to Maturity	-	-	9,734
Proceeds from Sale of Premises and Equipment	37,650	89,551	28,608
Net Loans to Customers	(14,459,526)	(2,167,126)	(21,255,018)
Purchase of Premises and Equipment	(1,344,898)	(3,259,859)	(3,189,969)
Proceeds from Sale of Other Real Estate and Repossessions	3,863,576	7,529,131	8,154,596
Proceeds from Sale of Federal Home Loan Bank Stock	-	-	100,300
Purchase of Federal Home Loan Bank Stock	(32,900)	(279,500)	-
	<u>(32,831,146)</u>	<u>(35,373,579)</u>	<u>(56,200,061)</u>
<b>Cash Flows from Financing Activities</b>			
Interest-Bearing Customer Deposits	(8,240,418)	7,629,930	26,704,254
Noninterest-Bearing Customer Deposits	31,869,295	25,172,362	5,546,508
Proceeds from Other Borrowed Money	10,015,500	10,000,000	27,000,000
Principal Payments on Other Borrowed Money	(8,515,500)	(4,000,000)	(27,000,000)
Dividends Paid on Preferred Stock	(315,900)	(1,590,746)	(2,487,274)
Redemption of Preferred Stock	(9,360,000)	(8,661,000)	(9,979,000)
Dividends Paid on Common Stock	(843,934)	-	-
	<u>14,609,043</u>	<u>28,550,546</u>	<u>19,784,488</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(5,676,968)</b>	6,565,458	(22,348,286)
<b>Cash and Cash Equivalents, Beginning</b>	<b>28,822,104</b>	22,256,646	44,604,932
<b>Cash and Cash Equivalents, Ending</b>	<b>\$ 23,145,136</b>	<b>\$ 28,822,104</b>	<b>\$ 22,256,646</b>

See accompanying notes which are an integral part of these financial statements.



## **COLONY BANKCORP, INC. AND SUBSIDIARY**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

#### **(1) Summary of Significant Accounting Policies**

##### **Principles of Consolidation**

Colony Bankcorp, Inc. (the Company) is a bank holding company located in Fitzgerald, Georgia. The consolidated financial statements include the accounts of Colony Bankcorp, Inc. and its wholly-owned subsidiary, Colony Bank, Fitzgerald, Georgia. All significant intercompany accounts have been eliminated in consolidation. The accounting and reporting policies of Colony Bankcorp, Inc. conform to generally accepted accounting principles and practices utilized in the commercial banking industry.

##### **Nature of Operations**

The Company provides a full range of retail and commercial banking services for consumers and small- to medium-size businesses located primarily in central, south and coastal Georgia. Colony Bank is headquartered in Fitzgerald, Georgia with banking offices in Albany, Ashburn, Broxton, Centerville, Columbus, Cordele, Douglas, Eastman, Fitzgerald, Leesburg, Moultrie, Quitman, Rochelle, Savannah, Soperton, Statesboro, Sylvester, Thomaston, Tifton, Valdosta and Warner Robins. Lending and investing activities are funded primarily by deposits gathered through its retail banking office network.

##### **Use of Estimates**

In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the balance sheet date and revenues and expenses for the period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near term 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.

##### **Reclassifications**

In certain instances, amounts reported in prior years' consolidated financial statements and note disclosures have been reclassified to conform to statement presentations selected for 2017. Such reclassifications had no effect on previously reported stockholders' equity or net income.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Concentrations of Credit Risk**

Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At December 31, 2017, approximately 87.1 percent of the Company's loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers' ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. Declining collateral real estate values that secure land development, construction and speculative real estate loans in the Company's larger MSA markets have resulted in high loan loss provisions in recent years. In addition, a large portion of the Company's foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

The success of the Company is dependent, to a certain extent, upon the economic conditions in the geographic markets it serves. Adverse changes in the economic conditions in these geographic markets would likely have a material adverse effect on the Company's results of operations and financial condition. The operating results of the Company depend primarily on its net interest income. Accordingly, operations are subject to risks and uncertainties surrounding the exposure to changes in the interest rate environment.

At times, the Company may have cash and cash equivalents at financial institutions in excess of federal deposit insurance limits. The Company places its cash and cash equivalents with high credit quality financial institutions whose credit rating is monitored by management to minimize credit risk.

### **Investment Securities**

The Company classifies its investment securities as trading, available for sale or held to maturity. Securities that are held principally for resale in the near term are classified as trading. Trading securities are carried at fair value, with realized and unrealized gains and losses included in noninterest income. Currently, no securities are classified as trading. Securities acquired with both the intent and ability to be held to maturity are classified as held to maturity and reported at amortized cost. All securities not classified as trading or held to maturity are considered available for sale. Securities available for sale are reported at estimated fair value. Unrealized gains and losses on securities available for sale are excluded from earnings and are reported, net of deferred taxes, in accumulated other comprehensive income (loss), a component of stockholders' equity. Gains and losses from sales of securities available for sale are computed using the specific identification method. Securities available for sale includes securities, which may be sold to meet liquidity needs arising from unanticipated deposit and loan fluctuations, changes in regulatory capital requirements, or unforeseen changes in market conditions.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Investment Securities (Continued)**

The Company evaluates each held to maturity and available for sale security in a loss position for other-than-temporary impairment (OTTI). In estimating other-than-temporary impairment losses, management considers such factors as the length of time and the extent to which the market value has been below cost, the financial condition of the issuer and the Company's intent to sell and whether it is more likely than not that the Company will be required to sell the security before anticipated recovery of the amortized cost basis. If the Company intends to sell or if it is more likely than not that the Company will be required to sell the security before recovery, the OTTI write-down is recognized in earnings. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the OTTI write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income (loss).

### **Federal Home Loan Bank Stock**

Investment in stock of a Federal Home Loan Bank (FHLB) is required for every federally insured institution that utilizes its services. FHLB stock is considered restricted, as defined in the accounting standards. The FHLB stock is reported in the consolidated financial statements at cost. Dividend income is recognized when earned.

### **Loans**

Loans that the Company has the ability and intent to hold for the foreseeable future or until maturity are recorded at their principal amount outstanding, net of unearned interest and fees. Loan origination fees, net of certain direct origination costs, are deferred and amortized over the estimated terms of the loans using the straight-line method. Interest income on loans is recognized using the effective interest method.

A loan is considered to be delinquent when payments have not been made according to contractual terms, typically evidenced by nonpayment of a monthly installment by the due date.

When management believes there is sufficient doubt as to the collectibility of principal or interest on any loan or generally when loans are 90 days or more past due, the accrual of applicable interest is discontinued and the loan is designated as nonaccrual, unless the loan is well secured and in the process of collection. Interest payments received on nonaccrual loans are either applied against principal or reported as income, according to management's judgment as to the collectibility of principal. Loans are returned to an accrual status when factors indicating doubtful collectibility on a timely basis no longer exist.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Loans Modified in a Troubled Debt Restructuring (TDR)**

Loans are considered to have been modified in a TDR when, due to a borrower's financial difficulty, the Company 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. Generally, a nonaccrual loan that has been modified in a TDR remains on nonaccrual status for a period of six months to demonstrate that the borrower is able to meet the terms of the modified loan. 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. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on nonaccrual status. Once a loan is modified in a troubled debt restructuring, it is accounted for as an impaired loan, regardless of its accrual status, until the loan is paid in full, sold or charged off.

### **Allowance for Loan Losses**

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

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

The allowance consists of specific, historical and general components. The specific component relates to loans that are classified as either doubtful, substandard or special mention. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan are lower than the carrying value of that loan. The historical component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. A general component is maintained to cover uncertainties that could affect management's estimate of probable losses. The general component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and historical losses in the portfolio. General valuation allowances are based on internal and external qualitative risk factors such as (1) changes in lending policies and procedures, including changes in underwriting standards and collections, charge offs, and recovery practices, (2) changes in international, national, regional, and local conditions, (3) changes in the nature and volume of the portfolio and terms of loans, (4) changes in the experience, depth, and ability of lending management, (5) changes in the volume and severity of past due loans and other similar conditions, (6) changes in the quality of the organization's loan review system, (7) changes in the value of underlying collateral for collateral dependent loans, (8) the existence and effect of any concentrations of credit and changes in the levels of such concentrations, and (9) the effect of other external factors (i.e. competition, legal and regulatory requirements) on the level of estimated credit losses.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Allowance for Loan Losses (Continued)**

Loans identified as losses by management, internal loan review and/or Bank examiners are charged off. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due 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 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.

A significant portion of the Company's impaired loans are deemed to be collateral dependent. Management therefore measures impairment on these loans based on the fair value of the collateral. Collateral values are determined based on appraisals performed by qualified licensed appraisers hired by the Company or by senior members of the Company's credit administration staff. The decision whether to obtain an external third-party appraisal usually depends on the type of property being evaluated. External appraisals are usually obtained on more complex, income producing properties such as hotels, shopping centers and businesses. Less complex properties such as residential lots, farm land and single family houses may be evaluated internally by senior credit administration staff. When the Company does obtain appraisals from external third-parties, the values utilized in the impairment calculation are "as is" or current market values. The appraisals, whether prepared internally or externally, may utilize a single valuation approach or a combination of approaches including the comparable sales, income and cost approach. Appraised amounts used in the impairment calculation are typically discounted 10 percent to account for selling and marketing costs, if the repayment of the loan is to come from the sale of the collateral. Although appraisals may not be obtained each year on all impaired loans, the collateral values used in the impairment calculations are evaluated quarterly by management. Based on management's knowledge of the collateral and the current real estate market conditions, appraised values may be further discounted to reflect facts and circumstances known to management since the initial appraisal was performed.

Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of collateral underlying impaired loans and because of the relationship between fair value and general economic conditions, we consider the fair value of impaired loans to be highly sensitive to changes in market conditions.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Premises and Equipment**

Premises and equipment are recorded at acquisition cost net of accumulated depreciation.

Depreciation is charged to operations over the estimated useful lives of the assets. The estimated useful lives and methods of depreciation are as follows:

<u>Description</u>	<u>Life in Years</u>	<u>Method</u>
Banking Premises	15-40	Straight-Line and Accelerated
Furniture and Equipment	5-10	Straight-Line and Accelerated

Expenditures for major renewals and betterments are capitalized. Maintenance and repairs are charged to operations as incurred. When property and equipment are retired or sold, the cost and accumulated depreciation are removed from the respective accounts and any gain or loss is reflected in other income or expense.

### **Other Intangible Assets**

Intangible assets consist of core deposit intangibles acquired in connection with a business combination. The core deposit intangible is initially recognized based on an independent valuation performed as of the consummation date. The core deposit intangible is amortized by the straight-line method over the average remaining life of the acquired customer deposits.

### **Transfers of Financial Assets**

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

### **Statement of Cash Flows**

For reporting cash flows, cash and cash equivalents include cash on hand, noninterest-bearing amounts due from banks, federal funds sold and securities purchased under agreement to resell. Cash flows from demand deposits, interest-bearing checking accounts, savings accounts, loans and certificates of deposit are reported net.

### **Advertising Costs**

The Company expenses the cost of advertising in the periods in which those costs are incurred.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Income Taxes**

The provision for income taxes is based upon income for financial statement purposes, adjusted for nontaxable income and nondeductible expenses. Deferred income taxes have been provided when different accounting methods have been used in determining income for income tax purposes and for financial reporting purposes.

Deferred tax assets and liabilities are recognized based on future tax consequences attributable to differences arising from the financial statement carrying values of assets and liabilities and their tax basis. The differences relate primarily to depreciable assets (use of different depreciation methods for financial statement and income tax purposes) and allowance for loan losses (use of the allowance method for financial statement purposes and the direct write-off method for tax purposes). In the event of changes in the tax laws, deferred tax assets and liabilities are adjusted in the period of the enactment of those changes, with effects included in the income tax provision. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company and its subsidiary file a consolidated federal income tax return. The subsidiary pays its proportional share of federal income taxes to the Company based on its taxable income.

The Company's federal and state income tax returns for tax years 2017, 2016, 2015 and 2014 are subject to examination by the Internal Revenue Service (IRS) and the Georgia Department of Revenue, generally for three years after filing.

Positions taken in the Company's tax returns may be subject to challenge by the taxing authorities upon examination. Uncertain tax positions are initially recognized in the consolidated financial statements when it is more likely than not the position will be sustained upon examination by the tax authorities. Such tax positions are both initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon settlement with the tax authority, assuming full knowledge of the position and all relevant facts. The Company provides for interest and, in some cases, penalties on tax positions that may be challenged by the taxing authorities. Interest expense is recognized beginning in the first period that such interest would begin accruing. Penalties are recognized in the period that the Company claims the position in the tax return. Interest and penalties on income tax uncertainties are classified within income tax expense in the consolidated statements of operations.

### **Other Real Estate**

Other real estate generally represents real estate acquired through foreclosure and is initially recorded at estimated fair value at the date of acquisition less the cost of disposal. Losses from the acquisition of property in full or partial satisfaction of debt are recorded as loan losses. Properties are evaluated regularly to ensure the recorded amounts are supported by current fair values, and valuation allowances are recorded as necessary to reduce the carrying amount to fair value less estimated cost of disposal. Routine holding costs and gains or losses upon disposition are included in foreclosed property expense.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Bank-Owned Life Insurance**

The Company has purchased life insurance on the lives of certain key members of management and directors. The life insurance policies are recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value adjusted for other charges or amounts due that are probable at settlement, if applicable. Increases in the cash surrender value are recorded as other income in the consolidated statements of income. The cash surrender value of the insurance contracts is recorded in other assets on the consolidated balance sheets in the amount of \$17,088,693 and \$15,419,269 as of December 31, 2017 and 2016, respectively.

### **Comprehensive Income**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on securities available for sale, represent equity changes from economic events of the period other than transactions with owners. Such items are considered components of other comprehensive income (loss). Accounting standards codification requires the presentation in the consolidated financial statements of net income and all items of other comprehensive income (loss) as total comprehensive income (loss).

### **Off-Balance Sheet Credit Related Financial Instruments**

In the ordinary course of business, the Company has entered into commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded on the consolidated balance sheets when they are funded.



## **(1) Summary of Significant Accounting Policies (Continued)**

### **Changes in Accounting Principles and Effects of New Accounting Pronouncements**

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity is expected to be entitled for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, in doing so, it is possible more judgment and estimates may be required within the revenue recognition process than required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each performance obligation. ASU 2014-09, as deferred one year by ASU 2015-14, is effective for the Company in the first quarter of fiscal year 2018. The Company is currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-01, among other things, (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 (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. ASU 2016-01 will be effective for the Company on January 1, 2018. The Company is currently evaluating the impact of the pending adoption of ASU 2016-01 on the consolidated financial statements.

ASU 2016-02, *Leases (Topic 842)*. This ASU requires lessees to put most leases on their balance sheets but recognize expenses in the income statement in a manner similar to current accounting treatment. This ASU changes the guidance on sale-leaseback transactions, initial direct costs and lease execution costs, and, for lessors, modifies the classification criteria and the accounting for sales-type and direct financing leases. For public business entities, this ASU is effective for annual periods beginning after December 15, 2018, and interim periods therein. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Company is evaluating the impact of this ASU on its financial statements and disclosures.

## **(1) Summary of Significant Accounting Policies (Continued)**

### **Changes in Accounting Principles and Effects of New Accounting Pronouncements (Continued)**

ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326)*. This ASU sets forth a “current expected credit loss” (CECL) model which requires the Company to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable supported forecasts. This replaces the existing incurred loss model and is applicable to the measurement of credit losses on financial assets measured at amortized cost and applies to some off-balance sheet credit exposures. This ASU is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently assessing the impact of the adoption of this ASU on its consolidated financial statements.

ASU 2016-15, *Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 provides guidance related to certain cash flow issues in order to reduce the current and potential future diversity in practice. ASU 2016-15 became effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Today, entities generally amortize the premium over the contractual life of the security. The new guidance does not change the accounting for purchased callable debt securities held at a discount; the discount continues to be amortized to maturity. ASU No. 2017-08 is effective for interim and annual reporting periods beginning after December 15, 2018; early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which the guidance is adopted. The Company is currently evaluating the provisions of ASU No. 2017-08 to determine the potential impact the new standard will have on the Company’s Consolidated Financial Statements.

ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220). Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This ASU allows an entity to elect a reclassification from accumulated other comprehensive income (AOCI) to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJA). ASU 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The Company elected to early adopt the provisions of ASU 2018-02 in the fourth quarter of 2017 and, as a result, reclassified \$1,068,295 from AOCI to retained earnings as of December 31, 2017.

## (2) Cash and Balances Due from Banks

Components of cash and balances due from banks are as follows as of December 31:

	<u>2017</u>	<u>2016</u>
Cash on Hand and Cash Items	<b>\$ 9,746,132</b>	\$ 8,509,530
Noninterest-Bearing Deposits with Other Banks	<b>13,399,004</b>	20,312,574
	<b><u>\$23,145,136</u></b>	<b><u>\$28,822,104</u></b>

The Company is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. Reserve balances totaled approximately \$1,515,000 and \$1,417,000 at December 31, 2017 and 2016, respectively.

## (3) Investment Securities

Investment securities as of December 31, 2017 are summarized as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Securities Available for Sale				
U.S. Government Agencies				
Mortgage-Backed	<b>\$354,931,318</b>	<b>\$258,049</b>	<b>\$(8,465,948)</b>	<b>\$346,723,419</b>
State, County and Municipal	<b>4,493,085</b>	<b>22,835</b>	<b>(23,094)</b>	<b>4,492,826</b>
Corporate	<b>2,047,517</b>	<b>12,483</b>	<b>-</b>	<b>2,060,000</b>
Asset-Backed	<b>992,641</b>	<b>-</b>	<b>(21,982)</b>	<b>970,659</b>
	<b><u>\$362,464,561</u></b>	<b><u>\$293,367</u></b>	<b><u>\$(8,511,024)</u></b>	<b><u>\$354,246,904</u></b>

The amortized cost and fair value of investment securities as of December 31, 2017, by contractual maturity, are shown hereafter. Expected maturities may differ from contractual maturities for certain investments because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. This is often the case with mortgage-backed securities, which are disclosed separately in the table below.

	<b>Securities Available for Sale</b>	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in One Year or Less	\$ 301,299	\$ 301,605
Due After One Year Through Five Years	4,668,954	4,658,344
Due After Five Years Through Ten Years	877,788	894,743
Due After Ten Years	1,685,202	1,668,793
	<u>\$ 7,533,243</u>	<u>\$ 7,523,485</u>
Mortgage-Backed Securities	<u>354,931,318</u>	<u>346,723,419</u>
	<u>\$362,464,561</u>	<u>\$354,246,904</u>

### (3) Investment Securities (Continued)

Investment securities as of December 31, 2016 are summarized as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Securities Available for Sale				
U.S. Government Agencies				
Mortgage-Backed	\$ 326,694,417	\$ 75,743	\$ (7,672,786)	\$ 319,097,374
State, County and Municipal	<u>4,572,756</u>	<u>18,350</u>	<u>(30,610)</u>	<u>4,560,496</u>
	<u>\$ 331,267,173</u>	<u>\$ 94,093</u>	<u>\$ (7,703,396)</u>	<u>\$ 323,657,870</u>

Proceeds from sales of investments available for sale were \$0 in 2017, \$25,209,851 in 2016 and \$28,273,634 in 2015. Gross realized gains totaled \$0 in 2017, \$391,976 in 2016 and \$207,896 in 2015. Gross realized losses totaled \$0 in 2017, \$6,753 in 2016 and \$196,316 in 2015.

Investment securities having a carrying value totaling \$175,484,021 and \$144,853,885 as of December 31, 2017 and 2016, respectively, were pledged to secure public deposits and for other purposes.

Information pertaining to securities with gross unrealized losses at December 31, 2017 and 2016 aggregated by investment category and length of time that individual securities have been in a continuous loss position, follows:

	<u>Less Than 12 Months</u>		<u>12 Months or Greater</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>
<b>December 31, 2017</b>						
U.S. Government Agencies						
Mortgage-Backed	\$120,139,340	\$(1,655,223)	\$190,196,101	\$(6,810,725)	\$310,335,441	\$(8,465,948)
State, County and Municipal	2,598,344	(23,094)	-	-	2,598,344	(23,094)
Asset – Backed	<u>970,659</u>	<u>(21,982)</u>	<u>-</u>	<u>-</u>	<u>970,659</u>	<u>(21,982)</u>
	<u>\$123,708,343</u>	<u>\$(1,700,299)</u>	<u>\$190,196,101</u>	<u>\$(6,810,725)</u>	<u>\$313,904,444</u>	<u>\$(8,511,024)</u>
<b>December 31, 2016</b>						
U.S. Government Agencies						
Mortgage-Backed	\$174,200,881	\$(3,459,564)	\$107,481,698	\$(4,213,222)	\$281,682,579	\$(7,672,786)
State, County and Municipal	<u>3,487,647</u>	<u>(30,610)</u>	<u>-</u>	<u>-</u>	<u>3,487,647</u>	<u>(30,610)</u>
	<u>\$177,688,528</u>	<u>\$(3,490,174)</u>	<u>\$107,481,698</u>	<u>\$(4,213,222)</u>	<u>\$285,170,226</u>	<u>\$(7,703,396)</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 Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

### (3) Investment Securities (Continued)

At December 31, 2017, 130 securities have unrealized losses which have depreciated 2.64 percent from the Company's amortized cost basis. These securities are guaranteed by either the U.S. Government, other governments or U.S. corporations. In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred and the results of reviews of the issuer's financial condition. The unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying securities were purchased. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary. However, the Company did own one asset-backed security at December 31, 2017 which was completely written off during prior years. This investment is comprised of one issuance of a trust preferred security and has no book value.

