ALERUS FINANCIAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2018, 2017 AND 2016

ALERUS

Consolidated Financial Statements and Notes Table of Contents

Independent Auditors' Report		1
Consolidated Financial Statements		
Consolidated Balance Sheets		3
Consolidated Statements of Income		4
Consolidated Statements of Comprehensive Income		5
Consolidated Statements of Stockholders' Equity		6
Consolidated Statements of Cash Flows		7
Notes to Consolidated Financial Statements		
NOTE 1	Significant Accounting Policies	9
NOTE 2	New Accounting Pronouncements	14
NOTE 3	Revisions of Previously-Issued Financial Statements	16
NOTE 4	Business Combinations	17
NOTE 5	Restrictions on Cash and Due from Banks	17
NOTE 6	Investment Securities	18
NOTE 7	Loans and Allowance for Loan Losses	20
NOTE 8	Land, Premises and Equipment, Net	24
NOTE 9	Goodwill and Other Intangible Assets	25
NOTE 10	Loan Servicing	25
NOTE 11	Other Assets	26
NOTE 12	Deposits	26
NOTE 13	Short-Term Borrowings	27
NOTE 14	Long-Term Debt	27
NOTE 15	True-Up Liability	28
NOTE 16	Financial Instruments With Off-Balance Sheet Risk	28
NOTE 17	Legal Contingencies	28
NOTE 18	Stock Based Compensation Plan	28
NOTE 19	Employee Benefits	30
NOTE 20	Noninterest Income	30
NOTE 21	Income Taxes	31
NOTE 22	Related Party Transactions	32
NOTE 23	Preferred Stock	32
NOTE 24	Derivative Instruments	32
NOTE 25	Regulatory Matters	33
NOTE 26	Fair Value of Assets and Liabilities	34
NOTE 27	Subsequent Events	39

CliftonLarsonAllen LLP
CLAconnect.com

INDEPENDENT AUDITORS' REPORT

Board of Directors and Audit Committee
Alerus Financial Corporation and Subsidiaries
Grand Forks, North Dakota

Report on Consolidated Financial Statements

We have audited the accompanying consolidated financial statements of Alerus Financial Corporation and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years ended December 31, 2018, 2017, and 2016, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated 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.

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the 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 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 financial statements.

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

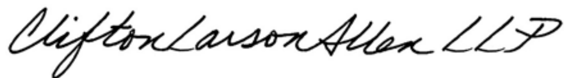
Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Alerus Financial Corporation and Subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years ended December 31, 2018, 2017, and 2016 in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Report on Internal Control Over Financial Reporting

We also have audited in accordance with attestation standards established by the American Institute of Certified Public Accountants, Alerus Financial Corporation and Subsidiaries' internal control over financial reporting as of December 31, 2018, based on criteria established in *2013 Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report date February 22, 2019, expressed an unqualified opinion on the Company's internal control over financial reporting.



CliftonLarsonAllen LLP

Minneapolis, Minnesota
February 22, 2019

Alerus Financial Corporation and Subsidiaries
Consolidated Balance Sheets

At December 31, *(dollars in thousands)*	2018	2017 Restated
Assets		
Cash and cash equivalents	$ 34,909	$ 40,336
Interest-bearing deposits	5,742	81,662
Cash and due from banks	40,651	121,998
Investment securities		
Trading	1,539	1,945
Available-for-sale	250,174	267,021
Equity, at fair value	3,165	5,445
Loans held for sale	14,486	17,938
Loans	1,733,881	1,574,474
Less allowance for loan losses	(22,174)	(16,564)
Net loans	1,711,707	1,557,910
Land, premises and equipment, net	21,743	21,229
Accrued interest receivable	7,645	6,817
Bank-owned life insurance	30,763	29,959
Goodwill	27,329	27,329
Other intangible assets	22,473	27,111
Servicing rights	4,623	4,686
Deferred income taxes	10,085	9,213
Other assets	32,687	37,480
Total assets	$2,179,070	$2,136,081
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing transaction	$ 563,130	$ 619,333
Interest-bearing transaction	1,061,709	1,011,368
Time deposits	174,454	204,261
Total deposits	1,799,293	1,834,962
Short-term borrowings	93,460	30,000
Long-term debt	58,824	58,819
Accrued expenses and other liabilities	30,539	32,706
Total liabilities	1,982,116	1,956,487
Stockholders' equity		
Common stock, $1 par value, 30,000,000 shares authorized; 13,775,327 and 13,669,066 issued and outstanding	13,775	13,699
Additional paid-in capital	27,743	26,040
Retained earnings	159,037	140,986
Accumulated other comprehensive income (loss)	(3,601)	(1,131)
Total stockholders' equity	196,954	179,594
Total liabilities and stockholders' equity	$2,179,070	$2,136,081

Alerus Financial Corporation and Subsidiaries

Consolidated Statements of Income

Year Ended December 31, *(dollars and shares in thousands, except per share data)*	2018	2017 Restated	2016 Restated
Interest Income			
Loans, including fees	$ 81,159	$ 68,799	$ 63,644
Investment securities			
Taxable	4,670	4,773	4,584
Exempt from federal income taxes	1,234	1,356	1,089
Other	639	709	625
Total interest income	87,702	75,637	69,942
Interest Expense			
Deposits	6,991	3,520	3,385
Short-term borrowings	1,896	942	11
Long-term debt	3,591	3,505	3,606
Total interest expense	12,478	7,967	7,002
Net interest income	75,224	67,670	62,940
Provision for loan losses	8,610	3,280	3,060
Net interest income after provision for loan losses	66,614	64,390	59,880
Noninterest Income			
Retirement and benefit services	63,316	62,390	57,804
Wealth management	14,900	13,953	12,640
Mortgage banking	17,630	19,882	26,528
Service charges on deposit accounts	1,808	1,854	1,916
Net gains (losses) on investment securities	85	(13)	(24)
Other	5,010	4,979	6,225
Total noninterest income	102,749	103,045	105,089
Noninterest Expense			
Compensation	69,403	67,576	70,359
Employee benefits	17,866	16,490	15,888
Occupancy and equipment expense	11,086	10,892	11,736
Business services, software and technology expense	14,525	12,976	14,510
Intangible amortization expense	4,638	5,623	7,005
Professional fees and assessments	5,098	6,158	6,301
Marketing and business development	3,459	3,271	3,237
Supplies and postage	2,737	2,609	2,930
Travel	1,738	1,530	1,721
Mortgage and lending expenses	2,153	2,235	2,439
Other	3,622	5,560	7,666
Total noninterest expense	136,325	134,920	143,792
Income before income taxes	33,038	32,515	21,177
Income tax expense	7,172	17,514	7,141
Net income	25,866	15,001	14,036
Less preferred stock dividends	-	-	25
Net income applicable to common stock	$ 25,866	$ 15,001	$ 14,011
Earnings per common share	$ 1.88	$ 1.10	$ 1.04
Diluted earnings per common share	$ 1.84	$ 1.07	$ 1.00
Dividends declared per common share	$ 0.53	$ 0.48	$ 0.44
Average common shares outstanding	13,763	13,653	13,495
Diluted average common shares outstanding	14,063	14,007	14,000

See Accompanying Notes to Consolidated Financial Statements

Alerus Financial Corporation and Subsidiaries
Consolidated Statements of Comprehensive Income

Year Ended December 31, *(dollars in thousands)*	2018	2017 Restated	2016 Restated
Net income	$ 25,866	$ 15,001	$ 14,036
Other Comprehensive Income, Net of Tax			
Unrealized gains (losses) on available-for-sale securities	(3,277)	1,542	(4,721)
Reclassification adjustment for losses (gains) realized in income	(116)	-	17
Total other comprehensive income (loss), before tax	(3,393)	1,542	(4,704)
Income tax (expense) benefit related to items of other comprehensive income	852	(735)	1,717
Other comprehensive income (loss), net of tax	(2,541)	807	(2,987)
Total comprehensive income	$ 23,325	$ 15,808	$ 11,049

See Accompanying Notes to Consolidated Financial Statements

Alerus Financial Corporation and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity

(dollars and shares in thousands, except per share data)

	Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings Restated	Accumulated Other Comprehensive Income (Loss)	Total
Balance December 31, 2015	$ 20	$ 13,434	$ 42,617	$ 125,162	$ 1,049	$ 182,282
Net income	-	-	-	14,036	-	14,036
Other comprehensive income (loss)	-	-	-	-	(2,987)	(2,987)
Common stock repurchased	-	(18)	(102)	(237)	-	(357)
Preferred stock dividends	-	-	-	(25)	-	(25)
Common stock dividends	-	-	-	(6,163)	-	(6,163)
Stock-based compensation expense	-	20	1,445	-	-	1,465
Vesting of restricted stock	-	98	(98)	-	-	-
Preferred stock redeemed	(20)	-	(19,980)	-	-	(20,000)
Balance December 31, 2016	-	13,534	23,882	132,773	(1,938)	168,251
Net income	-	-	-	15,001	-	15,001
Other comprehensive income (loss)	-	-	-	172	807	979
Common stock repurchased	-	(16)	(47)	(231)	-	(294)
Common stock issued	-	64	1,384	-	-	1,448
Common stock dividends	-	-	-	(6,729)	-	(6,729)
Stock-based compensation expense	-	17	921	-	-	938
Vesting of restricted stock	-	100	(100)	-	-	-
Balance December 31, 2017	-	13,699	26,040	140,986	(1,131)	179,594
Net income	-	-	-	25,866	-	25,866
Adjustment for adoption of ASU 2016-01	-	-	-	(71)	71	-
Other comprehensive income (loss)	-	-	-	-	(2,541)	(2,541)
Common stock repurchased	-	(15)	(53)	(288)	-	(356)
Common stock dividends	-	-	-	(7,456)	-	(7,456)
Stock-based compensation expense	-	11	1,836	-	-	1,847
Vesting of restricted stock	-	80	(80)	-	-	-
Balance December 31, 2018	$ -	$ 13,775	$ 27,743	$ 159,037	$ (3,601)	$ 196,954

Alerus Financial Corporation and Subsidiaries
Consolidated Statements of Cash Flows

Year Ended December 31, *(dollars in thousands)*	2018	2017	2016
Operating Activities			
Net income	$ 25,866	$ 15,001	$ 14,036
Adjustments to reconcile net income to net cash provided by operating activities			
Deferred income taxes	(20)	9,745	(3,044)
Provision for loan losses	8,610	3,280	3,060
Provision for foreclosed asset losses	245	425	226
Depreciation and amortization	8,729	9,856	11,385
Stock-based compensation	1,847	938	1,465
Investment securities premium amortization	1,570	2,069	2,364
Increase in value of bank-owned life insurance	(804)	(820)	(831)
Realized loss (gain) on forward sale derivatives	15	97	(81)
Realized loss (gain) on rate lock commitments	(14)	(70)	135
Realized loss (gain) on sale of premises and equipment	(11)	154	6
Realized loss (gain) on sale of foreclosed assets	(114)	38	73
Realized loss (gain) on sale of investment securities	(129)	-	17
Realized loss (gain) on servicing rights	(577)	(743)	(1,293)
Net change in			
Securities held for trading	406	14	(12)
Loans held for sale	3,452	17,125	13,579
Accrued interest receivable	(828)	(898)	(1,089)
Other assets	4,478	(1,693)	308
Accrued expenses and other liabilities	832	(6,628)	(6,315)
Net cash provided by operating activities	53,553	47,890	33,989
Investing Activities			
Proceeds from sales of investment securities available-for-sale	6,488	-	59,910
Proceeds from maturities of investment securities available-for-sale	35,082	42,257	42,806
Purchases of investment securities available-for-sale	(29,556)	(38,226)	(81,940)
Net (increase) decrease in equity securities	2,280	313	(547)
Net increase in loans	(163,156)	(210,286)	(38,884)
Net cash paid for business combinations	-	-	(45,441)
Payment to FDIC for termination of loss share agreements	(3,000)	-	-
Proceeds from bank-owned life insurance	-	-	5,331
Purchases of premises and equipment	(3,753)	(2,946)	(1,684)
Proceeds from sales of premises and equipment	11	2,390	404
Proceeds from sales of foreclosed assets	896	1,405	636
Net cash used by investing activities	(154,708)	(205,093)	(59,409)
Financing Activities			
Net increase (decrease) in deposits	(35,669)	49,754	25,020
Net increase (decrease) in short-term borrowings	63,460	29,271	(6,847)
Repayments of long-term debt	(171)	(168)	(25,000)
Cash dividends paid on preferred stock	-	-	(25)
Cash dividends paid on common stock	(7,456)	(6,729)	(6,163)
Redemption of preferred stock	-	-	(20,000)
Repurchase of common stock	(356)	(294)	(357)
Net cash provided (used) by financing activities	19,808	71,834	(33,372)
Net change in cash and due from banks	(81,347)	(85,369)	(58,792)
Cash and due from banks at beginning of year	121,998	207,367	266,159
Cash and due from banks	$ 40,651	$ 121,998	$ 207,367

Supplemental Cash Flow Disclosures	2018	2017	2016
Loan collateral transferred to foreclosed assets	$ 748	$ 433	$ 1,851
Unrealized gain (loss) on investment securities available-for-sale	(2,541)	807	(2,987)
Interest paid for the period	12,315	8,026	7,263
Income tax payments net of refunds received	5,347	13,074	1,612
Noncash assets acquired	-	-	335,830
Liabilities assumed	-	-	(328,748)
Net noncash assets acquired	-	-	7,082
Cash and due from banks acquired	-	-	18,748

Notes to Consolidated Financial Statements

NOTE 1 Significant Accounting Policies

Alerus Financial Corporation is a financial holding company organized under the laws of Delaware. Alerus Financial Corporation and its subsidiaries (the "Company") is a diversified financial services company that provides commercial banking, mortgage banking, retirement and benefit plan administration, and wealth management services.

