The Community
Financial Corporation

March 29, 2018

Dear Stockholder:

I am pleased to invite you to attend the annual meeting of stockholders of The Community Financial Corporation (the ''Company'') to be held in the Board Room at the main office of Community Bank of the Chesapeake, located at 3035 Leonardtown Road, Waldorf, Maryland, on Wednesday, May 16, 2018 at 10:00 a.m.

The attached notice and proxy statement describe the formal business to be transacted at the annual meeting. Directors and officers of the Company, as well as a representative of the Company's independent registered public accounting firm, Dixon Hughes Goodman LLP, will be present to respond to any questions stockholders may have.

Your vote is important, regardless of the number of shares you own. **On behalf of the Board of Directors, I urge you to vote via the Internet, by telephone or by signing, dating and returning a proxy card as soon as possible, even if you plan to attend the annual meeting.**

Sincerely,

Michael L. Middleton
Chairman of the Board

THE COMMUNITY FINANCIAL CORPORATION
3035 LEONARDTOWN ROAD
WALDORF, MARYLAND 20601
(301) 645-5601

NOTICE OF 2018 ANNUAL MEETING OF STOCKHOLDERS

TIME AND DATE	10:00 a.m. on Wednesday, May 16, 2018
PLACE	Board Room Community Bank of the Chesapeake 3035 Leonardtown Road Waldorf, Maryland 20601
ITEMS OF BUSINESS	(1) To elect four directors to serve for a term of three years; (2) To ratify the appointment of Dixon Hughes Goodman LLP as the independent registered public accounting firm for the year ending December 31, 2018; (3) To vote on a non-binding resolution to approve the compensation of the named executive officers; and (4) To transact such other business as may properly come before the meeting or any adjournments or postponement thereof.
RECORD DATE	In order to vote, you must have been a stockholder at the close of business on March 19, 2018. The Board does not know of any other business to be presented at the meeting.
PROXY VOTING	It is important that your shares be represented and voted at the meeting. You can vote your shares via the Internet, by telephone or by completing and signing a proxy card. Voting instructions are printed on your proxy or voting instruction card and included in the proxy statement. You can revoke a proxy at any time before the meeting by following the instructions in the proxy statement.

Christy Lombardi
Corporate Secretary
March 29, 2018

IMPORTANT: The prompt return of proxies will save the Company the expense of further requests for proxies to ensure a quorum. A self-addressed envelope is enclosed for your convenience. No postage is required if mailed in the United States.

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PROXY STATEMENT
OF
THE COMMUNITY FINANCIAL CORPORATION
3035 LEONARDTOWN ROAD
WALDORF, MARYLAND 20601
(301) 645-5601

GENERAL INFORMATION

We are providing this proxy statement to you in connection with the solicitation of proxies by the Board of Directors of The Community Financial Corporation for the 2018 annual meeting of stockholders and for any adjournment or postponement of the meeting. In this proxy statement, we may also refer to The Community Financial Corporation as the ''Company,'' ''we,'' ''our'' or ''us.''

The Community Financial Corporation is the holding company for Community Bank of the Chesapeake. In this proxy statement, we may also refer to Community Bank of the Chesapeake as the ''Bank.''

We are holding the 2018 annual meeting in the Board Room at the main office of the Bank, located at 3035 Leonardtown Road, Waldorf, Maryland, on Wednesday, May 16, 2018 at 10:00 a.m., local time.

We intend to provide access to this proxy statement and a proxy card to stockholders of record beginning on or about March 29, 2018.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE STOCKHOLDERS MEETING TO BE HELD ON MAY 16, 2018

The Proxy Statement and Annual Report to Stockholders are available at:
https://www.cbtc.com/about/investor-relations/proxyandannualreport

INFORMATION ABOUT VOTING

Who Can Vote at the Meeting. You are entitled to vote the shares of the Company's common stock that you owned as of the close of business on March 19, 2018. As of the close of business on March 19, 2018, 5,573,841 shares of Company common stock were outstanding. Each share of common stock has one vote.

Voting by Proxy. This proxy statement is being sent to you by the Board of Directors of the Company to request that you allow your shares of The Community Financial Corporation common stock to be represented at the annual meeting by the persons named in the enclosed proxy card. All shares of the Company's common stock represented at the meeting by properly executed, dated proxies will be voted according to the instructions indicated on the proxy card. If you sign, date and return a proxy card without giving voting instructions, your shares will be voted as recommended by the Company's Board of Directors. The Board of Directors recommends that you vote:

- **"FOR"** each of the nominees for director;
- **"FOR"** the ratification of the appointment of Dixon Hughes Goodman LLP as the Company's independent registered public accounting firm; and
- **"FOR"** the approval of the compensation of the named executive officers.

If any matters not described in this proxy statement are properly presented at the annual meeting, the persons named in the proxy card will use their judgment to determine how to vote your shares. This includes a motion to adjourn or postpone the meeting to solicit additional proxies. If the annual meeting is postponed or adjourned, your common stock may also be voted by the persons named on the proxy card on the new meeting date, unless you have revoked your proxy.

Registered stockholders can vote their shares of The Community Financial Corporation common stock by mailing a proxy card, via the Internet or by telephone. Specific instructions for Internet or telephone voting are set forth on the enclosed proxy or voting instruction card. The Internet and telephone voting procedures are designed to authenticate stockholders' identities, allow stockholders to provide their voting instructions and confirm that their instructions have been recorded properly. The deadline for voting by telephone or via the Internet is 11:59 p.m., Eastern time, on May 15, 2018.

Ownership of Shares; Attending the Meeting. You may own shares of the Company in one of the following ways:

- Directly in your name as the stockholder of record;
- Indirectly through a broker, bank or other holder of record in "street name;" or
- Indirectly in the Community Bank of the Chesapeake Employee Stock Ownership Plan.

If your shares are registered directly in your name, you are the holder of record of these shares and we are sending these proxy materials directly to you. As the holder of record, you have the right to give your proxy directly to us or to vote in person at the annual meeting.

If you hold your shares in street name, your broker, bank or other holder of record is sending these proxy materials to you. As the beneficial owner, you have the right to direct your broker, bank or other holder of record how to vote by filling out a voting instruction form that accompanies your proxy materials. Your broker, bank or other holder of record may allow you to provide voting instructions by telephone or via the Internet. Please see the voting instruction form provided by your broker, bank or other holder of record that accompanies this proxy statement. If you hold your shares in street name, you will need proof of ownership to be admitted to the annual meeting. A recent brokerage statement or letter from a bank or broker are examples of proof of ownership. If you want to vote your shares of The Community Financial Corporation common stock held in street name in person at the annual meeting, you must obtain a written proxy in your name from the broker, bank or other nominee who is the record holder of your shares.

If you participate in the Community Bank of the Chesapeake Employee Stock Ownership Plan, you will receive a voting instruction card that reflects all shares you may direct the plan trustees to vote on your behalf under the plan. Under the terms of the Employee Stock Ownership Plan, all allocated shares of Company stock held by the plan are voted by the trustees, as directed by plan participants. All unallocated shares of Company common stock held by the plan, and allocated shares for which no voting instructions are received, are voted by the trustees in the same proportion as shares for which the trustees have received timely voting instructions, subject to the exercise of their fiduciary duties. **The deadline for returning your voting instructions to the Employee Stock Ownership Plan trustees is May 9, 2018.**

Quorum. We will have a quorum and will be able to conduct the business of the annual meeting if the holders of a majority of the outstanding shares of common stock entitled to vote are represented at the meeting. If you return valid proxy instructions or attend the meeting in person, we will count your shares to determine whether there is a quorum, even if you abstain from voting. Broker non-votes (described below) also will be counted to determine the existence of a quorum.

Votes Required for Proposals. In voting on the election of directors, you may vote in favor of the nominees, withhold votes for all of the nominees, or withhold votes as to any of the nominees. There is no cumulative voting for the election of directors. Directors must be elected by a plurality of the votes cast at the annual meeting.

In voting on the ratification of the appointment of Dixon Hughes Goodman LLP as the Company's independent registered public accounting firm and on the non-binding resolution to approve the compensation of the named executive officers, you may vote in favor of the proposal, vote against the proposal or abstain from voting. All proposals will be decided by the affirmative vote of a majority of the shares cast at the annual meeting.

For all proposals, abstentions and broker non-votes will not be counted as votes cast and will have no effect on the outcome of the voting on the proposals.

Effect of Not Casting Your Vote. If you hold your shares in street name it is critical that you cast your vote if you want it to count in the election of directors (Item 1 of this proxy statement) and the approval of the non-binding advisory vote on executive compensation (Item 3 of this proxy statement). Current regulations restrict the ability of your bank or broker to vote your shares on these matters on a discretionary basis. Thus, if you hold your shares in street name and you do not instruct your bank or broker how to vote in the election of directors and the approval of the non-binding advisory vote on executive compensation no votes will be cast on your behalf. These are referred to as broker non-votes. Your bank or broker will, however, continue to have discretion to vote any shares for which you do not provide voting instructions on the ratification of the appointment of the Company's independent registered public accounting firm (Item 2 of this proxy statement). If you are a stockholder of record and you do not cast your vote, no votes will be cast on your behalf on any of the items of business at the annual meeting.

Revocation of Proxy. Stockholders who execute proxies retain the right to revoke them at any time. Unless revoked, the shares represented by such proxies will be voted at the annual meeting and all adjournments thereof. Proxies may be revoked by written notice delivered in person or mailed to the Secretary of the Company, by delivering a later-dated proxy or by attending the annual meeting and voting in person. Attendance at the annual meeting will not in and of itself constitute revocation of your proxy.