### (4) Loans

The following table presents the composition of loans, segregated by class of loans, as of December 31:

	<u>2017</u>	<u>2016</u>
<b>Commercial and Agricultural</b>		
Commercial	\$ 48,122,263	\$ 47,024,878
Agricultural	16,442,581	17,079,579
<b>Real Estate</b>		
Commercial Construction	45,213,960	30,358,362
Residential Construction	8,583,446	11,830,447
Commercial	351,171,668	349,090,031
Residential	194,048,945	195,579,967
Farmland	67,767,655	66,877,197
<b>Consumer and Other</b>		
Consumer	18,956,028	19,695,241
Other	14,977,309	16,747,861
<b>Total Loans</b>	<u>\$765,283,855</u>	<u>\$754,283,563</u>

#### **(4) Loans (Continued)**

Commercial and agricultural loans are extended to a diverse group of businesses within the Company's market area. These loans are often underwritten based on the borrower's ability to service the debt from income from the business. Real estate construction loans often require loan funds to be advanced prior to completion of the project. Due to uncertainties inherent in estimating construction costs, changes in interest rates and other economic conditions, these loans often pose a higher risk than other types of loans. Consumer loans are originated at the bank level. These loans are generally smaller loan amounts spread across many individual borrowers to help minimize risk.

*Credit Quality Indicators.* As part of the ongoing monitoring of the credit quality of the loan portfolio, management tracks certain credit quality indicators including trends related to (1) the risk grade assigned to commercial and consumer loans, (2) the level of classified commercial loans, (3) net charge-offs, (4) nonperforming loans, and (5) the general economic conditions in the Company's geographic markets.

The Company uses a risk grading matrix to assign a risk grade to each of its loans. Loans are graded on a scale of 1 to 8. A description of the general characteristics of the grades is as follows:

- Grades 1 and 2 - Borrowers with these assigned grades range in risk from virtual absence of risk to minimal risk. Such loans may be secured by Company-issued and controlled certificates of deposit or properly margined equity securities or bonds. Other loans comprising these grades are made to companies that have been in existence for a long period of time with many years of consecutive profits and strong equity, good liquidity, excellent debt service ability and unblemished past performance, or to exceptionally strong individuals with collateral of unquestioned value that fully secures the loans. Loans in this category fall into the "pass" classification.
- Grades 3 and 4 - Loans assigned these "pass" risk grades are made to borrowers with acceptable credit quality and risk. The risk ranges from loans with no significant weaknesses in repayment capacity and collateral protection to acceptable loans with one or more risk factors considered to be more than average.
- Grade 5 - This grade includes "special mention" loans on management's watch list and is intended to be used on a temporary basis for pass grade loans where risk-modifying action is intended in the short-term.
- Grade 6 - This grade includes "substandard" loans in accordance with regulatory guidelines. This category includes borrowers with well-defined weaknesses that jeopardize the payment of the debt in accordance with the agreed terms. Loans considered to be impaired are assigned this grade, and these loans often have assigned loss allocations as part of the allowance for loan and lease losses. Generally, loans on which interest accrual has been stopped would be included in this grade.
- Grades 7 and 8 - These grades correspond to regulatory classification definitions of "doubtful" and "loss," respectively. In practice, any loan with these grades would be for a very short period of time, and generally the Company has no loans with these assigned grades. Management manages the Company's problem loans in such a way that uncollectible loans or uncollectible portions of loans are charged off immediately with any residual, collectible amounts assigned a risk grade of 6.

#### (4) Loans (Continued)

The following tables present the loan portfolio by credit quality indicator (risk grade) as of December 31. Those loans with a risk grade of 1, 2, 3 or 4 have been combined in the pass column for presentation purposes.

2017	Pass	Special Mention	Substandard	Total Loans
<b>Commercial and Agricultural</b>				
Commercial	\$ 46,468,726	\$ 825,607	\$ 827,930	\$ 48,122,263
Agricultural	15,868,191	174,356	400,034	16,442,581
<b>Real Estate</b>				
Commercial Construction	41,282,295	577,765	3,353,900	45,213,960
Residential Construction	8,583,446	-	-	8,583,446
Commercial	338,775,805	7,662,637	4,733,226	351,171,668
Residential	177,962,870	4,864,893	11,221,182	194,048,945
Farmland	66,334,906	444,095	988,654	67,767,655
<b>Consumer and Other</b>				
Consumer	18,495,798	52,970	407,260	18,956,028
Other	14,968,677	8,632	-	14,977,309
<b>Total Loans</b>	<b>\$728,740,714</b>	<b>\$14,610,955</b>	<b>\$21,932,186</b>	<b>\$765,283,855</b>

2016

<b>Commercial and Agricultural</b>				
Commercial	\$ 44,249,874	\$ 1,861,757	\$ 913,247	\$ 47,024,878
Agricultural	16,585,646	192,445	301,488	17,079,579
<b>Real Estate</b>				
Commercial Construction	28,425,373	1,349,447	583,542	30,358,362
Residential Construction	11,630,165	-	200,282	11,830,447
Commercial	327,561,169	9,403,077	12,125,785	349,090,031
Residential	178,618,510	5,658,526	11,302,931	195,579,967
Farmland	65,074,715	839,362	963,120	66,877,197
<b>Consumer and Other</b>				
Consumer	19,071,739	225,959	397,543	19,695,241
Other	16,747,861	-	-	16,747,861
<b>Total Loans</b>	<b>\$707,965,052</b>	<b>\$19,530,573</b>	<b>\$26,787,938</b>	<b>\$754,283,563</b>

A loan's risk grade is assigned at the inception of the loan and is based on the financial strength of the borrower and the type of collateral. Loan risk grades are subject to reassessment at various times throughout the year as part of the Company's ongoing loan review process. Loans with an assigned risk grade of 6 or below and an outstanding balance of \$250,000 or more are reassessed on a quarterly basis. During this reassessment process individual reserves may be identified and placed against certain loans which are not considered impaired. In assessing the overall economic condition of the markets in which it operates, the Company monitors the unemployment rates for its major service areas. The unemployment rates are reviewed on a quarterly basis as part of the allowance for loan loss determination.

#### (4) Loans (Continued)

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due or when, in management's opinion, the borrower may be unable to meet payment obligations as they become due, as well as when required by regulatory provision. Loans may be placed on nonaccrual status regardless of whether such loans are considered past due.

The following table represents an age analysis of past due loans and nonaccrual loans, segregated by class of loans, as of December 31:

2017	Accruing Loans			Nonaccrual Loans	Current Loans	Total Loans
	30-89 Days Past Due	90 Days or More Past Due	Total Accruing Loans Past Due			
<b>Commercial and Agricultural</b>						
Commercial	\$ 328,483	\$ -	\$ 328,483	\$598,305	\$ 47,195,475	\$ 48,122,263
Agricultural	110,482	-	110,482	398,509	15,933,590	16,442,581
<b>Real Estate</b>						
Commercial Construction	27,062	-	27,062	477,043	44,709,855	45,213,960
Residential Construction	119,443	-	119,443	-	8,464,003	8,583,446
Commercial	918,997	-	918,997	2,172,229	348,080,442	351,171,668
Residential	2,482,276	-	2,482,276	2,829,966	188,736,703	194,048,945
Farmland	318,329	-	318,329	838,577	66,610,749	67,767,655
<b>Consumer and Other</b>						
Consumer	246,175	-	246,175	188,073	18,521,780	18,956,028
Other	7,158	-	7,158	-	14,970,151	14,977,309
<b>Total Loans</b>	<b>\$4,558,405</b>	<b>\$ -</b>	<b>\$4,558,405</b>	<b>\$7,502,702</b>	<b>\$753,222,748</b>	<b>\$765,283,855</b>
2016						
<b>Commercial and Agricultural</b>						
Commercial	\$ 419,969	\$ -	\$ 419,969	\$ 634,955	\$ 45,969,954	\$ 47,024,878
Agricultural	33,046	-	33,046	208,522	16,838,011	17,079,579
<b>Real Estate</b>						
Commercial Construction	54,001	-	54,001	190,494	30,113,867	30,358,362
Residential Construction	-	-	-	-	11,830,447	11,830,447
Commercial	491,468	-	491,468	6,360,176	342,238,387	349,090,031
Residential	3,178,833	-	3,178,833	3,944,337	188,456,797	195,579,967
Farmland	95,309	-	95,309	799,556	65,982,332	66,877,197
<b>Consumer and Other</b>						
Consumer	196,242	122	196,364	212,026	19,286,851	19,695,241
Other	-	-	-	-	16,747,861	16,747,861
<b>Total Loans</b>	<b>\$4,468,868</b>	<b>\$ 122</b>	<b>\$4,468,990</b>	<b>\$12,350,066</b>	<b>\$737,464,507</b>	<b>\$754,283,563</b>



#### (4) Loans (Continued)

Had nonaccrual loans performed in accordance with their original contractual terms, the Company would have recognized additional interest income of approximately \$205,000, \$387,300 and \$418,400 for the years ended December 31, 2017, 2016 and 2015, respectively.

The following table details impaired loan data as of December 31, 2017:

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 598,305	\$ 598,305	\$ -	\$ 633,528	\$ 33,283	\$ 33,868
Agricultural	485,132	398,509	-	296,578	11,046	19,376
Commercial Construction	54,306	54,306	-	141,396	3,526	3,836
Residential Construction	-	-	-	79,295	-	-
Commercial Real Estate	12,637,057	12,637,057	-	12,808,414	559,601	549,825
Residential Real Estate	4,977,769	4,579,614	-	4,566,041	211,318	226,684
Farmland	840,110	838,577	-	790,967	54,367	58,085
Consumer	188,073	188,073	-	186,348	8,576	9,452
	<b>\$19,780,752</b>	<b>\$19,294,441</b>	<b>\$ -</b>	<b>\$19,502,567</b>	<b>\$ 881,717</b>	<b>\$ 901,126</b>
<b>With An Allowance Recorded</b>						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Agricultural	-	-	-	-	-	-
Commercial Construction	493,067	493,067	65,635	241,063	22,626	32,922
Residential Construction	-	-	-	-	-	-
Commercial Real Estate	5,729,300	5,729,300	1,712,557	6,599,144	228,745	237,066
Residential Real Estate	108,859	108,859	27,123	482,228	4,261	7,446
Farmland	371,376	371,376	21,369	375,595	22,121	22,021
Consumer	-	-	-	-	-	-
	<b>\$ 6,702,602</b>	<b>\$ 6,702,602</b>	<b>\$1,826,684</b>	<b>\$ 7,698,030</b>	<b>\$ 277,753</b>	<b>\$ 299,455</b>
<b>Total</b>						
Commercial	\$ 598,305	\$ 598,305	\$ -	\$ 633,528	\$ 33,283	\$ 33,868
Agricultural	485,132	398,509	-	296,578	11,046	19,376
Commercial Construction	547,373	547,373	65,635	382,459	26,152	36,758
Residential Construction	-	-	-	79,295	-	-
Commercial Real Estate	18,366,357	18,366,357	1,712,557	19,407,558	788,346	786,891
Residential Real Estate	5,086,628	4,688,473	27,123	5,048,269	215,579	234,130
Farmland	1,211,486	1,209,953	21,369	1,166,562	76,488	80,106
Consumer	188,073	188,073	-	186,348	8,576	9,452
	<b>\$26,483,354</b>	<b>\$ 25,997,043</b>	<b>\$ 1,826,684</b>	<b>\$27,200,597</b>	<b>\$1,159,470</b>	<b>\$1,200,581</b>

#### (4) Loans (Continued)

The following table details impaired loan data as of December 31, 2016:

	<u>Unpaid Contractual Principal Balance</u>	<u>Impaired Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Interest Income Collected</u>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 634,955	\$ 634,955	\$ -	\$ 539,099	\$ 24,563	\$ 27,142
Agricultural	229,182	208,522	-	210,372	8,794	12,412
Commercial Construction	190,494	190,494	-	697,893	6,630	7,127
Commercial Real Estate	14,357,601	14,276,688	-	14,274,719	567,349	560,354
Residential Real Estate	4,261,558	3,952,139	-	4,553,322	73,099	190,373
Farmland	920,666	799,556	-	1,016,395	21,526	26,012
Consumer	212,376	212,026	-	213,309	9,599	12,036
	<u>\$20,806,832</u>	<u>\$ 20,274,380</u>	<u>\$ -</u>	<u>\$ 21,505,109</u>	<u>\$ 711,560</u>	<u>\$ 835,456</u>
<b>With An Allowance Recorded</b>						
Commercial	\$ -	\$ -	\$ -	\$ 30,270	\$ -	\$ -
Agricultural	-	-	-	-	-	-
Commercial Construction	72,296	72,296	21,135	74,098	1,532	1,416
Commercial Real Estate	8,557,582	8,467,135	3,021,943	8,339,666	238,684	235,749
Residential Real Estate	1,475,594	1,467,833	362,521	1,042,750	27,759	32,260
Farmland	379,851	379,851	29,173	384,056	21,098	21,310
Consumer	-	-	-	-	-	-
	<u>\$10,485,323</u>	<u>\$ 10,387,115</u>	<u>\$ 3,434,772</u>	<u>\$ 9,870,840</u>	<u>\$ 289,073</u>	<u>\$ 290,735</u>
<b>Total</b>						
Commercial	\$ 634,955	\$ 634,955	\$ -	\$ 569,369	\$ 24,563	\$ 27,142
Agricultural	229,182	208,522	-	210,372	8,794	12,412
Commercial Construction	262,790	262,790	21,135	771,991	8,162	8,543
Commercial Real Estate	22,915,183	22,743,823	3,021,943	22,614,385	806,033	796,103
Residential Real Estate	5,737,152	5,419,972	362,521	5,596,072	100,858	222,633
Farmland	1,300,517	1,179,407	29,173	1,400,451	42,624	47,322
Consumer	212,376	212,026	-	213,309	9,599	12,036
	<u>\$31,292,155</u>	<u>\$ 30,661,495</u>	<u>\$ 3,434,772</u>	<u>\$ 31,375,949</u>	<u>\$ 1,000,633</u>	<u>\$1,126,191</u>

#### (4) Loans (Continued)

The following table details impaired loan data as of December 31, 2015:

	<b>Unpaid Contractual Principal Balance</b>	<b>Impaired Balance</b>	<b>Related Allowance</b>	<b>Average Recorded Investment</b>	<b>Interest Income Recognized</b>	<b>Interest Income Collected</b>
<b>With No Related Allowance Recorded</b>						
Commercial	\$ 454,423	\$ 454,013	\$ -	\$ 534,814	\$ 17,259	\$ 21,253
Agricultural	195,654	178,021	-	163,078	(9,957)	10,334
Commercial Construction	6,887,522	1,896,938	-	2,867,061	25,788	27,007
Commercial Real Estate	15,569,340	15,122,486	-	15,430,252	529,376	530,699
Residential Real Estate	5,429,121	4,575,547	-	4,715,162	175,484	159,148
Farmland	1,104,887	1,103,353	-	1,339,863	583	2,076
Consumer	179,908	178,435	-	190,566	13,745	14,907
Other	-	-	-	48,438	-	-
	<u>\$29,820,855</u>	<u>\$23,508,793</u>	<u>\$ -</u>	<u>\$25,289,234</u>	<u>\$ 752,278</u>	<u>\$ 765,424</u>
<b>With An Allowance Recorded</b>						
Commercial	\$ 122,928	\$ 122,928	\$ 94,538	\$ 99,749	\$ 2,275	\$ 2,438
Agricultural	-	-	-	-	-	-
Commercial Construction	76,644	76,644	25,344	92,200	375	375
Commercial Real Estate	8,969,329	8,955,503	1,607,962	6,673,087	213,693	208,657
Residential Real Estate	1,083,127	1,075,367	308,188	1,088,380	16,380	15,873
Farmland	387,968	387,969	37,386	391,060	20,880	20,954
Consumer	-	-	-	-	-	-
Other	-	-	-	-	-	-
	<u>\$10,639,996</u>	<u>\$10,618,411</u>	<u>\$2,073,418</u>	<u>\$ 8,344,476</u>	<u>\$ 253,603</u>	<u>\$ 248,297</u>
<b>Total</b>						
Commercial	\$ 577,351	\$ 576,941	\$ 94,538	\$ 634,563	\$ 19,534	\$ 23,691
Agricultural	195,654	178,021	-	163,078	(9,957)	10,334
Commercial Construction	6,964,166	1,973,582	25,344	2,959,261	26,163	27,382
Commercial Real Estate	24,538,669	24,077,989	1,607,962	22,103,339	743,069	739,356
Residential Real Estate	6,512,248	5,650,914	308,188	5,803,542	191,864	175,021
Farmland	1,492,855	1,491,322	37,386	1,730,923	21,463	23,030
Consumer	179,908	178,435	-	190,566	13,745	14,907
Other	-	-	-	48,438	-	-
	<u>\$40,460,851</u>	<u>\$34,127,204</u>	<u>\$2,073,418</u>	<u>\$33,633,710</u>	<u>\$1,005,881</u>	<u>\$1,013,721</u>

#### **(4) Loans (Continued)**

Troubled Debt Restructurings (TDRs) are troubled loans on which the original terms of the loan have been modified in favor of the borrower due to deterioration in the borrower's financial condition. 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. Loan modifications are reviewed and approved by the Company's senior lending staff, who then determine whether the loan meets the criteria for a TDR. Generally, the types of concessions granted to borrowers that are evaluated in determining whether a 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 - These are often the result of commercial real estate loan workouts where two new notes are created. The primary note is underwritten based upon the Company's normal underwriting standards and is structured so that the projected cash flows are sufficient to repay the contractual principal and interest of the newly restructured note. The terms of the secondary note vary by situation and often involve that note being charged off, or the principal and interest payments being deferred until after the primary note has been repaid. In situations where a portion of the note is charged off during modification, there is often no specific reserve allocated to those loans. This is due to the fact that the amount of the charge-off usually represents the excess of the original loan balance over the collateral value and the Company has determined there is no additional exposure on those loans.

#### (4) Loans (Continued)

As discussed in Note 1, Summary of Significant Accounting Policies, once a loan is identified as a TDR, it is accounted for as an impaired loan. The Company had no unfunded commitments to lend to a customer that has a troubled debt restructured loan as of December 31, 2017. The following tables present the number of loan contracts restructured during the 12 months ended December 31, 2017, 2016 and 2015. It shows the pre- and post-modification recorded investment as well as the number of contracts and the recorded investment for those TDRs modified during the previous 12 months which subsequently defaulted during the period. Loans modified in a troubled debt restructuring are considered to be in default once the loan becomes 90 days past due. A TDR may cease being classified as impaired if the loan is subsequently modified at market terms, has performed according to the modified terms for at least six months, and has not had any prior principal forgiveness on a cumulative basis.

#### Troubled Debt Restructurings

<b>2017</b>	<b><u># of Contracts</u></b>	<b><u>Pre-Modification</u></b>	<b><u>Post-Modification</u></b>
Commercial Real Estate	-	\$ -	\$ -
Residential Real Estate	-	-	-
<b>Total Loans</b>	<b>-</b>	<b>\$ -</b>	<b>\$ -</b>
<b>2016</b>			
Commercial Real Estate	1	\$ 91,280	\$ 91,097
Residential Real Estate	1	354,784	354,784
<b>Total Loans</b>	<b>2</b>	<b>\$ 446,064</b>	<b>\$ 445,881</b>
<b>2015</b>			
Commercial Real Estate	1	\$ 513,868	\$ 505,978
Residential Real Estate	2	1,106,345	1,035,590
<b>Total Loans</b>	<b>3</b>	<b>\$1,620,213</b>	<b>\$1,541,568</b>

#### (4) Loans (Continued)

Troubled debt restructurings that subsequently defaulted as of December 31 are as follows:

	<u>2017</u>		<u>2016</u>		<u>2015</u>	
	<u># of Contracts</u>	<u>Recorded Investment</u>	<u># of Contracts</u>	<u>Recorded Investment</u>	<u># of Contracts</u>	<u>Recorded Investment</u>
Residential Real Estate	-	\$ -	1	\$ 89,297	-	\$ -
<b>Total Loans</b>	-	\$ -	1	\$ 89,297	-	\$ -

At December 31, 2017, all restructured loans were performing as agreed. During December 2016, a restructured loan totaling \$89,297 failed to continue to perform as agreed and was charged off in June 2016. At December 31, 2015, all restructured loans were performing as agreed.

#### (5) Allowance for Loan Losses

Changes in the allowance for loan losses for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Balance, Beginning of Year</b>	<b>\$8,923,293</b>	\$8,603,905	\$8,802,316
Provision for Loan Losses	<b>390,000</b>	1,062,000	865,500
Loans Charged Off	<b>(2,915,753)</b>	(2,087,850)	(2,083,347)
Recoveries of Loans Previously Charged Off	<b>1,109,968</b>	1,345,238	1,019,436
<b>Balance, End of Year</b>	<b>\$7,507,508</b>	<b>\$8,923,293</b>	<b>\$8,603,905</b>

**(5) Allowance for Loan Losses (Continued)**

The following tables detail activity in the allowance for loan losses, segregated by class of loan, for the years ended December 31. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other loan categories and periodically may result in reallocation within the provision categories.

