

Annual Disclosure Statement

The attached annual report serves as Bank of Tennessee's 2016 Annual Disclosure Statement as required by the Federal Deposit Insurance Corporation ("FDIC"). The Annual Report has not been reviewed, or confirmed for accuracy or relevance, by the FDIC.

Please contact either Roy L. Harmon, Jr. (Chairman & CEO) or Darla M. Scott (EVP & CFO) for any additional information.

Contact Information

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Darla M. Scott, CPA

A handwritten signature in dark ink that reads "Darla M. Scott". The signature is written in a cursive, flowing style.

Bank of Tennessee
EVP and CFO

The logo consists of the letters 'B' and 'T' in a bold, dark blue, sans-serif font. The 'B' is stylized with a thick, slanted stroke.

ANNUAL REPORT 2016

BancTenn Corp

**BANCTENN CORP.
AND SUBSIDIARY**

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2016

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INDEPENDENT AUDITOR'S REPORT

**To the Stockholders and Board of Directors
BancTenn Corp.
Kingsport, Tennessee**

We have audited the accompanying consolidated financial statements of BancTenn Corp. and its Subsidiary, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BancTenn Corp. and its Subsidiary as of December 31, 2016 and 2015, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Mauldin & Jenkins, LLC".

Chattanooga, Tennessee
March 23, 2017

BANCTENN CORP. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2016 and 2015
(amounts in thousands, except share data)

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and due from banks:		
Noninterest-bearing	\$ 15,212	\$ 19,143
Interest-bearing	<u>253</u>	<u>902</u>
Total cash and due from banks	15,465	20,045
Securities available for sale	205,409	219,347
Securities held to maturity (fair value of \$3,512 in 2016 and \$1,635 in 2015)	3,550	1,594
Other equity investments, at cost	701	1,061
Restricted equity investments, at cost	4,171	4,120
Loans, net of allowance for loan losses	777,787	678,100
Premises and equipment	31,665	29,666
Accrued interest receivable	2,605	2,436
Cash surrender value of life insurance	24,153	23,310
Annuity contracts	14,457	210
Foreclosed real estate	90	205
Other assets	<u>3,967</u>	<u>4,165</u>
Total assets	<u>\$1,084,020</u>	<u>\$984,259</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits:		
Noninterest-bearing	\$ 245,433	\$218,252
Interest-bearing	<u>641,575</u>	<u>561,457</u>
Total deposits	887,008	779,709
Securities sold under agreements to repurchase	986	18,308
Federal Home Loan Bank advances	58,281	64,375
Subordinated debentures	15,465	15,465
Accrued interest payable	177	173
Accrued expenses and other liabilities	<u>11,723</u>	<u>9,424</u>
Total liabilities	<u>973,640</u>	<u>887,454</u>
Stockholders' equity:		
Common stock, \$8 par value, 6,000,000 shares authorized, 2,520,641 and 2,515,641 shares issued and outstanding in 2016 and 2015	20,165	20,125
Additional paid-in capital	8,220	7,892
Retained earnings	60,155	56,826
Accumulated other comprehensive income	22,092	12,562
Unallocated ESOP shares	<u>(252)</u>	<u>(600)</u>
Total stockholders' equity	<u>110,380</u>	<u>96,805</u>
Total liabilities and stockholders' equity	<u>\$1,084,020</u>	<u>\$984,259</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

BANCTENN CORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2016 and 2015
(amounts in thousands)

	<u>2016</u>	<u>2015</u>
INTEREST INCOME		
Loans, including fees	\$ 34,343	\$ 30,641
Securities	4,265	4,784
Federal funds sold and other	<u>2</u>	<u>16</u>
	38,610	35,441
INTEREST EXPENSE		
Interest on deposits	1,510	1,368
Interest on other borrowed funds	<u>1,507</u>	<u>2,028</u>
	<u>3,017</u>	<u>3,396</u>
Net interest income	35,593	32,045
Provision for loan losses	<u>200</u>	<u>569</u>
Net interest income after provision for loan losses	<u>35,393</u>	<u>31,476</u>
NONINTEREST INCOME		
Customer service fees	2,436	2,370
Service revenue	445	2,126
Loan origination and settlement fees	2,786	2,440
Gains (losses) on securities	642	(101)
Other	<u>4,811</u>	<u>3,803</u>
	<u>11,120</u>	<u>10,638</u>
NONINTEREST EXPENSES		
Salaries and employee benefits	21,289	19,900
Occupancy expenses	3,188	2,429
Data processing	2,715	2,982
Other operating expenses	<u>8,535</u>	<u>8,029</u>
	<u>35,727</u>	<u>33,340</u>
Income before income taxes	10,786	8,774
Income tax benefit	<u>(34)</u>	<u>(136)</u>
Net income	<u>\$ 10,820</u>	<u>\$ 8,910</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

BANCTENN CORP. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2016 and 2015
(amounts in thousands)

	<u>2016</u>	<u>2015</u>
Net income	<u>\$10,820</u>	<u>\$ 8,910</u>
Other comprehensive income before tax:		
Unrealized gains on securities -		
Unrealized holding gains arising during the year, net of tax expense of \$697 and \$765 in 2016 and 2015, respectively	10,038	10,990
Reclassification adjustment for losses (gains) included in net income, net of tax (benefit) expense of \$42 and \$(6) in 2016 and 2015, respectively	(600)	95
Unrealized gains on derivative contracts -		
Unrealized holding gains arising during the year, net of tax expense of \$6 and \$8 in 2016 and 2015, respectively	<u>92</u>	<u>120</u>
Total comprehensive income	<u>9,530</u>	<u>11,205</u>
Comprehensive income	<u><u>\$20,350</u></u>	<u><u>\$20,115</u></u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

BANCTENN CORP. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2016 and 2015
(amounts in thousands, except share data)

	Total Stockholders' Equity	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Unallocated ESOP Shares
BALANCE, December 31, 2014	\$ 82,043	\$ 20,125	\$ 7,860	\$ 53,638	\$ 1,357	\$ (937)
Net income	8,910	-	-	8,910	-	-
Other comprehensive loss, net of tax	11,205	-	-	-	11,205	-
Employee stock ownership plan: Shares released to participants	369	-	32	-	-	337
Distributions to unallocated shares	64	-	-	64	-	-
Distributions to stockholders	<u>(5,786)</u>	<u>-</u>	<u>-</u>	<u>(5,786)</u>	<u>-</u>	<u>-</u>
BALANCE, December 31, 2015	96,805	20,125	7,892	56,826	12,562	(600)
Net income	10,820	-	-	10,820	-	-
Other comprehensive loss, net of tax	9,530	-	-	-	9,530	-
Issuance of 5,000 common shares pursuant to stock option plan	243	40	203	-	-	-
Employee stock ownership plan: Shares released to participants	473	-	125	-	-	348
Distributions to unallocated shares	56	-	-	56	-	-
Distributions to stockholders	<u>(7,547)</u>	<u>-</u>	<u>-</u>	<u>(7,547)</u>	<u>-</u>	<u>-</u>
BALANCE, December 31, 2016	<u>\$ 110,380</u>	<u>\$ 20,165</u>	<u>\$ 8,220</u>	<u>\$ 60,155</u>	<u>\$ 22,092</u>	<u>\$ (252)</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

BANCTENN CORP. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2016 and 2015
(amounts in thousands)

	<u>2016</u>	<u>2015</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 10,820	\$ 8,910
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	2,550	2,194
Provision for loan losses	200	569
Deferred income taxes	84	19
Net amortization on securities	660	756
Other (gains) losses, net	(567)	(1,647)
Change in operating assets and liabilities:		
Accrued interest receivable	(169)	(143)
Accrued interest payable	4	(71)
Other assets and liabilities	<u>313</u>	<u>(567)</u>
Net cash provided by operating activities	<u>13,895</u>	<u>10,020</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales, maturities, prepayments and calls of securities	34,277	33,111
Purchase of securities	(11,858)	(19,767)
Decrease in certificates of deposit with other financial institutions	-	490
Purchase of restricted stock	(51)	-
Decrease in federal funds sold	-	12,000
Proceeds from sale of foreclosed real estate	610	725
Loan originations and principal collections, net	(100,475)	(67,956)
Purchase of premises and equipment	(4,549)	(1,206)
Proceeds from sale of premises and equipment	8	977
Purchase of annuity contracts	(13,290)	(210)
Proceeds from life insurance	-	2,872
(Purchase) proceeds from other equity investments	<u>(255)</u>	<u>37</u>
Net cash used in investing activities	<u>(95,583)</u>	<u>(38,927)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in demand deposits and NOW, money market, and savings accounts	107,612	31,609
Net decrease in time deposits	(313)	(19,454)
Net decrease in securities sold under agreements to repurchase	(17,322)	(3,222)
Net increase (decrease) in Federal Home Loan Bank advances	(6,094)	28,907
Issuance of common stock	243	-
Net ESOP transactions	529	433
Distributions to stockholders	<u>(7,547)</u>	<u>(5,786)</u>
Net cash provided by financing activities	<u>77,108</u>	<u>32,487</u>
NET INCREASE (DECREASE) IN CASH AND DUE FROM BANKS	<u>(4,580)</u>	<u>3,580</u>
CASH AND DUE FROM BANKS, beginning of year	<u>20,045</u>	<u>16,465</u>
CASH AND DUE FROM BANKS, end of year	<u>\$ 15,465</u>	<u>\$ 20,045</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for interest	<u>\$ 3,013</u>	<u>\$ 3,467</u>
NONCASH INVESTING ACTIVITIES		
Real estate acquired in settlement of loans	<u>\$ 578</u>	<u>\$ 405</u>

The Notes to Consolidated Financial Statements are an integral part of these statements.

BANCTENN CORP. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

BancTenn Corp. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly-owned Subsidiary, Bank of Tennessee (the "Bank"). The Bank generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in eastern and middle Tennessee. The Bank's primary deposit products are transaction and savings accounts and certificates of deposit. Its primary lending products are commercial loans, residential real estate loans, and consumer loans.