CORPORATE GOVERNANCE

Director Independence. The Company's Board of Directors currently consists of ten members, all of whom are independent under the listing requirements of The NASDAQ Stock Market, except for Michael L. Middleton, former Executive Chairman of the Boards of Directors of the Company and the Bank and William J. Pasenelli, President and Chief Executive Officer of the Company, Chief Executive Officer of the Bank and Vice Chair of the Boards of Directors of the Company and Bank. In determining the independence of its directors, the Board considered transactions, relationships and arrangements between the Company and its directors that are not required to be disclosed in this proxy statement under the heading *"Relationships and Transactions with the Company and the Bank,"* including (i) legal services performed by the Jenkins Law Firm, LLC, of which Louis P. Jenkins, Jr. is a principal, and (ii) loans or lines of credit that the Bank has directly or indirectly made to each of the directors on the Board.

Board Leadership Structure. The Company currently separates the offices of President and Chief Executive Officer and Chairman of the Board. Doing so allows the President and Chief Executive Officer to better focus on his responsibilities of managing the day-to-day operations of the Company, enhancing stockholder value and expanding and strengthening the franchise while allowing the Chairman of the Board to lead the Board in its fundamental role of providing advice to and oversight of management. The Board also has created a Lead Director position to further enhance Board independence and oversight. Joseph V. Stone, Jr. is currently the Lead Director of the Board of Directors. Among other things, the Lead Director (i) presides at meetings of the Board at which the Chairman of the Board is not present, including executive sessions of the independent directors, and (ii) may call meetings of the independent directors.

The Board's Role in Risk Oversight. Risk is inherent with every business and how well a business manages risk can ultimately determine its success. We face a number of risks, including credit risk, interest rate risk, liquidity risk, operational risk, strategic risk and reputation risk. Management is responsible for the day-to-day management of risks the Company faces, while the Board, as a whole and through its committees, has responsibility for the oversight of risk management. In its risk oversight role, the Board of Directors has the responsibility to satisfy itself that the risk management processes designed and implemented by management are adequate and functioning as designed. To do this, senior management attends the Board meetings and is available to discuss strategy and risks facing the Company and to address any questions or concerns raised by the Board on risk management and any other matters. The Board also provides strong oversight of the Company's management and affairs through its standing committees and, when necessary, special meetings of independent directors.

Committees of the Board of Directors. The following table identifies the members of the Board's Audit, Enterprise Risk Management, Governance and Compensation Committees as of March 19, 2018. All members of the Audit, Governance and Compensation Committees are independent in accordance with the listing requirements of The NASDAQ Stock Market. Each committee operates under a written charter, which is approved by the Board of Directors, that governs its composition, responsibilities and operation. Each committee reviews and reassesses the adequacy on its charter at least annually.

Director	Audit Committee	Enterprise Risk Management Committee	Governance Committee	Compensation Committee
M. Arshed Javaid		X		
Louis P. Jenkins, Jr.		X	X*	X*
Michael L. Middleton		X		
John K. Parlett, Jr.	X	X		
William J. Pasenelli		X		
Mary Todd Peterson	X*	X		
E. Lawrence Sanders, III	X			
Austin J. Slater, Jr.	X	X*	X	X
Joseph V. Stone, Jr.**	X	X	X	X
Kathryn Zabriskie			X	X
Number of Meetings in 2017	8	4	5	6

* Chairperson

** Lead Director

Audit Committee. The Audit Committee engages the Company's independent registered public accounting firm and meets with them in connection with their annual audit and reviews the Company's accounting and financial and regulatory reporting policies and practices. Other responsibilities of the Audit Committee include engagement of compliance and internal audit providers and the review with management of reports issued by such parties. The Board of Directors has determined that the Audit Committee does not have a member who is an ''audit committee financial expert'' as defined under the rules and regulations of the Securities and Exchange Commission. While the Board has not designated any individual Board member as an ''audit committee financial expert,'' the Board believes the level of financial knowledge and experience of the current members of the Audit Committee, including the ability to read and understand financial statements, is cumulatively sufficient to discharge the Audit Committee's responsibilities. The Audit Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Enterprise Risk Management Committee. The Enterprise Risk Management Committee assists the Board in its oversight responsibilities by focusing specifically on the Company's enterprise risk management activities including the significant policies, procedures and practices employed to manage capital adequacy, market risk, earnings, credit risk, liquidity, compliance, regulatory, legal, reputation, and strategic operational risk and by providing recommendations to the Board and management on strategic guidance with respect to the assumption, management and mitigation of risk. The Enterprise Risk Management Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Governance Committee. The Governance Committee is responsible for promoting sound corporate governance policies that promote the best interests of the Company and its stockholders. The Committee's responsibilities include: identification of director candidates; director education; recommendations on the size and composition of the Board and the boards of any subsidiaries, review of any stockholder proposals; monitoring of regulatory and statutory compliance; review of committee charters; and evaluations of Board oversight and effectiveness. The Governance Committee also annually reviews and recommends, in conjunction with the Compensation Committee, the appropriate level of director compensation. The Governance Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Compensation Committee. The Compensation Committee approves the compensation objectives for the Company and the Bank and establishes the compensation for the Chief Executive Officer and other executives. Our Chief Executive Officer, Chief Operating Officer and Chief Administrative Officer make recommendations to the Compensation Committee from time to time regarding the appropriate mix and level of compensation for other executives. The Compensation Committee reviews compensation for the Company's executive officers to ensure an appropriate balance between short-term pay and long-term incentives. In addition to reviewing competitive market values, the Compensation Committee also examines the total compensation mix, pay-for-performance relationship, and how all elements, in the aggregate, comprise the executive's total compensation package. Decisions by the Compensation Committee with respect to the compensation of executive officers are approved by the full Board of Directors. The Compensation Committee also annually reviews and recommends, in conjunction with the Governance Committee, the appropriate level of director compensation. The Compensation Committee acts under a written charter adopted by the Board of Directors, a copy of which is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

Director Nomination Process. The Governance Committee selects nominees for election as directors. The Governance Committee seeks to create a Board that is strong in its collective knowledge and has a diversity of skills and experience in accounting and finance, management and leadership, vision and strategy, business operations, business judgment, industry knowledge and corporate governance. To accomplish this, the Governance Committee considers a candidate's knowledge of the banking business and involvement in community, business and civic affairs, and also considers whether the candidate would adequately represent the Company's market area. Any nominee for director must be highly qualified with regard to some or all of these attributes. In searching for qualified director candidates to fill vacancies on the Board, the Governance Committee solicits its current directors for the names of potential qualified candidates. The Governance Committee may also ask its directors to pursue their business contacts for the names of potentially qualified candidates. The Governance Committee would then consider the potential pool of director candidates, select the top candidates based on the candidates' qualifications and the Company's needs, and conduct a thorough investigation of each proposed candidate's background. If a stockholder has submitted a proposed nominee in accordance with the procedures specified below, the Governance Committee would consider the proposed nominee, along with any other proposed nominees recommended by directors, in the same manner in which the Governance Committee would evaluate nominees for director recommended by the Board of Directors.

Consideration of Recommendations by Stockholders. The Governance Committee will consider recommendations for directors submitted by stockholders. Stockholders who wish the Governance Committee to consider their recommendations for nominees for director should submit their recommendations in writing to the Governance Committee in care of the Corporate Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601. Each written recommendation must set forth (1) the name of the recommended candidate, (2) the number of shares of stock of the Company that are beneficially owned by the stockholder making the recommendation and by the recommended candidate, and (3) a detailed statement explaining why the stockholder believes the recommended candidate should be nominated for election as a director. In addition, the stockholder making such recommendation must promptly provide any other information reasonably requested by the Governance Committee. To be considered by the Governance Committee for nomination for election at an annual meeting of stockholders, the recommendation must be received by the January 1 preceding that annual meeting.

Board and Committee Meetings. During 2017, the Board of Directors of the Company held six (6) meetings. No director attended fewer than 75% of the meetings of the Board of Directors and Board committees on which they served in 2017.

Director Attendance at Annual Meeting of Stockholders. While the Company does not have a policy regarding Board member attendance at annual meetings of stockholders it encourages directors to attend the annual meeting of stockholders. All of the Company's directors attended the Company's 2017 annual meeting of stockholders.

Code of Ethics. The Community Financial Corporation maintains a Code of Ethics that is designed to ensure that the Company's directors and employees meet the highest standards of ethical conduct. The Code of Ethics, which applies to all employees and directors, addresses conflicts of interest, the treatment of confidential information, general employee conduct and compliance with applicable laws, rules and regulations. In addition, the Code of Ethics is designed to deter wrongdoing and promote honest and ethical conduct, the avoidance of conflicts of interest, full and accurate disclosure and compliance with all applicable laws, rules and regulations. Under the terms of the Code of Ethics, violations of the Code of Ethics are required to be reported to the Audit Committee of the Board of Directors. A copy of the Code of Ethics is available free of charge in the Investor Relations portion of the *"About Community Bank"* section of the Company's website (*www.cbtc.com*), and is available in print to any stockholder who requests a copy.

DIRECTOR COMPENSATION

The following table provides the compensation received by the non-employee directors of the Company and the Bank during 2017.