2017	<u>Beginning Balance</u>	<u>Charge-Offs</u>	<u>Recoveries</u>	<u>Provision</u>	<u>Ending Balance</u>
<b>Commercial and Agricultural</b>					
Commercial	\$ 456,197	\$ (299,079)	\$ 136,499	\$ 153,058	\$ 446,675
Agricultural	167,692	(159,500)	3,963	173,749	185,904
<b>Real Estate</b>					
Commercial Construction	322,725	(51,977)	266,459	678,808	1,216,015
Residential Construction	13,491	-	-	(13,491)	-
Commercial	5,750,998	(966,014)	527,150	(1,438,175)	3,873,959
Residential	1,396,099	(1,048,337)	82,079	538,260	968,101
Farmland	722,331	(60,902)	16,750	101,352	779,531
<b>Consumer and Other</b>					
Consumer	80,265	(329,944)	74,933	208,739	33,993
Other	13,495	-	2,135	(12,300)	3,330
	<u>\$ 8,923,293</u>	<u>\$(2,915,753)</u>	<u>\$1,109,968</u>	<u>\$ 390,000</u>	<u>\$ 7,507,508</u>
2016					
<b>Commercial and Agricultural</b>					
Commercial	\$ 855,364	\$ (304,918)	\$ 66,738	\$ (160,987)	\$ 456,197
Agricultural	203,091	(19,258)	4,150	(20,291)	167,692
<b>Real Estate</b>					
Commercial Construction	690,766	(25,318)	814,586	(1,157,309)	322,725
Residential Construction	19,890	-	-	(6,399)	13,491
Commercial	3,850,527	(992,067)	206,154	2,686,384	5,750,998
Residential	1,990,355	(361,630)	49,660	(282,286)	1,396,099
Farmland	911,692	(119,576)	145,000	(214,785)	722,331
<b>Consumer and Other</b>					
Consumer	63,377	(265,083)	52,629	229,342	80,265
Other	18,843	-	6,321	(11,669)	13,495
	<u>\$ 8,603,905</u>	<u>\$(2,087,850)</u>	<u>\$1,345,238</u>	<u>\$ 1,062,000</u>	<u>\$ 8,923,293</u>

**(5) Allowance for Loan Losses (Continued)**

2015	<b>Beginning Balance</b>	<b>Charge-Offs</b>	<b>Recoveries</b>	<b>Provision</b>	<b>Ending Balance</b>
<b>Commercial and Agricultural</b>					
Commercial	\$ 497,561	\$ (454,971)	\$ 52,111	\$760,663	\$ 855,364
Agricultural	304,172	(5,000)	3,600	(99,681)	203,091
<b>Real Estate</b>					
Commercial Construction	1,222,695	(97,698)	485,834	(920,065)	690,766
Residential Construction	138,092	-	-	(118,202)	19,890
Commercial	3,664,777	(275,297)	270,003	191,044	3,850,527
Residential	2,425,327	(929,668)	109,626	385,070	1,990,355
Farmland	103,800	(40,000)	20,000	827,892	911,692
<b>Consumer and Other</b>					
Consumer	66,914	(255,062)	61,976	189,549	63,377
Other	378,978	(25,651)	16,286	(350,770)	18,843
	<u>\$8,802,316</u>	<u>\$(2,083,347)</u>	<u>\$1,019,436</u>	<u>\$865,500</u>	<u>\$8,603,905</u>

The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and historical valuation allowances for other loans with similar risk characteristics. During the first quarter of 2016 Company management implemented a change to its allowance for loan loss methodology by expanding the historical loss period from a rolling 8 quarters to 16 quarters. Management believes the longer historical loss period better reflects the current and expected loss behavior of the loan portfolio within the current credit cycle. The transition to a rolling 16 quarter loss period was completed in the first quarter of 2017. As of December 31, 2017, this change in the historical loss period resulted in a decrease to the allowance for loan losses of \$114,144. The loss history period used at December 31, 2016 and 2015 was based on the loss rate from the eight quarters ended September 30, 2016 and 2015, respectively.

Effective with the quarter ended June 30, 2015, the calculation of the amount needed in the Allowance for Loan Losses changed. Management determined that the segmentation method for the ASC 450-20 portion of the loan portfolio should be changed to bank call report categories. Prior to this change, the ASC 450-20 segmentation categorized loans by various non-owner occupied commercial real estate loan types and risk grades for the remainder of the ASC 450-20 portion of the portfolio. On the date of change, June 30, 2015, the change in methodology resulted in an increase to the calculated allowance for loan loss reserve of \$1,621,424.



## (5) Allowance for Loan Losses (Continued)

Management feels these changes better align the calculation of the allowance for loan losses with the direction of the loan portfolio. These changes did not result in a significant change to the recorded allowance for loan loss balance.

The Company determines its individual reserves during its quarterly review of substandard loans. This process involves reviewing all loans with a risk grade of 6 or greater and an outstanding balance of \$250,000 or more, regardless of the loans impairment classification.

Since not all loans in the substandard category are considered impaired, this quarterly review process may result in the identification of specific reserves on nonimpaired loans. Management considers those loans graded substandard, but not classified as impaired, to be higher risk loans and, therefore, makes specific allocations to the allowance for those loans if warranted. The total of such loans is \$9,470,621 and \$10,786,699 as of December 31, 2017 and 2016, respectively. Specific allowance allocations were made for these loans totaling \$1,510,868 and \$632,706 as of December 31, 2017 and 2016, respectively. Since these loans are not considered impaired, both the loan balance and related specific allocation are included in the “Collectively Evaluated for Impairment” column of the following tables.

At December 31, 2017, there were 149 impaired loans totaling \$4,335,524 below the \$250,000 review threshold which were not individually reviewed for impairment. Those loans were subject to the Bank’s general loan loss reserve methodology and are included in the “Collectively Evaluated for Impairment” column of the following tables. Likewise, at December 31, 2016 and 2015, impaired loans totaling \$4,204,156 and \$3,744,733, respectively, were below the \$250,000 review threshold and were subject to the Bank’s general loan loss reserve methodology and are included in the “Collectively Evaluated for Impairment” column of the following tables.

2017	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$ -	\$ 446,675	\$ 446,675	\$ 77,599	\$ 48,044,664	\$ 48,122,263
Agricultural	-	185,904	185,904	5,121	16,437,460	16,442,581
<b>Real Estate</b>						
Commercial Construction	65,635	1,150,380	1,216,015	493,067	44,720,893	45,213,960
Residential Construction	-	-	-	-	8,583,446	8,583,446
Commercial	1,712,557	2,161,402	3,873,959	18,010,035	333,161,633	351,171,668
Residential	27,123	940,978	968,101	2,040,125	192,008,820	194,048,945
Farmland	21,369	758,162	779,531	1,035,572	66,732,083	67,767,655
<b>Consumer and Other</b>						
Consumer	-	33,993	33,993	-	18,956,028	18,956,028
Other	-	3,330	3,330	-	14,977,309	14,977,309
<b>Total End of Year Balance</b>	<b>\$1,826,684</b>	<b>\$ 5,680,824</b>	<b>\$ 7,507,508</b>	<b>\$21,661,519</b>	<b>\$743,622,336</b>	<b>\$765,283,855</b>

**(5) Allowance for Loan Losses (Continued)**

2016	Ending Allowance Balance			Ending Loan Balance		
	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total	Individually Evaluated for Impairment	Collectively Evaluated for Impairment	Total
<b>Commercial and Agricultural</b>						
Commercial	\$ -	\$ 456,197	\$ 456,197	\$ 6,671	\$ 47,018,207	\$ 47,024,878
Agricultural	-	167,692	167,692	-	17,079,579	17,079,579
<b>Real Estate</b>						
Commercial Construction	21,135	301,590	322,725	72,296	30,286,066	30,358,362
Residential Construction	-	13,491	13,491	-	11,830,447	11,830,447
Commercial	3,021,943	2,729,055	5,750,998	22,422,451	326,667,580	349,090,031
Residential	362,522	1,033,577	1,396,099	2,911,874	192,668,093	195,579,967
Farmland	29,172	693,159	722,331	1,044,047	65,833,150	66,877,197
<b>Consumer and Other</b>						
Consumer	-	80,265	80,265	-	19,695,241	19,695,241
Other	-	13,495	13,495	-	16,747,861	16,747,861
<b>Total End of Year Balance</b>	<b>\$ 3,434,772</b>	<b>\$ 5,488,521</b>	<b>\$ 8,923,293</b>	<b>\$ 26,457,339</b>	<b>\$ 727,826,224</b>	<b>\$ 754,283,563</b>
2015						
<b>Commercial and Agricultural</b>						
Commercial	\$ 94,538	\$ 760,826	\$ 855,364	\$ 122,928	\$ 47,658,761	\$ 47,781,689
Agricultural	-	203,091	203,091	8,445	19,185,052	19,193,497
<b>Real Estate</b>						
Commercial Construction	25,344	665,422	690,766	1,622,560	38,484,073	40,106,633
Residential Construction	-	19,890	19,890	-	9,413,263	9,413,263
Commercial	1,607,962	2,242,565	3,850,527	23,628,213	322,633,820	346,262,033
Residential	308,188	1,682,167	1,990,355	3,597,386	193,405,033	197,002,419
Farmland	37,386	874,306	911,692	1,402,939	60,376,920	61,779,859
<b>Consumer and Other</b>						
Consumer	-	63,377	63,377	-	20,605,465	20,605,465
Other	-	18,843	18,843	-	16,490,737	16,490,737
<b>Total End of Year Balance</b>	<b>\$ 2,073,418</b>	<b>\$ 6,530,487</b>	<b>\$ 8,603,905</b>	<b>\$ 30,382,471</b>	<b>\$ 728,253,124</b>	<b>\$ 758,635,595</b>

## (6) Premises and Equipment

Premises and equipment are comprised of the following as of December 31:

	<u>2017</u>	<u>2016</u>
Land	<b>\$9,668,722</b>	\$ 9,668,722
Building	<b>26,893,354</b>	25,239,165
Furniture, Fixtures and Equipment	<b>13,090,366</b>	12,461,043
Leasehold Improvements	<b>655,166</b>	653,939
Construction in Progress	<b>68,253</b>	1,530,359
	<b>50,375,861</b>	49,553,228
Accumulated Depreciation	<b>(22,736,431)</b>	(21,583,968)
	<b><u>\$27,639,430</u></b>	<b><u>\$27,969,260</u></b>

Depreciation charged to operations totaled \$1,647,813 in 2017, \$1,574,249 in 2016 and \$1,657,229 in 2015.

Certain Company facilities and equipment are leased under various operating leases. Rental expense approximated \$427,000 for 2017, \$437,000 for 2016 and \$560,000 for 2015.

Future minimum rental payments as of December 31, 2017 are as follows:

<u>Year Ending December 31</u>	<u>Amount</u>
2018	\$ 43,320
2019	42,000
2020	42,000
2021	42,000
2022 and Thereafter	38,500
	<b><u>\$207,820</u></b>

## (7) Other Real Estate Owned

The aggregate carrying amount of Other Real Estate Owned (OREO) at December 31, 2017, 2016 and 2015 was \$4,256,469, \$6,439,226 and \$8,839,103, respectively. All of the Company's other real estate owned represents properties acquired through foreclosure or deed in lieu of foreclosure. The following table details the change in OREO during 2017, 2016 and 2015 as of December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Balance, Beginning of Year</b>	<b>\$ 6,439,226</b>	\$ 8,839,103	\$10,401,832
Additions	<b>1,724,936</b>	5,664,554	7,536,165
Sales of OREO	<b>(3,786,567)</b>	(7,416,293)	(8,054,675)
Loss on Sale	<b>212,641</b>	(146,402)	(591,071)
Provision for Losses	<b>(333,767)</b>	(501,736)	(453,148)
<b>Balance, End of Year</b>	<b><u>\$ 4,256,469</u></b>	<b><u>\$ 6,439,226</u></b>	<b><u>\$ 8,839,103</u></b>

## (7) Other Real Estate Owned (Continued)

At December 31, 2017, the Company held \$479,352 of residential real estate property as foreclosed property. Also at December 31, 2017, \$183,588 of consumer mortgage loans collateralized by residential real estate property was in the process of foreclosure according to local requirements of the applicable jurisdictions.

## (8) Other Intangible Assets

The following is an analysis of the core deposit intangible activity for the years ended December 31:

	<u>Core Deposit Intangible</u>	<u>Accumulated Amortization</u>	<u>Net Core Deposit Intangible</u>
<b>Core Deposit Intangible</b>			
Balance, December 31, 2015	\$1,056,693	\$(940,429)	\$116,264
Amortization Expense	<u>-</u>	<u>(35,749)</u>	<u>(35,749)</u>
Balance, December 31, 2016	\$1,056,693	\$(976,178)	\$ 80,515
Amortization Expense	<u>-</u>	<u>(35,749)</u>	<u>(35,749)</u>
<b>Balance, December 31, 2017</b>	<u><b>\$1,056,693</b></u>	<u><b>\$(1,011,927)</b></u>	<u><b>\$ 44,766</b></u>

Amortization expense related to the core deposit intangible was \$35,749, \$35,749 and \$35,748 for the years ended December 31, 2017, 2016 and 2015. Amortizations expense will continue at an annual rate of approximately \$35,749 through the first quarter of 2019, at which point the core deposit will be fully amortized.

## (9) Income Taxes

The Tax Cuts and Jobs Act (the "TCJ Act"), enacted on December 22, 2017, reduced the U.S. federal corporate tax rate to 21 percent. As a result of the enactment of the TCJ Act we have remeasured our deferred tax assets and liabilities based upon the new U.S. statutory federal income tax rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. Notwithstanding the foregoing, we are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. Nonetheless, we recognized additional income tax expense of \$2,040,946 in the fourth quarter of 2017 related to the remeasurement of our deferred tax assets and liabilities.

## (9) Income Taxes (Continued)

The components of income tax expense for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current Federal Expense	<b>\$3,943,495</b>	\$3,629,213	\$3,162,367
Deferred Federal Expense	<b>793,012</b>	222,120	625,436
Deferred Tax Expense from Tax Rate Changes	<b>2,040,946</b>	-	-
Federal Income Tax Expense	<b>6,777,453</b>	3,851,333	3,787,803
Current State Income Tax Expense	-	-	-
Federal and State Income Tax Expense	<b><u>\$6,777,453</u></b>	<b><u>\$3,851,333</u></b>	<b><u>\$3,787,803</u></b>

The federal income tax expense of \$6,777,453 in 2017, \$3,851,333 in 2016 and \$3,787,803 in 2015 is different than the income taxes computed by applying the federal statutory rates to income before income taxes. The reasons for the differences are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Statutory Federal Income Taxes</b>	<b>\$4,954,199</b>	\$4,283,394	\$4,134,570
Tax-Exempt Interest	<b>(102,345)</b>	(109,759)	(83,903)
Income from Cash Value Life Insurance, net of premiums	<b>(198,730)</b>	(182,532)	(232,988)
Meal and Entertainment Disallowance	<b>14,354</b>	16,813	21,600
Other	<b>69,029</b>	(156,583)	(51,476)
Tax Expense from Tax Rate Changes	<b>2,040,946</b>	-	-
<b>Actual Federal Income Taxes</b>	<b><u>\$6,777,453</u></b>	<b><u>\$3,851,333</u></b>	<b><u>\$3,787,803</u></b>

## (9) Income Taxes (Continued)

Deferred taxes, which are included in Other Assets, in the accompanying consolidated balance sheets as of December 31 include the following:

	<u>2017</u>	<u>2016</u>
<b>Deferred Tax Assets</b>		
Allowance for Loan Losses	<b>\$1,576,577</b>	\$3,033,920
Other Real Estate	<b>304,813</b>	688,162
Deferred Compensation	<b>161,000</b>	280,704
Investments	<b>210,000</b>	340,000
Goodwill	<b>76,058</b>	167,666
Other	<b>237,591</b>	379,304
	<u><b>\$2,566,039</b></u>	<u>4,889,756</u>
<b>Deferred Tax Liabilities</b>		
Premises and Equipment	<b>(995,190)</b>	(1,553,460)
Other	<b>(2,585)</b>	(4,185)
	<u><b>(997,775)</b></u>	<u>(1,557,645)</u>
<b>Deferred Tax Assets (Liabilities) on Unrealized Securities Gains (Losses)</b>	<u><b>1,725,708</b></u>	<u>2,587,163</u>
<b>Net Deferred Tax Assets</b>	<u><b>\$3,293,972</b></u>	<u>\$5,919,274</u>

## (10) Deposits

The aggregate amount of overdrawn deposit accounts reclassified as loan balances totaled \$475,161 and \$413,563 as of December 31, 2017 and 2016, respectively.

Components of interest-bearing deposits as of December 31 are as follows:

	<u>2017</u>	<u>2016</u>
Interest-Bearing Demand	<b>\$458,717,332</b>	\$448,003,985
Savings	<b>78,172,441</b>	70,066,140
Time, \$250,000 and Over	<b>38,919,469</b>	32,168,191
Other Time	<b>301,248,235</b>	335,059,579
	<u><b>\$877,057,477</b></u>	<u>\$885,297,895</u>

At December 31, 2017 and 2016, the Company had brokered deposits of \$46,328,995 and \$49,303,139, respectively. All of these brokered deposits represent Certificate of Deposit Account Registry Service (CDARS) reciprocal deposits. The CDARS deposits are ones in which customers placed core deposits into the CDARS program for FDIC insurance coverage and the Company receives reciprocal brokered deposits in a like amount. The aggregate amount of jumbo certificates of deposit, each with a minimum denomination of \$250,000 was \$38,919,469 and \$32,168,191 as of December 31, 2017 and December 31, 2016, respectively.

## (10) Deposits (Continued)

As of December 31, 2017, the scheduled maturities of certificates of deposit are as follows:

<u>Year</u>	<u>Amount</u>
2018	\$255,574,623
2019	41,210,289
2020	22,116,817
2021	11,206,127
2022 and Thereafter	10,059,848
	<u>\$340,167,704</u>

## (11) Other Borrowed Money

Other borrowed money at December 31 is summarized as follows:

	<u>2017</u>	<u>2016</u>
Federal Home Loan Bank Advances	\$46,000,000	\$46,000,000
Other Borrowings	1,500,000	-
	<u>\$47,500,000</u>	<u>\$46,000,000</u>

Advances from the Federal Home Loan Bank (FHLB) have maturities ranging from 2018 to 2026 and interest rates ranging from 0.98 percent to 3.51 percent. As collateral on the outstanding FHLB advances, the Company has provided a blanket lien on its portfolio of qualifying residential first mortgage loans and commercial loans. At December 31, 2017, the book value of those loans pledged is \$109,771,074. At December 31, 2017, the Company had remaining credit availability from the FHLB of \$252,395,250. The Company may be required to pledge additional qualifying collateral in order to utilize the full amount of the remaining credit line.

The Company borrowed \$5,000,000 during the first quarter of 2017 as a short term loan to be paid off within one year with an interest rate of prime plus 0.75 percent, currently 5.25 percent. The Company paid down \$3,500,000 during November 2017. The remaining amount was paid off during January 2018. As of December 31, 2017, the balance of \$1,500,000 is included in Other Borrowings.

The aggregate stated maturities of other borrowed money at December 31, 2017 are as follows:

<u>Year</u>	<u>Amount</u>
2018	\$ 4,000,000
2019	5,000,000
2020	2,500,000
2021	-
2022	27,000,000
2023 and Thereafter	9,000,000
	<u>\$47,500,000</u>

## (11) Other Borrowed Money (Continued)

At December 31, 2017, \$13,000,000 of FHLB advances are subject to fixed rates of interest, while the remaining \$33,000,000 is subject to floating interest rates which will convert to fixed rates of interests in the next few years.

The Company also has available federal funds lines of credit with various financial institutions totaling \$43,500,000, of which there were none outstanding at December 31, 2017.

The Company has the ability to borrow funds from the Federal Reserve Bank (FRB) of Atlanta utilizing the discount window. The discount window is an instrument of monetary policy that allows eligible institutions to borrow money from the FRB on a short-term basis to meet temporary liquidity shortages caused by internal or external disruptions. At December 31, 2017, the Company had borrowing capacity available under this arrangement, with no outstanding balances. The Company would be required to pledge certain available-for-sale investment securities as collateral under this agreement.

## (12) Subordinated Debentures (Trust Preferred Securities)

Description	Date	Amount	3-Month Libor Rate	Added Points	Total Interest Rate	Maturity	5-Year Call Option
(In Thousands)							
Colony Bankcorp Statutory Trust III	6/17/2004	\$4,640	1.60042	2.68	4.28042	6/14/2034	6/17/2009
Colony Bankcorp Capital Trust I	4/13/2006	5,155	1.69465	1.50	3.19465	4/13/2036	4/13/2011
Colony Bankcorp Capital Trust II	3/12/2007	9,279	1.69465	1.65	3.34465	3/12/2037	3/12/2012
Colony Bankcorp Capital Trust III	9/14/2007	5,155	1.37796	1.40	2.77796	9/14/2037	9/14/2012

The Trust Preferred Securities are recorded as subordinated debentures on the consolidated balance sheets, and subject to certain limitations, qualify as Tier 1 Capital for regulatory capital purposes. The proceeds from these offerings were used to fund certain acquisitions, pay off holding company debt and inject capital into the Bank subsidiary. The Trust Preferred Securities pay interest quarterly.

## (13) Preferred Stock

At December 31, 2016, 9,360 shares of Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the Preferred Stock) was outstanding with private investors. On March 31, 2017 the Company redeemed these 9,360 shares of Preferred Stock at the stated rate of \$1,000 per share. Previously, the Company redeemed 8,661 shares in 2016 and 9,979 shares in 2015, all at the stated rate of \$1,000 per share. As a result, there is no outstanding Preferred Stock as of December 31, 2017. While outstanding, the Preferred Stock qualified as Tier I Capital and was nonvoting, other than class voting rights on certain matters that could adversely affect the Preferred Stock. The Preferred Stock paid cumulative cash dividends on a quarterly basis at a rate of 9 percent per annum for the years 2017, 2016 and 2015.

The Company issued a warrant (the Warrant) to private investors for the purchase of up to 500,000 shares of the Company's outstanding common stock. The Warrant originated in 2009 through transactions with the United States Department of the Treasury in conjunction with the issuance of the Preferred Stock. The Warrant may be exercised on or before January 9, 2019 at an exercise price of \$8.40 per share. No voting rights may be exercised with respect to the shares of the Warrant until the Warrant has been exercised.



## (14) Employee Benefit Plan

The Company offers a defined contribution 401(k) Profit Sharing Plan (the Plan) which covers substantially all employees who meet certain age and service requirements. The Plan allows employees to make voluntary pre-tax salary deferrals to the Plan. The Company, at its discretion, may elect to make an annual contribution to the Plan equal to a percentage of each participating employee's salary. Such discretionary contributions must be approved by the Company's board of directors. Employees are fully vested in the Company contributions after six years of service. In 2017, 2016 and 2015, the Company made total contributions of \$686,580, \$408,303 and \$385,453 to the Plan, respectively.

## (15) Commitments and Contingencies

*Credit-Related Financial Instruments.* The Company is a party to credit-related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance sheet instruments.

At December 31, 2017 and 2016, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<b>Contract Amount</b>	
	<b>2017</b>	<b>2016</b>
Commitments to Extend Credit	<b>\$ 96,374,000</b>	\$ 71,359,000
Standby Letters of Credit	<b>1,536,000</b>	1,551,000

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

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby and performance letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers.

## (15) Commitments and Contingencies (Continued)

*Legal Contingencies.* In the ordinary course of business, there are various legal proceedings pending against Colony and its subsidiary. The aggregate liabilities, if any, arising from such proceedings would not, in the opinion of management, have a material adverse effect on Colony's consolidated financial position.