Basis of Presentation and Accounting Estimates

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. Significant intercompany balances and transactions have been eliminated in consolidation.

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, other-than-temporary impairments of securities, and the fair value of financial instruments.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

The Company's loans are generally secured by specific items of collateral including real property, consumer assets, and business assets. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on local economic conditions.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The Company has evaluated all transactions, events, and circumstances for consideration or disclosure through March 23, 2017, the date these financial statements were available to be issued, and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash, Due from Banks and Cash Flows

For purposes of reporting consolidated cash flows, cash and due from banks includes cash on hand, cash items in process of collection, amounts due from banks, and interest-bearing deposits in banks. Cash flows from loans, federal funds sold, federal funds purchased and securities sold under agreements to repurchase, Federal Home Loan Bank advances, borrowings under line of credit, ESOP transactions and deposits are reported net.

The Bank is required to maintain average balances in cash or on deposit with the Federal Reserve Bank. The total of those reserve balances was approximately \$1,470 and \$1,460 at December 31, 2016 and 2015, respectively.

Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as “held to maturity” and recorded at amortized cost. Securities not classified as held to maturity are classified as “available for sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

The Company evaluates investment securities for other-than-temporary impairment using relevant accounting guidance specifying that (a) if the Company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless a credit loss has occurred in the security. If management does not intend to sell the security and it is more likely than not that they will not have to sell the security before recovery of the cost basis, management will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income.

Securities borrowed or purchased under agreements to resell and securities loaned or sold under agreements to repurchase are treated as collateralized financial transactions. These agreements are recorded at the amount at which the securities were acquired or sold plus accrued interest. It is the Company’s policy to take possession of securities purchased under resale agreements. The market value of these securities is monitored, and additional securities are obtained when deemed appropriate to ensure such transactions are adequately collateralized. The Company also monitors its exposure with respect to securities sold under repurchase agreements, and a request for the return of excess securities held by the counterparty is made when deemed appropriate.

Restricted Equity Investments

The Company is required to maintain an investment in capital stock of various entities. Based on redemption provisions of these entities, the stock has no quoted market value and is carried at cost. At their discretion, these entities may declare dividends on the stock. Management reviews for impairment based on the ultimate recoverability of the cost basis in these stocks.

Equity Investments

The Company maintains equity investments in various financial institutions for which it has no substantial influence, generally considered to be an investment of 20% or less. Further, these investments have no readily determinable fair value. These investments have been accounted for at the lower of historical cost, or fair market value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off are reported at their outstanding principal balances less the allowance for loan losses. Interest income is accrued on the outstanding principal balance. The Company does not defer loan fees and related loan origination costs. Based on management's assessment, the difference between deferral and immediate recognition of such fees and related costs is not material.

The accrual of interest on loans is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due, or at the time the loan is 90 days past due, unless the loan is well-secured and in the process of collection. Other personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal and interest is considered doubtful. All interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income or charged to the allowance unless management believes that the accrual of interest is recoverable through the liquidation of collateral. Interest income on nonaccrual loans is recognized on the cash basis or cost recovery method, until the loans are returned to accrual status. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and the loan has been performing according to the contractual terms generally for a period of not less than six months.

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 expense. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Confirmed losses are charged off immediately. Subsequent recoveries, if any, are credited to the allowance.

The allowance is an amount that management believes will be adequate to absorb estimated losses relating to specifically identified loans, as well as probable credit losses inherent in the balance of the loan portfolio. The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the uncollectibility of loans in light of historical experience, the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, current economic conditions that may affect the borrower's ability to pay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. This evaluation does not include the effects of expected losses on specific loans or groups of loans that are related to future events or expected changes in economic conditions. While management uses the best information available to make its evaluation, future adjustments to the allowance may be necessary if there are significant changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses, and may require the Company to make additions to the allowance based on their judgment about information available to them at the time of their examinations.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are classified as impaired. For impaired loans, an allowance is established when the discounted cash flows, collateral value, or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for other qualitative factors. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses (Continued)

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans, for which the terms have been modified at the borrower's request, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest when due.

Loans that experience insignificant payment delays and payment shortfalls are not classified as impaired. Impaired loans are measured 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. Interest on accruing impaired loans is recognized as long as such loans do not meet the criteria for nonaccrual status. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment.

The Company's homogeneous loan pools include residential real estate loans, commercial real estate loans, construction and land development loans, commercial and industrial loans, and consumer and other loans. The general allocations to these loan pools are based on the historical loss rates for specific loan types and the internal risk grade, if applicable, adjusted for both internal and external qualitative risk factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) the impact of competition on loan structuring and pricing; (6) the impact of interest rate changes on portfolio risk and (7) effectiveness of the Company's loan policies, procedures and internal controls. The total allowance established for each homogeneous loan pool represents the product of the historical loss ratio and the total dollar amount of the loans in the pool.

Troubled Debt Restructurings

The Company designates loan modifications as troubled debt restructurings ("TDRs") when, for economic and legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. TDRs can involve loans remaining on nonaccrual, moving to nonaccrual, or continuing on accrual status, depending on the individual facts and circumstances of the borrower. In circumstances where the TDR involves charging off a portion of the loan balance, the Company typically classifies these restructurings as nonaccrual.

In connection with restructurings, the decision to maintain a loan that has been restructured on accrual status is based on a current, well documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation includes consideration of the borrower's current capacity to pay, which among other things may include a review of the borrower's current financial statements, an analysis of global cash flow sufficient to pay all debt obligations, a debt to income analysis, and an evaluation of secondary sources of payment from the borrower and any guarantors. This evaluation also includes an evaluation of the borrower's current willingness to pay, which may include a review of past payment history, an evaluation of the borrower's willingness to provide information on a timely basis, and consideration of offers from the borrower to provide additional collateral or guarantor support. The credit evaluation also reflects consideration of the borrower's future capacity and willingness to pay, which may include evaluation of cash flow projections, consideration of the adequacy of collateral to cover all principal and interest, and trends indicating improving profitability and collectability of receivables.

Restructured nonaccrual loans may be returned to accrual status based on a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment under the modified terms. This evaluation must include consideration of the borrower's sustained historical repayment for a reasonable period, generally a minimum of six months, prior to the date on which the loan is returned to accrual status.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivatives

Derivatives are recognized as assets and liabilities on the consolidated balance sheets and measured at fair value. For exchange-traded contracts, fair value is based on quoted market prices. For non-exchange traded contracts, fair value is based on dealer quotes, pricing models, discounted cash flow methodologies, or similar techniques for which the determination of fair value may require significant management judgment or estimation.

For asset/liability management purposes, the Company and Bank use interest rate swap agreements to hedge various exposures or to modify interest rate characteristics of various balance sheet accounts. Interest rate swaps are contracts in which a series of interest rate cash flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged. These swap agreements are derivative instruments and generally convert a portion of the Company's and Bank's variable-rate debt and loans to a fixed rate.

The effective portion of the gain or loss on a derivative designated and qualifying as a cash flow hedging instrument is initially reported as a component of other comprehensive income and subsequently reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The ineffective portion of the gain or loss on the derivative instrument, if any, is recognized in current earnings.

Interest rate derivative financial instruments receive hedge accounting treatment only if they are designated as a cash flow hedge and are expected to be, and are, effective in substantially reducing interest rate risk arising from the assets and liabilities identified as exposing the Company and Bank to risk. Those derivative financial instruments that do not meet specified hedging criteria are recorded at fair value with changes in fair value recorded in income. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivative contracts would be closed out and settled, or classified as a trading activity.

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 - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 or the ability to unilaterally cause the holder to return specific assets.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value. Loans held for sale are classified as loans on the consolidated balance sheets and were \$9,933 and \$5,408 for the years ended December 31, 2016 and 2015, respectively.

Loan origination fees and related origination costs are recognized upon sale of loans to third parties. Gains and losses on sale of loans are recognized at the time of the sale. Losses on sales of loans are recognized when management has determined that such loans will be sold at a price less than the carrying value. Gains and losses are determined by the difference between the net sales proceeds and the cost basis of the loans sold.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premises and Equipment

Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line and the declining balance methods based principally on the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in other operating expenses.

	<u>Years</u>
Buildings	15-39
Furniture, fixtures and equipment	3-10

Foreclosed Real Estate

Foreclosed real estate acquired through, or in lieu of, loan foreclosure is held for sale and is initially recorded at fair value less estimated costs to sell. Any write-down to fair value at the time of transfer is charged to the allowance for loan losses. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less estimated costs to sell. Costs of improvements are capitalized, whereas costs related to holding foreclosed real estate and subsequent write-downs to value are expensed. The amount of residential real estate where physical possession had been obtained included within foreclosed real estate at December 31, 2016 and 2015 was \$55 and \$205, respectively. The recorded investment in consumer mortgage loans secured by residential real estate properties where formal foreclosure procedures are in process at December 31, 2016 and December 31, 2015 was \$243 and \$81, respectively.

Income Taxes

The Company has elected to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Earnings and losses are included in the personal income tax returns of the stockholders and taxed depending on their personal tax strategies. Accordingly, the Company does not incur federal income tax obligations, and the financial statements do not include a provision for federal income taxes. The Company incurs state income taxes, and the consolidated financial statements include a provision (benefit) for the state tax effect of transactions reported in the consolidated financial statements.

The income tax accounting guidance results in two components of state income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method.

Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. The Company's deferred taxes relate primarily to differences between the tax and book basis of the allowance for loan losses and accumulated depreciation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets may be reduced by deferred tax liabilities and a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred. Advertising expense charged to operations was \$100 and \$77 for the years ended December 31, 2016 and 2015, respectively.

Stock Compensation Plan

At December 31, 2016 and 2015, the Company had options outstanding under a stock-based compensation plan, which is described in more detail in Note 12. The plan has been accounted for under the accounting guidance (FASB ASC 718, *Compensation - Stock Compensation*) which requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employees' service period, generally defined as the vesting period. For awards with graded-vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award. A Black-Scholes model is used to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards and stock grants.