Name	Fees Earned or Paid in Cash ($)	Non-qualified Deferred Compensation Earnings ($)[1]	Total ($)
Eric S. Goldberg[2]	$32,975	$ —	$32,975
Philip T. Goldstein[3]	25,000	—	25,000
M. Arshed Javaid	$39,150	7,811	46,961
Louis P. Jenkins, Jr	48,080	—	48,080
Michael L. Middleton	50,000	10,551	60,551
John K. Parlett, Jr	43,625	—	43,625
Mary Todd Peterson	48,525	12,884	61,409
E. Lawrence Sanders, III[4]	—	—	—
James R. Shepherd[5]	38,050	—	38,050
Austin J. Slater, Jr	49,625	—	49,625
Joseph V. Stone, Jr	51,975	20,994	72,969
Kimberly C. Briscoe-Tonic	18,400	—	18,400
Kathryn Zabriskie	41,100	—	41,100

(1) Represents the portion of non-qualified deferred compensation earnings under the Community Bank of the Chesapeake Retirement Plan for Directors that was above the Internal Revenue Service long-term rate. Under the plan, interest is credited at a rate equal to the Company's annualized return on equity or based on the gains or losses on the deemed investments.

(2) Mr. Goldberg resigned from the Board of Directors of the Company and the Bank effective November 6, 2017.

(3) Mr. Goldstein retired from the Board of Directors of the Company and the Bank effective February 8, 2017.

(4) Mr. Sanders was appointed to the Board of Directors of the Company effective January 1, 2018 in connection with the acquisition of County First Bank.

(5) Mr. Shepherd resigned from the Board of Directors of the Company effective February 8, 2017. Mr. Shepherd continues to serve as a director of the Bank.

The Company has not identified any agreements or arrangements relating to compensation provided by a third party to the Company's directors or director nominees in connection with their candidacy or Board service as required to be disclosed by NASDAQ Rule 5250(b)(3).

Cash Retainer and Meeting Fees for Directors. The following tables set forth the applicable retainers and fees that will be paid to directors for their service on the Boards of Directors of the Company and the Bank for 2018.

***Board of Directors of the Company*:**

Annual Retainer	$15,000
Fee per Board Meeting (Regular or Special)	$750 ($225 per telephone meeting)
Fee per Committee Meeting	$500 ($225 per telephone meeting)
Annual Retainer for Audit Committee Chair	$5,000
Annual Retainer for Governance, Compensation, and Enterprise Risk Management, Committee Chairs	$2,500

***Board of Directors of the Bank*:**

Annual Retainer	$10,000
Fee per Board Meeting (Regular or Special)	$650 ($225 per telephone meeting)
Fee per Committee Meeting	$425 ($225 per telephone meeting)
Annual Retainer for ALCO and Credit Risk Committee Chairs	$2,500

Employee directors of the Company receive only the annual retainer and Board meeting fees; they do not receive fees for committee meetings. Employee directors of the Bank do not receive annual retainer, board meeting fees or fees for committee meetings.

Directors Retirement Plan. The Bank maintains a retirement plan for non-employee members of the Board of Directors of the Bank (the ''Directors' Plan''). Under the Directors' Plan, each eligible director of the Bank will receive an annual retirement benefit for ten years following his or her termination of service on the Bank's Board in an amount equal to the product of his ''Benefit Percentage'', ''Vested Percentage'', and $3,500. A participant's ''Benefit Percentage'' is 0% for less than five years of service, 33⅓% for five to nine years of service, 66⅔% for 10 to 14 years of service, and 100% for 15 or more years of service. A participant's ''Vested Percentage'' is 33⅓% for less than one year of service, 66⅔% for one year of service, and 100% for two or more years of service. If a participant terminates service on the Board due to disability, the Bank will pay the participant each year for ten years an amount equal to the product of his or her Benefit Percentage and $3,500. If a participant dies before collecting either his or her retirement or disability benefit, the participant's surviving spouse or estate will receive a lump sum payment having a present value equal to five times the annual retirement benefit to which the participant was entitled, assuming the participant separated service on the date of death and was fully vested. If the participant dies after beginning to receive his or her retirement or disability benefits, the participant's surviving spouse or estate will receive a lump sum payment having a present value equal to the remaining benefits to which the participant was entitled from the date of death through the tenth annual payment thereafter. A participant will become fully vested in the event of a ''change in control'' (as defined in the Directors' Plan) or upon separation from service on the Board after attaining the age 72 or incurring a disability.

The Directors' Plan also establishes a deferred compensation program for participants, under which they may elect to defer all or any portion of the fees and/or salary otherwise payable. Deferred amounts may be credited quarterly and adjusted annually with a rate of return equal to the consolidated return on equity of the Company for the calendar year, as determined under accounting principles generally accepted in the United States, and/or quarterly with the gain or loss generated on the investments in which the funds in those accounts are deemed to be invested.

Consulting Agreement with Michael L. Middleton. Effective June 30, 2016, Community Bank of the Chesapeake entered into a Consulting Agreement with Michael L. Middleton. Under the terms of the Consulting Agreement, Mr. Middleton retired as an employee of the Bank and serves as a consultant to the Bank for a period of 12 months. The Consulting Agreement will automatically be extended for an additional 12-month period on the anniversary of the effective date of the agreement (and each anniversary thereafter), unless 30 days' advance written notice of non-renewal is provided by either the Bank or Mr. Middleton. Mr. Middleton provides certain consulting services to the Bank, including but not limited to, advising on bank markets, operations and strategic direction of the Bank and as requested by the Board of Directors and Chief Executive Officer of the Bank. In consideration of the consulting services, Mr. Middleton will receive an annual fee of $100,000 payable in equal monthly installments in arrears and will be reimbursed for reasonable business expenses. Mr. Middleton is not entitled to participate in any benefit plans of the Bank or its affiliates. On July 1, 2017, the effective date of the Consulting Agreement Mr. Middleton's terms were extended for an additional 12 month period.

AUDIT RELATED MATTERS

Report of the Audit Committee. The Company's management is responsible for the Company's internal controls and financial reporting process. The Company's independent registered public accounting firm is responsible for performing an independent audit of the Company's consolidated financial statements and issuing an opinion on the conformity of those financial statements with accounting principles generally accepted in the United States. The Audit Committee oversees the Company's internal controls and financial reporting process on behalf of the Board of Directors.

The Audit Committee has met and held discussions with management and the independent registered public accounting firm. Management represented to the Audit Committee that the Company's consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States and the Audit Committee has reviewed and discussed the consolidated financial statements with management and the independent registered public accounting firm. The Audit Committee discussed with the independent registered public accounting firm matters required to be discussed by Statement on Auditing Standard No. 16, as amended (AICPA, *Professional Standards*, Vol. 1. AU Section 380) as adopted by the Public Company Accounting Oversight Board in Rule 3200T, including the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of the disclosures in the financial statements.

In addition, the Audit Committee has received the written disclosures and the letter from the independent registered public accounting firm required by the applicable requirements of the Public Company Accounting Oversight Board regarding the independent registered public accounting firm's communications with the Audit Committee concerning independence and has discussed with the independent registered public accounting firm the independent registered public accounting firm's independence from the Company and its management. In concluding that the registered public accounting firm is independent, the Audit Committee considered, among other factors, whether the non-audit services provided by the firm were compatible with its independence.

The Audit Committee discussed with the Company's independent registered public accounting firm the overall scope and plans for its audit. The Audit Committee meets with the independent registered public accounting firm, with and without management present, to discuss the results of its examination, its evaluation of the Company's internal controls, and the overall quality of the Company's financial reporting.

In performing all of these functions, the Audit Committee acts only in an oversight capacity. In its oversight role, the Audit Committee relies on the work and assurances of the Company's management, which has the primary responsibility for financial statements and reports, and of the independent registered public accounting firm that, in its report, expresses an opinion on the conformity of the Company's financial statements to accounting principles generally accepted in the United States. The Audit Committee's oversight does not provide it with an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or policies, or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's considerations and discussions with management and the independent registered public accounting firm do not assure that the Company's financial statements are presented in accordance with accounting principles generally accepted in the United States, that the audit of the Company's financial statements has been carried out in accordance with generally accepted auditing standards or that the Company's independent registered public accounting firm is ''independent.''

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors, and the Board has approved, that the audited consolidated financial statements be included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017 for filing with the Securities and Exchange Commission.

AUDIT COMMITTEE OF THE BOARD OF DIRECTORS OF THE COMMUNITY FINANCIAL CORPORATION

Mary Todd Peterson (Chair)
John K. Parlett, Jr.
E. Lawrence Sanders, III
Austin J. Slater, Jr.
Joseph V. Stone, Jr.

Change in Independent Registered Public Accounting Firm

The Company's independent registered public accounting firm, Stegman & Company, announced that effective June 1, 2016 substantially all directors and employees of Stegman & Company joined Dixon Hughes Goodman LLP. As a result, effective June 1, 2016 Stegman & Company resigned as the Company's independent registered public accounting firm. The Audit Committee of the Company's Board of Directors engaged Dixon Hughes Goodman to serve as the Company's independent registered public accounting firm effective June 1, 2016.

The reports of Stegman & Company on the audits of the consolidated financial statements of the Company as of and for the years ended December 31, 2015 and 2014, and audit of internal control over financial reporting as of December 31, 2015, did not contain an adverse opinion or a disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company's fiscal years ended December 31, 2015 and 2014 and the subsequent interim period through June 1, 2016, there were (i) no disagreements (as such term is used in Item 304(a)(1)(iv) of Regulation S-K) between the Company and Stegman & Company on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreement(s), if not resolved to the satisfaction of Stegman & Company, would have caused Stegman & Company to make reference to the subject matter of the disagreement(s) in connection with its report on the Company's financial statements and (ii) no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

During the Company's fiscal years ended December 31, 2015 and 2014 and the subsequent interim period through June 1, 2016, the Company did not consult with Dixon Hughes Goodman regarding any of the matters set forth in Items 304(a)(2)(i) and (ii) of Regulation S-K.