## (16) Deferred Compensation Plan

Colony Bank, the wholly-owned subsidiary, has deferred compensation plans covering certain former directors and certain officers choosing to participate through individual deferred compensation contracts. In accordance with terms of the contracts, the Bank is committed to pay the participant's deferred compensation over a specified number of years, beginning at age 65. In the event of a participant's death before age 65, payments are made to the participant's named beneficiary over a specified number of years, beginning on the first day of the month following the death of the participant.

Liabilities accrued under the plans totaled \$766,667 and \$825,599 as of December 31, 2017 and 2016, respectively. Benefit payments under the contracts were \$110,080 in 2017 and \$135,885 in 2016.

Provisions charged to operations totaled \$55,572 in 2017, \$57,125 in 2016 and \$196,869 in 2015.

The Company has purchased life insurance policies on the plans' participants and uses the cash flow from these policies to partially fund the plan. Fee income recognized with these plans totaled \$233,064 in 2017, \$165,128 in 2016 and \$174,675 in 2015. In addition death benefits recognized as income totaled \$137,058 in 2015.

## (17) Supplemental Cash Flow Information

Cash payments for the following were made during the years ended December 31:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Interest Expense	<u>\$ 6,851,541</u>	<u>\$ 6,529,615</u>	<u>\$ 6,536,994</u>
Income Taxes	<u>\$ 4,000,000</u>	<u>\$ 3,365,000</u>	<u>\$ 4,738,000</u>

Noncash financing and investing activities for the years ended December 31 are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Acquisitions of Real Estate Through Loan Foreclosures	<u>\$ 1,724,936</u>	<u>\$ 5,664,554</u>	<u>\$ 7,536,165</u>
Change in Unrealized Gain (Loss) on AFS Investment Securities	<u>\$ (608,355)</u>	<u>\$ (890,590)</u>	<u>\$ 622,155</u>

## (18) Related Party Transactions

The following table reflects the activity and aggregate balance of direct and indirect loans to directors, executive officers or principal holders of equity securities of the Company. All such loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and do not involve more than a normal risk of collectibility. A summary of activity of related party loans is shown below:

	<u>2017</u>	<u>2016</u>
<b>Balance, Beginning</b>	<b>\$1,025,543</b>	\$ 1,816,609
New Loans	<b>1,050,393</b>	2,379,026
Repayments	<b>(1,106,606)</b>	(3,170,092)
Transactions Due to Changes in Directors	<b>(224,693)</b>	-
<b>Balance, Ending</b>	<b><u>\$ 744,637</u></b>	<b><u>\$ 1,025,543</u></b>

## (19) Fair Value of Financial Instruments and Fair Value Measurements

Generally accepted accounting standards in the U.S. require disclosure of fair value information about financial instruments, whether or not recognized on the face of the balance sheet, for which it is practicable to estimate that value. The assumptions used in the estimation of the fair value of Colony Bankcorp, Inc. and Subsidiary's financial instruments are detailed hereafter. Where quoted prices are not available, fair values are based on estimates using discounted cash flows and other valuation techniques. The use of discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows.

Generally accepted accounting principles related to Fair Value Measurements define fair value, establish a framework for measuring fair value, establish a three-level valuation hierarchy for disclosure of fair value measurement and enhance disclosure requirements for fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 inputs to the valuation methodology are unobservable and represent the Company's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The following disclosures should not be considered a surrogate of the liquidation value of the Company, but rather a good-faith estimate of the increase or decrease in value of financial instruments held by the Company since purchase, origination or issuance.

## **(19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

**Cash and Short-Term Investments** - For cash, due from banks, bank-owned deposits and federal funds sold, the carrying amount is a reasonable estimate of fair value and is classified Level 1.

**Investment Securities** - Fair values for investment securities are based on quoted market prices where available and classified as Level 1. If quoted market prices are not available, estimated fair values are based on quoted market prices of comparable instruments and classified as Level 2. If a comparable is not available, the investment securities are classified as Level 3.

**Federal Home Loan Bank Stock** - The fair value of Federal Home Loan Bank stock approximates carrying value and is classified as Level 1.

**Loans** - The fair value of fixed rate loans 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 variable rate loans, the carrying amount is a reasonable estimate of fair value. Most loans are classified as Level 2, but impaired loans with a related allowance are classified as Level 3.

**Bank-Owned Life Insurance** - The carrying value of bank-owned life insurance policies approximates fair value and is classified as Level 1.

**Deposit Liabilities** - The fair value of demand deposits, savings accounts and certain money market deposits is the amount payable on demand at the reporting date and is classified as Level 1. The fair value of fixed maturity certificates of deposit is estimated by discounting the future cash flows using the rates currently offered for deposits of similar remaining maturities and is classified as Level 2.

**Subordinated Debentures** – The fair value of subordinated debentures is estimated by discounting the future cash flows using the current rates at which similar advances would be obtained. Subordinated debentures are classified as Level 2.

**Other Borrowed Money** - The fair value of other borrowed money is calculated by discounting contractual cash flows using an estimated interest rate based on current rates available to the Company for debt of similar remaining maturities and collateral terms. Other borrowed money is classified as Level 2 due to their expected maturities.

## (19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

The carrying amount and estimated fair values of the Company's financial instruments as of December 31 are as follows:

2017	Carrying Amount	Estimated Fair Value	Level		
			1	2	3
(in Thousands)					
<b>Assets</b>					
Cash and Short-Term Investments	\$ 57,813	\$ 57,813	\$ 57,813	\$ -	\$ -
Investment Securities Available for Sale	354,247	354,247	-	346,950	7,297
Federal Home Loan Bank Stock	3,043	3,043	3,043	-	-
Loans, Net	757,281	757,163	-	752,287	4,876
Bank-Owned Life Insurance	17,089	17,089	17,089	-	-
<b>Liabilities</b>					
Deposits	1,067,985	1,068,392	727,818	340,574	-
Subordinated Debentures	24,229	24,229	-	24,229	-
Other Borrowed Money	47,500	47,626	-	47,626	-
2016					
<b>Assets</b>					
Cash and Short-Term Investments	\$ 75,167	\$ 75,167	\$ 75,167	\$ -	\$ -
Investment Securities Available for Sale	323,658	323,658	-	323,082	576
Federal Home Loan Bank Stock	3,010	3,010	3,010	-	-
Loans, Net	744,999	745,240	-	738,288	6,952
Bank-Owned Life Insurance	15,419	15,419	15,419	-	-
<b>Liabilities</b>					
Deposits	1,044,357	1,045,726	677,129	368,597	-
Subordinated Debentures	24,229	24,229	-	24,229	-
Other Borrowed Money	46,000	46,232	-	46,232	-

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates do not reflect any premium or discount that could result from offering for sale at one time the Company's entire holdings of a particular financial instrument. Because no market exists for a significant portion of the Company's financial instruments, fair value estimates are based on many judgments. 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 are based on existing on- and off-balance sheet financial instruments without attempting to estimate the value of anticipated future business and the value of assets and liabilities that are not considered financial instruments. Significant assets and liabilities that are not considered financial instruments include deferred income taxes and 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.

## **(19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)**

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring and nonrecurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy:

### ***Assets***

*Securities* - Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 inputs include securities that have quoted prices in active markets for identical assets. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Examples of such instruments, which would generally be classified within level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations and certain high-yield debt securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. When measuring fair value, the valuation techniques available under the market approach, income approach and/or cost approach are used. The Company's evaluations are based on market data and the Company employs combinations of these approaches for its valuation methods depending on the asset class.

*Impaired Loans* - Impaired loans are those loans which the Company has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

*Other Real Estate* - Other real estate owned assets are adjusted to fair value less estimated selling costs upon transfer of the loans to other real estate owned. Typically, an external, third-party appraisal is performed on the collateral upon transfer into the other real estate owned account to determine the asset's fair value. Subsequent adjustments to the collateral's value may be based upon either updated third-party appraisals or management's knowledge of the collateral and the current real estate market conditions. Appraised amounts used in determining the asset's fair value, whether internally or externally prepared, are discounted 10 percent to account for selling and marketing costs. Adjustments are routinely made in the appraisal process by the appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are typically significant and result in a level 3 classification of the inputs for determining fair value. Because of the high degree of judgment required in estimating the fair value of other real estate owned assets and because of the relationship between fair value and general economic conditions, we consider the fair value of other real estate owned assets to be highly sensitive to changes in market conditions.

*Assets and Liabilities Measured at Fair Value on a Recurring and Nonrecurring Basis* - The following table presents the recorded amount of the Company's assets measured at fair value on a recurring and nonrecurring basis as of December 31, 2017 and 2016, aggregated by the level in the fair value hierarchy within which those measurements fall. The table below includes only impaired loans with a specific reserve and only other real estate properties with a valuation allowance at December 31, 2017 and 2016. Those impaired loans and other real estate properties are shown net of the related specific reserves and valuation allowances.

**(19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)****Assets (Continued)**

	2017	Fair Value Measurements at Reporting Date Using		
		Total Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
<b>Recurring</b>				
<b>Securities Available for Sale</b>				
U.S. Government Agencies Mortgage-Backed	\$346,723,419	\$ -	\$341,701,288	\$ 5,022,131
State, County and Municipal Corporate	4,492,826	-	4,277,460	215,366
Asset-Backed	2,060,000	-	-	2,060,000
	970,659	-	970,659	-
	<u>\$354,246,904</u>	<u>\$ -</u>	<u>\$346,949,407</u>	<u>\$ 7,297,497</u>
<b>Nonrecurring</b>				
Impaired Loans	<u>\$ 4,875,918</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 4,875,918</u>
Other Real Estate	<u>\$ 2,014,904</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,014,904</u>
	2016			
<b>Recurring</b>				
<b>Securities Available for Sale</b>				
U.S. Government Agencies Mortgage-Backed	\$319,097,374	\$ -	\$319,097,374	\$ -
State, County and Municipal	4,560,496	-	3,984,112	576,384
	<u>\$323,657,870</u>	<u>\$ -</u>	<u>\$323,081,486</u>	<u>\$ 576,384</u>
<b>Nonrecurring</b>				
Impaired Loans	<u>\$ 6,952,343</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 6,952,343</u>
Other Real Estate	<u>\$ 2,505,188</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,505,188</u>

**Liabilities**

The Company did not identify any liabilities that are required to be presented at fair value.

## (19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

### *Fair Value Measurements Using Significant Unobservable Inputs (Level 3)*

The following tables present quantitative information about the significant unobservable inputs used in the fair value measurements for assets in level 3 of the fair value hierarchy measured on a nonrecurring basis at December 31, 2017 and 2016. These tables are comprised primarily of collateral dependent impaired loans and other real estate owned:

	<b>December 31, 2017</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range Weighted Avg</b>
Real Estate				
Commercial Construction	<b>\$427,433</b>	Sales Comparison	Adjustment for Differences Between the Comparable Sales	<b>(16.00)% - 1,975.00%</b> <b>979.50%</b>
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	<b>0.00% - 10.00%</b> <b>5.00%</b>
Residential Real Estate	<b>81,736</b>	Sales Comparison	Adjustment for Differences Between the Comparable Sales	<b>(43.30)% - 83.30%</b> <b>20.00%</b>
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	<b>0.00% - 25.00%</b> <b>12.50%</b>
Commercial Real Estate	<b>4,016,742</b>	Income Approach	Management Adjustments for Age of Appraisals and/or Current Market Conditions	<b>0.00% - 10.00%</b> <b>5.00%</b>
			Capitalization Rate	<b>10.75%</b>
Farmland	<b>350,007</b>	Sales Comparison	Adjustment for Differences Between the Comparable Sales	<b>(71.00)% - 88.70%</b> <b>8.85%</b>
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	<b>10.00% - 75.00%</b> <b>42.50%</b>
Other Real Estate Owned	<b>2,014,904</b>	Sales Comparison	Adjustment for Differences Between the Comparable Sales	<b>(22.74)% - 15.00%</b> <b>(3.87)%</b>
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	<b>5.44% - 87.24%</b> <b>24.44%</b>
		Income Approach	Capitalization Rate	<b>10.00%</b>



**(19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)*****Fair Value Measurements using Significant Unobservable Inputs (Level 3) (Continued)***

	<u>December 31, 2016</u>	<u>Valuation Techniques</u>	<u>Unobservable Inputs</u>	<u>Range Weighted Avg</u>
Real Estate				
Commercial Construction	\$ 51,161	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(5.00)% - 99.00% 47.00%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 10.00% 5.00%
Residential Real Estate	1,105,312	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(22.00)% - 0.00% (11.00)%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 40.00% 20.00%
Commercial Real Estate	5,445,192	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(14.08)% - 24.62% 5.27%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	0.00% - 100.00% 50.00%
		Income Approach	Capitalization Rate	10.67%
Farmland	350,678	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(27.00)% - 15.00% (6.00)%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	10.00% - 75.00% 42.50%
Other Real Estate Owned	2,505,188	Sales Comparison	Adjustment for Differences Between the Comparable Sales	(50.80)% - 316.00% 132.60%
			Management Adjustments for Age of Appraisals and/or Current Market Conditions	6.25% - 76.92% 36.31%
		Income Approach	Discount Rate	12.50%

## (19) Fair Value of Financial Instruments and Fair Value Measurements (Continued)

### *Fair Value Measurements Using Significant Unobservable Inputs (Level 3) (Continued)*

The following table presents a reconciliation and statement of income classification of gains and losses for all assets measured at fair value on a recurring basis using significant unobservable inputs (level 3) for the years ended December 31, 2017, 2016 and 2015:

	<u>Available for Sale Securities</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Balance, Beginning</b>	<b>\$ 576,384</b>	\$ 930,311	\$ 948,390
Transfers into Level 3			-
Transfers out of Level 3			-
Securities Purchased During the Year	<b>7,069,649</b>		-
Securities Matured During the Year	<b>(360,000)</b>	(330,000)	-
Loss on OTTI Impairment Included in Noninterest Income			-
Unrealized Gains(Losses) Included in Other Comprehensive Income	<b>11,464</b>	(23,927)	(18,079)
<b>Balance, Ending</b>	<b><u>\$ 7,297,497</u></b>	<b><u>\$ 576,384</u></b>	<b><u>\$ 930,311</u></b>

The Company's policy is to recognize transfers in and transfers out of levels 1, 2 and 3 as of the end of a reporting period. There were no transfers of securities between level 1 and level 2 or level 3 for the years ended December 31, 2017, 2016 or 2015.

The following table presents quantitative information about recurring level 3 fair value measurements as of December 31, 2017 and 2016:

<b>December 31, 2017</b>	<b>Fair Value</b>	<b>Valuation Techniques</b>	<b>Unobservable Inputs</b>	<b>Range (Weighted Avg)</b>
State, County and Municipal	<b>\$ 215,366</b>	Discounted Cash Flow	Discount Rate or Yield	N/A*
U. S. Government Agencies Mortgage - Backed	<b>5,022,131</b>	Fundamental Analysis	Discount Rate or Yield	N/A*
Corporate	<b>2,060,000</b>	Option Pricing	Discount Rate or Yield	N/A*
December 31, 2016				
State, County and Municipal	\$ 576,384	Discounted Cash Flow	Discount Rate or Yield	N/A*

\* The Company relies on a third-party pricing service to value its securities. The details of the unobservable inputs and other adjustments used by the third-party pricing service were not readily available to the Company.

## **(20) Regulatory Capital Matters**

The amount of dividends payable to the parent company from the subsidiary bank is limited by various banking regulatory agencies. Upon approval by regulatory authorities, the Bank may pay cash dividends to the parent company in excess of regulatory limitations.

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

Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios of total and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. As of December 31, 2017, the interim final Basel III rules (Basel III) require the Company to also maintain minimum amounts and ratios of common equity Tier 1 capital to risk weighted assets. These amounts and ratios as defined in regulations are presented hereafter. Management believes, as of December 31, 2017, the Company meets all capital adequacy requirements to which it is subject under the regulatory framework for prompt corrective action. In the opinion of management, there are no conditions or events since prior notification of capital adequacy from the regulators that have changed the institution's category.

The Basel III rules also require the implementation of a new capital conservation buffer comprised of common equity Tier 1 capital. The capital conservation buffer was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets, with subsequent increases of 0.625% each year until reaching its final level of 2.5% on January 1, 2019.

The following table summarizes regulatory capital information as of December 31, 2017 and December 31, 2016 on a consolidated basis and for the subsidiary, as defined. Regulatory capital ratios for December 31, 2017 and 2016 were calculated in accordance with the Basel III rules.

**(20) Regulatory Capital Matters (Continued)**

The following table summarizes regulatory capital information as of December 31, 2017 and 2016 on a consolidated basis and for its wholly-owned subsidiary, as defined:

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Provisions</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
	(In Thousands)					
Total Capital to Risk-Weighted Assets						
Consolidated	\$127,786	15.56%	\$65,718	8.00%	N/A	N/A
Colony Bank	127,470	15.54	65,628	8.00	\$82,036	10.00%
Tier I Capital to Risk-Weighted Assets						
Consolidated	120,279	14.64	49,289	6.00	N/A	N/A
Colony Bank	119,963	14.62	49,221	6.00	65,628	8.00
Common Equity Tier 1 Capital to Risk-Weighted Assets						
Consolidated	96,779	11.78	36,967	4.50	N/A	N/A
Colony Bank	119,963	14.62	36,916	4.50	53,323	6.50
Tier I Capital to Average Assets						
Consolidated	120,279	9.89	48,635	4.00	N/A	N/A
Colony Bank	119,963	9.88	48,566	4.00	60,708	5.00
Total Capital to Risk-Weighted Assets						
Consolidated	\$130,785	16.64%	\$ 62,880	8.00%	N/A	N/A
Colony Bank	127,646	16.26	62,796	8.00	\$78,495	10.00%
Tier I Capital to Risk-Weighted Assets						
Consolidated	121,862	15.50	47,160	6.00	N/A	N/A
Colony Bank	118,723	15.12	47,097	6.00	62,796	8.00
Common Equity Tier 1 Capital to Risk-Weighted Assets						
Consolidated	89,002	11.32	35,370	4.50	N/A	N/A
Colony Bank	118,723	15.12	35,323	4.50	51,022	6.50
Tier I Capital to Average Assets						
Consolidated	121,862	10.29	47,368	4.00	N/A	N/A
Colony Bank	118,723	10.04	47,290	4.00	59,113	5.00

## **(20) Regulatory Capital Matters (Continued)**

In 2017, the Bank obtained approval of its regulators and paid a \$8,725,000 dividend to the Company. The dividend was utilized to redeem 9,360 shares of Preferred Stock. In 2016, the Bank obtained approval of its regulators and paid a \$9,100,000 dividend to the Company. The dividend was utilized to redeem 8,661 shares of Preferred Stock. In 2015, the Bank obtained approval of its regulators and paid a \$10,000,000 dividend to the Company. The dividend was utilized to redeem 9,979 shares of Preferred Stock.

**(21) Financial Information of Colony Bankcorp, Inc. (Parent Only)**

The parent company's balance sheets as of December 31, 2017 and 2016 and the related statements of operations and comprehensive income (loss) and cash flows for each of the years in the three-year period then ended are as follows:

**COLONY BANKCORP, INC. (PARENT ONLY)**  
**BALANCE SHEETS**  
**DECEMBER 31**

**ASSETS**

	<u>2017</u>	<u>2016</u>
Cash	\$ 910,239	\$ 2,307,008
Premises and Equipment, Net	1,099,626	1,074,884
Investment in Subsidiary, at Equity	114,235,955	114,478,277
Other	24,458	20,990
<b>Total Assets</b>	<b><u>\$116,270,278</u></b>	<b><u>\$117,881,159</u></b>

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**Liabilities**

Other Borrowed Money	\$ 1,500,000	\$ -
Dividends Payable	-	105,300
Other	218,615	159,126
	<b><u>\$ 1,718,615</u></b>	<b><u>\$ 264,426</u></b>
<b>Subordinated Debt</b>	<b><u>24,229,000</u></b>	<b><u>24,229,000</u></b>

**Stockholders' Equity**

Preferred Stock, Stated Value \$1,000; 10,000,000 Shares Authorized, 0 and 9,360 Shares Issued and Outstanding as of December 31, 2017 and 2016	-	9,360,000
Common Stock, Par Value \$1; 20,000,000 Shares Authorized, 8,439,258 Shares Issued and Outstanding as of December 31, 2017 and 2016	8,439,258	8,439,258
Paid-In Capital	29,145,094	29,145,094
Retained Earnings	59,230,260	51,465,521
Accumulated Other Comprehensive Loss, Net of Tax	(6,491,949)	(5,022,140)
	<b><u>90,322,663</u></b>	<b><u>93,387,733</u></b>
<b>Total Liabilities and Stockholders' Equity</b>	<b><u>\$116,270,278</u></b>	<b><u>\$117,881,159</u></b>

(21) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)

COLONY BANKCORP, INC. (PARENT ONLY)  
STATEMENTS OF OPERATIONS  
FOR THE YEARS ENDED DECEMBER 31

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Income</b>			
Dividends from Subsidiary	\$ 8,746,882	\$ 9,118,104	\$10,015,147
Management Fees	601,080	601,080	581,334
Other	97,103	103,612	112,876
	<u>\$9,445,065</u>	<u>\$ 9,822,796</u>	<u>\$10,709,357</u>
<b>Expenses</b>			
Interest	900,113	601,567	503,286
Salaries and Employee Benefits	917,259	840,130	811,150
Other	604,166	554,434	666,872
	<u>2,421,538</u>	<u>1,996,131</u>	<u>1,981,308</u>
<b>Income Before Taxes and Equity in Undistributed Earnings of Subsidiary</b>	<b>7,023,527</b>	<b>7,826,665</b>	<b>8,728,049</b>
Income Tax Benefits	568,258	457,934	444,764
<b>Income Before Equity in Undistributed Earnings of Subsidiary</b>	<b>7,591,785</b>	<b>8,284,599</b>	<b>9,172,813</b>
Dividends Received in Excess of Earnings of Subsidiary	-	-	(800,116)
Equity in Undistributed Earnings of Subsidiary	159,193	388,611	-
<b>Net Income</b>	<b>7,750,978</b>	<b>8,673,210</b>	<b>8,372,697</b>
Preferred Stock Dividends	210,600	1,493,310	2,375,010
<b>Net Income Available to Common Stockholders</b>	<b>\$ 7,540,378</b>	<b>\$ 7,179,900</b>	<b>\$ 5,997,687</b>