Alerus Financial, N.A. (the "Bank"), the subsidiary bank, operates under a national charter and provides full banking services. As a national bank, the Bank is subject to regulation by the Office of the Comptroller of Currency and the Federal Deposit Insurance Corporation.

Policies which materially affect the determination of financial position, cash flows, and results of operations are summarized below.

Principles of Consolidation

The consolidated financial statements include the accounts of Alerus Financial Corporation and its subsidiaries in which Alerus Financial Corporation has a controlling interest. Significant intercompany balances and transactions have been eliminated in consolidation. Certain items in prior periods have been reclassified to conform to the current presentation.

In the normal course of business, the Company may enter into a transaction with a variable interest entity ("VIE"). VIE's are legal entities whose investors lack the ability to make decisions about the entity's activities, or whose equity investors do not have the right to receive the residual returns of the entity. The applicable accounting guidance requires the Company to perform ongoing quantitative and qualitative analysis to determine whether it must consolidate any VIE. The Company does not have any ownership interest in or exert any control over any VIE, and thus no VIE's are included in the consolidated financial statements.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue 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 include the valuation of investment securities, determination of the allowance for loan losses, valuation of reporting units for the purpose of testing goodwill and other intangible assets for impairment, fair value of assets acquired and liabilities assumed upon completion of a business combination, valuation of deferred tax assets, and fair values of financial instruments.

Concentrations of Credit Risk

Substantially all of the Company's lending activities are with clients located within North Dakota, Minnesota, and Arizona. At December 31, 2018 and 2017, respectively, 29.9% and 30.5% of the Company's loan portfolio consisted of commercial and industrial loans that were not secured by real estate. The Company does not have any significant loan concentrations in any one industry or client. Note 7 discusses the Company's loan portfolio.

The Company invests in a variety of investment securities and does not have any significant concentrations in any one industry or to any one issuer. Note 6 discusses the Company's investment securities portfolio.

Cash and Due from Banks

For purposes of the consolidated statements of cash flows, cash and due from banks includes cash and cash equivalents, balances due from banks, federal funds sold, all of which have an original maturity within 90 days. Cash flows from loans and deposits are reported net.

Interest-bearing deposits in banks are carried at cost.

Investment Securities

Debt securities that are held for short-term resale are classified as trading securities and carried at estimated fair value, with increases and decreases in estimated fair value recognized in net gains (losses) on investment securities within the statements of income. Other marketable securities are classified as available-for-sale and are carried at estimated fair value. Realized gains (losses) on investment securities available-for-sale are included in net gains (losses) on investment securities and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. Gains (losses) on sales of investment securities are determined using the specific identification method on the trade date. The amortization of premiums and accretion of discounts are recognized in interest income using methods approximating the interest method over the period to maturity.

Declines in the estimated fair value of individual available-for-sale investment securities below their cost that are other than temporary, result in write-downs of the individual investment securities to their estimated fair value. The Company monitors the investment security portfolio for impairment on an individual security basis and has a process in place to identify investment securities that could potentially have a credit impairment that is other than temporary.

This process involves analyzing the length of time and the extent to which the estimated fair value has been less than the amortized cost basis, the market liquidity for the security, the financial condition and near-term prospects of the issuer, expected cash flows, and the Company's intent and ability to hold the investment for a period of time sufficient to recover the temporary loss. The ability to hold is determined by whether it is more likely than not that the Company will be required to sell the security before its anticipated recovery. A decline in value due to a credit event that is considered other than temporary is recorded as a loss in noninterest income.

Equity investments for which readily determinable values are unavailable are carried at cost in other assets on the consolidated balance sheet.

The Company has investments in certain partnerships for which the Company does not have a controlling interest.
For these investments, the Company records its interest in other assets using the equity method with its portion of income or loss being recorded in noninterest income in the consolidated statements of income. The Company periodically evaluates these investments for impairment.

Loans Held for Sale
Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. Gains (losses) on loan sales are recorded in mortgage banking revenue on the consolidated statements of income.

Loans
Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Loans that management has the intent and ability to hold for the foreseeable future, until maturity, or pay-off, generally are reported at their outstanding unpaid principal balances adjusted for charge-offs, and the allowance for loan losses. Loan fees received that are associated with originating or acquiring certain loans are deferred, net of costs, and amortized over the life of the loan as a yield adjustment to interest income.

The accrual of interest on loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans are typically charged-off no later than 120 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 or interest in considered doubtful.

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

Allowance for Loan Losses
The allowance for loan losses (allowance) is an estimate of loan losses inherent in the Company's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the adequacy of the total allowance after loan losses and loan growth. Loan losses are charged-off against the allowance when the Company determines the loan balance to be uncollectible. Cash received on previously charged-off amounts is recorded as a recovery to the allowance.

The allowance consists of three primary components, general reserves, specific reserves related to impaired loans, and unallocated reserves. The general component covers non-impaired loans and is based on historical losses adjusted for current qualitative factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent five years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Loans determined to be impaired are individually evaluated for impairment. When a loan is impaired, the Company measures impairment based on the present value of expected future cash flows discounted at the original contractual interest rate, except that as a practical expedient, it may measure impairment based on an observable market price for the estimated fair value of the collateral if collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

Allowance allocations other than general and specific are included in the unallocated portion. While allocations are made for loans based upon historical loss analysis, the unallocated portion is designed to cover the uncertainty of how current economic conditions and other uncertainties may impact the existing loan portfolio. Factors to consider include national and state economic conditions such as unemployment or real estate lending values. The unallocated reserve addresses inherent probable losses not included elsewhere in the allowance for loan losses.

The Company maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial, industrial, agricultural, and other, real estate construction, commercial real estate, residential real estate first mortgage, residential real estate junior liens, and other revolving and installment with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans consist of all commercial and industrial loans as well as agricultural production and other commercial loans. Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments as these loans are generally underwritten based on the cash flows of the operating business. Repayment is provided by business cash flows and is influenced by economic trends such as unemployment rates and other key economic factors. Agricultural loans generally possess a lower inherent risk of loss than real estate portfolio segments for the same reasons as commercial and industrial loans. However, they generally possess greater volatility of risk due to commodity pricing, which can lead to cash flow and collateral shortfalls.

Real Estate Construction: Real estate construction loans generally possess a higher inherent risk of loss than commercial and retail real estate portfolio segments. Significant inherent risks are project completion, cost overruns, and adherence to construction schedule. Additionally, real estate values could significantly impact the credit quality of these loans.

Commercial Real Estate: Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments, except real estate construction and agricultural land loans. Adverse economic developments such as high vacancy rates or decreasing real estate values may impact commercial real estate credit quality. Agricultural real estate loans are primarily comprised of loans for the purchase of farmland. Risks associated with farmland include volatility of real estate values driven by commodity prices, among other economic trends.

Residential real estate first and junior liens: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate, and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than commercial real estate portfolio segments. Credit quality is impacted by unemployment rates and other key economic indicators.

Other Revolving and Installment: The consumer loan portfolio is primarily comprised of homogenous loans. Credit quality is impacted by unemployment rates and other key economic indicators.

Although management believes the allowance to be adequate, actual losses may vary from its estimates. On a quarterly basis, management reviews the adequacy of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions, and other factors. If the board of directors and management determine that changes are warranted based on those reviews, the allowance is adjusted.

Off-Balance Sheet Credit Related Financial Instruments
In the ordinary course of business, the Company enters into commitments to extend credit, including commitments under credit arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded when they are funded. The Company establishes a reserve for unfunded commitments using historical loss data and utilization assumptions. This reserve is located under accrued expenses and other liabilities on the Consolidated Balance Sheets.

Land, Premises and Equipment, Net
Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed on a straight-line method 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 (losses) on dispositions are included in current operations.

Bank-Owned Life Insurance
The Company has purchased life insurance policies on certain key executives. Bank-owned life insurance is recorded at its cash surrender value, or the amount that can be realized, if lower.

Goodwill and Other Intangibles, Net
Goodwill resulting from acquisitions is not amortized, but is tested for impairment annually. As part of its testing, the Company first assesses the qualitative factors to determine whether it is more likely than not that the estimated fair value of a reporting unit is less than its carrying amount. If the Company determines the estimated fair value of a reporting unit is less than its carrying amount using these qualitative factors, the Company then compares the estimated fair value of the goodwill with its carrying amount, and then measures impairment loss by comparing the estimated fair value of goodwill with the carrying amount of that goodwill.

Significant judgement is applied when goodwill is assessed for impairment. This judgement includes developing cash flow projections, selecting appropriate discount rates, identifying relevant market comparables, incorporating general economic and market conditions, and selecting and appropriate control premium. At December 31, 2018, the Company believes it does not have any indications of potential impairment based on the estimated fair value of this reporting unit.

Intangible assets determined to have definite lives are amortized over the remaining useful lives. Intangible and other long-lived assets are reviewed for impairment whenever events occur or circumstances indicate that the carrying amount may not be recoverable.

Servicing Rights
Servicing rights are recognized as separate assets when rights are acquired through the sale of loans. Servicing rights are initially recorded at estimated fair value based on assumptions provided by a third-party valuation service. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as servicing cost per loan, the discount rate, the escrow float rate, an inflation rate, ancillary income, prepayment speeds, and default rates and losses. Loan servicing income is recorded on the accrual basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees, and is net of estimated fair value adjustments to capitalized mortgage servicing rights. Capitalized servicing rights are amortized into noninterest income in proportion to, and over the period of, the estimated future servicing income of the underlying loans.

Servicing rights are evaluated for impairment based upon the estimated fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that estimated fair value is less than the capitalized amount for the tranche. If the Company later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, or a fixed amount per loan, and are recorded as income when earned. The amortization of servicing rights is netted against loan servicing fee income.

Impairment of Long-Lived Assets
The Company tests long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of an asset to the future undiscounted net cash flows expected to be generated by the asset.

In the event such an asset is considered impaired, the impairment to be recognized is measured by the amount by which the carrying value of the asset exceeds the estimated fair value of the asset. Assets to be disposed of are reported at the lower of the carrying value of estimated fair value less estimated costs to sell.

Foreclosed Assets
Assets acquired through loan foreclosure are included in other assets and are initially recorded at estimated fair value less estimated selling costs. The estimated fair value of foreclosed assets is evaluated regularly and any decreases in value along with holding costs, such as taxes, insurance and utilities, are reported in noninterest expense.