Audit Fees. The following table sets forth fees billed to the Company by Dixon Hughes Goodman for the fiscal year ended December 31, 2017 and for the period for June 1, 2016 to December 31, 2016:

	2017	2016(1)
Audit Fees(2)	$186,328	$149,223
Audit Related Fees(3)	22,580	21,541
Tax Fees	3,057	10,000
All Other Fees	—	—

(1) Includes fees billed to the Company by Stegman & Company for the fiscal year ended December 31, 2016 and through June 1, 2016.

(2) Represents fees for review of Quarterly Reports on Form 10-Q and audit of financial statements.

(3) Represents fees for the audit of the 401(k) and ESOP plans.

Pre-Approval of Services by the Independent Registered Public Accounting Firm. The Audit Committee's charter provides that the Audit Committee will approve in advance any non-audit services permitted by the Securities Exchange Act, including tax services that its independent registered public accounting firm renders to the Company, unless such prior approval may be waived because of permitted exceptions under the Securities Exchange Act, including but not limited to a 5% *de minimis* exception. The Audit Committee may delegate to one or more members of the Audit Committee the authority to grant pre-approvals for auditing and allowable non-auditing services, which decision shall be presented to the full Audit Committee at its next scheduled meeting for ratification. During the fiscal year ended December 31, 2017, the Audit Committee approved 100% of all "audit-related," "tax" and "other fees."

PRINCIPAL HOLDERS OF VOTING SECURITIES

The following table sets forth, as of March 19, 2018, certain information as to those persons known by the Company to beneficially own more than 5% of the Company's outstanding shares of common stock and the shares of common stock beneficially owned by each director, each executive officer named in the summary compensation table and by all executive officers and directors of the Company as a group. All beneficial owners listed in the table have the same address as the Company, unless otherwise provided. Unless otherwise indicated, each of the named individuals has sole voting power and sole investment power with respect to the shares shown.

Name of Beneficial Owners	Number of Shares Beneficially Owned(1)(2)	Percent of Shares of Common Stock Outstanding(3)
Directors:		
M. Arshed Javaid	3,526	*
Louis P. Jenkins, Jr.	19,619	*
Michael L. Middleton	258,048(4)	4.63%
John K. Parlett, Jr.	4,400	*
William J. Pasenelli	47,998	*
Mary Todd Peterson	6,529	*
E. Lawrence Sanders, III	24,082(5)	*
Austin J. Slater, Jr.	20,378	*
Joseph V. Stone, Jr.	29,125(6)	*
Kathryn Zabriskie	2,550	*
Named Executive Officers Who are Not Also Directors		
James M. Burke	20,935	*
Todd L. Capitani	10,455	*
Gregory C. Cockerham	123,386	2.21%
James F. Di Misa	19,094	*
All Directors, Executive Officers and Nominees as a Group (17 persons)	610,130(7)(8)	10.95%
5% Owner(s):		
Basswood Capital Management, L.L.C. Matthew Lindenbaum Bennett Lindenbaum 645 Madison Avenue, 10th Floor New York, New York 10022	412,072(9)	7.39%

* Less than 1% of the shares outstanding

(1) Includes shares allocated to the account of the individuals under the Community Bank of the Chesapeake Employee Stock Ownership Plan, with respect to which the individual has voting but not investment power as follows: Mr. Capitani — 1,306 shares; Mr. Cockerham — 23,849 shares; Mr. Burke — 1,582 shares; Mr. Di Misa — 1,582 shares; Mr. Middleton — 48,973 shares; and Mr. Pasenelli — 5,124 shares.

(2) Includes shares of unvested restricted stock, with respect to which the individual has voting but no investment power as follows: Mr. Middleton — 3,474 shares; Mr. Pasenelli — 2,646 shares; Mr. Capitani — 1,977 shares; Mr. Cockerham — 2,014 shares; Mr. Burke — 2,034 shares and Mr. Di Misa — 2,014 shares.

(3) Based upon 5,573,841 shares of Company common stock outstanding as of March 19, 2018.

(4) Includes 69,351 shares owned by Mr. Middleton's wife and 5,227 shares held by the individual retirement account of Mr. Middleton's wife.

(5) Includes 2,118 shares held by the individual retirement account of Mr. Sanders's wife.

(6) Includes 2,000 shares held by the individual retirement account of Mr. Stone's wife.

(7) Amount includes an aggregate of 15,781 unvested shares of restricted stock over which directors and officers of the Company have voting but no dispositive power.

(8) Includes 9,934 shares held by James R. Shepherd who is a director of Community Bank and 85 shares held by Kimberly Briscoe-Tonic who is a director of Community Bank.

(9) Based on information contained in a Schedule 13G/A filed with the U.S. Securities and Exchange Commission on February 9, 2018.

ITEMS TO BE VOTED ON BY STOCKHOLDERS

Item 1 — Election of Directors

The Company's Board of Directors currently consists of ten members. The Board is divided into three classes, each with terms of three years, one-third of whom are elected annually. The Board of Directors has nominated William J. Pasenelli, E. Lawrence Sanders, III, Austin J. Slater, Jr. and Joseph V. Stone, Jr. to serve for a three-year term or until their successors have been elected and qualified. Messrs. Pasenelli, Sanders, Slater and Stone are currently directors of the Company.

On December 21, 2017, the Board of Directors appointed E. Lawrence Sanders, III to the Company's Board of Directors, effective January 1, 2018 the effective time of the merger of County First Bank with and into Community Bank of the Chesapeake. Mr. Sanders filled the vacancy on the Board created by the November 6, 2017 resignation of Eric Goldberg and was appointed to serve until the 2018 annual meeting of stockholders.

It is intended that the persons named in the proxies solicited by the Board will vote for the election of the named nominees. If any nominee is unable to serve, the shares represented by all valid proxies will be voted for the election of such substitute nominee as the Board of Directors may recommend. At this time, the Board knows of no reason why any nominee might be unable to serve.

The Board of Directors recommends a vote "FOR" the election of each of the nominees.

Information regarding the nominees and the directors continuing in office is provided below. Unless otherwise stated, each individual has held his or her current occupation for the last five years. The age indicated in each biography is as of December 31, 2017. There are no family relationships among the directors or executive officers.

Board Nominees with Term Ending in 2021

William J. Pasenelli is President and Chief Executive Officer of the Company and Chief Executive Officer of the Bank. He also serves as Vice Chair for the Company and the Bank. Mr. Pasenelli joined the Bank as Chief Financial Officer in 2000 and was named President of the Bank in 2010, President of the Company in 2012 and Chief Executive Officer in July 2014. Before joining the Bank, Mr. Pasenelli had been Chief Financial Officer of Acacia Federal Savings Bank, Annandale, Virginia, since 1987. Mr. Pasenelli serves on the Board of Directors for the Maryland Bankers Association and the Maryland Chamber of Commerce. Mr. Pasenelli is a member of the American Institute of Certified Public Accountants and the Greater Washington Society of Certified Public Accountants and other civic groups. Age 59. Director of the Bank and the Company since 2010.

Mr. Pasenelli's extensive experience in the local banking industry affords the Board valuable insight regarding the business and operations of the Bank. Mr. Pasenelli's financial acumen and knowledge of the Company's and the Bank's business and history position him well to serve as President and Chief Executive Officer and as a Director.

E. Lawrence Sanders, III is President of Edward L. Sanders Insurance Agency, which provides multi-line insurance services to clients in Maryland since 1903. Mr. Sanders graduated from NC State University in 1978, obtained his Certified Insurance Counselor designation in 1979 and became a licensed Insurance Advisor in 1981. Mr. Sanders served on the board of directors of County First Bank for 28 years, and served as chairman of the board from 2013 to 2018. He is a current member and past President of the Charles County Rotary, past director for the Professional Insurance Agent's Association, past director and past President for the Civista Foundation and current director for the Charles County Rotary Foundation. Age 61. Director of the Bank and the Company since 2018.

Through his experience as owner of an insurance agency, Mr. Sanders has extensive financial and operational knowledge. His years of experience serving as a bank director provides the Board valuable insight regarding corporate governance, regulatory compliance, risk assessment practices and bank operations.

Austin J. Slater, Jr. is the President and Chief Executive Officer of the Southern Maryland Electric Cooperative, which is one of the ten largest electrical distribution cooperatives in the country. Mr. Slater presently serves on the Board of Directors of the Federal Reserve Bank of Richmond, Baltimore Branch, serves on the Board of Directors as Secretary-Treasurer and is the Chair of the Board Finance Committee of the University of Maryland Charles Regional Medical Center. He has also served as Chairman of the Board of the Maryland Chamber of Commerce and Chairman of the Board of Trustees for the College of Southern Maryland, as well as numerous other industry and civic organizations. Mr. Slater holds a MBA in Finance from George Washington University and a BS in Accounting from Shepherd University. Age 64. Director of the Bank and the Company since 2003.

Mr. Slater has extensive management level experience in a large company setting outside of the financial services industry. Mr. Slater's financial acumen and operational experience allow him to understand the complexities of the Company and the Bank. His experience in a regulated industry has exposed Mr. Slater to many of the issues facing companies today, particularly regulated entities, making Mr. Slater a valued component of a well-rounded board.