**(21) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)**

**COLONY BANKCORP, INC. AND SUBSIDIARY  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE YEARS ENDED DECEMBER 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Net Income</b>	<u><b>\$7,750,978</b></u>	<u>\$8,673,210</u>	<u>\$8,372,697</u>
<b>Other Comprehensive Income (Loss)</b>			
Gains (Losses) on Securities Arising During the Year	<b>(608,355)</b>	(505,367)	610,689
Tax Effect	<b>206,841</b>	171,825	(207,634)
Realized (Gains) Losses on Sale of AFS Securities	-	(385,223)	11,466
Tax Effect	<u>-</u>	<u>130,976</u>	<u>(3,898)</u>
Change in Unrealized Gains (Losses) on Securities Available for Sale, Net of Reclassification Adjustment and Tax Effects	<u><b>(401,514)</b></u>	<u>(587,789)</u>	<u>410,623</u>
<b>Comprehensive Income</b>	<u><u><b>\$7,349,464</b></u></u>	<u><u>\$8,085,421</u></u>	<u><u>\$8,783,320</u></u>



**(21) Financial Information of Colony Bankcorp, Inc. (Parent Only) (Continued)****COLONY BANKCORP, INC. (PARENT ONLY)  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Cash Flows from Operating Activities</b>			
Net Income	\$ 7,750,978	\$ 8,673,210	\$ 8,372,697
Adjustments to Reconcile Net Income to Net Cash Provided by Operating			
Depreciation and Amortization	70,183	66,476	73,999
Equity in Undistributed Earnings of Subsidiary	(159,193)	(388,611)	-
Dividends Received in Excess of Earnings of Subsidiary	-	-	800,116
Change in Interest Payable	17,887	5,367	23,072
Other	38,135	108,288	1,555,482
	<u>7,717,990</u>	<u>8,464,730</u>	<u>10,825,366</u>
<b>Cash Flows from Investing Activities</b>			
Purchases of Premises and Equipment	<u>(94,925)</u>	<u>(6,836)</u>	<u>(8,884)</u>
<b>Cash Flows from Financing Activities</b>			
Proceeds from Other Borrowed Money	5,000,000	-	-
Principal Payments on Other Borrowed	(3,500,000)	-	-
Dividends Paid on Common Stock	(843,934)	-	-
Dividends Paid on Preferred Stock	(315,900)	(1,590,746)	(2,487,274)
Redemption of Preferred Stock	(9,360,000)	(8,661,000)	(9,979,000)
	<u>(9,019,834)</u>	<u>(10,251,746)</u>	<u>(12,466,274)</u>
<b>Increase (Decrease) in Cash</b>	<b>(1,396,769)</b>	<b>(1,793,852)</b>	<b>(1,649,792)</b>
<b>Cash, Beginning</b>	<u>2,307,008</u>	<u>4,100,860</u>	<u>5,750,652</u>
<b>Cash, Ending</b>	<u>\$ 910,239</u>	<u>\$ 2,307,008</u>	<u>\$ 4,100,860</u>

## (22) Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during each period. Diluted earnings per share reflects the potential dilution of common stock warrants. Net income available to common stockholders represents net income after preferred stock dividends. The following table presents earnings per share for the years ended December 31, 2017, 2016 and 2015:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Numerator</b>			
Net Income Available to Common Stockholders	<u><u>\$ 7,540,378</u></u>	<u><u>\$ 7,179,900</u></u>	<u><u>\$ 5,997,687</u></u>
<b>Denominator</b>			
Weighted Average Number of Common Shares Outstanding for Basic Earnings Per Common Share	<u><u>8,439,258</u></u>	<u><u>8,439,258</u></u>	<u><u>8,439,258</u></u>
Dilutive Effect of Potential Common Stock Stock Warrants	<u><u>194,323</u></u>	<u><u>74,037</u></u>	<u><u>19,203</u></u>
Weighted-Average Number of Shares Outstanding for Diluted Earnings Per Common Share	<u><u>8,633,581</u></u>	<u><u>8,513,295</u></u>	<u><u>8,458,461</u></u>
Earnings Per Share - Basic	<u><u>\$ 0.89</u></u>	<u><u>\$ 0.85</u></u>	<u><u>\$ 0.71</u></u>
Earnings Per Share - Diluted	<u><u>\$ 0.87</u></u>	<u><u>\$ 0.84</u></u>	<u><u>\$ 0.71</u></u>

## (23) Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) for unrealized gains and losses securities available for sale for the years ended December 31, 2017, 2016 and 2015 are as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Beginning Balance</b>	<u><u>\$ (5,022,140)</u></u>	<u><u>\$ (4,434,351)</u></u>	<u><u>\$ (4,844,974)</u></u>
Other Comprehensive Income Before Reclassification	<u><u>(401,514)</u></u>	<u><u>(333,542)</u></u>	<u><u>403,055</u></u>
Amounts Reclassified from Accumulated Other Comprehensive Income TCJ Act	<u><u>-</u></u> <u><u>(1,068,295)</u></u>	<u><u>(254,247)</u></u> <u><u>-</u></u>	<u><u>7,568</u></u> <u><u>-</u></u>
Net Current Period Other Comprehensive Income	<u><u>(1,469,809)</u></u>	<u><u>(587,789)</u></u>	<u><u>410,623</u></u>
<b>Ending Balance</b>	<u><u>\$ (6,491,949)</u></u>	<u><u>\$ (5,022,140)</u></u>	<u><u>\$ (4,434,351)</u></u>

## Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this Annual Report that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the Act), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in the Company's future filings with the SEC, in press releases, and in oral and written statements made by or with the approval of the Company that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include, but are not limited to: (i) projections of revenues, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital structure and other financial items; (ii) statements of plans and objectives of Colony Bankcorp, Inc. or its management or Board of Directors, including those relating to products or services; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "anticipates," "expects," "intends," "targeted" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include, but are not limited to:

- Local and regional economic conditions and the impact they may have on the Company and its customers and the Company's assessment of that impact;
- Changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- The effects of and changes in trade, monetary and fiscal policies and laws, including interest rate policies of the Federal Reserve Board;
- Inflation, interest rate, market and monetary fluctuations;
- Political instability;
- Acts of war or terrorism;
- The timely development and acceptance of new products and services and perceived overall value of these products and services by users;
- Changes in consumer spending, borrowings and savings habits;
- Technological changes;
- Acquisitions and integration of acquired businesses;
- The ability to increase market share and control expenses;

- The effect of changes in laws and regulations (including laws and regulations concerning taxes, banking, securities and insurance) with which the Company and its subsidiaries must comply;
- The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Financial Accounting Standards Board and other accounting standard setters;
- Changes in the Company's organization, compensation and benefit plans;
- The costs and effects of litigation and of unexpected or adverse outcomes in such litigation;
- Greater than expected costs or difficulties related to the integration of new lines of business; and
- The Company's success at managing the risks involved in the foregoing items.

Forward-looking statements speak only as of the date on which such statements are made. The Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events.

### **Future Outlook**

During the recent financial crisis, the financial industry experienced tremendous adversities as a result of the collapse of the real estate markets across the country. Colony, like most banking companies, has been affected by these economic challenges that started with a rapid stall of real estate sales and developments throughout the country. While much has been accomplished in addressing problem assets the past several years, there is still work to be done in bringing our problem assets to an acceptable level. A focus in 2018 will be directed toward further reduction of problem assets.

As we look forward to 2018 we are committed to improving earnings and reducing problem assets. Given the improved condition of the company we are also considering product and market expansion. In January 2017, the Company opened its third office in Savannah. Currently, the Company is performing due diligence on a property for a new office in Statesboro.

While the Company has improved earnings, reduced problem assets and maintained strong capital levels, we have reinstated dividend payments beginning first quarter 2017. The Company's board of directors suspended the payment of dividends in the third quarter of 2009.

We continue to explore opportunities to improve core non-interest income. Revenue enhancement initiatives to accomplish this include new product lines and services. The Company will also invest in new technology with implementation of a new loan platform which will offer much efficiency with our "back-office" operations.

In addition, we continue to make efforts to attract and retain top talent to improve business operations. To that end, the Company entered into Retention Agreements with members of management in the first quarter of 2015. The Company expects that these agreements will facilitate the retention of key individuals responsible for maintaining current operations and spearheading future product and market expansion.

## Tax Cuts and Jobs Act

On December 22, 2017, the Tax Cuts and Jobs Act (the “TCJ Act”) was enacted. The TCJ Act made broad changes to the U.S. tax code, including, but not limited to, a reduction of the U.S. federal corporate tax rate to 21 percent. As a result of the enactment of the TCJ Act, we have remeasured our deferred tax assets and liabilities based upon the new U.S. statutory federal income tax rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. We recognized additional income tax expense of \$2,040,946 in the fourth quarter of 2017 related to the remeasurement of our deferred tax assets and liabilities. Currently, we are still analyzing certain aspects of the new law and refining our calculations, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. The table below illustrates the effect the additional tax expense resulting from the TCJ Act had on our results of operations for the year ended December 31, 2017.

	2017 As Reported	TCJ Act Impact	2017 Adjusted (Non-GAAP)
Net Income	\$ 7,751	\$ (2,041)	\$ 9,792
Earnings Per Share	\$ 0.89	\$ (0.27)	\$ 1.16
Return on Average Assets <sup>(1)</sup>	0.63%	(0.19)	0.80%
Return on Average Equity <sup>(1)</sup>	8.28%	(2.24)	10.52%

(1) Computed using Net Income Available to Common Stockholders.

## Non-GAAP Financial Measures

Our accounting and reporting policies conform to generally accepted accounting principles (GAAP) in the United States and prevailing practices in the banking industry. However, certain non-GAAP measures are used by management to supplement the evaluation of our performance. These include the fully-taxable equivalent measures: tax-equivalent net interest income, tax-equivalent net interest margin and tax-equivalent net interest spread, which include the effects of taxable-equivalent adjustments using a federal income tax rate of 34% to increase tax-exempt interest income to a tax-equivalent basis. Tax-equivalent adjustments are reported in Notes 1 and 2 to the Average Balances with Average Yields and Rates table under Rate/Volume Analysis. Tangible book value per common share is also a non-GAAP measure used in the selected Financial Data Section.

*Tax-equivalent net interest income, net interest margin and net interest spread.* Net interest income on a tax-equivalent basis is a non-GAAP measure that adjusts for the tax-favored status of net interest income from loans and investments. We believe this measure to be the preferred industry measurement of net interest income and it enhances comparability of net interest income arising from taxable and tax-exempt sources. The most directly comparable financial measure calculated in accordance with GAAP is our net interest income. Net interest margin on a tax-equivalent basis is net interest income on a tax-equivalent basis divided by average interest-earning assets on a tax-equivalent basis. The most directly comparable financial measure calculated in accordance with GAAP is our net interest margin. Net interest spread on a tax-equivalent basis is the difference in the average yield on average interest-earning assets on a tax equivalent basis and the average rate paid on average interest-bearing liabilities. The most directly comparable financial measure calculated in accordance with GAAP is our net interest spread.

## Non-GAAP Financial Measures (Continued)

These non-GAAP financial measures should not be considered alternatives to GAAP-basis financial statements, and other bank holding companies may define or calculate these non-GAAP measures or similar measures differently.

A reconciliation of these performance measures to GAAP performance measures is included in the tables below.

### Non-GAAP Performance Measures Reconciliation

	Years Ended December 31,				
	2017	2016	2015	2014	2013
	(Dollars in Thousands, except per share data)				
<b>Interest Income Reconciliation</b>					
Interest Income – Taxable Equivalent	\$ 46,079	\$ 44,762	\$ 44,407	\$ 44,879	\$ 45,356
Tax Equivalent Adjustment	(163)	(173)	(132)	(117)	(170)
Interest Income (GAAP)	<u>\$ 45,916</u>	<u>\$ 44,589</u>	<u>\$ 44,275</u>	<u>\$ 44,762</u>	<u>\$ 45,186</u>
<b>Net Interest Income Reconciliation</b>					
Net Interest Income – Taxable Equivalent	\$ 39,206	\$ 38,279	\$ 37,838	\$ 38,080	\$ 37,859
Tax Equivalent Adjustment	(163)	(173)	(132)	(117)	(170)
Net Interest Income (GAAP)	<u>\$ 39,043</u>	<u>\$ 38,106</u>	<u>\$ 37,706</u>	<u>\$ 37,963</u>	<u>\$ 37,689</u>
<b>Net Interest Margin Reconciliation</b>					
Net Interest Margin – Taxable Equivalent	3.46%	3.51%	3.52%	3.60%	3.61%
Tax Equivalent Adjustment	(0.02)	(.02)	(.01)	(.01)	(.02)
Net Interest Margin (GAAP)	<u>3.44%</u>	<u>3.49%</u>	<u>3.51%</u>	<u>3.59%</u>	<u>3.59%</u>
<b>Interest Rate Spread Reconciliation</b>					
Interest Rate Spread – Taxable Equivalent	3.34%	3.40%	3.41%	3.49%	3.50%
Tax Equivalent Adjustment	(0.02)	(.02)	(.01)	(.01)	(.02)
Interest Rate Spread (GAAP)	<u>3.32%</u>	<u>3.38%</u>	<u>3.40%</u>	<u>3.48%</u>	<u>3.48%</u>
<b>Selected Financial Data</b>					
Tangible Book Value Per Common Share	\$ 10.69	\$ 9.95	\$ 9.16	\$ 8.40	\$ 7.32
Effect of Other Intangible Assets	0.01	0.01	0.02	0.02	0.02
Book Value Per Common Share (GAAP)	<u>\$ 10.70</u>	<u>\$ 9.96</u>	<u>\$ 9.18</u>	<u>\$ 8.42</u>	<u>\$ 7.34</u>

## **The Company**

Colony Bankcorp, Inc. (“Colony” or the “Company”) is a bank holding company headquartered in Fitzgerald, Georgia that provides, through its wholly-owned subsidiary Colony Bank (collectively referred to as the Company), a broad array of products and services throughout central, south and coastal Georgia markets. The Company offers commercial, consumer and mortgage banking services.

### **Overview**

The following discussion and analysis presents the more significant factors affecting the Company’s financial condition as of December 31, 2017 and 2016, and results of operations for each of the years in the three-year period ended December 31, 2017. This discussion and analysis should be read in conjunction with the Company’s consolidated financial statements, notes thereto and other financial information appearing elsewhere in this report.

Taxable-equivalent adjustments are the result of increasing income from tax-free loans and investments by an amount equal to the taxes that would be paid if the income were fully taxable based on a 34 percent federal tax rate, thus making tax-exempt yields comparable to taxable asset yields.

Dollar amounts in tables are stated in thousands, except for per share amounts.

## Results of Operations

The Company'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 market forces and economic conditions beyond the control of the Company determine interest rates, the ability to generate net interest income is dependent upon the Company'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 for net interest income is the interest margin or net yield, which is taxable-equivalent net interest income divided by average interest-earning assets. Net income available to common shareholders totaled \$7.54 million, or \$0.87 per diluted shares in 2017, compared to \$7.18 million, or \$0.84 per diluted common share in 2016 and compared to \$6.00 million, or \$0.71 per diluted common share in 2015.

Selected income statement data, returns on average assets and average equity and dividends per share for the comparable periods were as follows:

			\$	%			\$	%
	2017	2016	Variance	Variance	2016	2015	Variance	Variance
Taxable-equivalent net interest income	\$ 39,206	\$ 38,279	\$ 927	2.42%	\$ 38,279	\$ 37,838	\$ 441	1.17%
Taxable-equivalent adjustment	163	173	(10)	(5.78)	173	132	41	31.06
Net interest income	39,043	38,106	937	2.46	38,106	37,706	400	1.06
Provision for loan losses	390	1,062	(672)	(63.28)	1,062	866	196	22.63
Noninterest income	9,735	9,553	182	1.91	9,553	9,045	508	5.62
Noninterest expense	33,860	34,073	(213)	(0.63)	34,073	33,724	349	1.03
Income before income taxes	\$ 14,528	\$ 12,524	\$ 2,004	16.00%	\$ 12,524	\$ 12,161	\$ 363	2.98%
Income Taxes	6,777	3,851	2,926	75.98	3,851	3,788	63	1.66
Net income	\$ 7,751	\$ 8,673	\$ (922)	(10.63)%	\$ 8,673	\$ 8,373	\$ 300	3.58%
Preferred stock dividends	\$ 211	\$ 1,493	\$ (1,282)	(85.87)%	\$ 1,493	\$ 2,375	\$ (882)	(37.14)%
Net income available to common shareholders	\$ 7,540	\$ 7,180	\$ 360	5.01%	\$ 7,180	\$ 5,998	\$ 1,182	19.71%
Net income available to common shareholders:								
Basic	\$ 0.89	\$ 0.85	\$ 0.04	4.71%	\$ 0.85	\$ 0.71	\$ 0.14	19.72%
Diluted	\$ 0.87	\$ 0.84	\$ 0.03	3.57%	\$ 0.84	\$ 0.71	\$ 0.13	18.31%
Return on average assets (1)	0.63%	0.62%	0.01%	1.61%	0.62%	0.52%	0.10%	19.23%
Return on average common equity (1)	8.28%	7.17%	1.11%	15.48%	7.17%	5.90%	1.27%	21.53%

(1) Computed using net income available to common shareholders.



## Net Interest Income

Net interest income is the difference between interest income on earning assets, such as loans and securities, and interest expense on liabilities, such as deposits and borrowings, which are used to fund those assets. Net interest income is the Company's largest source of revenue, representing 80.04 percent of total revenue during 2017, 79.96 percent of total revenue during 2016, and 80.65 percent of total revenue during 2015.

Net interest margin is the taxable-equivalent net interest income as a percentage of average interest-earning assets for the period. The level of interest rates and the volume and mix of interest-earning assets and interest-bearing liabilities impact net interest income and net interest margin.

The Company's loan portfolio is significantly affected by changes in the prime interest rate. The prime interest rate, which is the rate offered on loans to borrowers with strong credit, is currently 4.50 percent. The Federal Reserve Board sets general market rates of interest, including the deposit and loan rates offered by many financial institutions. For the first time in several years, the prime interest rate increased by 25 basis points in the fourth quarter of 2015, followed by a similar 25-point increase in the fourth quarter of 2016. During 2017, the prime interest rate increased overall by 75 basis points. Given that the federal funds rate moves in accordance with the movement of the prime interest rate, we anticipate that the federal funds rate will also increase from its current 1.5 percent.

The following table presents the changes in taxable-equivalent net interest income and identifies the changes due to differences in the average volume of interest-earning assets and interest-bearing liabilities and the changes due to changes in the average interest rate on those assets and liabilities. The changes in net interest income due to changes in both average volume and average interest rate have been allocated to the average volume change or the average interest rate change in proportion to the absolute amounts of the change in each. The Company's consolidated average balance sheets along with an analysis of taxable-equivalent net interest earnings are presented in the Rate/Volume Analysis.

## Rate/Volume Analysis

The rate/volume analysis presented hereafter illustrates the change from year to year for each component of the taxable equivalent net interest income separated into the amount generated through volume changes and the amount generated by changes in the yields/rates.

	Changes From 2016 to 2017 (a)			Changes From 2015 to 2016 (a)		
	Volume	Rate	Total	Volume	Rate	Total
Interest Income						
Loans, Net-Taxable	\$ 72	\$ (407)	\$ (335)	\$ 221	\$ (951)	\$ (730)
Investment Securities						
Taxable	769	770	1,539	381	669	1,050
Tax-Exempt	(5)	(9)	(14)	12	(15)	(3)
Total Investment Securities	764	761	1,525	393	654	1,047
Interest-Bearing Deposits in						
Other Banks	(12)	120	108	(18)	62	44
Federal Funds Sold	-	-	-	(15)	-	(15)
Other Interest - Earning Assets	12	7	19	4	5	9
Total Interest Income	836	481	1,317	585	(230)	355
Interest Expense						
Interest-Bearing Demand and						
Savings Deposits	174	28	202	137	62	199
Time Deposits	(240)	15	(225)	(271)	(4)	(275)
Total Interest Expense						
On Deposits	(66)	43	(23)	(134)	58	(76)
Other Interest-Bearing Liabilities						
Subordinated Debentures	-	126	126	-	98	98
Other Debt	231	54	285	74	(183)	(109)
Federal Funds Purchased	4	(2)	2	-	1	1
Total Interest Expense	169	221	390	(60)	(26)	(86)
Net Interest Income (Loss)	\$ 667	\$ 260	\$ 927	\$ 645	\$ (204)	\$ 441

- (a) Changes in net interest income for the periods, based on either changes in average balances or changes in average rates for interest-earning assets and interest-bearing liabilities, are shown on this table. During each year there are numerous and simultaneous balance and rate changes; therefore, it is not possible to precisely allocate the changes between balances and rates. For the purpose of this table, changes that are not exclusively due to balance changes or rate changes have been attributed to rates.

The Company maintains about 22.6 percent of its loan portfolio in adjustable rate loans that reprice with prime rate changes, while the bulk of its other loans mature within 3 years. The liabilities to fund assets are primarily in non-maturing core deposits and short term certificates of deposit that mature within one year. The Federal Reserve rates have remained flat since 2008 until the 25 basis point increase in the fourth quarter of 2015 and 2016 followed by the 75 basis point increase during 2017. We have seen the net interest margin change to 3.46 percent for 2017, compared to 3.51 percent for 2016 and 3.52 percent for 2015. We have seen our net interest margin reach a low of 3.35 percent in first quarter of 2017 to a high of 3.50 percent in the third and fourth quarters 2017.

Taxable-equivalent net interest income for 2017 increased by \$927 thousand, or 2.42 percent, compared to 2016 while taxable-equivalent net interest income for 2016 increased by \$441 thousand, or 1.17 percent compared to 2015. The average volume of interest-earning assets during 2017 increased \$42.73 million compared to 2016 while over the same period the net interest margin dropped to 3.46 percent from 3.51 percent. The average volume of interest-earning assets during 2016 increased \$16.41 million compared to 2015 while over the same period the net interest margin dropped to 3.51 percent from 3.52 percent. The change in the net interest margin in 2017 was primarily driven by a higher level of low yielding assets offset by an increase in the cost of funds. The change in the net interest margin in 2016 was primarily driven by reduction in the cost of funds and a higher level of low yielding assets. The increase in average interest-earning assets in 2017 was primarily in investments. The increase in average interest-earning assets in 2016 was in loans, investments and other interest-earning assets.