Transfers of Financial Assets and Participating Interests
Transfers of financial assets are accounted for as sales when control over assets has been surrendered or in the case of loan participation, a portion of the asset has been surrendered and meets the definition of a "participating interest". Control over transferred assets is deemed to be surrendered when 1) the assets have been isolated from the Company, 2) the transferee obtains the rights 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. Should the transfer not meet these three criteria, the transaction is treated as a secured financing.

Loans serviced for others are not included in the accompanying consolidated balance sheets. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and collection and foreclosure processing.

Derivatives and Hedging Activities
In the ordinary course of business, the Company enters into derivative transactions to manage various risks and to accommodate the business requirements of its clients.

Derivative instruments are reported in other assets or other liabilities at estimated fair value. Changes in a derivative's estimated fair value are recognized currently in earnings unless specific hedge accounting criteria are met.

Noninterest Income
Specific guidelines are established for recognition of certain noninterest income components related to the Company's consolidated financial statements. In accordance with Topic 606, revenues are recognized when control of promised goods or services is transferred to customers in an amount that reflects the consideration the Company expects to be entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that an entity determines are within the scope of Topic 606, the Company performs the following five steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the Company satisfies a performance obligation.

The Company only applies the five-step model to contracts when it is probable that the entity will collect the consideration it is entitled to in exchange for the goods or services it transfers to the customer. At contract inception, once the contract is determined to be within the scope of Topic 606, the Company assesses the goods or services that are promised within each contract and identifies those that contain performance obligations, and assesses whether each promised good or service is distinct. The Company then recognizes as revenue the amount of the transaction price that is allocated to the respective performance obligation

when (or as) the performance obligation is satisfied. The material groups of noninterest income that this methodology is applied to are defined as follows:

Retirement and benefit services: Retirement and benefit services income is primarily comprised of fees earned from the administration of retirement plans, record-keeping, compliance services, payroll processing, health savings accounts, and flexible benefit plans. Fees are earned based on a combination of the market value of assets under administration and transaction based fees for services provided. Fees that are determined based on the market value of the assets under administration are generally billed monthly or quarterly in arrears and recognized monthly as the Company's performance obligations are met. Other transaction based fees are recognized monthly as the performance obligation is satisfied.

Wealth management: Wealth management income is earned from a variety of sources including trust administration and other related fiduciary services, custody, investment management and advisory services, and brokerage. Fees are based on the market value of the assets under management are generally billed monthly in arrears and recognized monthly as the Company's performance obligations are met. Commissions on transactions are recognized on a trade-date basis as the performance obligation is satisfied at the point in time in which the trade is processed. Other related services are based on a fixed fee schedule and the revenue is recognized when the services are rendered, which is when the Company has satisfied its performance obligation.

Service charges on deposit accounts: Service charges on deposit accounts primarily consist of account analysis fees, monthly maintenance fees, overdraft fees, and other deposit account related fees. Overdraft fees and certain service charges are fixed and the performance obligation is typically satisfied at the time of the related transaction. The consideration for analysis fees and monthly maintenance fees are variable as the fee can be reduced if the customer meets certain qualifying metrics. The Company's performance obligations are satisfied at the time of the transaction or over the course of a month.

Other noninterest income: Other noninterest income components include debit card interchange fees, bank-owned life insurance income and miscellaneous transactional fees.
Income earned from these revenue streams is generally recognized concurrently with the satisfaction of the performance obligation.

Advertising Costs
Advertising costs are expensed as incurred.

Income Taxes
Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance would be recognized if it is "more likely than not" that the deferred tax asset would not be realized.

These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal and state income tax laws, and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax liabilities.

The Company follows standards related to Accounting for Uncertainty in Income Taxes. These rules establish a higher standard for tax benefits to meet before they can be recognized in a Company's consolidated financial statements. The Company can recognize in financial statements the impact of a tax position taken, or expected to be taken, if it is more likely than not that the position will be sustained on an audit based on the technical merit of the position. See Note 21, Income Taxes for additional disclosures. The Company recognizes both interest and penalties as components of other operating expenses.

The amount of the uncertain tax position was not determined to be material. It is not expected that the unrecognized tax benefit will be material within the next 12 months. The Company did not recognize any interest or penalties in 2018, 2017, or 2016.

The Company files consolidated federal and state income tax returns. The Company is no longer subject to U.S. federal or state tax examinations by tax authorities for years before 2015.

Comprehensive Income
Recognized revenue, expenses, gains, and losses are included in net income. Certain changes in assets and liabilities, such as unrealized gains (losses) on investment securities available-for-sale, are reported as a separate component of the equity section of the consolidated balance sheets, such items, along with net income, are components of comprehensive income.

Stock Compensation Plans
Stock compensation accounting guidance requires that the compensation cost relating to share-based payment transactions be recognized in financial statements. The cost will be measured based on the grant date estimated fair value of the equity or liability instruments issued. The grant date estimated fair value is determined using the 20 day weighted- average closing price of the Company's common stock.

The stock compensation accounting guidance requires that compensation cost for all stock awards be calculated and recognized over the employee's 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.

Earnings per Share

Basic earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is calculated by dividing net income available to common shareholders by the weighted average number of common shares outstanding plus outstanding non-vested restricted stock awards.

NOTE 2 New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09 Revenue from Contracts with Clients (Topic 606). The Company adopted ASU 2014-09 effective January 1, 2018 which had no material impact on the Company's financial reporting. The scope of the guidance explicitly excludes net interest income as well as many other revenues for financial assets and liabilities including loans, leases, securities and derivatives. The Company has performed an assessment of revenue streams that are within the scope of the standard. The assessment did not identify material changes to the timing or amount of revenue recognition as the Company's current practices are consistent with the standard.

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Liabilities. This ASU addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments by making targeted improvements to GAAP as follows: (1) require equity investments (except those accounted for under the equity method of accounting for those that result in consolidation of the investee) to be measured at estimated fair value with changes in estimated fair value recognized in net income. However, an entity may choose to measure equity investments that do not have readily determinable estimated fair values at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer; (2) simplify the impairment assessment of equity investments without readily determinable estimated fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at estimated fair value; (3) eliminate the requirement to disclose the estimated fair value of financial instruments measured at amortized cost for entities that are not public business entities; (4) eliminate the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; (5) require public business entities to use the exit price notion when measuring the estimated fair value of financial instruments for disclosure purposes; (6) require an entity to present separately in other comprehensive income the portion of the total change in the estimated fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at estimated fair value in accordance with the estimated fair value option for financial instruments; (7) require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; (8) clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. ASU 2016-01 is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted ASU 2016-01 effective January 1, 2018. The new guidance did not materially impact the Company's consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. From the lessee's perspective, the new standard establishes a right-of-use (ROU) model that requires the lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement for lessees. From the lessor's perspective, the new standard requires a lessor to classify leases as either sales-type, finance or operating. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without a transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements, whether certain practical expedients available. Early adoption is permitted. The Company has evaluated the impact of this new guidance and determined there will be a $10.5 million increase to both assets and liabilities on the Company's Consolidated Balance Sheets.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU requires a new impairment model known as the current expected credit loss (CECL) which significantly changes the way impairment of financial instruments is recognized by requiring immediate recognition of estimated credit losses expected to occur over the remaining life of financial instruments. The main provisions of ASU 2016-13 include (1) replacing the "incurred cost" approach under GAAP with an "expected loss" model for instruments measured at amortized cost, (2) requiring entities to record an allowance for credit losses related to available-for-sale debt securities rather than a direct write-down of the carrying amount of the investments, as is required by the other-than-temporary impairment model under current GAAP, and (3) a simplified accounting model for purchase credit-impaired debt securities and loans. ASU 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019, although early adoption is permitted. The Company is currently evaluating the potential impact of ASU 2016-13 on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. This ASU included specific guidance on how to classify certain transactions in the statement of cash flows and reduced diversity in practice in how

eight particular transactions are classified in the statement of cash flows. ASU 2016-15 is effective for interim and annual reporting periods beginning after December 15, 2017. Entities were required to apply the guidance retrospectively unless it would have been impracticable to do, in which case the amendments could have been applied prospectively. Effective January 1, 2018 the Company adopted the guidance retrospectively. As this guidance only affects the classification within the statement of cash flows, ASU 2016-15 did not have a material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Simplifying the Test for Goodwill Impairment. This ASU removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. Under the amended guidance, a goodwill impairment charge will now be recognized for the amount by which the carrying value of a reporting unit exceeds its estimated fair value, not to exceed the carrying amount of goodwill. This guidance is effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted for any impairment tests performed after January 1, 2017. The Company has evaluated impact of this new guidance and determined that it will not have a significant impact of the consolidated financial statements.

In March 2017, the FASB issued ASU No. 2017-08, Premium Amortization on Purchased Callable Debt Securities. This ASU shortens the amortization period for the premium on certain purchased callable debt securities to the earliest call date. Currently, entities generally amortize the premium as an adjustment of yield over the contractual life of the security. ASU 2017-08 does not change the accounting for purchased callable debt securities held at a discount as the discount will continue to be accreted to maturity. ASU 2017-08 is effective for the interim and annual reporting periods beginning after December 15, 2018. Early adoption is permitted. The guidance calls for a modified retrospective transition approach under which a cumulative-effect adjustment will be made to retained earnings as of the beginning of the first reporting period in which ASU 2017-08 is adopted. The Company has evaluated the provisions of ASU 2017-08 and determined there is no impact on its consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Stock Compensation, Scope of Modification Accounting. This ASU clarifies when changes to the terms of conditions of a share-based payment award must be accounted for as modifications. Companies will apply the modification accounting guidance if any change in the value, vesting conditions or classification of the award occurs. The new guidance should reduce diversity in practice and result in fewer changes to the terms of an award being accounted for as modifications, as the guidance will allow companies to make certain non-substantive changes to awards without accounting for them as modifications. It does not change the accounting for modifications. ASU 2017-09 is effective for interim and annual reporting periods beginning after December 15, 2017. The Company adopted ASU 2017-09 effective January 1, 2018. The update did not have a material impact on the Company's consolidated financial statements.

In February 2018, the FASB issued Accounting Standard Update (ASU) 2018-02, Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings and eliminates the stranded tax effects resulting from the Tax Cuts and Jobs Act. The Company adopted the updated guidance effective January 1, 2017. This update did not have a significant impact on the Company's consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This ASU has been issued as part of a simplification initiative which will expand the scope of Topic 718 to include share-based payment transactions for the acquiring of goods and services from non-employees and expands the scope through the amendments to address and improve aspects of the accounting for non-employee share-based payment transactions. The amendments will be effective for interim and annual reporting periods beginning after December 15, 2018. The Company has evaluated the provisions of ASU 2018-07 and determined there will be no significant impact on its consolidated financial statements.

In August 2018, the FASB issued ASU No. 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement. This ASU eliminates, adds, and modifies certain disclosure requirements for estimated fair value measurements. Among the changes, entities will no longer be required to disclose the amount of and reasons for transfer between Level 1 and Level 2 of the estimated fair value hierarchy, but will be required to disclose the range and weighted average used to develop significant unobservable inputs for Level 3 estimated fair value measurements. ASU 2018-13 is effective for interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. Entities are also allowed to elect for early adoption of the eliminated or modified disclosure requirements and delay adoption of the new disclosure requirements until their effective date. The revised disclosure requirements will not have a material impact on the Company's consolidated financial statements.

NOTE 3 Revisions of Previously-Issued Financial Statements

In 2008, the Company acquired 6,924 shares of Visa Class B stock at no cost from the Company's prior participation in Visa's network. Only current owners of Class B Shares are allowed to transact in Class B shares. Following the resolution of Visa's covered litigation, shares of Visa's Class B stock will be converted to Visa Class A shares using a conversion factor which is periodically adjusted to reflect Visa's ongoing litigation costs.