Joseph V. Stone, Jr. owned and operated Joe Stone Insurance Agency, which provides multi-line insurance services to clients in Maryland and Virginia, from 1981 to 2016. He has served as a director for the Southern Maryland Electric Cooperative since 1996. Age 63. Director of the Bank and the Company since 2006.

Mr. Stone provides the Board with significant marketing and operational knowledge through his experience as owner of an insurance agency and various director positions with companies outside of the financial services industry. Mr. Stone also has considerable experience in the insurance industry, corporate governance and risk assessment practices necessary in banking operations.

Directors Continuing in Office

Directors with Terms Ending in 2019:

Louis P. Jenkins, Jr. is the principal of Jenkins Law Firm, LLC, located in La Plata, Maryland. Before entering private practice, Mr. Jenkins served as an Assistant State's Attorney in Charles County, Maryland from 1997 to 1999. In addition to his private practice, Mr. Jenkins serves as Court Auditor for the Circuit Court for Charles County, Maryland and attorney for the Charles County Board of Elections. Mr. Jenkins currently serves as a member of the Board of Directors of the University of Maryland Medical System which consists of twelve hospitals located throughout the State of Maryland with annual revenue in excess of $3.7 billion. Mr. Jenkins has also served as a board member of several other public service organizations including the University of Maryland Charles Regional Medical Center, Southern Maryland Chapter of the American Red Cross, Charles County Chamber of Commerce and the Charles County Bar Association. Age 46. Director of the Bank and the Company since 2000.

As an attorney, Mr. Jenkins provides the Board with substantial knowledge regarding issues facing the Company and the Bank. In addition, Mr. Jenkins brings a critical perspective to the lending and governance function of the Company and the Bank. Mr. Jenkins' experience in the public sector adds valuable expertise regarding local issues and provides first-hand understanding of the local political and business environment in which the Bank operates.

Michael L. Middleton is Chairman of the Board of the Company and the Bank and serves as a consultant to the Bank. On June 30, 2016, he retired as Executive Chairman of the Board of Directors of the Company and the Bank. Mr. Middleton joined the Bank in 1973 and served in various management positions until 1979 when he became President of the Bank, which he served as until 2010. He remained President of the Company until 2012 and Chief Executive Officer of the Company and the Bank until June 2014. Mr. Middleton is a lifetime member of the American Institute of Certified Public Accountants and holds a Masters of Business Administration. From 1996 to 2004, Mr. Middleton served on the Board of Directors of the Federal Home Loan Bank of Atlanta, serving as Chairman of the Board in 2004. Mr. Middleton served on the Board of Directors of the Federal Reserve Bank, Baltimore Branch, from 2004 to 2009. He completed his term as Chairman of the Maryland Bankers Association in June 2013 and is Trustee Emeritus and former Chairman of the Board for the College of Southern Maryland. He serves on the Advisory Board of the Robert H. Smith School of Business Center for Financial Policy, the American Bankers Association Government

Relations Council Administrative Committee and completed his term on the Federal Reserve's Community Depository Advisory Council in October 2015. He also serves on several philanthropic and civic boards. Age 70. Director of the Bank since 1979 and of the Company since 1989.

Mr. Middleton's extensive experience in the local banking industry and involvement in the communities in which the Bank serves affords the Board valuable insight regarding the business and operations of the Bank. In addition to his extensive background in finance and corporate management, Mr. Middleton also has significant expertise in large financial institution governance providing a unique and broad-based decision-making capability for the Company and the Bank. Mr. Middleton's knowledge of the Company's and the Bank's business and history, combined with his success and strategic vision, position him well to serve as our Chairman.

Mary Todd Peterson is a senior advisor to the Chairman and CEO of ProAssurance Corporation supporting key strategic initiatives. In February 2016, she retired as the President and Chief Executive Officer of Medmarc Insurance Group and as a Director of Medmarc Casualty Insurance Company and its subsidiary Noetic Specialty Insurance Company, both of which are subsidiaries of ProAssurance. Ms. Peterson has been associated with Medmarc since 2001 where she also held the positions of Chief Financial Officer and Chief Operating Officer. From 1993 to 2001, Ms. Peterson was a Partner with Johnson Lambert & Co., a certified public accounting firm. Ms. Peterson also held positions with Acacia Life Insurance Company, Oxford Development Corporation and Ernst & Whinney (now Ernst & Young). Prior to her retirement from Medmarc, Ms. Peterson served as a member of the Property Casualty Insurers Association of America (''PCI'') Board of Governors, Chair of PCI's Investment Committee and a member of PCI's Executive and Finance Committees. Ms. Peterson is a member of the American Institute of Certified Public Accountants. Age 63. Director of the Bank and the Company since 2010.

Ms. Peterson has extensive management level experience in a mid-size company setting within the financial services industry. As a Virginia resident from 1981 to 2016, Ms. Peterson provides valuable insight regarding local markets in Virginia. Ms. Peterson's financial and operational expertise within the insurance industry, including her corporate governance and risk assessment skills, provide the Board with a skill set critical to operating the Company and Bank in an efficient manner.

Directors with Terms Ending in 2020:

M. Arshed Javaid is President of Smartronix, Inc., an information technology and engineering solutions provider. Mr. Javaid founded Smartronix, Inc. in 1995, and has extensive experience in business management and community relations. He served on the Historic Sotterley Inc. Board of Trustees from 2008 to 2018. Age 62. Director of the Bank and the Company since 2013.

Mr. Javaid provides the Board with significant management, strategic and operational knowledge through his experience as founder and president of an information technology and engineering solutions provider that has evolved from a start-up company to a company with over 650 employees. Mr. Javaid's experience in the information technology industry, especially cyber security, provides the Board with valuable insight into the data security and reputational risk issues facing businesses.

John K. Parlett, Jr. is currently President of Parlett Affiliated Companies, LLC, a real estate development and property management firm in Charlotte Hall, Maryland primarily focusing on commercial rental properties; and President of Computech Systems, Inc., a nationally marketed company that designs instrumentation and other electrical components for the motorsports industry. Mr. Parlett also has an extensive history of community involvement. He has contributed his time and leadership experience to many organizations over the years including service organizations, community development groups and local government task forces. He has received many honors for his service, including the Jefferson Award Honoring Community and Public Service in America, the St. Mary's Chamber of Commerce Community Service Award and the Governor William Donald Schaefer Salute to Excellence Award. Age 62. Director of the Bank since 2014 and Director of the Company since February 8, 2017.

Mr. Parlett provides the Board with important knowledge and insight necessary to guide the Company and its management through the various issues facing financial institutions.

Kathryn M. Zabriskie is president of Business Training Works, Inc., an employee-development firm specializing in soft-skills training, leadership development, and customer-experience initiatives. Ms. Zabriskie started the company in 2000. Since that time, she and her team have worked with hundreds of organizations across industries, including several members of the Fortune 50. Ms. Zabriskie holds an MBA from the University of Texas at Austin and a BA from George Mason University. She has served on several philanthropic boards and civic organizations in the Bank's market. Age 46. Director of the Bank since 2013 and Director of the Company since February 8, 2017.

Ms. Zabriskie brings a depth and breadth of knowledge to the board related to best practices in employee development, human resources, facilitation, and organizational planning. Her experience working nationally, internationally, and across industries offers a broad perspective on issues related to training and development, corporate culture, managing and attracting talent, and planning for the future.

Item 2 — Ratification of the Independent Registered Public Accounting Firm

Dixon Hughes Goodman, which was the Company's independent registered public accounting firm for 2017, has been retained by the Audit Committee of the Board of Directors to be the Company's independent registered public accounting firm for 2018, subject to ratification by the Company's stockholders. A representative of Dixon Hughes Goodman is expected to be present at the annual meeting and will have the opportunity to make a statement if he or she desires to do so and will be available to respond to appropriate questions.

If the ratification of the appointment of the independent registered public accounting firm is not approved by a majority of the votes cast at the annual meeting, the Audit Committee will consider other independent registered public accounting firms. In addition, if the ratification of the independent registered public accounting firm is approved by stockholders at the annual meeting, the Audit Committee may also consider other independent registered public accounting firms in the future if it determines that such consideration is in the best interests of the Company and its stockholders.

The Board of Directors recommends that stockholders vote "FOR" the ratification of the appointment of Dixon Hughes Goodman as the Company's independent registered public accounting firm.

Item 3 — Advisory Vote on Executive Compensation

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the ''Dodd-Frank Act'') requires that we provide our stockholders with the opportunity to express their views, on a non-binding basis, on the compensation of our named executive officers as disclosed in this proxy statement. This vote, which is often referred to as the ''say-on-pay'' vote, provides stockholders with the opportunity to endorse or not endorse the following resolution:

''Resolved, that the stockholders approve the compensation of the named executive officers, as described in the tabular disclosure regarding named executive officer compensation and the accompanying narrative disclosure in this proxy statement.''

Because your vote is advisory, it will not be binding upon the Compensation Committee or the Board of Directors. However, the Compensation Committee will take into account the outcome of the vote when considering future executive compensation arrangements.

The Board of Directors unanimously recommends a vote "FOR" approval of the compensation of the named executive officers.