The average volume of loans increased \$1.41 million in 2017 compared to 2016 and increased \$4.20 million in 2016 compared to 2015. The average yield on loans decreased 5 basis points in 2017 compared to 2016 and decreased 13 basis points in 2016 compared to 2015. The average volume of deposits increased \$36.78 million in 2017 compared to 2016. The average volume of deposits increased \$17.35 million in 2016 compared to 2015. Demand deposits made up \$18.59 million of the increase in average deposits in 2017 compared to \$11.80 million of the increase in average deposits in 2016.

Accordingly, the ratio of average interest-bearing deposits to total average deposits was 84.6 percent in 2017, 85.9 percent in 2016 and 86.8 percent in 2015. This deposit mix, combined with a general decrease in interest rates, had the effect of (i) decreasing the average cost of total deposits by 2 basis points in 2017 compared to 2016 and decreasing the average cost of total deposits by 2 basis points in 2016 compared to 2015, and (ii) mitigating a portion of the impact of decreasing yields on interest-earning assets on the Company's net interest income.

The Company's net interest spread, which represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities, was 3.34 percent in 2017 compared to 3.40 percent in 2016 and 3.41 percent in 2015. The net interest spread, as well as the net interest margin, will be impacted by future changes in short-term and long-term interest rate levels, as well as the impact from the competitive environment. A discussion of the effects of changing interest rates on net interest income is set forth in *Market Risk and Interest Rate Sensitivity* included elsewhere in this report.

## Rate/Volume Analysis (Continued)

### AVERAGE BALANCE SHEETS

	2017			2016			2015		
	Average Balances	Income/Expense	Yields/Rates	Average Balances	Income/Expense	Yields/Rates	Average Balances	Income/Expense	Yields/Rates
Assets									
Interest-Earning Assets									
Loans, Net of Unearned Income (1)	\$ 762,554	\$ 38,749	5.08%	\$ 761,149	\$ 39,084	5.13%	\$ 756,953	\$ 39,814	5.26%
Investment Securities									
Taxable	344,790	6,867	1.99	301,357	5,328	1.77	276,807	4,278	1.55
Tax-Exempt (2)	2,310	81	3.51	2,440	95	3.89	2,171	98	4.51
Total Investment Securities	347,100	6,948	2.00	303,797	5,423	1.79	278,978	4,376	1.57
Interest-Bearing Deposits	20,920	232	1.11	23,167	124	0.54	29,815	80	0.27
Federal Funds Sold	-	-	-	-	-	-	6,056	15	0.25
Other Interest-Earning Assets	3,126	150	4.80	2,854	131	4.59	2,754	122	4.43
Total Interest-Earning Assets	1,133,700	46,079	4.06%	1,090,967	44,762	4.10	1,074,556	44,407	4.13
Noninterest-Earning Assets									
Cash	20,587			19,208			19,049		
Allowance for Loan Losses	(8,442)			(9,372)			(8,587)		
Other Assets	54,786			63,060			61,966		
Total Noninterest-Earning Assets	66,931			72,896			72,428		
Total Assets	\$ 1,200,631			\$ 1,163,863			\$ 1,146,984		
Liabilities and Stockholders' Equity									
Interest-Bearing Liabilities									
Interest-Bearing Demand and Savings	\$ 517,974	\$ 1,896	0.37%	\$ 469,740	\$ 1,694	0.36%	\$ 430,731	\$ 1,495	0.35%
Other Time	353,587	2,862	0.81	383,628	3,087	0.80	417,080	3,362	0.81
Total Interest-Bearing Deposits	871,561	4,758	0.55	853,368	4,781	0.56	847,811	4,857	0.57
Other Interest-Bearing Liabilities									
Other Borrowed Money	51,388	1,385	2.70	42,470	1,100	2.59	40,000	1,209	3.02
Subordinated Debentures	24,229	727	3.00	24,229	601	2.48	24,229	503	2.08
Federal Funds Purchased and Repurchase Agreements	178	3	1.69	35	1	2.86	3	-	-
Total Other Interest-Bearing Liabilities	75,795	2,115	2.79	66,734	1,702	2.55	64,232	1,712	2.67
Total Interest-Bearing Liabilities	947,356	6,873	0.73	920,102	6,483	0.70	912,043	6,569	0.72
Noninterest-Bearing Liabilities and Stockholders' Equity									
Demand Deposits	158,924			140,338			128,541		
Other Liabilities	3,306			3,309			4,690		
Stockholders' Equity	91,045			100,114			101,710		
Total Noninterest-Bearing Liabilities and Stockholders' Equity	253,275			243,761			234,941		
Total Liabilities and Stockholders' Equity	\$ 1,200,631			\$ 1,163,863			\$ 1,146,984		
Interest Rate Spread			3.34%			3.40%			3.41%
Net Interest Income	\$ 39,206			\$ 38,279			\$ 37,838		
Net Interest Margin			3.46%			3.51%			3.52%

- (1) The average balance of loans includes the average balance of nonaccrual loans. Income on such loans is recognized and recorded on the cash basis. Taxable equivalent adjustments totaling \$135, \$141 and \$99 for 2017, 2016 and 2015, respectively, are included in interest on loans. The adjustments are based on a federal tax rate of 34 percent.
- (2) Taxable-equivalent adjustments totaling \$28, \$32 and \$33 for 2017, 2016 and 2015, respectively, are included in tax-exempt interest on investment securities. The adjustments are based on a federal tax rate of 34 percent with appropriate reductions for the effect of disallowed interest expense incurred in carrying tax-exempt obligations.

## Provision for Loan Losses

The provision for loan losses is determined by management as the amount to be added to the allowance for loan losses after net charge-offs have been deducted to bring the allowance to a level which, in management's best estimate, is necessary to absorb probable losses within the existing loan portfolio. The provision for loan losses totaled \$390 thousand in 2017 compared to \$1.06 million in 2016 and \$866 thousand in 2015. See the section captioned "Allowance for Loan Losses" elsewhere in this discussion for further analysis of the provision for loan losses.

## Noninterest Income

The components of noninterest income were as follows:

	<u>2017</u>	<u>2016</u>	<u>\$</u> <u>Variance</u>	<u>%</u> <u>Variance</u>	<u>2016</u>	<u>2015</u>	<u>\$</u> <u>Variance</u>	<u>%</u> <u>Variance</u>
Service Charges on Deposit Accounts	\$ 4,467	\$ 4,307	\$ 160	3.71%	\$ 4,307	\$ 4,269	\$ 38	0.89%
Other Charges, Commissions and Fees	3,040	2,803	237	8.46	2,803	2,627	176	6.70
Mortgage Fee Income	859	682	177	25.95	682	527	155	29.41
Securities Gains (Losses)	-	385	(385)	(100.00)	385	(11)	396	3,600.00
Other	1,369	1,377	(8)	(0.58)	1,377	1,633	(256)	(15.68)
Total	<u>\$ 9,735</u>	<u>\$ 9,554</u>	<u>\$ 181</u>	<u>1.89%</u>	<u>\$ 9,554</u>	<u>\$ 9,045</u>	<u>\$ 509</u>	<u>5.63%</u>

*Other Charges, Commissions and Fees.* Significant amounts impacting the comparable periods was primarily attributed to ATM and debit card interchange fees which increased \$209 thousand in 2017 compared to 2016 and \$184 thousand in 2016 compared to 2015.

*Mortgage Fee Income.* The increase in mortgage fee income in 2017 compared to the same period in 2016 is due to an increase in the volume of mortgage loans.

*Securities Gains (Losses).* The decrease in 2017 is attributable to no sale of securities in 2017 compared to a gain on sale of securities in 2016.

*Other.* The Bank did not have any significant changes for 2017 compared to 2016. Significant amounts impacting the comparable periods was primarily attributed to having income from the sale of a tax credit of \$66 thousand and life insurance benefits of \$137 that did not occur in 2016 when compared to 2015.

## Noninterest Expense

The components of noninterest expense were as follows:

			\$	%			\$	%
	2017	2016	Variance	Variance	2016	2015	Variance	Variance
Salaries and Employee Benefits	\$ 19,223	\$ 18,483	\$ 740	4.00%	\$ 18,483	\$ 17,590	\$ 893	5.08%
Occupancy and Equipment	3,948	3,970	(22)	(0.55)	3,970	3,989	(19)	(0.48)
Directors' Fees	298	349	(51)	(14.61)	349	358	(9)	(2.51)
Legal and Professional Fees	894	792	102	12.88	792	738	54	7.32
Foreclosed Property	363	1,143	(780)	(68.24)	1,143	1,683	(540)	(32.09)
FDIC Assessment	387	604	(217)	(35.93)	604	899	(295)	(32.81)
Advertising	350	610	(260)	(42.62)	610	625	(15)	(2.40)
Software	1,192	1,112	80	7.19	1,112	993	119	11.98
Telephone	814	737	77	10.45	737	710	27	3.80
ATM/Card Processing	1,467	1,136	331	29.14	1,136	1,061	75	7.07
Other	4,924	5,137	(213)	(4.15)	5,137	5,078	59	1.16
Total	<u>\$ 33,860</u>	<u>\$ 34,073</u>	<u>\$ (213)</u>	<u>(0.63)%</u>	<u>\$ 34,073</u>	<u>\$ 33,724</u>	<u>\$ 349</u>	<u>1.03%</u>

*Salaries and Employee Benefits.* The increase in salary and employee benefits for 2017 and 2016 is due to merit pay increases.

*Foreclosed Property.* The decrease in foreclosed property and repossession expense for 2017 and 2016 is primarily attributable to the decrease in the volume of OREO.

*Advertising.* The decrease in advertising expense for 2017 is due to management changing its approach to advertising by decreasing its television ads.

*ATM/Card Processing.* The increase is proportional to the Bank's increase in deposits and to ATM and debit card interchange fees.

## Sources and Uses of Funds

The following table illustrates, during the years presented, the mix of the Company's funding sources and the assets in which those funds are invested as a percentage of the Company's average total assets for the period indicated. Average assets totaled \$1.20 billion in 2017 compared to \$1.16 billion in 2016 and \$1.15 billion in 2015.

	2017		2016		2015	
Sources of Funds:						
Deposits:						
Noninterest-Bearing	\$ 158,924	13.24%	\$ 140,338	12.1%	\$ 128,541	11.2%
Interest-Bearing	871,561	72.59%	853,368	73.3%	847,811	73.9%
Federal Funds Purchased and Repurchase Agreements	178	0.01%	35	- %	3	- %
Subordinated Debentures and Other Borrowed Money	75,617	6.30%	66,699	5.7%	64,229	5.6%
Other Noninterest-Bearing Liabilities	3,306	0.28%	3,309	0.3%	4,690	0.4%
Equity Capital	91,045	7.58%	100,114	8.6%	101,710	8.9%
<b>Total</b>	<b>\$ 1,200,631</b>	<b>100.00%</b>	<b>\$ 1,163,863</b>	<b>100.0%</b>	<b>\$ 1,146,984</b>	<b>100.0%</b>
Uses of Funds:						
Loans (Net of Allowance)	\$ 754,112	62.81%	\$ 751,777	64.6%	\$ 748,366	65.3%
Investment Securities	347,100	28.91%	303,797	26.1%	278,978	24.3%
Federal Funds Sold	-	- %	-	- %	6,056	0.5%
Interest-Bearing Deposits	20,920	1.74%	23,167	2.0%	29,815	2.6%
Other Interest-Earning Assets	3,126	0.26%	2,854	0.2%	2,754	0.2%
Other Noninterest-Earning Assets	75,373	6.28%	82,268	7.1%	81,015	7.1%
<b>Total</b>	<b>\$ 1,200,631</b>	<b>100.00%</b>	<b>\$ 1,163,863</b>	<b>100.0%</b>	<b>\$ 1,146,984</b>	<b>100.0%</b>

Deposits continue to be the Company's primary source of funding. Over the comparable periods, the relative mix of deposits continues to be high in interest-bearing deposits. Interest-bearing deposits totaled 84.6 percent of total average deposits in 2017 compared to 85.9 percent in 2016 and 86.8 percent in 2015.

The Company primarily invests funds in loans and securities. Loans continue to be the largest component of the Company's mix of invested assets. Loan demand increased in 2017 as total loans were \$765.3 million at December 31, 2017, up 1.46 percent, compared to loans of \$754.3 million at December 31, 2016, which went down 0.57 percent, compared to loans of \$758.6 million at December 31, 2015. See additional discussion regarding the Company's loan portfolio in the section captioned "Loans" on the following page. The majority of funds provided by deposits have been invested in loans and securities.

## Loans

The following table presents the composition of the Company's loan portfolio as of December 31 for the past five years.

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
<b>Commercial and Agricultural</b>					
Commercial	\$ 48,122	\$ 47,025	\$ 47,782	\$ 50,960	\$ 48,107
Agricultural	16,443	17,080	19,193	16,689	10,666
<b>Real Estate</b>					
Commercial Construction	45,214	30,358	40,107	51,259	52,739
Residential Construction	8,583	11,830	9,413	11,221	6,549
Commercial	351,172	349,090	346,262	332,231	341,783
Residential	194,049	195,580	197,002	203,753	206,258
Farmland	67,768	66,877	61,780	49,951	47,034
<b>Consumer and Other</b>					
Consumer	18,956	19,695	20,605	22,820	25,676
Other	14,977	16,748	16,492	7,210	12,406
	<u>765,284</u>	<u>754,283</u>	<u>758,636</u>	<u>746,094</u>	<u>751,218</u>
Unearned Interest and Fees	(495)	(361)	(357)	(362)	(360)
Allowances for Loan Losses	<u>(7,508)</u>	<u>(8,923)</u>	<u>(8,604)</u>	<u>(8,802)</u>	<u>(11,806)</u>
<b>Loans</b>	<u><u>\$ 757,281</u></u>	<u><u>\$ 744,999</u></u>	<u><u>\$ 749,675</u></u>	<u><u>\$ 736,930</u></u>	<u><u>\$ 739,052</u></u>

The following table presents total loans as of December 31, 2017 according to maturity distribution and/or repricing opportunity on adjustable rate loans.

### Maturity and Repricing Opportunity

One Year or Less	<b>\$279,145</b>
After One Year through Three Years	<b>270,161</b>
After Three Years through Five Years	<b>169,049</b>
Over Five Years	<u><b>46,929</b></u>
	<u><u><b>\$765,284</b></u></u>

*Overview.* Loans totaled \$765.3 million at December 31, 2017 up 1.46 percent from 754.3 million at December 31, 2016. The majority of the Company's loan portfolio is comprised of the real estate loans. Commercial and residential real estate which is primarily 1-4 family residential properties and nonfarm nonresidential properties, made up 71.24 percent and 72.21 percent of total loans, real estate construction loans made up 7.03 percent and 5.59 percent while commercial and agricultural loans made up 8.44 percent and 8.50 percent of total loans at December 31, 2017 and December 31, 2016, respectively.



*Loan Origination/Risk Management.* In accordance with the Company's decentralized banking model, loan decisions are made at the local bank level. The Company utilizes both an Executive Loan Committee and a Director Loan Committee to assist lenders with the decision making and underwriting process of larger loan requests. Due to the diverse economic markets served by the Company, evaluation and underwriting criterion may vary slightly by market. Overall, loans are extended after a review of the borrower's repayment ability, collateral adequacy, and overall credit worthiness.

Commercial purpose, commercial real estate, and agricultural loans are underwritten similarly to how other loans are underwritten throughout the Company. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. In addition, the Company restricts total loans to \$10 million per borrower, subject to exception and approval by the Director Loan Committee. This diversity helps reduce the company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans monthly based on collateral, geography, and risk grade criteria. The Company also utilizes information provided by third-party agencies to provide additional insight and guidance about economic conditions and trends affecting the markets it serves.

The Company extends loans to builders and developers that are secured by non-owner occupied properties. In such cases, the Company reviews the overall economic conditions and trends for each market to determine the desirability of loans to be extended for residential construction and development. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim mini-perm loan commitment from the Company until permanent financing is obtained. In some cases, loans are extended for residential loan construction for speculative purposes and are based on the perceived present and future demand for housing in a particular market served by the Company. These loans are monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, general economic conditions and trends, the demand for the properties, and the availability of long-term financing.

The Company originates consumer loans at the bank level. Due to the diverse economic markets served by the Company, underwriting criterion may vary slightly by market. The Company is committed to serving the borrowing needs of all markets served and, in some cases, adjusts certain evaluation methods to meet the overall credit demographics of each market. Consumer loans represent relatively small loan amounts that are spread across many individual borrowers to help minimize risk. Additionally, consumer trends and outlook reports are reviewed by management on a regular basis.

The Company utilizes an independent third party company for loan review and validation of the credit risk program on an ongoing quarterly basis. Results of these reviews are presented to management and the audit committee. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

*Commercial and Agricultural.* Commercial and agricultural loans at December 31, 2017 increased 0.78 percent to \$64.6 million from December 31, 2016 at \$64.1 million. The Company's commercial and agricultural loans are a diverse group of loans to small, medium and large businesses. The purpose of these loans varies from supporting seasonal working capital needs to term financing of equipment. While some short-term loans may be made on an unsecured basis, most are secured by the assets being financed with collateral margins that are consistent with the Company's loan policy guidelines.

*Real Estate.* Commercial and residential construction loans increased by \$11.6 million, or 27.49 percent, at December 31, 2017 to \$53.8 million from \$42.2 million at December 31, 2016. This increase is partially due to new commercial construction loans being financed during the year that were not completed by the end of the year. Commercial real estate increased \$2.1 million or 0.6 percent at December 31, 2017 to \$351.17 million from \$349.09 million at December 31, 2016.

*Other.* Other loans at December 31, 2017 decreased 10.6 percent to \$14.98 million from \$16.75 million in December 31, 2016.

*Industry Concentrations.* As of December 31, 2017 and December 31, 2016, there were no concentrations of loans within any single industry in excess of 10 percent of total loans, as segregated by Standard Industrial Classification code (“SIC code”). The SIC code is a federally designed standard industrial numbering system used by the Company to categorize loans by the borrower’s type of business. The Company has established industry-specific guidelines with respect to maximum loans permitted for each industry with which the Company does business.

*Collateral Concentrations.* Concentrations of credit risk can exist in relation to individual borrowers or groups of borrowers, certain types of collateral, certain types of industries, or certain geographic regions. The Company has a concentration in real estate loans as well as a geographic concentration that could pose an adverse credit risk, particularly with the current economic downturn in the real estate market. At December 31, 2017, approximately 87 percent of the Company’s loan portfolio was concentrated in loans secured by real estate. A substantial portion of borrowers’ ability to honor their contractual obligations is dependent upon the viability of the real estate economic sector. In addition, a large portion of the Company’s foreclosed assets are also located in these same geographic markets, making the recovery of the carrying amount of foreclosed assets susceptible to changes in market conditions. Management continues to monitor these concentrations and has considered these concentrations in its allowance for loan loss analysis.

*Large Credit Relationships.* The Company is currently in eighteen counties in central, south and coastal Georgia and includes metropolitan markets in Dougherty, Lowndes, Houston, Chatham and Muscogee counties. As a result, the Company originates and maintains large credit relationships with several commercial customers in the ordinary course of business. The Company considers large credit relationships to be those with commitments equal to or in excess of \$5.0 million prior to any portion being sold. Large relationships also include loan participations purchased if the credit relationship with the agent is equal to or in excess of \$5.0 million. In addition to the Company’s normal policies and procedures related to the origination of large credits, the Company’s Executive Loan Committee and Director Loan Committee must approve all new and renewed credit facilities which are part of large credit relationships. The following table provides additional information on the Company’s large credit relationships outstanding at December 31, 2017 and December 31, 2016.

	December 31, 2017			December 31, 2016		
	Number of Relationships	Period End Balances		Number of Relationships	Period End Balances	
		Committed	Outstanding		Committed	Outstanding
Large Credit Relationships:						
\$10 million or greater	1	\$ 11,541	\$ 8,718	-	\$ -	\$ -
\$5 million to \$9.9 million	15	98,718	89,556	14	96,807	86,712

*Maturities and Sensitivities of Loans to Changes in Interest Rates.* The following table presents the maturity distribution of the Company's loans at December 31, 2017. The table also presents the portion of loans that have fixed interest rates or variable interest rates that fluctuate over the life of the loans in accordance with changes in an interest rate index such as the prime rate.

	<u>Due in One Year or Less</u>	<u>After One, but Within Three Years</u>	<u>After Three, but Within Five Years</u>	<u>After Five Years</u>	<u>Total</u>
Loans with fixed interest rates	\$200,340	\$232,129	\$ 115,366	\$ 44,363	\$ 592,198
Loans with floating interest rates	<u>78,805</u>	<u>38,032</u>	<u>53,683</u>	<u>2,566</u>	<u>173,086</u>
Total	<u>\$279,145</u>	<u>\$270,161</u>	<u>\$169,049</u>	<u>\$46,929</u>	<u>\$765,284</u>

The Company may renew loans at maturity when requested by a customer whose financial strength appears to support such renewal or when such renewal appears to be in the Company's best interest. In such instances, the Company generally requires payment of accrued interest and may adjust the rate of interest, require a principal reduction or modify other terms of the loan at the time of renewal.