Variable Interest Entities

An entity is referred to as a variable interest entity (VIE) if it meets the criteria outlined in ASC Topic 810, which are: (1) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors that cannot make significant decisions about the entity's operations or that do not absorb the expected losses or receive the expected returns of the entity. A VIE must be consolidated by the Company if it is deemed to be the primary beneficiary of the VIE, which is the party involved with the VIE that has a majority of the expected losses, expected residual returns, or both. The Company has two wholly-owned subsidiary grantor trusts which are deemed to be VIEs. These two VIEs have not been consolidated by the Company as BancTenn Corp. is not the primary beneficiary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Employee Benefit Plan

Employee benefit plan costs are based on a percentage of individual employee's salary, not to exceed the amount that can be deducted for federal income tax purposes.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and cash flow hedges, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassifications

Certain amounts in the 2015 consolidated financial statements have been reclassified to conform to the 2016 presentation. Such reclassifications had no impact on total assets, total stockholders' equity or net income.

NOTE 2. SECURITIES

The amortized cost and fair value of investment securities at December 31, 2016 and 2015, are as follows:

	2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities available for sale:				
U.S. Government-sponsored enterprises (GSEs)	\$ 33,990	\$ 178	\$ (500)	\$ 33,668
Obligations of states and political subdivisions	85,801	894	(733)	85,962
Mortgage backed securities:				
Government National Mortgage Association guaranteed	6,870	95	(45)	6,920
GSE residential	44,288	197	(409)	44,076
Equity securities	<u>10,638</u>	<u>24,215</u>	<u>(70)</u>	<u>34,783</u>
	<u>\$181,587</u>	<u>\$25,579</u>	<u>\$(1,757)</u>	<u>\$205,409</u>
Debt securities held to maturity:				
Obligations of states and political subdivisions	\$ 1,113	\$ -	\$ (43)	\$ 1,070
Mortgage backed securities:				
GSE residential	<u>2,437</u>	<u>17</u>	<u>(12)</u>	<u>2,442</u>
	<u>\$ 3,550</u>	<u>\$ 17</u>	<u>\$ (55)</u>	<u>\$ 3,512</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 2. SECURITIES (Continued)

	2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Debt securities available for sale:				
U.S. Government-sponsored enterprises (GSEs)	\$ 35,474	\$ 279	\$(269)	\$ 35,484
Obligations of states and political subdivisions	87,141	2,144	(128)	89,157
Mortgage backed securities:				
Government National Mortgage Association guaranteed	7,108	210	(10)	7,308
GSE residential	64,405	298	(581)	64,122
Equity securities	<u>11,492</u>	<u>11,784</u>	<u>-</u>	<u>23,276</u>
	<u>\$205,620</u>	<u>\$14,715</u>	<u>\$(988)</u>	<u>\$219,347</u>
Debt securities held to maturity:				
Obligations of states and political subdivisions	\$ 148	\$ -	\$ -	\$ 148
Mortgage backed securities:				
GSE residential	<u>1,446</u>	<u>41</u>	<u>-</u>	<u>1,487</u>
	<u>\$ 1,594</u>	<u>\$ 41</u>	<u>\$ -</u>	<u>\$ 1,635</u>

U.S. Government sponsored enterprises include entities such as Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, and Federal Home Loan Banks.

The scheduled maturities of securities available for sale and securities held to maturity at December 31, 2016, are as follows:

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	\$ 5,534	\$ 5,552	\$ -	\$ -
Due from one to five years	36,144	36,419	113	113
Due from five to ten years	34,101	34,175	-	-
Due after ten years	44,012	43,484	1,000	957
Mortgage-backed securities	51,158	50,996	2,437	2,442
Securities with no stated maturity	<u>10,638</u>	<u>34,783</u>	<u>-</u>	<u>-</u>
	<u>\$181,587</u>	<u>\$205,409</u>	<u>\$3,550</u>	<u>\$3,512</u>

During the years ended December 31, 2016 and 2015, proceeds from sales of securities available for sale and other equity investments were \$10,960 and \$9,428, respectively. The Company recognized gross gains of \$644 and gross losses of \$2 for 2016, and gross gains of \$164 and gross losses of \$265 for 2015.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 2. SECURITIES (Continued)

Temporarily Impaired Securities

The following tables show the gross unrealized losses and fair value of the Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2016 and 2015.

	<u>Less Than 12 Month</u>		<u>12 Months or More</u>		
	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>	<u>Gross Unrealized Losses</u>	<u>Total Unrealized Losses</u>
December 31, 2016:					
Available for sale securities:					
U.S. Government-sponsored enterprises (GSEs)	\$25,832	\$ (500)	\$ -	\$ -	\$ (500)
Obligations of states and political subdivisions	39,946	(733)	-	-	(733)
Mortgage-backed securities-					
Government National Mortgage Association guaranteed	2,935	(41)	331	(4)	(45)
GSE residential	24,579	(325)	2,533	(84)	(409)
Equity securities	<u>129</u>	<u>(70)</u>	<u>-</u>	<u>-</u>	<u>(70)</u>
	<u>\$93,421</u>	<u>\$(1,669)</u>	<u>\$ 2,864</u>	<u>\$ (88)</u>	<u>\$(1,757)</u>
Debt securities held to maturity:					
Obligations of states and political subdivisions	\$ 957	\$ (43)	\$ -	\$ -	\$ (43)
Mortgage-backed securities-					
GSE residential	<u>1,698</u>	<u>(12)</u>	<u>-</u>	<u>-</u>	<u>(12)</u>
	<u>\$ 2,655</u>	<u>\$ (55)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (55)</u>
December 31, 2015:					
Available for sale securities:					
U.S. Government-sponsored enterprises (GSEs)	\$ 9,256	\$ (60)	\$11,125	\$(209)	\$ (269)
Obligations of states and political subdivisions	6,360	(35)	4,158	(93)	(128)
Mortgage-backed securities-					
Government National Mortgage Association guaranteed	-	-	471	(10)	(10)
GSE residential	<u>26,509</u>	<u>(278)</u>	<u>11,800</u>	<u>(303)</u>	<u>(581)</u>
	<u>\$42,125</u>	<u>\$ (373)</u>	<u>\$27,554</u>	<u>\$(615)</u>	<u>\$ (988)</u>

For U.S. Government-sponsored enterprises and mortgage-backed securities, the unrealized losses on the securities shown above were caused by interest rate increases. For obligations of states and political subdivisions, the unrealized losses were caused by the interest rate environment and reduced desirability for long-duration obligations of states and political subdivisions. The unrealized loss on the one equity security is based on normal stock price fluctuations. It is expected that the securities would not be settled at a price less than the amortized cost bases of the investments. Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2016.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 2. SECURITIES (Continued)

Temporarily Impaired Securities (Continued)

Securities with a carrying value of approximately \$105,907 and \$147,060 at December 31, 2016 and 2015, respectively, were pledged to secure various deposits and borrowings.

Restricted equity investments, at cost, consist of the following:

	<u>2016</u>	<u>2015</u>
Federal Home Loan Bank stock	\$4,069	\$4,018
Pacific Coast Bankers Bank stock	<u>102</u>	<u>102</u>
	<u>\$4,171</u>	<u>\$4,120</u>

NOTE 3. OTHER EQUITY INVESTMENTS, AT COST

Other equity investments, at cost consist of the following:

	<u>2016</u>	<u>2015</u>
Union Bank	\$ 652	\$ 652
Great State Bank	-	200
Other	<u>49</u>	<u>209</u>
	<u>\$ 701</u>	<u>\$1,061</u>

Management reviews for impairment based on the ultimate recoverability of the cost basis of these investments. At December 31, 2016 and 2015, management has determined there is no impairment.

During 2016, Great State Bank became listed securities with the National Association of Securities Dealers Automated Quotations system or OTC Market Group, Inc. and is considered to have a readily determinable fair value. Therefore, these securities are reported within securities available for sale at December 31, 2016.

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Portfolio Segmentation

At December 31, 2016 and 2015, the Company's loans consist of the following:

	<u>2016</u>	<u>2015</u>
Commercial real estate	\$268,777	\$236,805
Residential real estate	341,184	307,835
Construction and land development	63,768	58,208
Commercial and industrial	81,327	51,764
Consumer and other	<u>30,132</u>	<u>31,091</u>
Total loans	785,188	685,703
Less - Allowance for loan losses	<u>(7,401)</u>	<u>(7,603)</u>
Net loans	<u>\$777,787</u>	<u>\$678,100</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Portfolio Segmentation (Continued)

For purposes of the disclosures required by ASC 310, the loan portfolio was disaggregated into segments. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. There are five loan portfolio segments that include commercial real estate, residential real estate, construction and land development, commercial and industrial, and consumer and other.

The following describe risk characteristics relevant to each of the portfolio segments:

Commercial Real Estate: Include owner-occupied commercial real estate loans and loans secured by income producing properties. Owner-occupied commercial real estate loans to operating businesses are long-term financing of land and buildings. These loans are repaid by cash flow generated from the business operation. Real estate loans for income-producing properties such as apartment buildings, office and industrial buildings, and retail shopping centers are repaid from rent income derived from the properties. Loans within this segment are particularly sensitive to the valuation of real estate collateral.

Residential Real Estate: Include 1-4 family residential real estate loans, second liens, or open end real estate loans, such as home equity lines and up to four unit multifamily residential loans. These are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property. These loans are sensitive to the valuation of real estate collateral, unemployment and other key economic measures.

Construction and Land Development: Loans for real estate construction and land development are repaid through cash flow related to the operations, sale or refinance of the underlying property. This portfolio segment includes extensions of credit to real estate developers or investors where repayment is dependent on the sale of the real estate or income generated from the real estate collateral. These loans are particularly sensitive to the valuation of real estate.

Commercial and Industrial: Include commercial, financial and agricultural loans. These loans include those loans to commercial customers for use in normal business operations to finance working capital needs, equipment purchases, or expansion projects. Loans are repaid by business cash flows. Collection risk in this portfolio is driven by the creditworthiness of the underlying borrower, particularly cash flows from the customers' business operations.

Consumer and Other: The consumer loan portfolio segment includes direct consumer installment loans, overdrafts and other revolving credit loans, and loans secured by farmland. Loans in this portfolio are sensitive to unemployment and other key consumer economic measures.