COMPENSATION DISCUSSION AND ANALYSIS

The following discussion and analysis is intended to provide stockholders with a description of the Company's executive compensation philosophy, components of its executive compensation program, and the factors considered by the Compensation Committee (or "Committee" in this section) for determining executive compensation for our named executive officers (or "NEO" in this section) in 2017. Our 2017 named executive officers are our Chief Executive Officer, Chief Financial Officer and our next three most highly-compensated executive officers who were serving as an executive officer at the end of 2017. This compensation discussion and analysis should be read in conjunction with the compensation tables and associated narrative that follows.

Named Executive Officer	Title
William J. Pasenelli	President and Chief Executive Officer (CEO)
Todd L. Capitani	Executive Vice President and Chief Financial Officer (CFO)
James M. Burke	Executive Vice President and Chief Risk Officer (CRO)
Gregory C. Cockerham	Executive Vice President and Chief Lending Officer (CLO)
James F. Di Misa	Executive Vice President and Chief Operating Officer (COO)

Executive Summary

Our executive compensation program is structured to motivate and retain our named executive officers who are critical to our success. Our competitive salary and benefits program reflects a balanced and responsible pay approach while also considering the environment in which the Company operates. Our executive compensation program is designed to reward our named executive officers for delivering results and driving sustainable growth. We seek to accomplish this goal in a way that rewards performance and is aligned with its stockholders' long-term interests.

2017 Performance Highlights

During 2017, the Company and its subsidiary, Community Bank of the Chesapeake, continued to successfully execute on its strategic longer-term objectives of increased profitability and shareholder value. We accomplished the increased profitability primarily by controlling expense growth and improved asset quality. The Company's cost control efforts and continued asset growth continued to create operating leverage[1] in 2017. Pretax income increased $4.6 million or 39.3% to $16.3 million for the year ended December 31, 2017 compared to $11.7 million for the year ended December 31, 2016. The Company's pretax returns on average assets and common stockholders' equity for 2017 were 1.19% and 14.88%, respectively, compared to 0.96% and 11.36%, respectively, for 2016. 2017 net income was impacted by the passage of the Tax Cuts and Jobs Act in December 2017, as well as for merger and acquisition costs related to the County First acquisition that closed in January 2018. Below are a few highlights of our 2017 performance:

- Net income for year ended December 31, 2017 was $7.2 million or $1.56 per diluted share compared to $7.3 million or $1.59 per diluted share for the year ended December 31, 2016. There were two primary reasons net income for the comparable years was flat:
  - Net income in 2017 decreased $2.7 million due to the one-time adjustment of deferred tax assets for the recently enacted Tax Cuts and Jobs Act; and,
  - Net income in 2017 decreased $724,000, net of tax, for expenses associated with the acquisition of County First Bank.

  The tax adjustments and the merger and acquisition costs resulted in a reduction of earnings per share of approximately $0.75 per share for 2017. The Company's after-tax returns on average assets and common stockholders' equity for 2017 were 0.52% and 6.55%, respectively, compared to 0.60% and 7.09%, respectively, for 2016.

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[1] **Operating leverage** occurs when the Company increases its assets, and by extension its net interest income, while limiting increases in noninterest expense. In order for this to be effective, the Company must simultaneously pursue the following: increase the asset size while maintaining asset quality, increase funding at an economically viable cost, and control noninterest expense growth.

- We completed a very strong 2017 with operating net income[2] growing at a record pace for the Company. Operating earnings per share increased to $2.31 per share, an increase of $0.72 or 45% from $1.59 per share in 2016.
- We significantly increased operating return on average assets (''ROAA'') and operating return on average common equity (''ROACE'') compared to the prior year. Operating ROAA increased 18 basis points from 0.60% in 2016 to 0.78% in 2017. Operating ROACE increased 261 basis points from 7.09% in 2016 to 9.70% in 2017.
- The Company's efficiency ratio[3] was 63.40% for the year ended December 31, 2017 compared to 67.40% for the year ended December 31, 2016.
- Net charge-offs of 0.03% of average loans were the lowest since before the financial crisis (2007 was 0.04%).
- We successfully completed our legal merger with County First Bank on January 1, 2018. The acquisition of included $160 million of stable low-cost deposit transaction accounts that will fund planned loan growth in 2018. The costs savings expected in the second half of 2018 should complement the Company's strategy to enhance net interest income while we remain focused on creating operating leverage.
- During 2017, balance sheet growth was proportional with deposit growth of $67.4 million slightly exceeding loan growth of $61.1 million. Deposits increased by 6.5%, or $67.4 million, to $1,106.2 million at December 31, 2017 compared to $1,038.8 million at December 31, 2016. Retail deposits, which include all deposits except traditional brokered deposits, increased a total of $79.4 million, comprised of increases in transaction accounts of $48.6 million and time deposits of $30.8 million. These retail increases to deposits were partially offset by a decrease to brokered deposits of $12.0 million.
- Our one-year total shareholder return (TSR) was 33.64%, which was in the 96th percentile in our compensation peer group. Our stock performance improved during 2017 increasing from $29.00 per share on December 30, 2016 to $38.30 per share on December 29, 2017.

2017 Key Compensation Decisions and Actions

The following is a summary of key actions taken by the Compensation Committee on executive compensation in 2017:

Base Salaries: Base salary increases for the NEOs ranged between 1% and 5% in 2017 to reward for individual performance.

2017 Short-Term Incentive Awards: Incentive payouts for all NEOs equaled 45% of base salary reflecting very strong corporate performance achievements across the predetermined performance metrics as well as other significant corporate and individual performance achievements during the year.

2017 Long-Term Incentives: A quarter (25%) of the earned short-term incentive award was paid to the executives in shares of restricted stock which vest over a three-year period.

Say-On-Pay Vote Results

The Company provides its stockholders with the opportunity to cast an annual advisory vote on executive compensation. At the Company's 2017 annual meeting of stockholders, approximately 94.8% of the votes cast on the say-on-pay proposal were voted for the proposal, demonstrating support of the Committee's executive pay decisions.

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2 **Operating net income** is defined by the Company as net income before merger and acquisition costs and the deferred tax adjustment for Tax Cuts and Jobs Act. Operating earnings per share, operating return on average assets and operating return on average common equity is calculated using adjusted operating net income. See Non-GAAP reconciliation schedule that immediately follows: Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations.

3 **Efficiency Ratio —** noninterest expense divided by the sum of net interest income and noninterest income.

The Committee considers the results of the Company's say-on-pay votes when making compensation decisions for the named executive officers, along with the other factors discussed in this CD&A.

Our Governance Practices

The Committee believes that the application of the executive compensation philosophy requires a compensation program design which considers a balanced evaluation of performance. Committee discretion, flexibility and judgement are essential to its ability to deliver incentive compensation that focuses on short term performance results and progress toward longer term initiatives which allow the Company to enhance shareholder value. The following table includes important features of our executive compensation program:

- Performance measures and individual goals for incentive compensation are linked to strategic, operating and financial goals designed to create long-term shareholder value.
- Our compensation program includes features intended to discourage employees from taking unnecessary and excessive risks, including balanced performance metrics, emphasis on long-term shareholder value creation, and clawback provisions.
- We have stock ownership guidelines for our executives requiring them to hold substantial equity ownership.
- The Compensation Committee engages its own independent compensation consultant to review the Company's executive compensation program and practices.
- Our employment agreements include a double trigger for payment upon a change in control.
- We conduct an annual Say-on-Pay advisory vote with stockholders.

What Guides Our Executive Compensation Program

Our Compensation Philosophy

Our compensation philosophy is grounded on the following guiding principles:

Team-Based Approach. Each named executive officer is a member of the Company's executive team. The Company's executive compensation program is intended to promote and maintain stability within the executive team. As such, compensation levels amongst the NEOs are closely aligned and their incentive opportunities are linked to similar performance metrics.

Performance Expectations. The Company has clear performance expectations of its officers that are reinforced by its performance review and compensation programs. First, each executive officer must demonstrate exceptional personal performance in order to remain part of the executive team. Second, each executive officer must contribute to the Company's overall success, rather than focus solely on specific objectives within the officer's area of responsibility.

Internal Equity. Because the Company's executive officers operate as a team, the Committee considers internal pay equity to be an important factor in its decisions on executive compensation. As a result, the incentive portion of compensation awarded to each of the Company's executive officers in 2017 was generally the same percentage of salary.

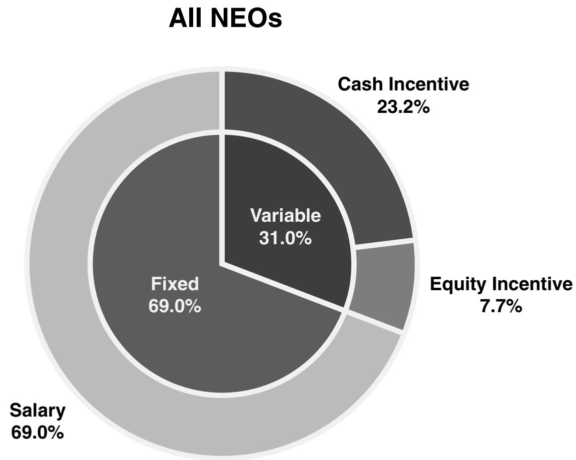
Ownership. We believe executives should have an ownership position in our Company. A meaningful portion of the annual incentive is paid in restricted stock. The Company has in place stock ownership guidelines for its executive officers (ranging between 1x – 2x base pay).

Principal Elements of Pay

The executive compensation program for named executive officers reflects our compensation philosophy and uses a full range of pay components to achieve our objectives. We believe that we can meet the objectives of our compensation philosophy by reaching a balance among base salary, short-term incentives and long-term incentives for our named executive officers.