During the fourth quarter of fiscal year 2018, the Company reassessed the value of its Visa Class B stock. As a part of this reassessment, the Company determined there were revisions which affected prior periods, and recording the adjustment cumulatively in fiscal year 2018 would materially misstate the Company's consolidated statement of income for the year ended December 31, 2018. Accordingly, the Company's financial results for all prior periods presented herein have been restated to reflect this reassessment. These restatements were immaterial to each of the prior reporting periods affected. The cumulative effect of the restatement has been reflected in the beginning retained earnings balance of January 1, 2017, in the amount of $1 million in the consolidated statement of changes in stockholders' equity. The table below shows the effect of the restatement on the Company's consolidated statement of income as well as the consolidated statement of condition for the periods presented.

	Year ended December 31, 2017			Year ended December 31, 2016		
	Previously Reported	Correction	Revised	Previously Reported	Correction	Revised
Other noninterest income	$ 4,575	$ (414)	$ 4,161	$ 4,449	$ 8	$ 4,457
Total noninterest income	103,459	(414)	103,045	105,081	8	105,089
Income before income taxes	32,929	(414)	32,515	21,169	8	21,177
Income taxes	17,485	29	17,514	7,138	3	7,141
Net income	15,444	(443)	15,001	14,031	5	14,036
Earnings per common share	1.13	(0.03)	1.10	1.04	-	1.04
Diluted earnings per common share	1.10	(0.03)	1.07	1.00	-	1.00

	December 31, 2017		
	Previously Reported	Correction	Revised
Other assets	$ 38,457	$ (977)	$ 37,480
Total assets	2,137,058	(977)	2,136,081
Retained earnings	141,963	(977)	140,986
Total stockholders' equity	180,571	(977)	179,594
Total liabilities and stockholders' equity	2,137,058	(977)	2,136,081

NOTE 4 Business Combinations

On January 1, 2016, the Company acquired Alliance Benefit Group North Central States, Inc. located in Albert Lea, Minnesota, for cash consideration of $23.4 million. The purchased assets and assumed liabilities were recorded at their respective acquisition date estimated fair values, identified intangible assets were recorded at estimated fair value. The purchase, consisting of approximately 900 retirement plans with more than 75,000 retirement participants, increased the Company's retirement services division by $6.0 billion in retirement and individual asset managed accounts. As part of the transaction, $17.9 million was allocated to an identified customer intangible and $4.8 million to goodwill.

On January 15, 2016 the Company acquired Beacon Bank (Beacon), with locations in Shorewood, Excelsior, Eden Prairie, and Duluth, Minnesota. The purchased assets and assumed liabilities were recorded at their respective acquisition date estimated fair values as indicated in the following table:

(dollars in thousands)	As Recorded by Beacon	Fair Value Adjustments	As Recorded by The Company
Assets			
Cash and cash equivalents	$ 16,821	$ -	$ 16,821
Fed funds sold	1,617	-	1,617
Securities	113,687	183	113,870
Loans	206,999	(1,867)	205,132
Premises and equipment	3,626	(44)	3,582
Foreclosed assets	851	-	851
Accrued interest receivable	747	-	747
Bank-owned life insurance	5,331	-	5,331
Core deposit intangible	-	3,794	3,794
Other assets	887	16	903
Total assets	350,566	2,082	352,648
Liabilities			
Deposits	309,516	228	309,744
Long-term debt	15,000	(2,151)	12,849
Other liabilities	2,895	41	2,936
Total liabilities	327,411	(1,882)	325,529
Excess of assets over liabilities	$ 23,155	$ 3,964	27,119
Cash paid for Beacon			45,989
Total goodwill Recorded			$ 18,870

NOTE 5 Restrictions on Cash and Due from Banks

Banking regulators require bank subsidiaries to maintain minimum average reserve balances, either in the form of vault cash or reserve balances held with central banks or other financial institutions. The amount of required reserve balances were approximately $9.1 million and $7.9 million at December 31, 2018 and 2017, respectively, and represent those required to be held at the Federal Reserve Bank. In addition to vault cash, the Company held balances at the Federal Reserve Bank and other financial institutions of $7.2 million and $83.5 million at December 31, 2018 and 2017, respectively, to meet these requirements. The balances are included in cash and due from banks on the Consolidated Balance Sheets.

NOTE 6 Investment Securities

The amortized cost of investment securities and their estimated fair values, with gross unrealized gains (losses) at December 31, 2018 and 2017 are as follows:

	2018				2017			
(dollars in thousands)	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale								
U.S. Treasury and agencies	$ 19,364	$ -	$ (222)	$ 19,142	$ 19,086	$ 16	$ (158)	$ 18,944
Obligations of state and political agencies	67,662	171	(1,446)	66,387	74,803	437	(765)	74,475
Mortgage backed securities								
Residential Agency	129,906	210	(3,118)	126,998	149,373	643	(1,386)	148,630
Commercial	29,050	20	(303)	28,767	14,432	12	(233)	14,211
Asset backed securities	398	5	(4)	399	530	12	(1)	541
Corporate bonds	8,602	-	(121)	8,481	10,212	19	(11)	10,220
Total available-for-sale	$254,982	$ 406	$ (5,214)	$ 250,174	$268,436	$ 1,139	$ (2,554)	$267,021

The amortized cost and estimated fair value of investment securities at December 31, 2018, by contractual maturity are as follows:

	Securities Available-for-Sale	
(dollars in thousands)	Amortized Cost	Fair Value
Due in one year or less	$ 5,209	$ 4,987
Due after one year through five years	51,538	50,720
Due after five year through ten years	91,058	89,145
Due after 10 years	107,177	105,322
Total	$ 254,982	$ 250,174

Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

Investment securities with carrying value of $149.0 million and $166.9 million were pledged at December 31, 2018 and 2017, respectively, to secure public deposits and for other purposes required or permitted by law.

Proceeds from the sale of available-for-sale securities for the years ended December 31, 2018, 2017, and 2016 are displayed in the table below:

	Securities Available-for-Sale		
(dollars in thousands)	2018	2017	2016
Proceeds	$ 6,488	$ -	$ 59,910
Realized Gains	144	-	83
Realized Losses	(15)	-	(100)
Total	$ 6,617	$ -	$ 59,893

Information pertaining to investment securities with gross unrealized losses that are not deemed to be other-than-temporarily impaired at December 31, 2018 and 2017 aggregated by investment category and length of time that individual investment securities have been in a continuous loss position, follows:

	Less than 12 Months		Over 12 Months		Total	
At December 31, 2018 *(dollars in thousands)*	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Available-for-sale						
U.S. Treasury and agencies	$ (8)	$ 5,288	$ (214)	$ 11,598	$ (222)	$ 16,886
Obligations of state and political agencies	-	389	(1,446)	55,770	(1,446)	56,159
Mortgage backed securities						
Residential Agency	(44)	7,352	(3,074)	112,293	(3,118)	119,645
Commercial	(39)	7,844	(264)	9,741	(303)	17,585
Asset backed securities	-	2	(4)	155	(4)	157
Corporate bonds	-	-	(121)	8,481	(121)	8,481
Total available-for-sale	$ (91)	$ 20,875	$ (5,123)	$ 198,038	$ (5,214)	$ 218,913

	Less than 12 Months		Over 12 Months		Total	
At December 31, 2017 *(dollars in thousands)*	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value
Available-for-sale						
U.S. Treasury and agencies	$ -	$ -	$ (158)	$ 12,400	$ (158)	$ 12,400
Obligations of state and political agencies	(298)	21,860	(467)	26,643	(765)	48,503
Mortgage backed securities						
Residential Agency	(772)	86,442	(614)	33,691	(1,386)	120,133
Commercial	(26)	1,776	(207)	10,070	(233)	11,846
Asset backed securities	(1)	184	-	-	(1)	184
Corporate bonds	(11)	5,040	-	-	(11)	5,040
Total available-for-sale	$ (1,108)	$ 115,302	$ (1,446)	$ 82,804	$ (2,554)	$ 198,106

At December 31, 2018, all of the available-for-sale debt securities in an unrealized loss position were investment grade. During the year ended December 31, 2018, the Company evaluated all of its debt securities for credit impairment and determined there were no credit losses evident and did not record any other-than-temporary impairment. At December 31, 2018, the Company's evaluation of other investment securities with continuous unrealized losses indicated that there were no credit losses evident. Furthermore, the Company does not intend to sell and it is more likely than not that the Company will not be required to sell these debt securities before the anticipated recovery of the amortized cost basis.

The Company conducts periodic reviews to identify and evaluate each investment that has an unrealized loss for other-than-temporary impairment. An unrealized loss exists when the current estimated fair value of an individual security is less than its amortized cost basis. Unrealized losses that are determined to be temporary in nature are recorded, net of tax, in accumulated other comprehensive income for available-for-sale securities.

NOTE 7 Loans and Allowance for Loan Losses

The components of loans in the consolidated balance sheets and the associated allowance by impairment methodology at December 31, 2018 and 2017 are displayed in the following table:

	Recorded Investment			Allowance Allocation			
(dollars in thousands)	Individually Evaluated	Collectively Evaluated	Total	Individually Evaluated	Collectively Evaluated	Unallocated	Total
December 31, 2018							
Commercial							
Commercial and industrial	$ 3,945	$ 515,107	$ 519,052	$ 2,059	$ 10,068	$ -	$ 12,127
Real estate construction	-	19,079	19,079	-	250	-	250
Commercial real estate	1,684	448,571	450,255	455	5,824	-	6,279
Total commercial	5,629	982,757	988,386	2,514	16,142	-	18,656
Consumer							
Residential real estate first mortgage	352	459,380	459,732	-	1,156	-	1,156
Residential real estate junior lien	559	188,930	189,489	4	801	-	805
Other revolving and installment	20	96,254	96,274	20	360	-	380
Total consumer	931	744,564	745,495	24	2,317	-	2,341
Total	$ 6,560	$ 1,727,321	$ 1,733,881	$ 2,538	$ 18,459	$ 1,177	$ 22,174
December 31, 2017							
Commercial							
Commercial and industrial	$ 3,387	$ 477,208	$ 480,595	$ 833	$ 6,756	$ -	$ 7,589
Real estate construction	61	22,287	22,348	-	343	-	343
Commercial real estate	-	444,857	444,857	-	4,909	-	4,909
Total commercial	3,448	944,352	947,800	833	12,008	-	12,841
Consumer							
Residential real estate first mortgage	508	348,456	348,964	-	1,411	-	1,411
Residential real estate junior lien	1,862	193,241	195,103	41	861	-	902
Other revolving and installment	84	82,523	82,607	68	431	-	499
Total consumer	2,454	624,220	626,674	109	2,703	-	2,812
Total	$ 5,902	$ 1,568,572	$ 1,574,474	$ 942	$ 14,711	$ 911	$ 16,564

Changes in the allowance for years ended December 31, 2018, 2017, and 2016 are summarized in the following tables:

(dollars in thousands)	Beginning Balance	Provision for credit losses	Loan charge-offs	Loan recoveries	Ending Balance
Balance at December 31, 2016					
Commercial					
Commercial and industrial	$ 6,740	$ 507	$ (1,629)	$ 1,084	$ 6,702
Real estate construction	244	1,304	(1,655)	587	480
Commercial real estate	4,070	269	(43)	188	4,484
Total commercial	11,054	2,080	(3,327)	1,859	11,666
Consumer					
Residential real estate first mortgage	1,243	(328)	-	211	1,126
Residential real estate junior lien	1,189	453	(829)	94	907
Other revolving and installment	525	16	(280)	139	400
Total consumer	2,957	141	(1,109)	444	2,433
Unallocated	677	839	-	-	1,516
Total	$ 14,688	$ 3,060	$ (4,436)	$ 2,303	$ 15,615

(dollars in thousands)	Beginning Balance	Provision for credit losses	Loan charge-offs	Loan recoveries	Ending Balance
Balance at December 31, 2017					
Commercial					
Commercial and industrial	$ 6,702	$ 3,244	$ (3,287)	$ 930	$ 7,589
Real estate construction	480	(416)	-	279	343
Commercial real estate	4,484	352	-	73	4,909
Total commercial	11,666	3,180	(3,287)	1,282	12,841
Consumer					
Residential real estate first mortgage	1,126	182	-	103	1,411
Residential real estate junior lien	907	247	(1,124)	872	902
Other revolving and installment	400	276	(429)	252	499
Total consumer	2,433	705	(1,553)	1,227	2,812
Unallocated	1,516	(605)	-	-	911
Total	$ 15,615	$ 3,280	$ (4,840)	$ 2,509	$ 16,564
Balance at December 31, 2018					
Commercial					
Commercial and industrial	$ 7,589	$ 6,911	$ (3,123)	$ 750	$ 12,127
Real estate construction	343	(35)	(60)	2	250
Commercial real estate	4,909	1,889	(600)	81	6,279
Total commercial	12,841	8,765	(3,783)	833	18,656
Consumer					
Residential real estate first mortgage	1,411	(226)	(29)	-	1,156
Residential real estate junior lien	902	(171)	(133)	207	805
Other revolving and installment	499	(24)	(308)	213	380
Total consumer	2,812	(421)	(470)	420	2,341
Unallocated	911	266	-	-	1,177
Total	$ 16,564	$ 8,610	$ (4,253)	$ 1,253	$ 22,174

The Company assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal and external reviews of risk rated loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Company's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the estimated fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The Company's ratings are aligned to Pass and Criticized categories. The Criticized category includes Special Mention, Substandard, and Doubtful risk ratings. The risk ratings are defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention: Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date. Special mention loans are not adversely classified and do not expose the Company to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well-defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

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

Loss: Loans classified as loss are considered uncollectible and charged off immediately.