Credit Risk Management

The Company employs a credit risk management process with defined policies, accountability and routine reporting to manage credit risk in the loan portfolio segments. Credit risk management is guided by credit policies that provide for a consistent and prudent approach to underwriting and approvals of credits. Within the Credit Policy, procedures exist that elevate the approval requirements as credits become larger and more complex. All loans are individually underwritten, risk-rated, approved, and monitored.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

Responsibility and accountability for adherence to underwriting policies and accurate risk ratings lies in each portfolio segment. For the residential real estate and consumer and other portfolio segments, the risk management process focuses on managing customers who become delinquent in their payments. For the commercial and industrial, commercial real estate and construction and land development portfolio segments, the risk management process focuses on underwriting new business and, on an ongoing basis, monitoring the credit of the portfolios, including a third party review of the largest credits on an annual basis or more frequently as needed. To ensure problem credits are identified on a timely basis, several specific portfolio reviews occur periodically to assess the larger adversely rated credits for proper risk rating and accrual status.

Credit quality and trends in the loan portfolio segments are measured and monitored regularly. Detailed reports, by product, collateral, accrual status, etc., are reviewed by the Senior Credit Officer and the Directors Loan Committee.

The allowance for loan losses is a valuation reserve allowance established through provisions for loan losses charged against income. The allowance for loan losses, which is evaluated monthly, is maintained at a level that management deems sufficient to absorb probable losses inherent in the loan portfolio.

Loans deemed to be uncollectible are charged against the allowance for loan losses, while recoveries of previously charged-off amounts are credited to the allowance for loan losses. The allowance for loan losses is comprised of specific valuation allowances for loans evaluated individually for impairment, general allocations for pools of homogeneous loans with similar risk characteristics and trends, and an unallocated component that reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

The allowance for loan losses related to specific loans is based on management's estimate of potential losses on impaired loans as determined by (1) the present value of expected future cash flows; (2) the fair value of collateral if the loan is determined to be collateral dependent or (3) the loan's observable market price. The Company's homogeneous loan pools include commercial real estate loans, residential real estate loans, construction and land development loans, commercial and industrial loans, and consumer and other loans.

The general allocations to these loan pools are based on the historical loss rates for specific loan types and the internal risk grade, if applicable, adjusted for both internal and external qualitative risk factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) the impact of competition on loan structuring and pricing; (6) the impact of interest rate changes on portfolio risk and (7) effectiveness of the Company's loan policies, procedures and internal controls. The total allowance established for each homogeneous loan pool represents the product of the historical loss ratio and the total dollar amount of the loans in the pool.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

The following tables detail activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2016 and 2015. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Year Ended December 31, 2016						Total
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Unallocated	
Balance, beginning of year	\$2,784	\$2,575	\$1,125	\$325	\$ 431	\$ 363	\$ 7,603
Provision for (reallocation of) loan losses	712	(28)	(226)	167	(143)	(282)	200
Recoveries of loans charged off	8	306	96	19	562	-	991
Loans charged off	(719)	(252)	-	(12)	(410)	-	(1,393)
Balance, end of year	<u>\$2,785</u>	<u>\$2,601</u>	<u>\$ 995</u>	<u>\$499</u>	<u>\$ 440</u>	<u>\$ 81</u>	<u>\$ 7,401</u>

	Year Ended December 31, 2015						Total
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Unallocated	
Balance, beginning of year	\$1,169	\$2,050	\$1,184	\$285	\$ 221	\$ 2,534	\$ 7,443
Provision for (reallocation of) loan losses	1,578	585	379	66	132	(2,171)	569
Recoveries of loans charged off	106	142	50	13	323	-	634
Loans charged off	(69)	(202)	(488)	(39)	(245)	-	(1,043)
Balance, end of year	<u>\$2,784</u>	<u>\$2,575</u>	<u>\$1,125</u>	<u>\$325</u>	<u>\$ 431</u>	<u>\$ 363</u>	<u>\$ 7,603</u>

The composition of loans by primary loan classification as well as impaired and performing loan status at December 31, 2016 and 2015, is summarized in the tables below:

	December 31, 2016					Total
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	
Performing loans	\$261,899	\$339,129	\$62,827	\$81,280	\$29,423	\$774,558
Impaired loans	<u>6,878</u>	<u>2,055</u>	<u>941</u>	<u>47</u>	<u>709</u>	<u>10,630</u>
Total loans	<u>\$268,777</u>	<u>\$341,184</u>	<u>\$63,768</u>	<u>\$81,327</u>	<u>\$30,132</u>	<u>\$785,188</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

	December 31, 2015					
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Total
Performing loans	\$229,251	\$305,281	\$57,577	\$51,650	\$30,156	\$673,915
Impaired loans	<u>7,554</u>	<u>2,554</u>	<u>631</u>	<u>114</u>	<u>935</u>	<u>11,788</u>
Total loans	<u>\$236,805</u>	<u>\$307,835</u>	<u>\$58,208</u>	<u>\$51,764</u>	<u>\$31,091</u>	<u>\$685,703</u>

The following tables show the allowance for loan losses allocation by loan classification for impaired and performing loans as of December 31, 2016 and 2015:

	December 31, 2016						
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Unallocated	Total
Allowance related to:							
Performing loans	\$1,880	\$2,535	\$ 995	\$499	\$364	\$ 81	\$6,354
Impaired loans	<u>905</u>	<u>66</u>	<u>-</u>	<u>-</u>	<u>76</u>	<u>-</u>	<u>1,047</u>
Total allowance	<u>\$2,785</u>	<u>\$2,601</u>	<u>\$ 995</u>	<u>\$499</u>	<u>\$440</u>	<u>\$ 81</u>	<u>\$7,401</u>

	December 31, 2015						
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Unallocated	Total
Allowance related to:							
Performing loans	\$1,743	\$2,460	\$1,125	\$325	\$374	\$363	\$6,390
Impaired loans	<u>1,041</u>	<u>115</u>	<u>-</u>	<u>-</u>	<u>57</u>	<u>-</u>	<u>1,213</u>
Total allowance	<u>\$2,784</u>	<u>\$2,575</u>	<u>\$1,125</u>	<u>\$325</u>	<u>\$431</u>	<u>\$363</u>	<u>\$7,603</u>

A description of the general characteristics of the risk grades used by the Company is as follows:

Pass: Loans in this risk category involve borrowers of acceptable-to-strong credit quality and risk who have the apparent ability to satisfy their loan obligations. Loans in this risk grade would possess sufficient mitigating factors, such as adequate collateral or strong guarantors possessing the capacity to repay the debt if required, for any weakness that may exist.

Special Mention: Loans in this risk grade are the equivalent of the regulatory definition of "Other Assets Especially Mentioned" classification. Loans in this category possess some credit deficiency or potential weakness, which requires a high level of management attention. Potential weaknesses include declining trends in operating earnings and cash flows and /or reliance on the secondary source of repayment. If left uncorrected, these potential weaknesses may result in noticeable deterioration of the repayment prospects for the asset or in the Company's credit position.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Credit Risk Management (Continued)

Substandard: Loans in this risk grade are inadequately protected by the borrower's current financial condition and payment capability or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the orderly repayment of debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans in this risk grade have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or orderly repayment in full, on the basis of current existing facts, conditions and values, highly questionable and improbable. Possibility of loss is extremely high, but because of certain important and reasonably specific factors that may work to the advantage and strengthening of the exposure, its classification as an estimated loss is deferred until its more exact status may be determined.

Uncollectable: Loans in this risk grade are considered to be non-collectible and of such little value that their continuance as bankable assets is not warranted. This does not mean the loan has absolutely no recovery value, but rather it is neither practical nor desirable to defer writing off the loan, even though partial recovery may be obtained in the future. Charge-offs against the allowance for loan losses are taken in the period in which the loan becomes uncollectible. Consequently, the Company typically does not maintain a recorded investment in loans within this category.

The following tables outline the amount of each loan classification and the amount categorized into each risk rating as of December 31, 2016 and 2015:

	December 31, 2016					
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Total
Pass	\$261,862	\$335,118	\$62,686	\$81,000	\$29,311	\$769,977
Special mention	-	-	-	-	-	-
Substandard	6,915	6,066	1,082	327	821	15,211
Doubtful	-	-	-	-	-	-
Total	<u>\$268,777</u>	<u>\$341,184</u>	<u>\$63,768</u>	<u>\$81,327</u>	<u>\$30,132</u>	<u>\$785,188</u>

	December 31, 2015					
	Commercial Real Estate	Residential Real Estate	Construction and Land Development	Commercial and Industrial	Consumer and Other	Total
Pass	\$228,971	\$302,268	\$57,478	\$51,485	\$30,663	\$670,865
Special mention	-	46	-	-	-	46
Substandard	7,834	5,521	730	279	428	14,792
Doubtful	-	-	-	-	-	-
Total	<u>\$236,805</u>	<u>\$307,835</u>	<u>\$58,208</u>	<u>\$51,764</u>	<u>\$31,091</u>	<u>\$685,703</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Past Due Loans

A loan is considered past due if any required principal and interest payments have not been received as of the date such payments were required to be made under the terms of the loan agreement. Generally, management places loans on non-accrual when there is a clear indication that the borrower's cash flow may not be sufficient to meet payments as they become due, which is generally when a loan is 90 days past due. The following tables present the aging of the recorded investment in loans and leases as of December 31, 2016 and 2015:

	December 31, 2016					
	30-89 Days Past Due and Accruing	Past Due 90 Days or More and Accruing	Nonaccrual	Total Past Due	Current Loans	Total Loans
Commercial real estate	\$ 633	\$ -	\$3,324	\$ 3,957	\$264,820	\$268,777
Residential real estate	2,921	188	4,196	7,305	333,879	341,184
Construction and land development	79	-	643	722	63,046	63,768
Commercial and industrial	150	-	30	180	81,147	81,327
Consumer and other	<u>382</u>	<u>-</u>	<u>606</u>	<u>988</u>	<u>29,144</u>	<u>30,132</u>
Total	<u>\$4,165</u>	<u>\$188</u>	<u>\$8,799</u>	<u>\$13,152</u>	<u>\$772,036</u>	<u>\$785,188</u>