The Company's executive compensation program consists of four components: base salary, annual cash incentives, equity awards, and benefits.

The allocation of base salary and performance-based compensation (short-term cash incentives and equity awards) varies depending upon the role of a named executive officer in our organization and his or her individual performance and achievements in support of our strategic objectives. The allocation of base salary, annual incentive compensation and equity based compensation for our named executive officers in 2017 is illustrated in the chart below.



Our Decision-Making Process

Role of the Compensation Committee. The Committee is responsible for overseeing and administering the Company's employee benefit plans and policies. The Committee determines all compensation for the named executive officers. Each year, the Committee conducts an evaluation of each executive officer to determine if any changes in the officer's compensation would be appropriate based on the considerations described above.

The Committee is composed of at least three directors who are determined to be ''independent directors'' as defined by NASDAQ Rule 5605(d) (2) (A). The members of the Committee are appointed annually by the Board of Directors. Four members of the Company's Board of Directors serve on the Committee, each of whom is an ''independent director''. The Chair of the Committee reports to the Company's Board regarding Committee actions.

Compensation Committee Interlocks and Insider Participation. No member of the Committee is a current or former officer or employee of the Company or any of its subsidiaries. There are no compensation committee interlocks with other entities with respect to any such member.

Role of Management. At the Committee's request, Mr. Pasenelli, our Chief Executive Officer, provides input regarding the performance and appropriate compensation of the other executive officers. The Committee considers Mr. Pasenelli's evaluation of the other executive officers because of his direct knowledge of each executive officer's performance and contributions. In accordance with NASDAQ rules, Mr. Pasenelli is not present when his compensation is being discussed or approved.

Role of the Compensation Consultant. In 2017, the Committee retained the services of Pearl Meyer & Partners, LLC (Pearl Meyer) to perform a competitive assessment of our executive compensation programs, as well as to provide guidance on the changing regulatory environment governing executive compensation. The Committee assessed the independence of Pearl Meyer pursuant to SEC and NASDAQ rules and concluded that no conflict of interest exists that would prevent Pearl Meyer from serving as an independent consultant to the Committee.

The executive compensation review included an assessment of our financial performance relative to peers and a review of equity compensation and bonuses for named executive officers. The Committee sought input from Pearl Meyer on a range of external market factors, including evolving compensation trends, appropriate peer companies, and market survey data. The compensation assessment provided the Committee with a broad array of information from which to assess the effectiveness of our compensation programs and served as a foundation for 2018 compensation decisions.

Compensation Peer Group and Benchmarking. The following peer group was used in making pay decisions in early 2017 for our NEOs. In determining the compensation peer group, the Committee selected publicly traded banks from Maryland and Virginia with assets ranging approximately one half to two times our asset size ($700 million to $2.6 billion)

Access National Corporation	Middleburg Financial Corporation
American National Bankshares, Inc.	National Bankshares, Inc.
C&F Financial Corporation	Old Line Bancshares, Inc.
Community Bankers Trust Corporation	Old Point Financial Corporation
Eagle Financial Services, Inc.	Shore Bancshares, Inc.
F&M Bank Corp.	Southern National Bancorp of Virginia, Inc.
First United Corporation	WashingtonFirst Bankshares, Inc.
Howard Bancorp, Inc.	Xenith Bankshares, Inc.

In the Fall of 2017 and with the assistance of Pearl Meyer, the Committee updated the compensation peer group in light of its pending merger with County First Bank which was due to close in early 2018. The peer group was identified based, generally, on the following criteria:

- Publicly-traded commercial banks
- Located in MD, VA, NJ, PA and NC
- Asset size range of 0.5 to 2 times our anticipated asset size at the close of the merger ($1.7 billion)
- Comparable business models

The resulting peer group which was used in making pay decisions for 2018 consisted of the following 17 banks ranging in assets between $1.1 billion and $3.4 billion.

Access National Corporation	National Bankshares, Inc.
ACNB Corporation	Old Line Bancshares, Inc.
BCB Bancorp, Inc.	Orrstown Financial Services, Inc.
Bryn Mawr Bank Corporation	Penns Woods Bancorp, Inc.
C&F Financial Corporation	Peoples Financial Services Corp.
Codorus Valley Bancorp, Inc.	The Community Financial Corporation
Community Bankers Trust Corporation	Republic First Bancorp, Inc.
HomeTrust Bancshares, Inc.	Unity Bancorp, Inc.
Howard Bancorp, Inc.	

The following summary data for the peer group was obtained from SNL Financial's database as of December 31, 2017:

Percentile	Total Assets ($)
25th Percentile	$1,469,743
50th Percentile	$1,658,420
75th Percentile	$2,208,292
Community Financial (post-merger)	$1,700,000
Community Financial Percentile Rank	53rd

The Committee reviews both compensation and performance at peer companies to inform its decision-making process so it can set total compensation levels that it believes are commensurate with the market and the Company's scope and performance. The Committee refers to executive compensation studies prepared by its independent consultants when it reviews and approves executive compensation. The studies reflect compensation levels and practices for executives holding comparable positions at peer group companies, which help the Committee set compensation at competitive levels. The Committee's primary selection criteria are industry (commercially focused banks), asset size, and geography. The Committee compares each executive officer's base salary, target total cash compensation, and target long-term incentive compensation value to amounts paid for similar positions at peer group companies.

The Committee believes that the market median is a useful reference point in helping to achieve the executive compensation program objectives. However, the Committee also considers other factors when setting compensation; and target total direct compensation for each executive may vary from the market median based on the factors the Committee considers relevant each year, including particular job responsibilities and scope, adjustments for individual skills and expertise, and internal pay equity.

The Committee's executive compensation determinations are the result of the Committee's business judgment, which is informed by the experiences of the members of the Committee and market data.

2017 Executive Compensation Decisions

The Committee began its work on executive compensation for 2017 by assessing competitive market compensation using a number of data sources including publicly disclosed information on a selected peer group of publicly traded banking organizations similar in asset size and geographic region. Consideration was given to the Company's 2016 financial performance and the goals and objectives set forth in the Company's strategic plan. In 2016, the Committee implemented a scorecard approach to executive incentive awards by establishing threshold, target and maximum incentive opportunities tied to a number of performance factors. The Committee did not make any significant changes to the compensation program for 2017.

The Committee approved modest increases to base salaries for 2017. Incentive award targets and objectives were aligned with the annual strategic plan approved by the board. Based on the Company's performance and the achievement of specific strategic objectives, the Committee approved cash and equity awards as described under Performance-Based Incentive Compensation and Long-Term Equity Awards sections.

Base Salaries. Competitive base salaries are critical in attracting and retaining our executives. We establish base salaries and assess market competitiveness by comparing our executives' qualifications, experience, and responsibilities as well as their individual performance and value with similar positions among our peers.

The following table reflects each active named executive officer's increase in base pay for 2017 as well as increases for 2018, based on 2017 performance and market data.

Executive	Title	2016 Salary	2017 Salary	% Increase	2018 Salary	% Increase
William J. Pasenelli	President & CEO	$408,000	$412,000	0.98%	$440,000	6.80%
Todd L. Capitani	EVP, CFO	278,154	285,000	2.46%	298,000	4.56%
James M. Burke	EVP, CRO	290,980	305,000	4.82%	336,000	10.16%
Gregory C. Cockerham	EVP, CLO	290,980	294,000	1.04%	320,000	8.84%
James F. Di Misa	EVP, COO	290,980	294,000	1.04%	320,000	8.84%

Historically, Messrs. Pasenelli, Burke, Cockerham and Di Misa received $15,000 each year for their service on the Bank's Board of Directors. The Committee chose to roll these fees into their base salaries beginning in 2018 and therefore, the percent increases reflect this action. Excluding the $15,000 increase, base pay increases range between 3% and 5% for the NEOs.

Annual Performance-Based Incentive Compensation. We maintain a short-term annual compensation plan which allows us to provide our active named executive officers with the opportunity to earn incentive compensation for achieving specific Company performance goals. The plan ties incentive payments to achievement levels in several key performance areas. A portion of the incentives, once earned, is paid in restricted stock which vests in thirds beginning on the first anniversary of the grant date.

For the 2017 year, the performance factors included ROAA, EPS growth and efficiency ratio. The plans for the CEO and Chief Risk Officer also included non-performing assets as a percentage of total assets. These criteria were chosen because they reflect commonly recognized measures of overall company performance and are associated with shareholder value creation. The plan included threshold, target and maximum levels of performance for each performance factor and a corresponding payout, weighted as a percentage of salary, to each of the named executive officers based upon actual achievement. The annual bonus opportunity for the CEO ranged from 18% to 30% of base salary and 17.5% to 27.5% for the other named executive officers. At the end of the year, the Committee determines the amount of the bonus to be paid to each executive officer by comparing the Company's financial results to the performance goals. For 2017, ROAA and EPS growth exceeded maximum performance levels, efficiency ratio aligned slightly below target, and non-performing assets achieved performance slightly above target.

Based upon actual performance across these corporate performance metrics, the executives earned the following incentive awards:

Executive	Title	Short-Term Annual Incentive Award	% of 2017 Salary
William J. Pasenelli	President & CEO	$107,120	26%
Todd L. Capitani	EVP, CFO	72,319	25%
James M. Burke	EVP, CRO	74,725	25%
Gregory C. Cockerham	EVP, CLO	74,603	25%
James F. Di Misa	EVP, COO	74,603	25%

In addition to the earned incentive award, the Committee awarded each executive a supplemental bonus which was intended to recognize significant improvement in performance metrics which weren't included in the 2017 annual incentive plan such as stock performance and shareholder return, as well as individual performance achievements during the year.