The tables below provide a breakdown of outstanding commercial loans by risk category at December 31, 2018 and 2017. All criticized loans are subject to high levels of monitoring by management. The Criticized category includes Special Mention, Substandard, and Doubtful categories which are defined by banking regulatory agencies.

		Criticized			
(dollars in thousands)	Pass	Special Mention	Substandard	Doubtful	Total
December 31, 2018					
Commercial					
Commercial and industrial	$ 467,911	$ 12,055	$ 37,523	$ 1,563	$ 519,052
Real estate construction	18,024	-	1,055	-	19,079
Commercial real estate	417,470	6,304	26,481	-	450,255
Total commercial	903,405	18,359	65,059	1,563	988,386
Consumer					
Residential real estate first mortgage[1]	459,713	-	19	-	459,732
Residential real estate junior lien[1]	187,004	-	2,485	-	189,489
Other revolving and installment[1]	96,274	-	-	-	96,274
Total consumer	742,991	-	2,504	-	745,495
Total Loans	$ 1,646,396	$ 18,359	$ 67,563	$ 1,563	$1,733,881
December 31, 2017					
Commercial					
Commercial and industrial	$ 455,941	$ 12,722	$ 11,000	$ 932	$ 480,595
Real estate construction	18,880	2,689	779	-	22,348
Commercial real estate	414,622	10,474	19,761	-	444,857
Total commercial	889,443	25,885	31,540	932	947,800
Consumer					
Residential real estate first mortgage[1]	348,718	178	68	-	348,964
Residential real estate junior lien[1]	192,459	242	2,402	-	195,103
Other revolving and installment[1]	82,584	-	23	-	82,607
Total consumer	623,761	420	2,493	-	626,674
Total Loans	$ 1,513,204	$ 26,305	$ 34,033	$ 932	$1,574,474

[1]The Company generally does not risk rate consumer loans unless a default event such as bankruptcy or extended nonperformance takes place. Alternatively, standard credit scoring systems are used to assess credit risks of consumer loans

The following tables reflect the past due aging analysis of the loan portfolio at December 31, 2018 and 2017:

(dollars in thousands)	Current	Accruing 30-89 Days Past Due	Accruing 90 Days or More Past Due	Nonperforming	Total Loans
December 31, 2018					
Commercial					
Commercial and industrial	$ 512,659	$ 2,815	$ -	$ 3,578	$ 519,052
Real estate construction	19,079	-	-	-	19,079
Commercial real estate	448,738	-	-	1,517	450,255
Total commercial	980,476	2,815	-	5,095	988,386
Consumer					
Residential real estate first mortgage	456,059	2,411	-	1,262	459,732
Residential real estate junior lien	188,136	769	-	584	189,489
Other revolving and installment	95,671	581	-	22	96,274
Total consumer	739,866	3,761	-	1,868	745,495
Total loans	$ 1,720,342	$ 6,576	$ -	$ 6,963	$1,733,881
December 31, 2017					
Commercial					
Commercial and industrial	$ 476,210	$ 1,192	$ -	$ 3,193	$ 480,595
Real estate construction	22,287	-	-	61	22,348
Commercial real estate	440,412	4,445	-	-	444,857
Total commercial	938,909	5,637	-	3,254	947,800
Consumer					
Residential real estate first mortgage	347,941	361	-	662	348,964
Residential real estate junior lien	191,856	1,374	-	1,873	195,103
Other revolving and installment	82,002	521	-	84	82,607
Total consumer	621,799	2,256	-	2,619	626,674
Total loans	$ 1,560,708	$ 7,893	$ -	$ 5,873	$1,574,474

Interest income foregone on nonaccrual loans approximated $0.3 million and $0.2 million for the years ended December 31, 2018 and 2017, respectively.

The table below summarizes key information for impaired loans. These impaired loans may have estimated losses which are included in the allowance for loan losses.

	December 31, 2018			December 31, 2017		
(dollars in thousands)	Unpaid Principal	Recorded Investment	Related Allowance	Unpaid Principal	Recorded Investment	Related Allowance
Commercial and industrial	$ 4,174	$ 3,945	$ 2,059	$ 3,423	$ 3,387	$ 833
Real estate construction	-	-	-	62	61	-
Commercial real estate	1,735	1,684	455	-	-	-
Residential real estate first mortgage	504	352	-	591	508	-
Residential real estate junior lien	701	559	4	1,969	1,862	41
Other revolving and installment	22	20	20	84	84	68
Total impaired loans	$ 7,136	$ 6,560	$ 2,538	$ 6,129	$ 5,902	$ 942

The table below presents the average recorded investment in impaired loans and interest income for years ended December 31, 2018 and 2017 respectively. No interest income on impaired loans was recognized using the cash basis of accounting during the years ended December 31, 2018 and 2017.

(dollars in thousands)	2018 Average Recorded Investments	2018 Interest Income	2017 Average Recorded Investments	2017 Interest Income	2016 Average Recorded Investments	2016 Interest Income
Commercial						
Commercial and industrial	$ 4,758	$ 35	$ 4,515	$ 246	$ 4,209	$ 204
Commercial real estate	1,781	9	65	3	752	30
Consumer						
Residential real estate first mortgage	533	-	620	37	1,102	50
Residential real estate junior lien	722	6	2,280	141	2,983	180
Other revolving and installment	31	-	89	6	81	6
Total Impaired Loans	$ 7,825	$ 50	$ 7,569	$ 433	$ 9,127	$ 470

Loans with a carrying value of $1.1 billion and $1.0 billion were pledged at December 31, 2018 and 2017, respectively, to secure public deposits, and for other purposes required or permitted by law.

Troubled Debt Restructurings

Under certain circumstances, the Company will provide borrowers relief through loan restructurings. A restructuring of debt constitutes a troubled debt restructuring (TDR) if the Company for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that it would not otherwise consider. TDR concessions can include reduction of interest rates, extension of maturity dates, forgiveness of principal or interest due, or acceptance of other assets in full or partial satisfaction of the debt.

During 2018, there was one loan modified as a troubled debt restructuring as a result of adjusting the interest rate below current market levels. The balance at the time of restructuring was $1.0 million. For year ending December 31, 2018 the carrying value of the restructured loan was $0.2 million. The loan is currently performing according to the modified terms and there were no specific reserves for loans losses allocated to loans modified as troubled debt restructurings. During 2017, there were no loans that were modified as a troubled debt restructuring.

The Company does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

NOTE 8 Land, Premises and Equipment, Net

Components of premises and equipment at December 31, 2018 and 2017 are as follows:

(dollars in thousands)	2018	2017
Land	$ 4,663	$ 4,663
Buildings and improvements	25,902	25,888
Assets under capital lease	2,657	2,657
Furniture, fixtures, and equipment	29,767	32,397
	62,989	65,605
Less accumulated depreciation	(41,246)	(44,376)
Total	$ 21,743	$ 21,229

Depreciation expense for years ended December 31, 2018, 2017, and 2016 amounted to $3.2 million, $3.2 million, and $3.3 million, respectively.

Total rent expense for the years ended December 31, 2018, 2017, and 2016 amounted to $3.6 million, $3.6 million, and $3.7 million, respectively.

Pursuant to the terms of the noncancelable lease agreements in effect at December 31, 2018, pertaining to banking premises, future minimum rent commitments under various operating leases are as follows:

(dollars in thousands)	Amount
2019	$ 3,609
2020	3,127
2021	2,333
2022	1,985
2023	1,421
Thereafter	1,158
Total	$ 13,633

The annual minimum future rents due to the Company on noncancelable operating leases at December 31, 2018 are as follows:

(dollars in thousands)	Amount
2019	$ 267
2020	204
2021	196
2022	181
2023	106
Total	$ 954

NOTE 9 Goodwill and Other Intangible Assets

The following is a summary of the Company's intangible assets.

At December 31, 2018 *(dollars in thousands)*	Estimated Life	Amortization Method	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill			$ 27,329	-	$ 27,329
Identifiable customer intangibles	9 years	Straight Line	55,744	(34,972)	20,772
Core deposit intangibles	5 years	Straight Line	7,216	(5,515)	1,701
Total			$ 90,289	$ (40,487)	$ 49,802

At December 31, 2017 *(dollars in thousands)*	Estimated Life	Amortization Method	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill			$ 27,329	-	$ 27,329
Identifiable customer intangibles	9 years	Straight Line	55,744	(31,333)	24,411
Core deposit intangibles	5 years	Straight Line	7,216	(4,516)	2,700
Total			$ 90,289	$ (35,849)	$ 54,440

Aggregate amortization expense for the years ended December 31, 2018, 2017, and 2016 was $4.6 million, $5.6 million, and $7.0 million, respectively.

Estimated aggregate amortization expenses for each of the next five years and thereafter is as follows:

(dollars in thousands)	Amount
2019	$ 4,081
2020	3,961
2021	3,266
2022	3,202
2023	3,202
Thereafter	4,761
Total	$ 22,473

NOTE 10 Loan Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of loans serviced for others totaled $591.6 million and $591.8 million at December 31, 2018 and 2017, respectively. Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and

collection and foreclosure processing. Loan servicing income is recorded on the accrual basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees, and is net of fair value adjustments to capitalized mortgage servicing rights.

The balance of servicing rights included at December 31, 2018 and 2017 is $4.6 million and $4.7 million, respectively. Servicing rights of $0.5 million, $0.7 million and $1.2 million were capitalized in 2018, 2017, and 2016, respectively. Amortization of servicing rights was $0.7 million, $0.8 million, and $0.8 million in 2018, 2017, and 2016, respectively. Changes in estimated fair value of servicing rights arising from adjustments to valuation allowances are recognized in other noninterest expense were $(72) thousand, $14 thousand, and $(139) thousand in 2018, 2017, and 2016, respectively.

The amount of loan servicing obligations included in other liabilities is $92 thousand and $128 thousand as of December 31, 2018 and 2017, respectively.

The estimated fair value of loan servicing rights and obligations were determined using discount rates averaging 10.50% as of December 31, 2018 and 2017, and prepayment speeds averaging 7.79% and 9.30%, respectively.

NOTE 11 Other Assets

Other assets on the balance sheet consist of the following balances at December 31, 2018 and 2017:

(dollars in thousands)	2018	2017
Federal Reserve Bank stock	$ 2,675	$ 2,675
Foreclosed assets	169	446
Prepaid expenses	5,163	6,448
Investments in partnerships	75	390
Trust fees receivable	11,724	15,883
Income tax refund receivable	2,379	3,902
Federal Home Loan Bank stock	6,875	4,281
Other assets	3,627	3,455
Total	$ 32,687	$ 37,480

Federal Reserve Bank stock and Federal Home Loan Bank stock are carried at cost which is the expected recoverability of the par value. The investments are required to be maintained in order to be members of the Federal Reserve Bank and to obtain borrowings from the Federal Home Loan Bank.