	December 31, 2015					
	30-89 Days Past Due and Accruing	Past Due 90 Days or More and Accruing	Nonaccrual	Total Past Due	Current Loans	Total Loans
Commercial real estate	\$2,111	\$ -	\$ 744	\$ 2,855	\$233,950	\$236,805
Residential real estate	4,801	6	2,791	7,598	300,237	307,835
Construction and land development	51	-	217	268	57,940	58,208
Commercial and industrial	100	-	56	156	51,608	51,764
Consumer and other	<u>277</u>	<u>-</u>	<u>470</u>	<u>747</u>	<u>30,344</u>	<u>31,091</u>
Total	<u>\$7,340</u>	<u>\$ 6</u>	<u>\$4,278</u>	<u>\$11,624</u>	<u>\$674,079</u>	<u>\$685,703</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans

A loan held for investment is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement. The following tables detail impaired loans, by portfolio segment as of December 31, 2016 and 2015:

	<u>As of December 31, 2016</u>			<u>For the Year Ended December 31, 2016</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Impaired loans without a valuation allowance:					
Commercial real estate	\$ 3,408	\$ 3,408	\$ -	\$3,228	\$241
Residential real estate	1,399	1,399	-	1,522	353
Construction and land development	941	941	-	786	57
Commercial and industrial	47	47	-	81	19
Consumer and other	<u>335</u>	<u>335</u>	<u>-</u>	<u>485</u>	<u>75</u>
Total	<u>6,130</u>	<u>6,130</u>	<u>-</u>	<u>6,102</u>	<u>745</u>
Impaired loans with a valuation allowance:					
Commercial real estate	3,470	3,470	905	3,988	111
Residential real estate	656	656	66	783	42
Construction and land development	-	-	-	-	-
Commercial and industrial	-	-	-	-	-
Consumer and other	<u>374</u>	<u>374</u>	<u>76</u>	<u>337</u>	<u>10</u>
Total	<u>4,500</u>	<u>4,500</u>	<u>1,047</u>	<u>5,108</u>	<u>163</u>
Total impaired loans	<u>\$10,630</u>	<u>\$10,630</u>	<u>\$1,047</u>	<u>\$11,210</u>	<u>\$908</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Impaired Loans (Continued)

	<u>As of December 31, 2015</u>			<u>For the Year Ended December 31, 2015</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Impaired loans without a valuation allowance:					
Commercial real estate	\$ 3,048	\$ 3,048	\$ -	\$ 4,540	\$ 198
Residential real estate	1,645	1,645	-	1,845	427
Construction and land development	631	631	-	1,462	91
Commercial and industrial	114	114	-	121	20
Consumer and other	<u>635</u>	<u>635</u>	<u>-</u>	<u>1,017</u>	<u>117</u>
Total	<u>6,073</u>	<u>6,073</u>	<u>-</u>	<u>8,985</u>	<u>853</u>
Impaired loans with a valuation allowance:					
Commercial real estate	4,506	4,506	1,041	3,033	212
Residential real estate	909	909	115	1,885	8
Construction and land development	-	-	-	-	-
Commercial and industrial	-	-	-	131	-
Consumer and other	<u>300</u>	<u>300</u>	<u>57</u>	<u>168</u>	<u>-</u>
Total	<u>5,715</u>	<u>5,715</u>	<u>1,213</u>	<u>5,217</u>	<u>220</u>
Total impaired loans	<u>\$11,788</u>	<u>\$11,788</u>	<u>\$1,213</u>	<u>\$14,202</u>	<u>\$1,073</u>

Troubled Debt Restructurings

At December 31, 2016 and 2015, impaired loans included loans that were classified as Troubled Debt Restructurings "TDRs". The restructuring of a loan is considered a TDR if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession.

In assessing whether or not a borrower is experiencing financial difficulties, the Company considers information currently available regarding the financial condition of the borrower. This information includes, but is not limited to, whether (i) the debtor is currently in payment default on any of its debt; (ii) a payment default is probable in the foreseeable future without the modification; (iii) the debtor has declared or is in the process of declaring bankruptcy and (iv) the debtor's projected cash flow is sufficient to satisfy contractual payments due under the original terms of the loan without a modification.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Troubled Debt Restructurings (Continued)

The Company considers all aspects of the modification to loan terms to determine whether or not a concession has been granted to the borrower. Key factors considered by the Company include the debtor's ability to access funds at a market rate for debt with similar risk characteristics, the significance of the modification relative to unpaid principal balance or collateral value of the debt, and the significance of a delay in the timing of payments relative to the original contractual terms of the loan.

The most common concessions granted by the Company generally include one or more modifications to the terms of the debt, such as (i) a reduction in the interest rate for the remaining life of the debt, (ii) an extension of the maturity date at an interest rate lower than the current market rate for new debt with similar risk, (iii) a temporary period of interest-only payments, and (iv) a reduction in the contractual payment amount for either a short period or remaining term of the loan. As of December 31, 2016 and 2015, management had \$3,193 and \$6,461, respectively, in loans considered restructured that are not on nonaccrual. Of the nonaccrual loans at December 31, 2016 and 2015, \$2,737 and \$941, respectively met the criteria for restructured. A loan is placed back on accrual status when both principal and interest are current and it is probable that management will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following table presents a summary of loans that were modified as troubled debt restructurings during the year ended December 31, 2015. There were no loans modified as troubled debt restructurings during the year ended December 31, 2016.

	<u>Number of Contracts</u>	<u>Year Ended December 31, 2015</u>	
		<u>Pre-Modification Outstanding Recorded Investment</u>	<u>Post-Modification Outstanding Recorded Investment</u>
Commercial real estate	5	\$2,028	\$2,028

The following table present a summary of loans that were modified as troubled debt restructurings during the year ended December 31, 2015, and for which there was a subsequent payment default during the year:

	<u>Year Ended December 31, 2015</u>	
	<u>Number of Contracts</u>	<u>Recorded Investment</u>
Commercial real estate	3	\$1,751

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES (Continued)

Related Party Loans

In the ordinary course of business, the Company has granted loans to certain related parties, including directors, executive officers, and their affiliates. The interest rates on these loans were substantially the same as rates prevailing at the time of the transaction and repayment terms are customary for the type of loan. The total of these loans was approximately \$15,729 and \$15,125 at December 31, 2016 and 2015, respectively.

NOTE 5. PREMISES AND EQUIPMENT

A summary of premises and equipment at December 31, 2016 and 2015, is as follows:

	<u>2016</u>	<u>2015</u>
Land	\$ 6,433	\$ 6,377
Buildings and leasehold improvements	32,878	32,676
Furniture and equipment	16,049	16,087
Transportation equipment	1,175	1,189
Construction in progress	<u>4,097</u>	<u>81</u>
	60,632	56,410
Accumulated depreciation	<u>(28,967)</u>	<u>(26,744)</u>
	<u>\$ 31,665</u>	<u>\$ 29,666</u>

At December 31, 2016, management estimates the costs necessary to complete the construction in progress will be approximately \$2,400.

NOTE 6. DEPOSITS

The composition of deposits at December 31, 2016 and 2015, is as follows:

	<u>2016</u>	<u>2015</u>
Demand deposits, noninterest bearing	\$245,433	\$218,252
NOW accounts	197,637	178,664
Money market accounts	234,097	187,266
Savings accounts	117,070	102,443
Time deposits	<u>92,771</u>	<u>93,084</u>
	<u>\$887,008</u>	<u>\$779,709</u>

The aggregate amount of time deposits in denominations of \$250 or more at December 31, 2016 and December 31, 2015 were approximately \$19,821 and \$10,731, respectively. At December 31, 2016 and 2015, the scheduled maturities of time deposits are as follows:

	<u>2016</u>	<u>2015</u>
Less than one year	\$75,776	\$72,309
One through three years	12,659	13,852
Three through five years	<u>4,336</u>	<u>6,923</u>
	<u>\$92,771</u>	<u>\$93,084</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 7. SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase represent the purchase of interest in securities by commercial checking customers. The Company may also enter into structured repurchase agreements with other financial institutions. Repurchase agreements with commercial checking customers generally settle the following business day, while structured repurchase agreements with other financial institutions will have varying terms.

At December 31, 2016 and 2015, the Company had securities sold under agreements to repurchase of \$986 and \$18,308, respectively, with commercial checking customers.

NOTE 8. FEDERAL HOME LOAN BANK ADVANCES

The Bank has an agreement with the Federal Home Loan Bank (FHLB) that can provide short-term and long-term funding to the Bank in an amount up to \$304,279. The Bank has pledged its loans secured by one to four single-family mortgages, second mortgages and home equity lines, multi-family, commercial real estate, and agricultural real estate properties. The collateral to loan ratio ranges from 115% to 235%.