## Nonperforming Assets and Potential Problem Loans

Year-end nonperforming assets and accruing past due loans were as follows:

	<u>2017</u>	2016	2015	2014	2013
Loans Accounted for on Nonaccrual	<b>\$ 7,503</b>	\$ 12,350	\$ 14,408	\$18,334	\$ 24,114
Loans Accruing Past Due 90 Days or More	-	-	8	7	4
Other Real Estate Foreclosed	<b>4,256</b>	6,439	8,839	10,402	15,502
Securities Accounted for on Nonaccrual	-	-	-	-	-
Total Nonperforming Assets	<b><u>\$ 11,759</u></b>	<u>\$ 18,789</u>	<u>\$ 23,255</u>	<u>\$28,743</u>	<u>\$ 39,620</u>
Nonperforming Assets by Segment					
Construction and Land Development	<b>\$ 2,630</b>	\$ 3,376	\$ 7,106	\$ 9,655	\$ 17,323
1-4 Family Residential	<b>3,309</b>	4,375	4,197	8,237	5,926
Multifamily Residential	-	-	-	173	335
Nonfarm Residential	<b>3,796</b>	9,182	9,908	8,375	12,441
Farmland	<b>839</b>	800	1,103	1,449	1,629
Commercial and Consumer	<b>1,185</b>	1,056	941	854	1,966
Total Nonperforming Assets	<b><u>\$ 11,759</u></b>	<u>\$ 18,789</u>	<u>\$ 23,255</u>	<u>\$28,743</u>	<u>\$ 39,620</u>
Nonperforming Assets as a Percentage of:					
Total Loans and Foreclosed Assets	<b>1.53%</b>	2.47%	3.03%	3.80%	5.17%
Total Assets	<b>0.95%</b>	1.55%	1.98%	2.51%	3.45%
Nonperforming Loans as a Percentage of:					
Total Loans	<b>0.98%</b>	1.64%	1.90%	2.46%	3.21%
Supplemental Data:					
Trouble Debt Restructured Loans					
In Compliance with Modified Terms	<b>\$ 18,363</b>	\$ 17,992	\$ 19,375	\$19,229	\$ 20,715
Trouble Debt Restructured Loans					
Past Due 30-89 Days	<b>131</b>	319	344	757	435
Accruing Past Due Loans:					
30-89 Days Past Due	<b>4,558</b>	4,469	10,959	9,701	9,366
90 or More Days Past Due	-	-	8	7	4
Total Accruing Past Due Loans	<b><u>\$ 4,558</u></b>	<u>\$ 4,469</u>	<u>\$ 10,967</u>	<u>\$ 9,708</u>	<u>\$ 9,370</u>
Allowance for Loan Losses	<b>\$ 7,508</b>	\$ 8,923	\$ 8,604	\$ 8,802	\$ 11,806
ALLL as a Percentage of:					
Total Loans	<b>0.98%</b>	1.18%	1.13%	1.18%	1.57%
Nonperforming Loans	<b>100.06%</b>	72.25%	59.68%	47.99%	48.95%

Nonperforming assets include nonaccrual loans, loans past due 90 days or more, foreclosed real estate and nonaccrual securities. Nonperforming assets at December 31, 2017 decreased 37.42 percent from December 31, 2016.

Generally, loans are placed on nonaccrual status if principal or interest payments become 90 days past due and/or management deems the collectibility of the principal and/or interest to be in question, as well as when required by regulatory requirements. Loans to a customer whose financial condition has deteriorated are considered for nonaccrual status whether or not the loan is 90 days or more past due. For consumer loans, collectibility and loss are generally determined before the loan reaches 90 days past due. Accordingly, losses on consumer loans are recorded at the time they are determined. Consumer loans that are 90 days or more past due are generally either in liquidation/payment status or bankruptcy awaiting confirmation of a plan. Once interest accruals are discontinued, accrued but uncollected interest is charged to current year operations. Subsequent receipts on nonaccrual loans are recorded as a reduction of principal, and interest income is recorded only after principal recovery is reasonably assured. Classification of a loan as nonaccrual does not preclude the ultimate collection of loan principal or interest.

Troubled debt restructured loans are loans on which, due to deterioration in the borrower's financial condition, the original terms have been modified in favor of the borrower or either principal or interest has been forgiven.

Foreclosed assets represent property acquired as the result of borrower defaults on loans. Foreclosed assets are recorded at estimated fair value, less estimated selling costs, at the time of foreclosure. Write-downs occurring at foreclosure are charged against the allowance for loan losses. On an ongoing basis, properties are appraised as required by market indications and applicable regulations. Write-downs are provided for subsequent declines in value and are included in other non-interest expense along with other expenses related to maintaining the properties.

### **Allowance for Loan Losses**

The allowance for loan losses is a reserve established through a provision for loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the judgment of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The allowance for loan losses includes allowance allocations calculated in accordance with current U.S. accounting standards. The level of the allowance reflects management's continuing evaluation of industry concentrations, specific credit risks, loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions and unidentified losses inherent in the current loan portfolio. Portions of the allowance may be allocated for specific credits; however, the entire allowance is available for any credit that, in management's judgment, should be charged off. While management utilizes its best judgment and information available, the ultimate adequacy of the allowance is dependent upon a variety of factors beyond the Company's control, including the performance of the Company's loan portfolio, the economy, changes in interest rates and the view of the regulatory authorities toward loan classifications.

The Company's allowance for loan losses consists of specific valuation allowances established for probable losses on specific loans and historical valuation allowances for other loans with similar risk characteristics. During the first quarter of 2016 Company management implemented a change to its allowance for loan loss methodology by expanding the historical loss period from a rolling 8 quarters to 16 quarters. Management believes the longer historical loss period better reflects the current and expected loss behavior of the loan portfolio within the current credit cycle. The transition to a rolling 16 quarter loss period was complete in the first quarter of 2017. As of December 31, 2017, this change in the historical loss period resulted in a decrease to the allowance for loan losses of \$114,144. The loss history period used at December 31, 2016 and 2015 was based on the loss rate from the eight quarters ended September 30, 2016 and 2015, respectively.

Effective with the quarter ended June 30, 2015, the calculation of the amount needed in the Allowance for Loan Losses changed. Management determined that the segmentation method for the ASC 450-20 portion of the loan portfolio should be changed to bank call report categories. Prior to this change, the ASC 450-20 segmentation categorized loans by various non-owner occupied commercial real estate loan types and risk grades for the remainder of the ASC 450-20 portion of the portfolio. On the date of change, June 30, 2015, the change in methodology resulted in an increase to the calculated allowance for loan loss reserve of \$1,621,424.

The allowances established for probable losses on specific loans are the result of management's quarterly review of substandard loans with an outstanding balance of \$250,000 or more. This review process usually involves regional credit officers along with local lending officers reviewing the loans for impairment. Specific valuation allowances are determined after considering the borrower's financial condition, collateral deficiencies, and economic conditions affecting the borrower's industry, among other things. In the case of collateral dependent loans, collateral shortfall is most often based upon local market real estate value estimates. This review process is performed at the subsidiary bank level and is reviewed at the parent Company level.

Once the loan becomes impaired, it is removed from the pool of loans covered by the general reserve and reviewed individually for exposure as described above. In cases where the individual review reveals no exposure, no reserve is recorded for that loan, either through an individual reserve or through a general reserve. If, however, the individual review of the loan does indicate some exposure, management often charges off this exposure, rather than recording a specific reserve. In these instances, a loan which becomes nonperforming could actually reduce the allowance for loan losses. Those loans deemed uncollectible are transferred to our problem loan department for workout, foreclosure and/or liquidation. The problem loan department obtains a current appraisal on the property in order to record the fair market value (less selling expenses) when the property is foreclosed on and moved into other real estate.

The allowances established for the remainder of the loan portfolio are based on historical loss factors, adjusted for certain qualitative factors, which are applied to groups of loans with similar risk characteristics. Loans are segregated into fifteen separate groups based on call codes. Most of the Company's charge-offs during the past two years have been real estate dependent loans. The historical loss ratios applied to these groups of loans are updated quarterly based on actual charge-off experience. The historical loss ratios are further adjusted by qualitative factors.

Management evaluates the adequacy of the allowance for each of these components on a quarterly basis. Peer comparisons, industry comparisons, and regulatory guidelines are also used in the determination of the general valuation allowance. Loans identified as losses by management, internal loan review, and/or bank examiners are charged off. Additional information about the Company's allowance for loan losses is provided in the Notes to the Consolidated Financial Statements for Allowance for Loan Losses.

The following table sets forth the breakdown of the allowance for loan losses by loan category for the periods indicated. The allocation of the allowance to each category is subjective and is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any other category.

	2017		2016		2015		2014		2013	
	Reserve	%*	Reserve	%*	Reserve	%*	Reserve	%*	Reserve	%*
<b>Commercial and Agricultural</b>										
Commercial	\$ 447	6%	\$ 456	6%	\$ 855	6%	\$ 497	7%	\$ 1,017	6%
Agricultural	186	2%	168	2%	203	3%	304	2%	294	2%
<b>Real Estate</b>										
Commercial Construction	1,216	6%	323	4%	691	5%	1,223	7%	1,782	7%
Residential Construction	-	1%	13	2%	20	1%	138	1%	138	1%
Commercial	3,874	46%	5,751	46%	3,851	46%	3,665	45%	4,380	46%
Residential	968	25%	1,396	26%	1,990	26%	2,425	27%	3,278	27%
Farmland	780	9%	722	9%	912	8%	104	7%	312	6%
<b>Consumer and Other</b>										
Consumer	34	3%	80	3%	63	3%	67	3%	243	3%
Other	3	2%	14	2%	19	2%	379	1%	362	2%
	<u>\$ 7,508</u>	<u>100%</u>	<u>\$ 8,923</u>	<u>100%</u>	<u>\$ 8,604</u>	<u>100%</u>	<u>\$ 8,802</u>	<u>100%</u>	<u>\$ 11,806</u>	<u>100%</u>

\* Percentage represents the loan balance in each category expressed as a percentage of total end of period loans.

The following table presents an analysis of the Company's loan loss experience for the periods indicated.

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Allowance for Loan Losses at Beginning of Year	<b>\$ 8,923</b>	\$ 8,604	\$ 8,802	\$ 11,806	\$12,737
Charge-Offs					
Commercial	<b>299</b>	305	455	625	121
Agricultural	<b>159</b>	19	5	-	34
Commercial Construction	<b>52</b>	25	98	1,543	2,071
Residential Construction	-	-	-	-	-
Commercial	<b>966</b>	992	275	1,327	2,873
Residential	<b>1,048</b>	362	930	1,034	706
Farmland	<b>61</b>	120	40	233	21
Consumer	<b>330</b>	265	255	342	398
Other	-	-	25	-	4
	<b>\$ 2,915</b>	\$ 2,088	\$ 2,083	\$ 5,104	\$ 6,228
Recoveries					
Commercial	<b>137</b>	67	52	76	56
Agricultural	<b>4</b>	4	3	3	6
Commercial Construction	<b>266</b>	814	486	485	253
Residential Construction	-	-	-	-	-
Commercial	<b>527</b>	206	270	90	298
Residential	<b>82</b>	50	110	31	65
Farmland	<b>17</b>	145	20	20	22
Consumer	<b>75</b>	53	62	72	94
Other	<b>2</b>	6	16	15	18
	<b>1,110</b>	1,345	1,019	792	812
Net Charge-Offs	<b>1,805</b>	743	1,064	4,312	5,416
Provision for Loans Losses	<b>390</b>	1,062	866	1,308	4,485
Allowance for Loan Losses at End of Year	<b>\$ 7,508</b>	\$ 8,923	\$ 8,604	\$ 8,802	\$11,806
Ratio of Net Charge-Offs to Average Loans	<b>0.24%</b>	0.10%	0.14%	0.58%	0.73%

The allowance for loan losses decreased from \$8.92 million, or 1.18 percent of total loans at December 31, 2016 to \$7.51 million, or 0.98 percent of total loans at December 31, 2017. The provision for loan losses reflects loan quality trends, including the level of net charge-offs or recoveries, among other factors. Significant changes in the allowance during 2017 was the increase in the net charge-offs in 2017 to \$1.81 million from \$743 thousand in 2016, or an increase of \$1.06 million. Significant changes in the allowance during 2016 was the reduction in the net charge-offs in 2016 to \$743 thousand from \$1.06 million in 2015. The Company believes that collection efforts have reduced impaired loans and the reduction in net charge-offs runs parallel with the improvement in the substandard assets. As we begin to see stabilization in the economy and the housing and real estate market, we expect continued improvement in our substandard assets, including net charge-offs. There were no charge-offs or recoveries related to foreign loans during any of the periods presented.



## Investment Portfolio

The following table presents carrying values of investment securities held by the Company as of December 31, 2017, 2016 and 2015.

	<u>2017</u>	<u>2016</u>	<u>2015</u>
State, County and Municipal	<b>\$ 4,493</b>	\$ 4,561	\$ 5,099
Mortgage-Backed Securities	<b>346,723</b>	319,097	291,050
Corporate	<b>2,060</b>	-	-
Asset-Backed	<b>971</b>	-	-
Total Investment Securities and Mortgage-Backed Securities	<u><b>\$354,247</b></u>	<u>\$323,658</u>	<u>\$296,149</u>

The following table represents expected maturities and weighted-average yields of investment securities held by the Company as of December 31, 2017. (Mortgage-backed securities are based on the average life at the projected speed, while State and Political Subdivisions reflect anticipated calls being exercised.)

	Within 1 Year		After 1 Year But Within 5 Years		After 5 Years But Within 10 Years		After 10 Years	
	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield
Mortgage-Backed Securities	<b>\$ 29,606</b>	<b>2.78%</b>	<b>\$ 204,342</b>	<b>1.79%</b>	<b>\$ 98,304</b>	<b>2.57%</b>	<b>\$ 14,471</b>	<b>2.96%</b>
Obligations of State and Political Subdivisions	<b>517</b>	<b>3.03</b>	<b>3,037</b>	<b>2.09</b>	<b>679</b>	<b>3.10</b>	<b>260</b>	<b>4.03</b>
Corporate	-	-	<b>2,060</b>	<b>4.03</b>	-	-	-	-
Asset-Backed	-	-	<b>971</b>	<b>3.12</b>	-	-	-	-
Total Investment Portfolio	<u><b>\$ 30,123</b></u>	<u><b>2.78%</b></u>	<u><b>\$ 210,410</b></u>	<u><b>1.82%</b></u>	<u><b>\$ 98,983</b></u>	<u><b>2.57%</b></u>	<u><b>\$ 14,731</b></u>	<u><b>2.98%</b></u>

Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income. The Company has 100 percent of its portfolio classified as available for sale.

At December 31, 2017, there were no holdings of any one issuer, other than the U.S. government and its agencies, in an amount greater than 10 percent of the Company's stockholders' equity.

The average yield of the securities portfolio was 2.00 percent in 2017 compared to 1.79 percent in 2016 and 1.57 percent in 2015. The increase in the average yield from 2016 to 2017 was primarily attributed to the purchase of new securities which have a higher yield. The increase in the average yield from 2015 to 2016 was primarily attributed to the adjustment in amortization resulting from the deceleration of prepayment speeds.

## Deposits

The following table presents the average amount outstanding and the average rate paid on deposits by the Company for the years 2017, 2016 and 2015.

	2017		2016		2015	
	Average Amount	Average Rate	Average Amount	Average Rate	Average Amount	Average Rate
Noninterest-Bearing						
Demand Deposits	\$ 158,924		\$ 140,338		\$ 128,541	
Interest-Bearing						
Demand and Savings	517,974	0.37%	469,740	0.36%	430,731	0.35%
Time Deposits	353,587	0.81%	383,628	0.80%	417,080	0.81%
<b>Total Deposits</b>	<b>\$ 1,030,485</b>	<b>0.46%</b>	<b>\$ 993,706</b>	<b>0.48%</b>	<b>\$ 976,352</b>	<b>0.50%</b>

The following table presents the maturities of the Company's time deposits as of December 31, 2017.

	Time Deposits \$250,000 or Greater	Time Deposits Less Than \$250,000	Total
Months to Maturity			
3 or Less	\$ 4,166	\$67,962	\$72,128
Over 3 through 6	7,316	62,163	69,479
Over 6 through 12	20,670	93,298	113,968
Over 12 Months	6,767	77,825	84,592
	<b>\$38,919</b>	<b>\$301,248</b>	<b>\$340,167</b>

Average deposits increased \$36.78 million in 2017 compared to 2016 and increased \$17.35 million in 2016 compared to 2015. The increase in 2017 included \$48.23 million, or 10.27 percent in interest-bearing demand and savings deposits while, at the same time noninterest bearing deposits increased \$18.59 million, or 13.24 percent and time deposits decreased \$30.04 million, or 7.83 percent. The increase in 2016 included \$39.01 million, or 9.06 percent in interest-bearing demand and savings deposits while, at the same time noninterest bearing deposits increased \$11.80 million, or 9.18 percent and time deposits decreased \$33.45 million, or 8.02 percent. Accordingly, the ratio of average noninterest-bearing deposits to total average deposits was 15.42 percent in 2017, 14.12 percent in 2016 and 13.17 percent in 2015. The general decrease in market rates in 2017 had the effect of (i) decreasing the average cost of interest-bearing deposits by 2 basis points in 2017 compared to 2016 and (ii) mitigating a portion of the impact of decreasing yields on interest-earning assets in the Company's net interest income in 2017. The general decrease in market rates in 2016 had the effect of (i) decreasing the average cost of interest-bearing deposits by 2 basis points in 2016 compared to 2015 and (ii) mitigating a portion of the impact of decreasing yields on interest-earning assets in the Company's net interest income in 2016.

Total average interest-bearing deposits increased \$18.19 million, or 2.13 percent in 2017 compared to 2016 and increased \$5.56 million, or 0.66 percent in 2016 compared to 2015. This increase was primarily attributable to the increase in interest-bearing demand and savings accounts in 2017 and in 2016 as well.

The Company supplements deposit sources with brokered deposits. As of December 31, 2017, the Company had \$46.33 million, or 4.34 percent of total deposits, in brokered certificates of deposit attracted by external third parties. Additional information is provided in the Notes to Consolidated Financial Statements for Deposits.

### Off-Balance-Sheet Arrangements, Commitments, Guarantees, and Contractual Obligations

The following table summarizes the Company's contractual obligations and other commitments to make future payments as of December 31, 2017. Payments for borrowings do not include interest. Payments related to leases are based on actual payments specified in the underlying contracts. Loan commitments and standby letters of credit are presented at contractual amounts; however, since many of these commitments are expected to expire unused or only partially used, the total amounts of these commitments do not necessarily reflect future cash requirements. The off-balance-sheet arrangements for loan commitments consist of approximately \$10 million in 1-4 residential home equity and construction loans, \$28 million in commercial real estate construction loans, \$18 million in commercial/industrial loans and \$40 million in the overdraft privilege program.

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1 – 3 Years</b>	<b>3 – 5 Years</b>	<b>More Than 5 Years</b>
<b>Contractual Obligations:</b>					
Subordinated Debentures	\$ 24,229	\$ -	\$ -	\$ -	\$ 24,229
Federal Home Loan Bank Advances	46,000	2,500	5,000	29,500	9,000
Other Borrowings	1,500	1,500	-	-	-
Operating Leases	208	43	42	123	-
Deposits with Stated Maturity Dates	340,168	255,575	41,210	43,266	117
	<b>412,105</b>	<b>259,618</b>	<b>46,252</b>	<b>72,889</b>	<b>33,346</b>
<b>Other Commitments:</b>					
Loan Commitments	96,374	96,374	-	-	-
Standby Letters of Credit	1,536	1,536	-	-	-
	<b>97,910</b>	<b>97,910</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Total Contractual Obligations and Other Commitments</b>	<b>\$510,015</b>	<b>\$357,528</b>	<b>\$46,252</b>	<b>\$72,889</b>	<b>\$33,346</b>

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments which are not reflected in the consolidated financial statements. These instruments include commitments to extend credit, standby letters of credit, performance letters of credit, guarantees and liability for assets held in trust.

Such financial instruments are recorded in the financial statements when funds are disbursed or the instruments become payable. The Company uses the same credit policies for these off-balance sheet financial instruments as they do for instruments that are recorded in the consolidated financial statements.

*Loan Commitments.* The Company enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Company's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Company minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for loan losses. Loan commitments outstanding at December 31, 2017 are included in the preceding table.

*Standby Letters of Credit.* Letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer. The Company's policies generally require that standby letters of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit outstanding at December 31, 2017 are included in the preceding table.

## **Capital and Liquidity**

At December 31, 2017, shareholders' equity totaled \$90.32 million compared to \$93.39 million at December 31, 2016. In addition to net income of \$7.75 million, other significant changes in shareholders' equity during 2017 included \$210.6 thousand of dividends declared on preferred stock, \$843.9 thousand of dividends declared on common stock and \$9.36 million redemption of preferred stock. The accumulated other comprehensive loss component of stockholders' equity totaled \$(6.49) million at December 31, 2017 compared to \$(5.02) million at December 31, 2016. This fluctuation was mostly related to the after-tax effect of changes in the fair value of securities available for sale. Under regulatory requirements, the unrealized gain or loss on securities available for sale does not increase or reduce regulatory capital and is not included in the calculation of risk-based capital and leverage ratios. Regulatory agencies for banks and bank holding companies utilize capital guidelines designed to measure Tier 1 and total capital and take into consideration the risk inherent in both on-balance sheet and off-balance sheet items. Tier 1 capital consists of common stock and qualifying preferred stockholders' equity less goodwill and disallowed deferred tax assets. Tier 2 capital consists of certain convertible, subordinated and other qualifying debt and the allowance for loan losses up to 1.25 percent of risk-weighted assets. The Company has no Tier 2 capital other than the allowance for loan losses.

Using the capital requirements presently in effect, the Tier 1 ratio as of December 31, 2017 was 14.64 percent and total Tier 1 and 2 risk-based capital was 15.56 percent. Both of these measures compare favorably with the regulatory minimum of 6 percent for Tier 1 and 8 percent for total risk-based capital. The Company's common equity Tier 1 ratio as of December 31, 2017 was 11.78, which exceeds the regulatory minimum of 4.50 percent. The Company's Tier 1 leverage ratio as of December 31, 2017 was 9.89 percent, which exceeds the required ratio standard of 4 percent.

For 2017, average capital was \$91.05 million, representing 7.58 percent of average assets for the year. This compares to 8.60 percent for 2016.

For 2017, the Company did not have any material commitments for capital expenditures.

The Company reinstated payment of common stock dividends in 2017 with a cash dividend of \$844 thousand. The Company did not pay any common stock dividends in 2016. The Company suspended common stock dividend payments beginning in the third quarter of 2009 for capital retention purposes.

The Company declared dividends of \$211 thousand and \$1,493 million on preferred stock during 2017 and 2016, respectively. On November 17, 2014 the Company reinstated dividend payments after being on deferral since February 12, 2012, on the Preferred Stock and paid \$5.5 million of accumulated dividends in arrears to the holders of the Preferred Stock. Additional information is provided in the Notes to the Consolidated Financial Statements for Preferred Stock.

The Company, primarily through the actions of its subsidiary bank, engages in liquidity management to ensure adequate cash flow for deposit withdrawals, credit commitments and repayments of borrowed funds. Needs are met through loan repayments, net interest and fee income and the sale or maturity of existing assets. In addition, liquidity is continuously provided through the acquisition of new deposits, the renewal of maturing deposits and external borrowings.