NOTE 12 Deposits

The components of deposits in the consolidated balance sheets at December 31, 2018 and 2017 are as follows:

(dollars in thousands)	2018	2017
Noninterest-bearing transaction	$ 563,130	$ 619,333
Interest-bearing transaction		
Savings accounts	54,947	50,794
Interest-bearing checking accounts	511,090	416,991
Money market savings	495,672	543,583
Time deposits	174,454	204,261
Total interest-bearing transactions	1,236,163	1,215,629
Total deposits	$ 1,799,293	$ 1,834,962

Certificates of deposit in excess of $250,000 totaled $27.5 million and $28.2 million at December 31, 2018 and 2017, respectively.

At December 31, 2018, the scheduled maturities of certificates of deposit are as follows:

(dollars in thousands)	Amount
2019	$ 137,395
2020	11,911
2021	11,128
2022	4,153
2023	4,756
Thereafter	5,111
Total	$ 174,454

NOTE 13 Short-Term Borrowings

Federal Funds purchased at December 31, 2018 and 2017 were $93.5 million and $-0-, respectively. The average interest rate charged on Federal Funds purchased during 2018, 2017, and 2016 was 2.2%, 1.3%, and 0.41%, respectively.

At December 31, 2018, the Company had available $87 million of unsecured lines of credit and no secured lines of credit for Federal Funds outstanding.

At December 31, 2017, the Company had $30 million of short-term borrowings with the Federal Home Loan Bank. The interest rate was 1.42% and the borrowing matured on January 2, 2018.

NOTE 14 Long-Term Debt

Long-term debt at December 31, 2018 and 2017 consisted of the following:

(dollars in thousands)	Face Value	Carrying Value	Interest Rate	Year End Interest Rate	Maturity Date	Call Date
2018						
Subordinated notes payable	$ 50,000	$ 49,562	Fixed	5.75%	12/30/2025	12/30/2020
Junior subordinated debenture (Trust I)	4,000	3,357	Three-month LIBOR + 3.10%	5.92%	6/26/2033	6/26/2008
Junior subordinated debenture (Trust II)	6,000	5,035	Three-month LIBOR + 1.80%	4.59%	9/15/2036	9/15/2011
Obligations under capital lease	2,700	870	Fixed		10/31/2022	
Total	$ 62,700	$ 58,824				

	Face Value	Carrying Value	Interest Rate	Year End Interest Rate	Maturity Date	Call Date
2017						
Subordinated notes payable	$ 50,000	$ 49,500	Fixed	5.75%	12/30/2025	12/30/2020
Junior subordinated debenture (Trust I)	4,000	3,311	Three-month LIBOR + 3.10%	5.92%	6/26/2033	6/26/2008
Junior subordinated debenture (Trust II)	6,000	4,967	Three-month LIBOR + 1.80%	4.59%	9/15/2036	9/15/2011
Obligations under capital lease	2,700	1,041	Fixed		10/31/2022	
Total	$ 62,700	$ 58,819				

At December 31, 2018, the Company had a $150 thousand line of credit with the Federal Home Loan Bank. Bank of North Dakota letters of credit are collateralized by loans pledged to the Bank of North Dakota in the amount of $260.6 million at December 31, 2018. There were no outstanding letters of credit at December 31, 2018.

The following schedule represents the future minimum lease payments under the capital lease together with the present value of the net minimum lease payments at December 31, 2018:

(dollars in thousands)	Amount
2019	$ 251
2020	251
2021	251
2022	231
2023	7
Total minimum lease payments	991
Less amount representing interest	(121)
Net minimum lease payments	$ 870

NOTE 15 True-Up Liability

In connection with the Prosperan Bank acquisition in 2009, the Bank agreed to pay the FDIC, should the estimated losses on the acquired loan portfolios as well as servicing fees earned on the acquired loan portfolios not meet thresholds as stated in the loss sharing agreements (the "true-up liability"). This contingent consideration was classified as a liability within other liabilities on the Consolidated Balance Sheet and was re-measured at each reporting date until the contingency was resolved. At December 31, 2017, the value of the true-up liability was $3.2 million. Changes in the value of the liability were reported in other noninterest expense.

On October 24, 2018, the Company entered into a termination agreement with the FDIC that terminated both the Single Family Shared-Loss Agreement as well as the Commercial and Other Assets Shared-Loss Agreement. The Company agreed to pay the FDIC $3.0 million. All rights and obligations of the parties under these loss share agreements, including the claw-back provisions, terminated effective October 24, 2018. As a result, all recoveries, gains, charge-offs, losses and expenses related to assets previously covered under loss share agreements are recognized entirely by the Company from the date of termination.

NOTE 16 Financial Instruments With Off-Balance Sheet Risk

In the normal course of business, the Bank has outstanding commitment and contingent liabilities, such as commitments to extend credit and standby letters of credit, which are not included in the accompanying consolidated financial statements. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. The Bank uses the same credit policies in making such commitments as it does for instruments that are included in the statements of financial condition.

At December 31, 2018 and 2017, the following financial instruments whose contract amount represents credit risk were approximately as follows:

(dollars in thousands)	2018	2017
Commitments to extend credit	$ 529,890	$ 509,071
Standby letters of credit	8,852	9,255
Total	$ 538,742	$ 518,326

Commitments to extend credit are agreements to lend to a client 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 client'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.

The Company was not required to perform on any financial guarantees and did not incur any losses on its commitments during the past two years.

NOTE 17 Legal Contingencies

The Company may be subject to claims and lawsuits which may arise primarily in the ordinary course of business. It is the opinion of management, that if such claims are made, the disposition or ultimate resolution of the claims and lawsuits will not have a material adverse effect on the financial position of the Company.

NOTE 18 Stock Based Compensation Plan

Effective May 2009, the Company adopted the Alerus Financial Corporation 2009 Stock Award Plan (the 2009 Plan) providing for the grant of up to 1.4 million shares of its common stock to employees, officers, and directors pursuant to awards of non-qualified options, restricted stock, or other stock-based employee benefits.

The 2009 Plan provides for the granting of restricted stock at no cost to certain key employees. Shares of stock are issued to each employee immediately upon the grant of the award and the employee becomes entitled to all rights of a shareholder, unless such shares are forfeited under the plan.

The restricted stock is subject to full or partial forfeiture, as defined, if the employee terminates employment with the Company within prescribed time periods (generally five to ten years) or violates any restrictions under their agreement. Restricted stock awards generally vest over a five to ten year period, but vesting may be accelerated or immediate due to death or disability of the employee or the occurrence of certain events relating primarily to significant changes in directors or ownership of the Company. Restricted stock awards are considered to represent an element of employee compensation and are charged to expense over the period earned. Compensation expense relating to stock awards under this plan was $1.2 million in 2018, $0.7 million in 2017, and $1.1 million in 2016.

On February 22, 2018, the Company granted 42,038 restricted stock units to officers. The restricted stock units vest, in the form of Company common stock, after three years based on the target performance metric associated with the award. The final award will be adjusted to reflect actual performance versus target performance, using a linear scale, with a threshold (minimum) of 50% award for 80% performance, and a maximum of 150% award for 120% performance. In determining compensation expense, the fair value of the restricted stock unit awards was determined based on the 20 day weighted average trade price of the Company's common stock on the date of grant, which was $22.80 per share. The expense is being recognized over the applicable vesting period. Due to the fact that the measurements cannot be determined at the time of the grant, the Company estimated that the most likely outcome is the achievement of the target level. If during the Performance Period, additional information becomes available to lead the Company to believe a different level will be achieved for the Performance Period, the Company will reassess the number of units that will vest for the grant and adjust its compensation expense accordingly on a prospective basis. The total amount of expense for restricted stock units during the year ended December 31, 2018 was $0.4 million.

Amounts granted under the 2009 plan have been retroactively adjusted for all stock splits effected in the form of dividends.

Activity in the stock plans for the years ended December 31, 2018, 2017, and 2016 is as follows:

	Number of Shares	
	Available for Future Grant	Restricted Stock Awards
Balance - December 31, 2015	678,682	671,318
Restricted units awarded	(2,558)	2,558
Restricted shares awarded	(52,050)	52,050
Shares withheld for taxes	5,557	(5,557)
Awards forfeited	31,283	(31,283)
Balance - December 31, 2016	660,914	689,086
Restricted units awarded	(5,287)	5,287
Restricted shares awarded	(51,576)	51,576
Shares withheld for taxes	13,273	(13,273)
Awards forfeited	55,134	(55,134)
Balance - December 31, 2017	672,458	677,542
Restricted units awarded	(42,038)	42,038
Restricted shares awarded	(45,764)	45,764
Shares withheld for taxes	9,703	(9,703)
Awards forfeited	4,696	(4,696)
Balance - December 31, 2018	599,055	750,945

The number of unvested shares outstanding was 295,972, 335,092, and 440,511 respectively, at December 31, 2018, 2017, and 2016.

Effective May 2009, the Company also adopted the Alerus Financial Corporation Stock Grant Plan for Non-Employee Directors (the Retainer Plan) providing for the issuance of up to 180,000 shares of its common stock to non-employee directors. The purpose of the Retainer Plan is to provide for payment for the annual retainer to directors in shares of Company common stock. The number of shares to be issued is based on the retainer divided by the fair market value per share as of the grant date, as defined in Note 1. Upon the issuance of shares under this plan, the then current value of the shares is charged to expense. Compensation expense relating to stock awards under this plan was $0.3 million in 2018, $0.3 million in 2017, and $0.3 million in 2016.
Activity in the Retainer Plan for the years ended December 31, 2018, 2017, and 2016 is as follows:

	Number of Shares	
(dollars in thousands)	Available for Future Grant	Retainer Stock Awards
Balance - December 31, 2015	68,471	111,529
Retainer shares awarded	(17,829)	17,829
Balance - December 31, 2016	50,642	129,358
Retainer shares awarded	(14,800)	14,800
Balance - December 31, 2017	35,842	144,158
Retainer shares awarded	(10,017)	10,017
Balance - December 31, 2018	25,825	154,175

NOTE 19 Employee Benefits

The Company maintains two employee retirement plans including a defined benefit employee stock ownership plan (ESOP) and a defined contribution salary reduction profit sharing plan. The plans cover substantially all full-time employees upon satisfying prescribed eligibility requirements for age and length of service. Contributions to the non-contributory profit sharing plan and the ESOP are determined annually by the Board of Directors at their discretion and allocated to participants based on a percentage of annual compensation. Under the salary reduction profit sharing plan, the Company contributes 100% of amounts deferred by employees up to 3% of eligible compensation and 50% of amounts deferred by employees between 3% and 6% of eligible compensation. Under the ESOP, corporate stock is transferred to the plan at market value on the date of transfer. Market value is established by a third party valuation. The Company treats these as outstanding shares, accordingly, dividends on these shares are charged to retained earnings. Retirement plan contributions are reflected under employee benefits in the income statement and for years ending December 31, 2018, 2017, and 2016 are as follows:

(dollars in thousands)	2018	2017	2016
Salary reduction plan	$ 2,402	$ 2,317	$ 2,290
ESOP	1,665	1,684	1,444
Total	$ 4,067	$ 4,001	$ 3,734
Total ESOP shares outstanding	1,334,372	1,393,395	1,337,999

Under Federal income tax regulations, the employer stock that is held by the plan and its participants is not readily tradable on an established market, or is subject to trading limitations and includes a put option. The put option is a right to demand that the Company buys shares of its stock distributed to participants for which there is no market. The put price is representative of the fair market value of the stock. Market value is established by a third party valuation. The Company's ESOP repurchase obligation was $26 million, $31 million, and $23 million respectively, for years ended December 31, 2018, 2017, and 2016.

NOTE 20 Noninterest Income

All of the Company's revenue from contracts with customers within the scope of ASC 606 is recognized in noninterest income. The following table presents the Company's noninterest income for the years ended December 31, 2018, 2017, and 2016.