At December 31, 2016 and 2015, FHLB advances consist of the following:

	<u>2016</u>	<u>2015</u>
Long-term advance requiring monthly interest payments, fixed at 2.86%, principal due December 2017	\$10,000	\$10,000
Long-term advance requiring monthly interest payments, fixed at 4.25%, principal due January 2017	5,000	5,000
Long-term advance requiring monthly interest payments, fixed at 2.99%, principal due September 2018	5,000	5,000
Long-term amortizing advance requiring monthly principal and interest payments, fixed at 2.30%, matures February 2023	1,848	1,915
Long-term amortizing advance requiring monthly principal and interest payments, fixed at 2.00%, matures July 2030	433	460
Repo based advance, principal and interest due at maturity, fixed at 0.68%, matures March 10, 2017	15,000	-
Overnight advance, principal and interest due at maturity, fixed at 0.64%, matures January 3, 2017 (January 2, 2016 for 2015)	<u>21,000</u>	<u>42,000</u>
	<u>\$58,281</u>	<u>\$64,375</u>

The long-term advances may be prepaid subject to a prepayment penalty as defined in the agreements. The FHLB has the right to exercise a put on certain of these advances as defined in the agreements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 8. FEDERAL HOME LOAN BANK ADVANCES (Continued)

Aggregate principal payments required on FHLB borrowings at December 31, 2016, are as follows:

2017	\$51,000
2018	5,000
2019	-
2020	-
2021	-
Thereafter	<u>2,281</u>
	<u>\$58,281</u>

NOTE 9. SUBORDINATED DEBENTURES

Effective June 22, 2004 and December 4, 2006, two wholly-owned subsidiary grantor trusts were established by the Company, BancTenn Capital Trust II and BancTenn Capital Trust III, respectively. These subsidiaries issued \$6,000 and \$9,000 of pooled Trust Preferred Securities ("trust preferred securities"), respectively. Trust preferred securities accrue and pay distributions periodically at specified annual rates as provided in the indentures. The trust used the net proceeds from the offering to purchase a like amount of Junior Subordinated Debentures (the "Debentures") of the Company. The Debentures are the sole assets of the trust. The trust preferred securities are mandatorily redeemable upon the maturity of the Debentures, or upon earlier redemption as provided in the indentures. The Company has the right to redeem the Debentures in whole or in part after specific dates, at a redemption price specified in the indenture plus any accrued but unpaid interest to the redemption date. The trust preferred securities have a maturity of 30 years and are redeemable at the Company's option with certain exceptions. At December 31, 2016, the floating-rate securities in BancTenn Capital Trust II had a 3.53% interest rate which resets quarterly at the three-month LIBOR rate plus 2.65% and BancTenn Capital Trust III had a 2.61% interest rate which resets quarterly at the three-month LIBOR rate plus 1.65%.

For regulatory capital purposes, these trust-preferred securities qualify as a component of Tier I capital, subject to certain limitations.

ASC Topic 810 resulted in the Company's investment in the common equity of the trust being included in the consolidated balance sheets as other assets, totaling \$465 at December 31, 2016 and 2015. The outstanding balance of the subordinated debentures was \$15,465 at December 31, 2016 and 2015.

NOTE 10. BORROWINGS UNDER LINE OF CREDIT

The Company had a \$5,000 line of credit with another financial institution at December 31, 2015. The line expired on December 10, 2016, and was not renewed. Subsequent to December 31, 2016, the Company obtained a \$10,000 line of credit with another financial institution. The line is secured by 100% of the stock of Bank of Tennessee. Interest on the line is Wall Street Journal Prime less 15 basis points, with a floor of 2.5%. The line matures in March 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 11. DERIVATIVE INSTRUMENTS – INTEREST RATE CONTRACTS

Cash Flow Hedges

At December 31, 2016, the Company has an interest rate swap derivative instrument, used to minimize interest rate volatility on trust preferred securities, which is designated and qualify as a cash flow hedge.

In December 2008, the Company, relating to the Company's subordinated debentures, entered into an interest rate swap agreement with Compass Bank to pay a fixed rate of 5.48% while receiving a variable rate of the three-month LIBOR plus 265 basis points. This swap has a \$6 million notional value and the termination date is January 2019.

At December 31, 2016 and 2015, the estimated fair value of the cash flow hedge derivative instrument recorded in other liabilities was \$194 and \$292, respectively. Changes in the fair value of the derivative instrument are reported in accumulated other comprehensive income. These amounts subsequently are reclassified into interest expense as a yield adjustment in the same period in which the related interest on the subordinated debentures affects earnings. Included in interest expense is \$130 and \$223 which resulted from the reclassification of accumulated other comprehensive income into earnings during 2016 and 2015, respectively. Hedge ineffectiveness recognized into income during 2016 and 2015 was insignificant.

NOTE 12. EMPLOYEE BENEFIT PLANS

Employee Retirement Plans

The Company has a salary reduction/profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code. All employees are eligible to participate immediately upon hire. The Plan provides for contributions by the Company in such amounts as determined by the Board of Directors not to exceed 6 percent of the participant's annual compensation. In addition, the Plan provides for the Company to match employee contributions to the Plan equal to 50 percent of the first 6 percent of the participant's annual compensation. The Company contributed \$348 and \$345 to the Plan for the years ended December 31, 2016 and 2015, respectively.

The Company and the Bank provide deferred compensation agreements for the benefit of executive and other key officers. The Bank records the estimated amount of future payments to be made over the active service periods of the officers. Deferred compensation expense under these agreements was \$782 and \$837 for the years ended December 31, 2016 and 2015, respectively. Accrued deferred compensation of approximately \$6,478 and \$6,019 is included in other liabilities at December 31, 2016 and 2015 respectively.

Employee Stock Ownership Plan

Effective January 1, 2004, the Company established an Employee Stock Ownership Plan (the "Plan"), within the guidelines as defined by the Internal Revenue Code, for the purpose of enabling participants to acquire an ownership interest in the Company. All employees are eligible to participate in the Plan after completing one year of service with a minimum of 1,000 hours. Initial funding for the purchase of the Company's common stock was provided by Security Acquisition Loans from the Company to the Plan. The Security Acquisition Loans call for principal and interest to be repaid in ten equal annual installments of principal and interest. Shares obtained in connection with Security Acquisition Loans are held in a suspense account and are classified as unallocated shares.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 12. EMPLOYEE BENEFIT PLANS (Continued)

Contributions are made to the Plan as determined by the Company's Board of Directors, generally commensurate with the debt service requirements set forth in the loan agreements. Unallocated shares held in suspense by the Plan are released based on the ratio of principal payments made in the current year to total required future principal payments. Shares of the Company's common stock owned by the Plan are allocated as of each year end to each participant based on the ratio of individual compensation to total covered compensation, as defined by the agreement. Contributions can be in the form of cash, shares of Company stock, or other property as determined by the Board.

S Corporation distributions related to unallocated shares are used to fund the debt service requirements defined in the Security Acquisition Loans. Any remaining distributions are allocated proportionately to the participant, as defined by the plan agreement. At the Board's discretion, S Corporation distributions related to allocated shares may be used to make payments on Securities Acquisition Loans or shall be allocated to the participants, in accordance with the plan agreement.

The Company recognizes compensation expense for contributions and for allocated shares that were previously unallocated. The fair value, as determined by an independent appraisal, is used to calculate the compensation expense. Compensation expense recognized in association with the Plan for 2016 and 2015 totaled \$425 and \$323, respectively.

When a participant retires or otherwise terminates from the Plan, the Company is required to offer the participant the fair value for any allocated, vested shares of company stock. If the participant declines this option, the Company retains the right of first refusal of such shares. At December 31, 2016 and 2015, there were no repurchase obligations outstanding.

The fair value of unallocated shares at December 31, 2016 and 2015, was \$43.85 and \$37.00, respectively, per share as determined by the most recent stock valuations performed as of December 31, 2015 and 2014. The number of shares allocated, unallocated and committed to be released totaled 73,012, 7,734 and zero, respectively, as of December 31, 2016 and 61,919; 18,527 and zero, respectively, as of December 31, 2015.

Stock Option Plan

The Company has a stock option plan, which is administered by the Board of Directors that provides for both incentive stock options and nonqualified stock options. The Company also grants non-qualified stock options to the Board of Directors. The maximum number of common shares that can be sold or optioned under the plan is 670,000 shares. Under the plan, the exercise price of each option shall not be less than 100 percent of the fair market value of the common stock on the date of grant, those options awards generally vest based on five years of continuous service and have a ten-year contractual term.

A summary of stock option activity for the years ended December 31, 2016 and 2015 is as follows:

	2016		2015	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at beginning of period	39,000	\$48.34	61,000	\$48.40
Options granted	-	-	-	-
Options exercised	(5,000)	48.55	-	-
Options forfeited	(3,000)	48.55	(22,000)	48.51
Outstanding at end of period	<u>31,000</u>	48.28	<u>39,000</u>	48.34

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 12. EMPLOYEE BENEFIT PLANS (Continued)

Stock Option Plan (Continued)

Information pertaining to options outstanding at December 31, 2016, is as follows:

<u>Exercise Prices</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number Outstanding</u>	<u>Weighted Average Remaining Life</u>	<u>Weighted Average Exercise Price</u>	<u>Number Exercisable</u>	<u>Weighted Average Exercise Price</u>
\$46.20	4,000	2.3	\$46.20	4,000	\$46.20
\$48.55	25,000	1.3	48.55	25,000	48.55
\$49.10	<u>2,000</u>	0.7	49.10	<u>2,000</u>	49.10
Outstanding at end of year	<u>31,000</u>	1.4	48.28	<u>31,000</u>	48.28

There were 5,000 options exercised during 2016 and no options exercised during 2015. There were no options vested during the years ended December 31, 2016 and 2015. There was no stock-based compensation expense and no income tax benefits recognized during 2016 or 2015.

Cash received from option exercises under all share-based payment arrangements for the year ended December 31, 2016, was \$243. There was no intrinsic value related to options exercised. There was no actual tax benefit realized for the tax deductions from option exercises of the share-based payment arrangements for the years ended December 31, 2016 and 2015.

NOTE 13. INCOME TAXES

The Company files consolidated income tax returns with its subsidiary, Bank of Tennessee. Under the terms of a tax-sharing agreement, the subsidiary's allocated portion of the consolidated tax liability is computed as if it were reporting its income and expenses as a separate entity.

The income tax benefit in the consolidated statements of income for the years ended December 31, 2016 and 2015, includes the following:

	<u>2016</u>	<u>2015</u>
Current tax benefit:		
State	\$(118)	\$(155)
Deferred income taxes related to:		
Provision for loan losses	13	(10)
Depreciation	(39)	4
Deferred compensation retirement plans	(30)	(18)
Cash method of accounting	(66)	(25)
Other	<u>206</u>	<u>68</u>
Income tax benefit	<u>\$ (34)</u>	<u>\$(136)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 13. INCOME TAXES (Continued)

Deferred tax assets recognized for deductible temporary differences totaled \$919 and \$950 at December 31, 2016 and 2015, respectively. Deferred tax liabilities for taxable temporary differences totaled \$449 and \$583 at December 31, 2016 and 2015, respectively.