Management monitors deposit flow and evaluates alternate pricing structures to retain and grow deposits. To the extent needed to fund loan demand, traditional local deposit funding sources are supplemented by the use of FHLB borrowings, brokered deposits and other wholesale deposit sources outside the immediate market area. Internal policies have been updated to monitor the use of various core and non-core funding sources, and to balance ready access with risk and cost. Through various asset/liability management strategies, a balance is maintained among goals of liquidity, safety and earnings potential. Internal policies that are consistent with regulatory liquidity guidelines are monitored and enforced by the Bank.

The investment portfolio provides a ready means to raise cash if liquidity needs arise. As of December 31, 2017, the available for sale bond portfolio totaled \$354.2 million. At December 31, 2016, the available for sale bond portfolio totaled \$323.7 million. Only marketable investment grade bonds are purchased. Although most of the Bank's bond portfolio is encumbered as pledges to secure various public funds deposits, repurchase agreements, and for other purposes, management can restructure and free up investment securities for sale if required to meet liquidity needs.

Management continually monitors the relationship of loans to deposits as it primarily determines the Company's liquidity posture. Colony had ratios of loans to deposits of 71.6 percent as of December 31, 2017 and 72.2 percent as of December 31, 2016. Management employs alternative funding sources when deposit balances will not meet loan demands. The ratios of loans to all funding sources (excluding Subordinated Debentures) at December 31, 2017 and December 31, 2016 were 68.6 percent and 69.2 percent, respectively. Management continues to emphasize programs to generate local core deposits as our Company's primary funding sources. The stability of the Banks' core deposit base is an important factor in Colony's liquidity position. A heavy percentage of the deposit base is comprised of accounts of individuals and small businesses with comprehensive banking relationships and limited volatility. At December 31, 2017 and December 31, 2016, the Bank had \$38.9 million and \$32.2 million, respectively, in certificates of deposit of \$250,000 or more. These larger deposits represented 3.6 percent and 3.1 percent of respective total deposits. Management seeks to monitor and control the use of these larger certificates, which tend to be more volatile in nature, to ensure an adequate supply of funds as needed. Relative interest costs to attract local core relationships are compared to market rates of interest on various external deposit sources to help minimize the Company's overall cost of funds.

The Company supplemented deposit sources with brokered deposits. As of December 31, 2017, the Company had \$46.3 million or 4.3 percent of total deposits in CDARS. Additional information is provided in the Notes to the Consolidated Financial Statements regarding these brokered deposits. Additionally, the Company uses external deposit listing services to obtain out-of-market certificates of deposit at competitive interest rates when funding is needed. The deposits obtained from listing services are often referred to as wholesale or Internet CDs. As of December 31, 2017, the Company had \$13.5 million, or 1.3 percent of total deposits, in internet certificates of deposit obtained through deposit listing services.

To plan for contingent sources of funding not satisfied by both local and out-of-market deposit balances, Colony and its subsidiary have established multiple borrowing sources to augment their funds management. The Company has borrowing capacity through membership of the Federal Home Loan Bank program. The Bank has also established overnight borrowing for Federal Funds Purchased through various correspondent banks. Management believes the various funding sources discussed above are adequate to meet the Company's liquidity needs in the future without any material adverse impact on operating results.

Liquidity measures the ability to meet current and future cash flow needs as they become due. The liquidity of a financial institution reflects its ability to meet loan requests, to accommodate possible outflows in deposits and to take advantage of interest rate market opportunities. The ability of a financial institution to meet its current financial obligations is a function of balance sheet structure, the ability to liquidate assets, and the availability of alternative sources of funds. The Company seeks to ensure its funding needs are met by maintaining a level of liquid funds through asset/liability management.

Asset liquidity is provided by liquid assets which are readily marketable or pledgeable or which will mature in the near future. Liquid assets include cash, interest-bearing deposits in banks, securities available for sale and federal funds sold and securities purchased under resale agreements.

Liability liquidity is provided by access to funding sources which include core deposits. Should the need arise, the Company also maintains relationships with the Federal Home Loan Bank, Federal Reserve Bank, two correspondent banks and repurchase agreement lines that can provide funds on short notice.

Since Colony is a bank holding Company and does not conduct operations, its primary sources of liquidity are dividends up streamed from the subsidiary bank and borrowings from outside sources.

The liquidity position of the Company is continuously monitored and adjustments are made to the balance between sources and uses of funds as deemed appropriate. Management is not aware of any events that are reasonably likely to have a material adverse effect on the Company's liquidity, capital resources or operations. In addition, management is not aware of any regulatory recommendations regarding liquidity, which if implemented, would have a material adverse effect on the Company.

## **Impact of Inflation and Changing Prices**

The Company's financial statements included herein have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). GAAP presently requires the Company to measure financial position and operating results primarily in terms of historic dollars. Changes in the relative value of money due to inflation or recession are generally not considered. The primary effect of inflation on the operations of the Company is reflected in increased operating costs, though given recent economic conditions, the Company has not experienced any material effects of inflation during the last three fiscal years. In management's opinion, changes in interest rates affect the financial condition of a financial institution to a far greater degree than changes in the inflation rate. While interest rates are greatly influenced by changes in the inflation rate, they do not necessarily change at the same rate or in the same magnitude as the inflation rate. Interest rates are highly sensitive to many factors that are beyond the control of the Company, including changes in the expected rate of inflation, the influence of general and local economic conditions and the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things, as further discussed in the next section.

## **Regulatory and Economic Policies**

The Company's business and earnings are affected by general and local economic conditions and by the monetary and fiscal policies of the United States government, its agencies and various other governmental regulatory authorities, among other things. The Federal Reserve Board regulates the supply of money in order to influence general economic conditions. Among the instruments of monetary policy available to the Federal Reserve Board are (i) conducting open market operations in United States government obligations, (ii) changing the discount rate on financial institution borrowings, (iii) imposing or changing reserve requirements against financial institution deposits, and (iv) restricting certain borrowings and imposing or changing reserve requirements against certain borrowings by financial institutions and their affiliates. These methods are used in varying degrees and combinations to affect directly the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. For that reason alone, the policies of the Federal Reserve Board have a material effect on the earnings of the Company.

Governmental policies have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future; however, the Company cannot accurately predict the nature, timing or extent of any effect such policies may have on its future business and earnings.

## **Recently Issued Accounting Pronouncements**

See Note 1 - Summary of Significant Accounting Policies under the section headed Changes in Accounting Principles and Effects of New Accounting Pronouncements included in the Notes to the Consolidated Financial Statements.

## Market Risk and Interest Rate Sensitivity

Our financial performance is impacted by, among other factors, interest rate risk and credit risk. We do not utilize derivatives to mitigate our credit risk, relying instead on an extensive loan review process and our allowance for loan losses.

Interest rate risk is the change in value due to changes in interest rates. The Company is exposed only to U.S. dollar interest rate changes and, accordingly, the Company manages exposure by considering the possible changes in the net interest margin. The Company does not have any trading instruments nor does it classify any portion of its investment portfolio as held for trading. The Company does not engage in any hedging activity or utilize any derivatives. The Company has no exposure to foreign currency exchange rate risk, commodity price risk and other market risks. Interest rate risk is addressed by our Asset & Liability Management Committee (ALCO) which includes senior management representatives. The ALCO monitors interest rate risk by analyzing the potential impact to the net portfolio of equity value and net interest income from potential changes to interest rates and considers the impact of alternative strategies or changes in balance sheet structure.

Interest rates play a major part in the net interest income of financial institutions. The repricing of interest earnings assets and interest-bearing liabilities can influence the changes in net interest income. The timing of repriced assets and liabilities is Gap management and our Company has established its policy to maintain a Gap ratio in the one-year time horizon of .80 to 1.20.

Our exposure to interest rate risk is reviewed at least quarterly by our Board of Directors and the ALCO. Interest rate risk exposure is measured using interest rate sensitivity analysis to determine our change in net portfolio value in the event of assumed changes in interest rates. In order to reduce the exposure to interest rate fluctuations, we have implemented strategies to more closely match our balance sheet composition. The Company has engaged FTN Financial to run a quarterly asset/liability model for interest rate risk analysis. We are generally focusing our investment activities on securities with terms or average lives in the 3 ½ - 5 ½ year range.

Market risk reflects the risk of economic loss resulting from adverse changes in market prices and interest rates. This risk of loss can be reflected in either reduced current market values or reduced current and potential net income. Colony's most significant market risk is interest rate risk. This risk arises primarily from Colony's extension of loans and acceptance of deposits.

Managing interest rate risk is a primary goal of the asset liability management function. Colony attempts to achieve stability in net interest income while limiting volatility arising from changes in interest rates. Colony seeks to achieve this goal by balancing the maturity and repricing characteristics of assets and liabilities. Colony manages its exposure to fluctuations in interest rates through policies established by ALCO and approved by the Board of Directors. ALCO meets at least quarterly and has responsibility for developing asset liability management policies, reviewing the interest rate sensitivity of Colony, and developing and implementing strategies to improve balance sheet structure and interest rate risk positioning.



Colony measures the sensitivity of net interest income to changes in market interest rates through the utilization of Asset/Liability simulation modeling. On at least a quarterly basis, the following twenty-four month time period is simulated to determine a baseline net interest income forecast and the sensitivity of this forecast to changes in interest rates. These simulations include all of Colony's earning assets and liabilities. Forecasted balance sheet changes, primarily reflecting loan and deposit growth and forecasts, are included in the periods modeled. Projected rates for loans and deposits are based on management's outlook and local market conditions.

The magnitude and velocity of rate changes among the various asset and liability groups exhibit different characteristics for each possible interest rate scenario; additionally, customer loan and deposit preferences can vary in response to changing interest rates. Simulation modeling enables Colony to capture the expected effect of these differences. Assumptions utilized in the model are updated on an ongoing basis and are reviewed and approved by the ALCO Committee of the Board of Directors.

Colony has modeled its baseline net interest income forecast assuming a flat interest rate environment with the federal funds rate at the Federal Reserve's current targeted range of 1.25% to 1.50% and the current prime rate of 4.50%. Colony has modeled the impact of a gradual increase in short-term rates of 100 and 200 basis points and a decline of 100 basis points to determine the sensitivity of net interest income for the next twelve months. As illustrated in the table below, the net interest income sensitivity model indicates that, compared with a net interest income forecast assuming stable rates, net interest income is projected to increase by 0.58% and increase by 0.27% if interest rates increased by 100 and 200 basis points, respectively. Net interest income is projected to decline by 2.57% if interest rates decreased by 100 basis points. These changes were within Colony's policy limit of a maximum 15% negative change.

#### Twelve Month Net Interest Income Sensitivity

Change in Short-term Interest Rates (in basis points)	Estimated Change in Net Interest Income As of December 31,	
	2017	2016
+200	0.27%	3.35%
+100	0.58%	1.88%
Flat	-%	- %
-100	-2.57%	-3.67%

The measured interest rate sensitivity indicates an asset sensitive position over the next year, which could serve to improve net interest income in a rising interest rate environment. The actual realized change in net interest income would depend on several factors, some of which could serve to reduce or eliminate the asset sensitivity noted above. These factors include a higher than projected level of deposit customer migration to higher cost deposits, such as certificates of deposit, which would increase total interest expense and serve to reduce the realized level of asset sensitivity. Another factor which could impact the realized interest rate sensitivity in a rising rate environment is the repricing behavior of interest bearing non-maturity deposits. Assumptions for repricing are expressed as a beta relative to the change in the prime rate. For instance, a 25% beta would correspond to a deposit rate that would increase 0.25% for every 1% increase in the prime rate. Projected betas for interest bearing non-maturity deposit repricing are a key component of determining the Company's interest rate risk position. Should realized betas be higher than projected betas, the expected benefit from higher interest rates would be reduced.

The net interest income simulation model is the primary tool utilized to evaluate potential interest rate risks over a shorter term time horizon. Colony also evaluates potential longer term interest rate risk through modeling and evaluation of economic value of equity (EVE). This EVE modeling allows Colony to capture longer-term repricing risk and options risk embedded in the balance sheet. Simulation modeling is utilized to measure the economic value of equity and its sensitivity to immediate changes in interest rates. These simulations value only the current balance sheet and do not incorporate growth assumptions used in the net interest income simulation. The economic value of equity is the net fair value of assets and liabilities derived from the present value of future cash flows discounted at current market interest rates. From this baseline valuation, Colony evaluates changes in the value of each of these items in various interest rate scenarios to determine the net impact on the economic value of equity. Key assumptions utilized in the model, namely loan prepayments, deposit pricing betas, and non-maturity deposit durations have a significant impact on the results of the EVE simulations.

As illustrated in the table below, the economic value of equity model indicates that, compared with a valuation assuming stable rates, EVE is projected to increase by 7.93% and 13.13%, assuming an immediate and sustained increase in interest rates of 100 and 200 basis points, respectively. The primary reason for the increase in asset sensitivity from the prior year is a more aggressive assumption regarding non-maturity deposit durations. Assuming an immediate 100 basis point decline in rates, EVE is projected to decrease by 11.73%. These changes were within Colony’s policy except in the -100 basis point change, which limits the maximum negative change in EVE to 10% of the base EVE. We believe this projection outside of policy is mitigated by the unlikely reduction in interest rates due to the current rate environment.

### Economic Value of Equity Sensitivity

Immediate Change in Interest Rates (in basis points)	Estimated Change in EVE As of December 31,	
	2017	2016
+200	13.13%	16.27%
+100	7.93%	9.59%
-100	-11.73%	-12.44%

Colony is also subject to market risk in certain of its fee income business lines. Financial management services revenues, which include trust, brokerage, and asset management fees, can be affected by risk in the securities markets, primarily the equity securities market. A significant portion of the fees in this unit are determined based upon a percentage of asset values. Weaker securities markets and lower equity values have an adverse impact on the fees generated by these operations. Trading account assets, maintained to facilitate brokerage customer activity, are also subject to market risk. This risk is not considered significant, as trading activities are limited and subject to risk policy limits. Mortgage banking income is also subject to market risk. Mortgage loan originations are sensitive to levels of mortgage interest rates and therefore, mortgage banking income could be negatively impacted during a period of rising interest rates. The extension of commitments to customers to fund mortgage loans also subjects Colony to market risk. This risk is primarily created by the time period between making the commitment and closing and delivering the loan. Colony seeks to minimize this exposure by utilizing various risk management tools, the primary of which are forward sales commitments and best efforts commitments.

The following table is an analysis of the Company's interest rate-sensitivity position at December 31, 2017. The interest-bearing rate-sensitivity gap, which is the difference between interest-earning assets and interest-bearing liabilities by repricing period, is based upon maturity or first repricing opportunity, along with a cumulative interest rate-sensitivity gap. It is important to note that the table indicates a position at a specific point in time and may not be reflective of positions at other times during the year or in subsequent periods. Major changes in the gap position can be, and are, made promptly as market outlooks change.

	Assets and Liabilities Repricing Within					Total
	3 Months or Less	4 to 12 Months	1 Year	1 to 5 Years	Over 5 Years	
INTEREST-EARNING ASSETS:						
Interest-Bearing Deposits	\$ 34,668	\$ -	\$ 34,668	\$ -	\$ -	\$34,668
Investment Securities	302	2,883	3,185	215,082	135,980	354,247
Loans, Net of Unearned Income	142,947	135,950	278,897	438,962	46,929	764,788
Other Interest- Earning Assets	3,043	-	3,043	-	-	3,043
Total Interest-Earning Assets	<u>\$180,960</u>	<u>\$138,833</u>	<u>\$319,793</u>	<u>\$654,044</u>	<u>\$182,909</u>	<u>\$1,156,746</u>
INTEREST-BEARING LIABILITIES:						
Interest-Bearing Demand Deposits (1)	458,717	-	458,717	-	-	458,717
Savings (1)	78,172	-	78,172	-	-	78,172
Time Deposits	72,128	183,447	255,575	84,476	117	340,168
Other Borrowings	4,000	-	4,000	34,500	9,000	47,500
Subordinated Debentures	24,229	-	24,229	-	-	24,229
Total Interest-Bearing Liabilities	<u>637,246</u>	<u>183,447</u>	<u>820,693</u>	<u>118,976</u>	<u>9,117</u>	<u>948,786</u>
Interest Rate-Sensitivity Gap	<u>(456,286)</u>	<u>(44,614)</u>	<u>(500,900)</u>	<u>535,068</u>	<u>173,792</u>	<u>\$ 207,960</u>
Cumulative Interest-Sensitivity Gap	<u><u>\$(456,286)</u></u>	<u><u>\$(500,900)</u></u>	<u><u>\$(500,900)</u></u>	<u><u>\$ 34,168</u></u>	<u><u>\$207,960</u></u>	
Interest Rate-Sensitivity Gap as a Percentage of Interest-Earning Assets	<u><u>(39.44)%</u></u>	<u><u>(3.86)%</u></u>	<u><u>(43.30)%</u></u>	<u><u>46.26%</u></u>	<u><u>15.02%</u></u>	
Cumulative Interest Rate-Sensitivity as a Percentage of Interest-Earning Assets	<u><u>(39.44)%</u></u>	<u><u>(43.30)%</u></u>	<u><u>(43.30)%</u></u>	<u><u>2.96%</u></u>	<u><u>17.98%</u></u>	

(1) Interest-bearing Demand and Savings Accounts for repricing purposes are considered to reprice within 3 months or less.

The foregoing table indicates that we had a one year negative gap of \$500.9 million, or 43.30 percent of total interest-earning assets at December 31, 2017. In theory, this would indicate that at December 31, 2017, \$500.9 million more in liabilities than assets would reprice if there were a change in interest rates over the next 365 days. Thus, if interest rates were to decline, the gap would indicate a resulting increase in net interest margin. However, changes in the mix of interest-earning assets or supporting liabilities can either increase or decrease the net interest margin without affecting interest rate sensitivity. In addition, the interest rate spread between an asset and our supporting liability can vary significantly while the timing of repricing of both the assets and our supporting liability can remain the same, thus impacting net interest income. This characteristic is referred to as a basis risk and, generally, relates to the repricing characteristics of short-term funding sources such as certificates of deposits.

Gap analysis has certain limitations. Measuring the volume of repricing or maturing assets and liabilities does not always measure the full impact on the portfolio value of equity or net interest income. Gap analysis does not account for rate caps on products; dynamic changes such as increasing prepay speeds as interest rates decrease, basis risk, or the benefit of non-rate funding sources. The majority of our loan portfolio reprices quickly and completely following changes in market rates, while non-term deposit rates in general move slowly and usually incorporate only a fraction of the change in rates. Products categorized as nonrate sensitive, such as our noninterest-bearing demand deposits, in the gap analysis behave like long term fixed rate funding sources. Both of these factors tend to make our actual behavior more asset sensitive than is indicated in the gap analysis. In fact, we experience higher net interest income when rates rise, opposite what is indicated by the gap analysis. Therefore, management uses gap analysis, net interest margin analysis and market value of portfolio equity as our primary interest rate risk management tools. The Company has established its one year gap to be 80 percent to 120 percent. The most recent analysis as of December 31, 2017 indicates a one year gap of 1.10 percent. The analysis reflects slight net interest margin compression in both a declining and increasing interest rate environment. Given that interest rates have shown a gradual increase with the Federal Reserve actions since 2015, the Company is anticipating interest rates to increase in the future though we believe that interest rates will increase modestly in 2018. The Company is focusing on areas to minimize margin compression in the future by minimizing longer term fixed rate loans, shortening on the yield curve with investments, securing longer term FHLB advances, securing certificates of deposit for longer terms and focusing on reduction of nonperforming assets.

The Company utilizes FTN Financial Asset/Liability Management Analysis for a more dynamic analysis of balance sheet structure. The Company has established policies for rate shock per basis point (bp) for earnings at risk for net interest income and for equity at risk. The following table shows the policy limits with the rate shock for earnings at risk and equity at risk as of December 31, 2017.

	Rate Shock	Policy Limit	Immediate Shock (-) decrease bp	Immediate Shock (+) increase bp
Net Interest Income –				
Earnings at Risk	+/- 100 bp	+/- 10%	-2.80%	0.79%
	+/- 200 bp	+/- 15%	-7.96	0.27
	+/- 300 bp	+/- 20%	-11.08	0.13
	+/- 400 bp	+/- 25%	-12.45	-1.24
Equity at Risk	+/- 100 bp	+/- 10%	-11.73	7.93
	+/- 200 bp	+/- 20%	-26.41	13.13
	+/- 300 bp	+/- 30%	-34.15	15.81
	+/- 400 bp	+/- 40%	-35.09	17.08

## Return on Assets and Stockholder's Equity

The following table presents selected financial ratios for each of the periods indicated.

	Years Ended December 31		
	2017	2016	2015
Return on Average Assets(1)	<b>0.63%</b>	0.62%	0.52%
Return on Average Equity(1)	<b>8.28%</b>	7.17%	5.90%
Equity to Assets	<b>7.33%</b>	7.72%	8.13%
Common Stock Dividends Declared	<b>\$0.10</b>	\$0.00	\$0.00

(1) Computed using net income available to common shareholders.



Colony Bankcorp, Inc. common stock is quoted on the NASDAQ Global Market under the symbol "CBAN."

## COLONY BANKCORP, INC. SHAREHOLDER INFORMATION

### **CORPORATE HEADQUARTERS:**

Colony Bankcorp, Inc.  
P.O. Box 989  
115 South Grant Street  
Fitzgerald, Georgia 31750  
229-426-6000

### **ANNUAL MEETING**

Tuesday, May 22, 2018 at 2:00 p.m.  
Colony Bankcorp, Inc.  
115 South Grant Street  
Fitzgerald, Georgia 31750

### **INDEPENDENT AUDITORS:**

McNair, McLemore, Middlebrooks & Co., LLC  
P.O. Box One  
Macon, Georgia 31202

### **SHAREHOLDER SERVICES:**

Shareholders who want to change the name, address or ownership of stock; to report lost, stolen or destroyed certificates; or to consolidate accounts should contact:

American Stock Transfer & Trust Company  
Operations Center  
6201 15th Avenue  
Brooklyn, NY 11219  
800-937-5449  
[www.amstock.com](http://www.amstock.com)

# COLONY

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