(dollars in thousands)	2018	2017	2016
Noninterest Income			
Retirement and benefit services	$ 63,316	$ 62,390	$ 57,804
Wealth management	14,900	13,953	12,640
Mortgage Banking [(1)]	17,630	19,882	26,528
Service charges on deposit accounts	1,808	1,854	1,916
Net gain (loss) on investment securities [(1)]	85	(13)	(24)
Other			
Interchange fees	2,005	1,997	2,025
Bank owned life insurance income [(1)]	803	820	991
Misc transactional fees	1,106	1,070	1,071
Other noninterest income	1,096	1,092	2,138
Total	$ 102,749	$ 103,045	$ 105,089

[(1)] Not within the scope of ASC 606

NOTE 21 Income Taxes

The components of income tax expense (benefit) for the years ended December 31, 2018, 2017, and 2016 are as follows:

(dollars in thousands)	2018	2017	2016
Federal			
Current	$ 5,801	$ 6,791	$ 9,090
Deferred	(49)	2,975	(2,659)
Federal income tax	5,752	9,766	6,431
State			
Current	1,265	949	1,089
Deferred	155	734	(382)
State income tax	1,420	1,683	707
Deferred tax impairment and statutory rate change	-	6,036	-
Total income tax provision	$ 7,172	$ 17,514	$ 7,141

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2018 and 2017 are as follows:

(dollars in thousands)	2018	2017
Deferred Tax Assets		
Allowance for loan losses	$ 5,566	$ 4,157
Employee compensation and benefit accruals	2,167	2,017
Expense accruals	740	1,701
Identifiable intangible amortization	3,351	3,392
Deferred loan fees	462	332
Net operating loss carry forwards	266	436
Nonaccrual loan interest	143	193
Unrealized gain on available-for-sale investment securities	1,207	379
Other	533	615
Total	14,435	13,222
Valuation allowance	-	(150)
Total deferred tax assets from temporary differences	14,435	13,072
Deferred Tax Liabilities		
Accumulated depreciation	1,079	499
Goodwill and intangible amortization	1,443	1,120
Servicing assets	1,137	1,144
Prepaid expenses	644	1,051
Other	47	45
Total deferred tax liabilities from temporary differences	4,350	3,859
Net Deferred Tax Assets	$ 10,085	$ 9,213

The reconciliation between applicable income taxes and the amount computed at the applicable statutory Federal tax rate for years ending December 31, 2018, 2017, and 2016 is as follows:

	2018		2017		2016	
(dollars in thousands)	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income	Amount	Percent of Pretax Income
Taxes at statutory federal income tax rate	$ 6,938	21.0%	$11,380	35.0%	$ 7,412	35.0%
Tax effect of:						
Tax exempt income	(365)	(1.1)	(562)	(1.7)	(736)	(3.4)
State income taxes, net of federal benefits	1,399	4.2	1,414	4.3	(602)	(2.8)
Change in federal statutory tax rate	-	-	4,818	14.1	-	-
Deferred tax asset impairment	-	-	1,392	4.2	-	-
Nondeductible items and other	(800)	(2.4)	(928)	(2.8)	1,067	5.0
Applicable income taxes	$ 7,172	21.7%	$17,514	53.1%	$ 7,141	33.8%

On December 22, 2017 the U.S. Government enacted "To provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018", also known as the Tax Cuts and Jobs Act. This resulted in the corporate income tax rate being reduced from the 35% level to 21%. The Company adjusted the carrying value of the deferred tax assets using the new tax rate, which resulted in a charge to earnings in the fourth quarter of 2017. Impairment expense of $4.6 million was recorded. The Company was unable to recognize certain tax benefits related to loans acquired in 2009 and recorded an impairment expense of $1.4 million in 2017.

It is the opinion of management that the Company has no significant uncertain tax positions that would be subject to change upon examination.

NOTE 22 Related Party Transactions

In the ordinary course of business, the Bank has granted loans to executive officers, directors, and their affiliates (related parties). These loans are made on substantially the same terms and conditions as those prevailing at the time for comparable transactions with outsiders and are not considered to involve more than the normal risk of collectability. Loans outstanding both direct and indirect to related parties totaled $12.6 million and December 31, 2018 and $19.9 million at December 31, 2017. During 2018, new loans total $0.8 million were made and $3.3 million were repaid.

Deposits from related parties held by the Company at December 31, 2018 and 2017 amounted to $5.6 million and $5.8 million respectively.

NOTE 23 Preferred Stock

The Company is authorized to issue 2,000,000 shares of preferred stock. The Company redeemed 20,000 shares of Series A preferred stock in February 2016 that had previously been issued to the Secretary of the Treasury under the Small Business Lending Fund. At December 31, 2018 and 2017, there were no shares that were issued or outstanding.

NOTE 24 Derivative Instruments

The Company maintains an overall interest rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Company's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain balance sheet assets and liabilities so that the net interest margin is not, on a material basis, adversely affected by movements in interest rates. As a result of the interest rate fluctuations, hedged assets and liabilities will appreciate or depreciate in market value. The effect of this unrealized appreciation or depreciation will generally be offset by income or loss on the derivative instruments that are linked to the hedged assets and liabilities. The Company views this strategy as a prudent management of interest rate sensitivity, such that earnings are not exposed to undue risk presented by changes in interest rate risks.

Derivative instruments that are used as part of the Company's interest rate risk management strategy include interest rate swaps, futures contracts, and options contracts with indices that relate to the pricing of specific balance sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable rate interest payments between two parties, based on a common notional principal amount and maturity date.

Interest rate options represent contracts that allow the holder of the option to (1) receive cash or (2) purchase, sell, or enter into a financial instrument at a specified price within a specified period of time. Certain of these contracts also provide the Company with the right to enter into interest-rate swaps and cap and floor agreements with the writer of the option.

By using derivative instruments, the Company is exposed to credit and market risk. If the counterparty fails to perform, credit risk is equal to the extent of the estimated fair value gain in a derivative. When the estimated fair value of a derivative contract is positive, this generally indicates that the counterparty owes the Company and therefore, creates a repayment risk for the Company.

When the estimated fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it has no repayment risk. The Company minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with high-quality counterparties that are reviewed periodically by the Company's credit committee.

The Company also maintains a policy of requiring that all derivative contracts be governed by an International Swaps and Derivatives Association Master Agreement. Various derivatives, including interest rate, commodity, equity, credit, and foreign exchange contracts, are offered to clients but usually offset the exposure from such contracts by purchasing other financial contracts. The customer accommodations and any offsetting financial contracts are treated as freestanding derivatives. Free-standing derivatives also include derivatives entered into for risk management that do not otherwise qualify for hedge accounting, including domestic hedge derivatives.

The following table presents the total notional or contractual amounts and estimated fair values for derivatives not designated as hedging instruments that are recorded on the balance sheet in other assets or other liabilities. Customer accommodation, trading, and other free-standing derivatives are recorded on the balance sheet at fair value in trading assets or other liabilities at December 31, 2018 and 2017:

	2018			2017		
		Fair Value			Fair Value	
(dollars in thousands)	Notional Amount	Derivative Assets	Derivative Liabilities	Notional Amount	Derivative Assets	Derivative Liabilities
Free standing derivatives (economic hedges)						
Interest rate contracts	$ -	$ -	$ -	$ 542	$ 9	$ 9
Customer accommodation, trading, and other contracts						
Interest rate contracts	36,814	12	7	38,964	8	1
Total		$ 12	$ 7		$ 17	$ 10

The gain (loss) recognized on derivatives instruments for years ended December 31, 2018, 2017, and 2016 was as follows:

Derivatives not designated as hedging instruments	Location of gain or loss recognized in income	Amount of gain or (loss) recognized in income		
		2018	2017	2016
Interest Rate Contracts	Other Income (Expenses)	$ (2)	$ (26)	$ (54)

NOTE 25 Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and the Bank's consolidated financial statements.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of common equity tier 1, tier 1, and total capital (as defined in the regulations) to risk weighted assets (as defined) and of tier 1 capital (as defined) to average assets (as defined). Management believes at December 31, 2018 and 2017, the Bank has met all of the capital adequacy requirements to which it is subject.

On August 28, 2018, the Federal Reserve Board (the "Board") issued an interim final rule expanding the applicability of the Board's small bank holding company policy statement, as required by the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018. The interim final rule raises the small bank holding company policy statement's asset threshold from $1 billion to $3 billion in total consolidated assets, and as result, our holding company was exempted from all regulatory guidelines, to which it previously had been subject, until such time as its consolidated assets exceed $3 billion. As of December 31, 2018, the most recent notification from the Federal Deposit Insurance Corporation, categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believe have changed in the Bank's category.

The Bank's actual capital amounts and ratios at December 31, 2018 and 2017 are presented in the following table:

At December 31, 2018 *(dollars in thousands)*	Actual		Minimum Capital		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1 capital to risk weighted assets (CET 1)						
Consolidated	$151,745	8.43%	N/A	N/A	N/A	N/A
Bank	204,680	11.39%	80,866	4.5%	116,806	6.5%
Tier 1 capital to risk weighted assets						
Consolidated	159,774	8.87%	N/A	N/A	N/A	N/A
Bank	204,680	11.39%	107,821	6.0%	143,761	8.0%
Total capital to risk weighted assets:						
Consolidated	231,510	12.86%	N/A	N/A	N/A	N/A
Bank	226,854	12.62%	143,806	8.0%	179,758	10.0%
Tier 1 capital to average assets:						
Consolidated	159,774	7.51%	N/A	N/A	N/A	N/A
Bank	204,680	9.63%	85,018	4.0%	106,272	5.0%

At December 31, 2017 *(dollars in thousands)*	Actual		Minimum Capital		Minimum to be Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1 capital to risk weighted assets (CET 1)						
Consolidated	$133,149	7.83%	$ 76,522	4.5%	N/A	N/A
Bank	187,115	11.01%	76,478	4.5%	110,468	6.5%
Tier 1 capital to risk weighted assets						
Consolidated	141,037	8.29%	102,077	6.0%	136,103	8.0%
Bank	187,115	11.01%	101,970	6.0%	135,960	8.0%
Total capital to risk weighted assets:						
Consolidated	207,101	12.17%	136,139	8.0%	170,173	10.0%
Bank	203,679	11.99%	135,899	8.0%	169,874	10.0%
Tier 1 capital to average assets:						
Consolidated	141,037	7.07%	79,795	4.0%	N/A	N/A
Bank	187,115	9.40%	79,623	4.0%	99,529	5.0%

The Bank is subject to certain restrictions on the amount of dividends that it may pay without prior regulatory approval. The Bank normally restricts dividends to a lesser amount. In addition, the Company must adhere to various U.S. Department of Housing and Urban Development (HUD) regulatory guidelines including required minimum capital and liquidity to maintain their Federal Housing Administration approval status. Failure to comply with the HUD guidelines could result in withdrawal of this certification. As of December 31, 2018, the Company was in compliance with HUD guidelines.

NOTE 26 Fair Value of Assets and Liabilities

The Company categorizes its assets and liabilities measured at estimated fair value into a three level hierarchy based on the priority of the inputs to the valuation technique used to determine estimated fair value. The estimated fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). If the inputs used in the determination of the estimated fair value measurement fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the estimated fair value measurement. Assets and liabilities valued at estimated fair value are categorized based on the following inputs to the valuation techniques as follows:

Level 1 – Inputs that utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that an entity has the ability to access.

Level 2 – Inputs that include quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Estimated fair values for

these instruments are estimated using pricing models, quoted prices of investment securities with similar characteristics, or discounted cash flows.

Level 3 – Inputs that are unobservable inputs for the asset or liability, which are typically based on an entity's own assumptions, as there is little, if any, related market activity. Subsequent to initial recognition, the Company may re-measure the carrying value of assets and liabilities measured on a nonrecurring basis to estimated fair value. Adjustments to estimated fair value usually result when certain assets are impaired. Such assets are written down from their carrying amounts to their estimated fair value.