The income tax returns of the Company for 2015, 2014 and 2013 are subject to examination by the IRS, generally for three years after they were filed.

NOTE 14. COMMITMENTS AND CONTINGENCIES

Loan Commitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets. The majority of all commitments to extend credit and standby letters of credit are variable rate instruments.

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

	<u>2016</u>	<u>2015</u>
Commitments to extend credit	\$116,161	\$123,054
Financial standby letters of credit	<u>1,883</u>	<u>1,160</u>
	<u>\$118,044</u>	<u>\$124,214</u>

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

Standby letters of credit are conditional 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. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. Collateral held varies and is required in instances which the Company deems necessary.

At December 31, 2016 and 2015, the carrying amount of liabilities related to the Company's obligation to perform under standby letters of credit was insignificant. The Company was not required to perform on any standby letters of credit during 2016 or 2015.

Contingencies

During the normal course of business, the Company is subject to various lawsuits and claims. As of December 31, 2016, management believes that there are no current proceedings that would materially impact the consolidated financial statements of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share data)

NOTE 15. CONCENTRATIONS OF CREDIT RISK

The Company originates primarily commercial, residential, and consumer loans to customers in eastern and middle Tennessee and western North Carolina. The ability of the majority of the Company's customers to honor their contractual loan obligations is dependent on the economy in these areas.

Seventy-eight percent of the Company's loan portfolio is concentrated in loans secured by real estate, of which a substantial portion is secured by real estate in the Company's primary market area. Additionally, forty-three percent of the Company's loan portfolio is concentrated in residential real estate loans. Accordingly, the ultimate collectability of the loan portfolio and recovery of the carrying amount of foreclosed real estate is susceptible to changes in real estate conditions in the Company's primary market area. The other concentrations of credit by type of loan are set forth in Note 4.

The Company, as a matter of policy, does not generally extend credit to any single borrower or group of related borrowers in excess of 25% of statutory capital, or approximately \$22,957.

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES

Determination of Fair Value

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the *Fair Value Measurements and Disclosures* topic (FASB ASC 820), the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument.

The fair value guidance provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

Fair Value Hierarchy

In accordance with this guidance, the Company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2 - Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Hierarchy (Continued)

Level 3 - Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and Due From Banks: The carrying amounts of cash and due from banks approximate fair values based on the short-term nature of the assets.

Securities: Where quoted prices are available in an active market, management classifies the securities within Level 1 of the valuation hierarchy. Level 1 securities include exchange-traded equities. If quoted market prices are not available, management estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include GSE obligations and other securities. Mortgage-backed securities are included in Level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, management classifies those securities in Level 3.

Restricted and Equity Investments: The carrying value of restricted and equity investments approximate fair value based on the stock redemption provisions of the respective entities.

Loans: For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. Fair value for other loans are estimated using discounted cash flow analyses, using market interest rates for comparable loans. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Cash Surrender Value of Life Insurance and Annuity Contracts: The carrying amounts of cash surrender value of life insurance and annuity contracts approximate their fair value. The carrying amount is based on information received from the insurance carriers indicating the financial performance of the policies and the amount the Company would receive should the policies be surrendered.

Deposits: The fair value of deposits with no stated maturity, such as noninterest-bearing demand deposits and NOW, money market, and savings accounts, is equal to the amount payable on demand at the reporting date. The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Securities Sold Under Agreements to Repurchase: For securities sold under agreements to repurchase with commercial checking customers, the estimated fair value approximates their carrying value.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES

Fair Value Hierarchy (Continued)

Subordinated Debentures: The carrying amount of the subordinated debentures with floating interest rates is a reasonable estimate of fair value.

Interest Rate Swaps: Substantially all interest rate swaps held or issued by the Company for risk management are traded in over-the-counter markets where quoted market prices are not readily available. For these derivatives, the Company measures fair value using models that use primarily market observable inputs, such as yield curves and option volatilities, and include the value associated with counterparty risk. The Company classifies interest rate swaps held or issued for risk management activities as Level 2 inputs.

Federal Home Loan Bank Advances: Fair values of advances are estimated using discounted cash flow analyses based on current market rates for similar types of borrowing arrangements.

Accrued Interest: The carrying amounts of accrued interest approximate fair value.

The tables below present the recorded amount of assets and liabilities measured at fair value on a recurring basis.

	Balance as of December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Securities available for sale:				
U.S. Government-sponsored enterprises (GSEs)	\$ 33,668	\$ -	\$ 33,668	\$ -
Obligations of states and political subdivisions	85,962	-	85,962	-
Mortgage-backed securities:				
Government National Mortgage Association guaranteed	6,920	-	6,920	-
GSE residential	44,076	-	44,076	-
Equity securities	<u>34,783</u>	<u>34,654</u>	<u>129</u>	<u>-</u>
Total securities available for sale	<u>\$205,409</u>	<u>\$34,654</u>	<u>\$170,755</u>	<u>\$ -</u>
Liabilities				
Interest rate swaps	<u>\$ 194</u>	<u>\$ -</u>	<u>\$ 194</u>	<u>\$ -</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Fair Value Hierarchy (Continued)

	Balance as of December 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Securities available for sale:				
U.S. Government-sponsored enterprises (GSEs)	\$ 35,484	\$ -	\$ 35,484	\$ -
Obligations of states and political subdivisions	89,157	-	89,157	-
Mortgage-backed securities:				
Government National Mortgage Association guaranteed	7,308	-	7,308	-
GSE residential	64,122	-	64,122	-
Equity securities	<u>23,276</u>	<u>22,444</u>	<u>832</u>	<u>-</u>
Total securities available for sale	<u>\$219,347</u>	<u>\$22,444</u>	<u>\$196,903</u>	<u>\$ -</u>
Liabilities				
Interest rate swaps	<u>\$ 292</u>	<u>\$ -</u>	<u>\$ 292</u>	<u>\$ -</u>

Assets Measured at Fair Value on a Nonrecurring Basis: Under certain circumstances management makes adjustments to fair value for assets and liabilities although they are not measured at fair value on an ongoing basis. The following tables present the financial instruments carried on the consolidated balance sheets by caption and by level in the fair value hierarchy, for which a nonrecurring change in fair value has been recorded:

	Balance as of December 31, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Impaired loans	\$3,453	\$ -	\$ -	\$3,453
Foreclosed real estate	90	-	-	90

	Balance as of December 31, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Impaired loans	\$4,502	\$ -	\$ -	\$4,502
Foreclosed real estate	205	-	-	205

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

Fair Value Hierarchy (Continued)

Impaired Loans: Loans considered impaired under ASC 310-10-35, *Receivables*, are loans for which, based on current information and events, it is probable that the Company will be unable to collect all principal and interest payments due in accordance with the contractual terms of the loan agreement. Impaired loans can be measured based on the present value of expected payments using the loan's original effective rate as the discount rate, the loan's observable market price, or the fair value of the collateral less selling costs if the loan is collateral dependent.

The fair value of impaired loans were primarily measured based on the value of the collateral securing these loans. Collateral may be real estate and/or business assets including equipment, inventory, and/or accounts receivable. The Company determines the value of the collateral based on independent appraisals performed by qualified licensed appraisers. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Appraised values are discounted for costs to sell and may be discounted further based on management's historical knowledge, changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts by management are subjective and are typically significant unobservable inputs for determining fair value. Impaired loans are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors discussed above.

Foreclosed Real Estate: Foreclosed real estate, consisting of properties obtained through foreclosure or in satisfaction of loans, is initially recorded at fair value less estimated costs to sell upon transfer of the loans to other real estate. Subsequently, other real estate is carried at the lower of carrying value or fair value less costs to sell.

Fair values are generally based on third party appraisals of the property and if unadjusted, are classified within Level 2 of the fair value hierarchy. The appraisals are sometimes discounted based on management's historical knowledge, and/or changes in market conditions from the date of the most recent appraisal, and/or management's expertise and knowledge of the customer and the customer's business. Such discounts are typically significant unobservable inputs for determining fair value and are classified within Level 3 of the fair value hierarchy. In cases where the carrying amount exceeds the fair value, less estimated costs to sell, a loss is recognized in noninterest expense.

Quantitative Disclosures for Level 3 Fair Value Measurements: The Company had no Level 3 assets measured at fair value on a recurring basis at December 31, 2016 and 2015.

For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2016 and 2015, the significant unobservable inputs used in the fair value measurements are presented below.

	<u>Carrying Amount</u>	<u>Valuation Technique</u>	<u>Significant Unobservable Input</u>	<u>Weighted Average of Input</u>
Nonrecurring - 2016:				
Impaired loans	\$3,453	Appraisal	Appraisal discounts	13%
Foreclosed real estate	90	Appraisal	Appraisal discounts	45%
Nonrecurring - 2015:				
Impaired loans	\$4,502	Appraisal	Appraisal discounts	9%
Foreclosed real estate	205	Appraisal	Appraisal discounts	10%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 16. FAIR VALUE OF ASSETS AND LIABILITIES (Continued)

The carrying amount and estimated fair value of the Company's financial instruments at December 31, 2016 and 2015, are as follows:

	2016		2015	
	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>	<u>Carrying Amount</u>	<u>Estimated Fair Value</u>
Assets:				
Cash and due from banks	\$ 15,465	\$ 15,465	\$ 20,045	\$ 20,045
Securities available for sale	205,409	205,409	219,347	219,347
Securities held to maturity	3,550	3,512	1,594	1,635
Other equity investments, at cost	701	701	1,061	1,061
Restricted equity investments, at cost	4,171	4,171	4,120	4,120
Net loans	777,787	778,754	678,100	679,078
Cash surrender value of life insurance	24,153	24,153	23,310	23,310
Annuity contracts	14,457	14,457	210	210
Accrued interest receivable	2,605	2,605	2,436	2,436
Liabilities:				
Noninterest-bearing demand deposits	245,433	245,433	218,252	218,252
NOW accounts	197,637	197,637	178,664	178,664
Savings and money market accounts	351,167	351,167	289,709	289,709
Time deposits	92,771	93,001	93,084	93,320
Securities sold under agreements to repurchase	986	986	18,308	18,308
Subordinated debentures	15,465	15,465	15,465	15,465
Interest rate swaps	194	194	292	292
Federal Home Loan Bank borrowings	58,281	58,539	64,375	65,007
Accrued interest payable	177	177	173	173

NOTE 17. REGULATORY MATTERS

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

Federal and state banking agencies have adopted regulations that substantially amend the capital regulations currently applicable. The regulations implement the Basel III regulatory capital reforms and changes required by the Dodd-Frank Act.

Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), the Bank became subject to new capital requirements adopted by the FDIC. These new requirements created a new required ratio for common equity Tier I capital, increased the leverage and Tier I capital ratios, changed the risk weight of certain assets for purposes of the risk-based capital ratios, created an additional capital conservation buffer over the required capital ratios and changed what qualifies as capital for purposes of meeting these various capital requirements. Beginning in 2016, failure to maintain the required capital conservation buffer would limit the ability of the Bank to pay dividends, repurchase shares or pay discretionary bonuses.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 17. REGULATORY MATTERS (Continued)

The Company is exempt from consolidated capital requirements as those requirements do not apply to certain small savings bank holding companies with assets under \$1 billion.

Under the new capital regulations, the minimum capital ratios are: (1) common equity Tier I capital ratio of 4.5% of risk-weighted assets, (2) a Tier I capital ratio of 6.0% of risk-weighted assets, (3) a total capital ratio of 8.0% of risk-weighted assets, and (4) a Tier I capital to average assets ratio of 4.0%. Common equity Tier I capital generally consists of common stock and retained earnings, subject to applicable regulatory adjustments and deductions.

There are a number of changes in what constitutes regulatory capital, some of which are subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital. The Bank does not use any of these instruments. Under the new requirements for total capital, Tier II capital is no longer limited to the amount of Tier I capital included in total capital. Mortgage servicing rights, certain deferred tax assets and investments in unconsolidated subsidiaries over designated percentages of common equity Tier I capital will be deducted from capital. The Bank has elected to permanently opt-out of the inclusion of accumulated other comprehensive income in our capital calculations, as permitted by the regulations. This opt-out reduces the impact of market volatility on its regulatory capital levels.

The new requirements also include changes in the risk-weights of assets to better reflect credit risk and other risk exposures. These include a 150% risk weight (increased from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non-residential mortgage loans that are 90 days past due or otherwise in non-accrual status; a 20% (increased from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (increased from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital; and increased risk weights (0% to 600%) for equity exposures.

In addition to the minimum common equity Tier I, Tier I and total capital ratios, the Bank will have to maintain a capital conservation buffer consisting of additional common equity Tier I capital greater than 2.5% to risk weighted assets above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.635% of risk-weighted assets and increasing each year until fully implemented in January 2019.

The FDIC's prompt corrective action standards also changed effective January 1, 2015. Under the new standards, in order to be considered well-capitalized, the Bank must have a common equity Tier I ratio of 6.5% (new), a Tier I ratio of 8.0% (increased from 6.0%), a total risk-based capital ratio of 10.0% (unchanged) and a leverage ratio of 5.0% (unchanged). The Bank meets all these new requirements, including the full capital conservation buffer.

As of December 31, 2016, the Bank was well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since December 31, 2016, that management believes have changed the Bank's category.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in thousands, except share data)

NOTE 17. REGULATORY MATTERS (Continued)

The Bank's actual capital amounts and ratios as of December 31, 2016 and 2015, are presented in the following table:

	<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>
As of December 31, 2016:						
Total capital						
(to risk-weighted assets)	\$99,228	12.0%	\$66,313	8.0%	\$82,892	10.0%
Tier I capital						
(to risk-weighted assets)	91,827	11.1%	49,735	6.0%	66,313	8.0%
Common equity Tier I capital						
(to risk-weighted assets)	91,827	11.1%	37,301	4.5%	53,880	6.5%
Tier I capital						
(to average assets)	91,827	8.8%	41,522	4.0%	51,903	5.0%
As of December 31, 2015:						
Total capital						
(to risk-weighted assets)	\$93,874	13.3%	\$56,307	8.0%	\$70,384	10.0%
Tier I capital						
(to risk-weighted assets)	86,271	12.3%	42,231	6.0%	56,307	8.0%
Common equity Tier I capital						
(to risk-weighted assets)	86,271	12.3%	31,673	4.5%	45,750	6.5%
Tier I capital						
(to average assets)	86,271	9.2%	37,441	4.0%	46,802	5.0%

NOTE 18. CONCENTRATIONS IN DEPOSITS

The Company had a concentration in its deposits to one customer totaling approximately \$44,944 and \$40,129 at December 31, 2016 and 2015, respectively.



INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATING INFORMATION

**To the Stockholders and Board of Directors
BancTenn Corp.
Kingsport, Tennessee**

We have audited the consolidated financial statements of BancTenn Corp. and its Subsidiary as of and for the year ended December 31, 2016, and have issued our report thereon dated March 23, 2017, which contains an unmodified opinion on those consolidated financial statements. See page 1.

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position and results of operations of the individual companies, and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Mauldin & Jenkins, LLC

Chattanooga, Tennessee
March 23, 2017

BANCTENN CORP. AND SUBSIDIARY
CONSOLIDATING BALANCE SHEET
December 31, 2016
(amounts in thousands, except share data)

	Bank of Tennessee	BancTenn Corp.	Eliminations	Consolidated
ASSETS				
Cash and due from banks:				
Noninterest-bearing	\$ 15,212	\$ 792	\$ 792	\$ 15,212
Interest-bearing	253	-	-	253
Total cash and due from banks	15,465	792	792	15,465
Securities available for sale	170,626	34,783	-	205,409
Securities held to maturity	3,550	-	-	3,550
Other equity investments, at cost	-	701	-	701
Restricted equity investments, at cost	4,171	-	-	4,171
Loans, net of allowance for loan losses	777,787	-	-	777,787
Premises and equipment	31,079	586	-	31,665
Accrued interest receivable	2,605	-	-	2,605
Cash surrender value of life insurance	24,153	-	-	24,153
Annuity contracts	14,457	-	-	14,457
Foreclosed real estate	90	-	-	90
Other assets	3,661	638	332	3,967
Investment in subsidiary	-	91,903	91,903	-
Total assets	<u>\$ 1,047,644</u>	<u>\$ 129,403</u>	<u>\$ 93,027</u>	<u>\$ 1,084,020</u>
LIABILITIES AND STOCKHOLDERS' EQUITY				
Deposits:				
Noninterest-bearing	\$ 246,225	\$ -	\$ 792	\$ 245,433
Interest-bearing	641,575	-	-	641,575
Total deposits	887,800	-	792	887,008
Securities sold under agreements to repurchase	986	-	-	986
Federal Home Loan Bank advances	58,281	-	-	58,281
Subordinated debentures	-	15,465	-	15,465
Accrued interest payable	104	73	-	177
Accrued expenses and other liabilities	8,570	3,485	332	11,723
Total liabilities	955,741	19,023	1,124	973,640
Stockholders' equity:				
Common stock, no par value; 250,000 shares authorized; 209,148 shares outstanding	2,269	-	2,269	-
Common stock, \$8 par value; 6,000,000 shares authorized; 2,520,641 shares outstanding	-	20,165	-	20,165
Additional paid-in capital	16,142	8,220	16,142	8,220
Retained earnings	73,793	60,155	73,793	60,155
Accumulated other comprehensive income (loss)	(301)	22,092	(301)	22,092
Unallocated ESOP shares	-	(252)	-	(252)
Total stockholders' equity	91,903	110,380	91,903	110,380
Total liabilities and stockholders' equity	<u>\$ 1,047,644</u>	<u>\$ 129,403</u>	<u>\$ 93,027</u>	<u>\$ 1,084,020</u>

BANCTENN CORP. AND SUBSIDIARY
CONSOLIDATING STATEMENT OF INCOME
Year Ended December 31, 2016
(Amounts in thousands)

	<u>Bank of Tennessee</u>	<u>BancTenn Corp.</u>	<u>Eliminations</u>	<u>Consolidated</u>
INTEREST INCOME				
Loans, including fees	\$ 34,343	\$ -	\$ -	\$ 34,343
Securities	4,265	-	-	4,265
Federal funds sold and other	<u>2</u>	<u>-</u>	<u>-</u>	<u>2</u>
	38,610	-	-	38,610
INTEREST EXPENSE				
Interest on deposits	1,510	-	-	1,510
Interest on other borrowed funds	<u>954</u>	<u>553</u>	<u>-</u>	<u>1,507</u>
	2,464	553	-	3,017
Net interest income (expense)	36,146	(553)	-	35,593
Provision for loan losses	<u>200</u>	<u>-</u>	<u>-</u>	<u>200</u>
Net interest income (expense) after provision for loan losses	<u>35,946</u>	<u>(553)</u>	<u>-</u>	<u>35,393</u>
NONINTEREST INCOME				
Customer service fees	2,436	-	-	2,436
Service revenue	445	-	-	445
Loan origination and settlement fees	2,786	-	-	2,786
Gains on securities	6	626	(10)	642
Other	4,803	62	54	4,811
Equity in subsidiary's earnings	<u>-</u>	<u>13,033</u>	<u>13,033</u>	<u>-</u>
	<u>10,476</u>	<u>13,721</u>	<u>13,077</u>	<u>11,120</u>
NONINTEREST EXPENSES				
Salaries and employee benefits	19,582	1,707	-	21,289
Occupancy expenses	3,188	-	-	3,188
Data processing	2,715	-	-	2,715
Other operating expenses	<u>7,779</u>	<u>810</u>	<u>54</u>	<u>8,535</u>
	<u>33,264</u>	<u>2,517</u>	<u>54</u>	<u>35,727</u>
Income before income taxes	13,158	10,651	13,023	10,786
Income tax expense (benefit)	<u>125</u>	<u>(159)</u>	<u>-</u>	<u>(34)</u>
Net income	<u>\$ 13,033</u>	<u>\$ 10,810</u>	<u>\$ 13,023</u>	<u>\$ 10,820</u>