Professional standards allow entities the irrevocable option to elect to measure certain financial instruments and other items at estimated fair value for the initial and subsequent measurement on an instrument-by-instrument basis. The Company adopted the policy to value certain financial instruments at estimated fair value. The Company has not elected to measure any existing financial instruments at estimated fair value; however, it may elect to measure newly acquired financial instruments at estimated fair value in the future.

Recurring Basis

The Company uses estimated fair value measurements to record estimated fair value adjustments to certain assets and liabilities and to determine estimated fair value disclosures. For additional information on how the Company measures estimated fair value refer to Note 1 – Summary to Significant Accounting Principles to the Consolidated Financial Statements.

The following tables present the balances of the assets and liabilities measured at estimated fair value on a recurring basis at December 31, 2018 and 2017:

At December 31, 2018 *(dollars in thousands)*	Level 1	Level 2	Level 3	Total
Trading securities				
U.S. treasury and government agencies	$ -	$ 1,539	$ -	$ 1,539
Available-for-sale and equity securities				
U.S. treasury and government agencies	$ -	$ 19,142	$ -	$ 19,142
Obligations of state and political agencies	-	66,387	-	66,387
Mortgage backed securities				
Residential agency	-	126,998	-	126,998
Commercial	-	28,767	-	28,767
Asset backed securities	-	399	-	399
Corporate bonds	-	8,481	-	8,481
Equity securities	3,165	-	-	3,165
Total availabe-for-sale and equity securities	$ 3,165	$ 250,174	$ -	$ 253,339
Other assets				
Derivatives	$ -	$ 12	$ -	$ 12
Other liabilities				
Derivatives	$ -	$ 7	$ -	$ 7

At December 31, 2017 *(dollars in thousands)*	Level 1	Level 2	Level 3	Total
Trading securities				
U.S. treasury and government agencies	$ -	$ 1,945	$ -	$ 1,945
Available-for-sale and equity securities				
U.S. treasury and government agencies	$ -	$ 18,944	$ -	$ 18,944
Obligations of state and political agencies	-	74,475	-	74,475
Mortgage backed securities				
Residential agency	-	148,630	-	148,630
Commercial	-	14,211	-	14,211
Asset backed securities	-	541	-	541
Corporate bonds	-	10,220	-	10,220
Equity securities	5,445	-	-	5,445
Total available-for-sale and equity securities	$ 5,445	$ 267,021	$ -	$ 272,466
Other assets				
Derivatives	$ -	$ 17	$ -	$ 17
Other liabilities				
Derivatives	$ -	$ 9	$ 1	$ 10

The following is a description of the valuation methodologies used for instruments measured at estimated fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Investment Securities

When available, the Company uses quoted market prices to determine the estimated fair value of investment securities; such items are classified in Level 1 of the estimated fair value hierarchy. For the Company's investment securities for which quoted prices are not available for identical investment securities in an active market, the Company determines estimated fair value utilizing vendors who apply matrix pricing for similar bonds for which no prices are observable or may compile prices from various sources. These models are primarily industry-standard models that consider various assumptions, including time value, yield curve, volatility factors, prepayment speeds, default rates, loss severity, current market, and contractual prices for the underlying financial instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data, or are supported by observable levels at which transactions are executed in the marketplace. Estimated fair values from these models are verified, where possible, against quoted prices for recent trading activity of assets with similar characteristics to the security being valued. Such methods are generally classified as Level 2. However, when prices from independent sources vary, cannot be obtained, or cannot be corroborated, a security is generally classified as Level 3.

Derivatives

All of the Company's derivatives are traded in over-the-counter markets where quoted market prices are not readily available. For these derivatives, estimated fair value is measured using internally developed models that use primarily market observable inputs, such as yield curves and option volatilities, and accordingly, classify as Level 2. Examples of Level 2 derivatives are basic interest rate swaps and forward contracts. Any remaining derivative estimated fair value measurements using significant assumptions that are unobservable are classified as Level 3. Level 3 derivatives include interest rate lock commitments written for residential mortgage loans that are held for sale.

Nonrecurring Basis

Certain assets are measured at estimated fair value on a nonrecurring basis. These assets are not measured at estimated fair value on an ongoing basis; however, they are subject to estimated fair value adjustments in certain circumstances, such as when there is evidence of impairment or a change in the amount of previously recognized impairment.

Net impairment losses related to nonrecurring estimated fair value measurements of certain assets for the years ended December 31, 2018 and 2017 consisted of the following:

	2018				2017			
(dollars in thousands)	Level 2	Level 3	Total	Losses	Level 2	Level 3	Total	Losses
Loans held for sale	$ 14,486	$ -	$ 14,486	$ -	$ 17,938	$ -	$ 17,938	$ -
Impaired loans	-	6,560	6,560	2,538	-	5,902	5,902	942
Foreclosed assets	-	169	169	245	-	446	446	425
Servicing rights	-	4,623	4,623	-	-	4,686	4,686	-

Loans Held for Sale
Loans originated and held for sale are carried at the lower of cost or estimated fair value. The Company obtains quotes or bids on these loans directly from purchasing financial institutions. Typically these quotes include a premium on the sale and thus these quotes indicate estimated fair value of the held for sale loans is greater than cost.

Impairment losses for loans held for sale that are carried at the lower of cost or estimated fair value represent additional net write-downs during the period to record these loans at the lower of cost or estimated fair value subsequent to their initial classification as loans held for sale.

Impaired Loans
In accordance with the provisions of the loan impairment guidance, loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms are measured for impairment. Allowable methods for estimating fair value include using the estimated fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using a discounted cash flow method. The estimated fair value method requires obtaining a current independent appraisal of the collateral and applying a discount factor, if necessary, to the appraised value and including costs to the sell. Because many of these inputs are not observable, the measurements are classified as Level 3.

Foreclosed Assets
Foreclosed assets are recorded at estimated fair value based on property appraisals, less estimated selling costs, at the date of the transfer with any impairment amount charged to the allowance for loan losses. Subsequent to the transfer, foreclosed assets are carried at the lower of cost or estimated fair value, less estimated selling costs with changes in the estimated fair value or any impairment amount recorded in other noninterest expense. Fair value measurements may be based upon appraisals, third-party price opinions, or internally developed pricing methods. These measurements are classified as Level 3.

Servicing Rights
Servicing rights do not trade in an active market with readily observable prices. Accordingly, the estimated fair value of servicing rights is determined using a valuation model that calculates the present value of estimated future net servicing income. The model incorporates assumptions that market participants use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, cost to service, escrow account earnings, contractual servicing fee income, ancillary income, and late fees. Servicing rights are carried at lower of cost or market value, and therefore can be subject to estimated fair value measurements on a nonrecurring basis. Estimated fair value measurements of servicing rights use significant unobservable inputs and accordingly, are classified as Level 3. The Company obtains the estimated fair value of servicing rights from an independent third party pricing service and records the unadjusted estimated fair values in the financial statements.

The valuation techniques and significant unobservable inputs used to measure Level 3 estimated fair values at December 31, 2018 and 2017, are as follows:

(dollars in thousands)			2018			2017		
Asset Type	Valuation Technique	Unobservable Input	Fair Value	Range	Weighted Average	Fair Value	Range	Weighted Average
Impaired loans	Appraisal value	Property specific adjustment	6,560	N/A	N/A	5,902	N/A	N/A
Foreclosed assets	Appraisal value	Property specific adjustment	169	N/A	N/A	446	N/A	N/A
Servicing rights	Discounted cash flows	Prepayment speed assumptions	4,623	104-211	130	4,686	119-239	155
		Discount rate		10.5%	10.5%		9.5%	9.5%

Disclosure of estimated fair value information about financial instruments, for which it is practicable to estimate that value, is required whether or not recognized in the consolidated balance sheets. In cases in which quoted market prices are not available, estimated 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 estimate of future cash flows. In that regard, the derived estimated fair value estimates cannot be substantiated by comparison to independent markets and, in many cases could not be realized in immediate settlement of the instruments. Certain financial instruments with an estimated fair value that is not practicable to estimate and all non-financial instruments are excluded from the disclosure requirements. Accordingly, the aggregate estimated fair value amounts presented do not necessarily represent the underlying value of the Company.

The following disclosures represent financial instruments in which the ending balances at December 31, 2018 and 2017 are not carried at estimated fair value in their entirety on the consolidated balance sheets.

Cash and Due from Banks and Accrued Interest
The carrying amounts reported in the Consolidated Balance Sheets approximate those assets and liabilities estimated fair values.

Loans
For variable-rate loans that reprice frequently and with no significant change in credit risk, estimated fair values are based on carrying values. The estimated fair values of other loans are estimated using discounted cash flow analysis, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Bank-Owned Life Insurance
Bank-owned life insurance is carried at the amount due upon surrender of the policy, which is also the estimated fair value. This amount was provided by the insurance companies based on the terms of the underlying insurance contract.

Deposits
The estimated fair values of demand deposits are, by definition, equal to the amount payable on demand at the consolidated balance sheet date. The estimated fair values of fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies current incremental interest rates being offered on certificates of deposit to a schedule of aggregated expected monthly maturities of the outstanding certificates of deposit.

Short-Term Borrowings and Long-Term Debt
For variable-rate borrowings that reprice frequently, estimated fair values are based on carrying values. The estimated fair value of fixed-rate borrowings are estimated using discounted cash flow analysis, based on the Company's current incremental borrowing rates for similar types of borrowing arrangements.

Off-Balance Sheet Credit-Related Commitments
Off-balance sheet credit related commitments are generally of short-term nature. The contract amount of such commitments approximates their estimated fair value since the commitments are comprised primarily of unfunded loan commitments which are generally priced at market at the time of funding.

The estimated fair values, and related carrying or notional amounts, of the Company's financial instruments are as follows:

	Carrying	Estimated Fair Value			
At December 31, 2018 *(dollars in thousands)*	Amount	Level 1	Level 2	Level 3	Total
Financial Assets					
Cash and cash equivalents	$ 40,651	$ 40,651	$ -	$ -	$ 40,651
Loans	1,711,707	-	-	1,695,432	1,695,432
Accrued interest receivable	7,645	7,645	-	-	7,645
Bank-owned life insurance	30,763	-	30,763	-	30,763
Financial Liabilities					
Noninterest-bearing transaction	$ 563,130	$ -	$ 563,130	$ -	$ 563,130
Interest-bearing transaction	1,061,709	-	1,061,709	-	1,061,709
Time deposits	174,454	-	-	172,656	172,656
Short-term borrowings	93,460	93,460	-	-	93,460
Long-term debt	58,824	-	59,988	-	59,988
Accrued interest payable	720	720	-	-	720

	Carrying	Estimated Fair Value			
At December 31, 2017 *(dollars in thousands)*	Amount	Level 1	Level 2	Level 3	Total
Financial Assets					
Cash and cash equivalents	$ 121,998	$ 121,998	$ -	$ -	$ 121,998
Loans	1,557,910	-	-	1,552,399	1,552,399
Accrued interest receivable	6,817	6,817	-	-	6,817
Bank-owned life insurance	29,959	-	29,959	-	29,959
Financial Liabilities					
Noninterest-bearing transaction	$ 619,333	$ -	$ 619,333	$ -	$ 619,333
Interest-bearing transaction	1,011,368	-	1,011,368	-	1,011,368
Time deposits	204,261	-	-	202,608	202,608
Short-term borrowings	30,000	30,000	-	-	30,000
Long-term debt	58,819	-	59,193	-	59,193
Accrued interest payable	557	557	-	-	557

NOTE 27 Subsequent Events

On January 15, 2019, the Company announced that its subsidiary, the Bank entered into an agreement for the sale of its deposits and assets in Duluth, MN to Frandsen Bank & Trust (FB&T). The transaction includes approximately $39 million in assets and $24 million in deposits. As part of the transaction FB&T will assume the Company's existing downtown Duluth branch located at 331 W Superior St. Additionally, the Company will close its Duluth Miller Hill branch, located at 1405 Miller Trunk Hwy. The transaction is subject to regulatory approval and the satisfaction of customary closing conditions and is expected to be completed in late April.

Subsequent events have been evaluated through February 22, 2019, which is the date these financial statements were available to be issued.