Executive	Title	Supplemental Bonus Award	% of 2017 Salary
William J. Pasenelli	President & CEO	$77,880	19%
Todd L. Capitani	EVP, CFO	55,681	20%
James M. Burke	EVP, CRO	62,275	20%
Gregory C. Cockerham	EVP, CLO	57,398	20%
James F. Di Misa	EVP, COO	57,398	20%

The Compensation Committee, at its discretion, has the ability to adjust for one-time non-recurring charges. Through its deliberations, the Compensation Committee decided to adjust for the effects of the expenses associated to the acquisition of County First Bank as well as the impact of the $2.7 million write-off of our net deferred tax asset as a result of the Tax Cuts and Jobs Act enacted in December 2017. In awarding the supplemental bonus, the Compensation Committee considered the Company's strong performance and enhanced profitability as discussed in the 2017 Performance Highlights section above, which was accomplished during a year in which the Company's management team was working through the acquisition of County First Bank that legally closed on January 1, 2018.

The supplemental bonus awards are included in the table below. See also "*Executive Compensation — Summary Compensation Table*" for the bonus earned by our active named executive officers in 2017.

Total incentive awards to executive officers for 2017 performance, including annual incentive awards and supplemental bonuses, totaled 45% of base salary. Each named executive officer received 25% of the 2017 total incentive award in restricted stock. The restricted stock awards vest over a three year period, beginning on the first anniversary of the grant date.

Executive	Title	2017 Annual Award	% of Salary	25% of Award Paid in Equity
William J. Pasenelli	President & CEO	$185,000	45.00%	$46,250
Todd L. Capitani	EVP, CFO	128,000	45.00%	32,000
James M. Burke	EVP, CRO	137,000	45.00%	34,250
Gregory C. Cockerham	EVP, CLO	132,000	45.00%	33,000
James F. Di Misa	EVP, COO	132,000	45.00%	33,000

See "*Grant of Plan-Based Awards*" for information on the value of each active named executive officer's incentive opportunity for 2017.

For 2018, the Company adopted an incentive plan for the named executive officers that is similar in structure to the plan for the 2017 year. The 2018 plan retains several metrics (profitability, efficiency ratio and non-performing assets) and ROAA will continue to be the most heavily weighted performance measure. In 2018, the plans for the CEO and EVP, Chief Risk Officer (this individual also serves as the Bank's President) will again include the asset quality metric. The 2018 plan will include a holistic assessment component for all executives which will encompass individual performance and achievements, successful execution of strategic initiatives and other qualitative factors which may not be effectively measured by the plan's performance metrics. The holistic component will replace the additional discretionary bonus award which has historically been provided in addition to the earned EIP awards. In 2018 the target bonus opportunity will be 35% of base salary for the CEO and 30% of base salary for the NEOs. The incentive opportunity between threshold and stretch performance will range between 50% and 150% of target. The Compensation Committee approved this plan on March 7, 2018.

Long-Term, Equity Based Compensation. The Committee believes that equity should represent a meaningful portion of executive compensation to align the interests of our executives and stockholders. Additionally, we believe that equity provides for a longer-term retention tool. These ownership and retention objectives are supported by paying a portion of incentives in restricted stock and through the use of time-based vesting for equity awards. The Committee makes an annual determination as to who will receive equity awards, the type of awards, vesting conditions, and level of the awards. All equity grants made to named executives have a minimum three year vesting period. In addition, we require certain levels of stock ownership as described in the Compensation Philosophy section above.

For 2017, no executives received additional equity awards outside of what was provided through the short-term incentive plan (25% of earned incentive award was paid in restricted stock).

Committee Discretion

The Committee retains the discretion to decrease all forms of incentive payouts based on significant individual or Company performance shortfalls. The Committee also retains the discretion to increase awards or consider special awards for significant performance or due to subjective factors, or exclude extraordinary non-recurring results. For purposes of 2017 incentive payout calculations, the Committee awarded executives a supplemental incentive amount in addition to the amounts earned in the annual incentive plan as described in the section above.

Other Compensation Guidelines, Practices and Policies

Stock Ownership Guidelines

Under the Company's stock ownership guidelines, our CEO is expected to own shares of Company common stock that have a value equal to 2.0 times his base salary. The EVP, CRO (this individual also serves as the Bank's President) is expected to own shares with a value equal to 1.5 times his base salary and other named executives must own 1.0 times their salary. Until these target ownership levels are reached, an executive must retain 100% of his or her net shares from any vested awards (after taxes and any exercise price). All named executive officers met the minimum stock ownership requirements at the end of 2017. Because an executive officer must retain 100% of net shares acquired from equity awards until the specified target of ownership is met, there is no minimum time period required to achieve the target level of ownership.

Risk Considerations

In addition to our guiding principles, the Company engages in the following practices to ensure its executive compensation program is aligned with stockholders' interests and protects us against risk. We believe that the design and objectives of our executive compensation program provide an appropriate balance of incentives for executives and avoid inappropriate risks. The Committee considers, in establishing and reviewing the executive compensation program, whether the program encourages unnecessary or excessive risk taking and has concluded that it does not. In this regard, our executive compensation program includes, among other things, the following design features:

- Variable compensation based on a variety of performance goals
- Committee discretion to lower annual incentive award amounts

- Balanced mix of short-term and long-term incentives
- Stock ownership requirements
- Claw-back provisions

The Committee conducts an annual evaluation of all of the Company's compensation programs, policies and practices to ensure that compensation policies and incentive compensation programs in place are not reasonably likely to have a material adverse impact on the Company and do not encourage our employees to excessive risks.

Employment Agreements. Our named executive officers have employment agreements that protect both the Company and our named executive officers in the event of certain separation events including termination following a change-in-control. Our employment agreements include a double trigger for payment upon a change in control. The Committee believes the terms of our employment agreements are in line with industry standards and are necessary to maintain a stable management team. See "*Executive Compensation — Employment Agreements*" for information on the terms and conditions of the employment agreements with our active named executive officers.

Benefits and Perquisites

Our objective is to attract and retain talented executive officers who will make positive contributions to the overall success of the Company. The Committee feels that the benefits offered to named executives are effective in achieving retention objectives and maintaining stability within the management team. These types of benefits are commonly offered by peers within the industry.

The Company offers named executives the following additional executive benefits and perquisites.

Retirement Benefits. In addition to participation in the Bank's employee stock ownership program and 401(k) plan, our active named executive officers are eligible for retirement benefits under the following non-qualified deferred compensation arrangements:

> **Pension Benefits.** The Company maintains Supplemental Executive Retirement Plans (SERPs) and Salary Continuation Agreements (SCAs) with each of the named executives which provide additional compensation at retirement or upon termination of employment due to death, disability, or a change of control. The SERPs and SCAs aim to provide named executives a percentage of projected final base salary for 15 years following retirement at age 65. The targets are based on final projected base salary and are approximately thirty-five percent (35%) for the CEO and twenty-five percent (25%) for our other named executives. See "*Executive Compensation — Pension Benefits*" for additional information on these arrangements.
>
> **Executive Deferred Compensation Plan.** The Company maintains a voluntary deferred compensation plan in which our named executives can defer all or a portion of their base salaries. Participants may elect to have their deferred account balances credited with earnings based on the consolidated ROE of the Company and/or the rate of return of mutual funds available as deemed investment options. See "*Executive Benefits — Nonqualified Deferred Compensation*" for additional information.

Life Insurance. The CEO has pre-retirement split dollar and supplemental life insurance benefits of $1 million and the other named executives have $500 thousand.

Other Benefits. The named executive officers are also eligible to participate in the Company's health and welfare programs and other broad-based programs on the same basis as other employees.

Accounting and Tax Considerations

The Committee considers the accounting and tax implications of compensation plans prior to making any changes. To the extent required by law, the Committee has structured the compensation program to comply with Section 162(m) and Section 409A of the Internal Revenue Code (the "Code").

Section 162(m) of the Internal Revenue Code (the "Code") places a $1 million limit on the amount of compensation the Company can deduct in any one year for compensation paid to the NEOs. Prior to tax reform in 2018, this included our chief executive officer and the three most highly-compensated executive officers employed by the Company at the end of the year, and also included an exception for ‘‘performance-based compensation’’ Following tax reform the limitation also applies to our CFO and anyone who has served as an NEO since 2017, with the performance-based compensation limitation being repealed. While the Committee considers the deductibility of awards as one factor in determining executive compensation, it also looks at other factors in making its decisions, as noted above, and retains the flexibility to grant awards it determines to be consistent with the Company's goal for its executive compensation program, even if the award is not deductible by the Company for tax purposes.

In general, prior to 2018 the Company's performance-based cash bonuses were designed to qualify for tax deductibility because they are paid based on achievement of pre-determined performance goals established by the Committee pursuant to its incentive plans. There are certain transition rules that may allow for further extension of the performance-based exception, but rules have not yet been promulgated.

Responsible Equity Practices. The grant date for all equity awards is established when the grants and all key terms are approved by the Board or the Compensation Committee. Our 2015 Equity Compensation Plan includes prohibitions on the repricing of stock options without stockholder approval.

Prohibition on Hedging and Short Sales. The Company prohibits short sales and transactions in derivatives of Company securities, including hedging transactions, for all directors and officers of the Company.

COMPENSATION COMMITTEE REPORT

The Compensation Committee has received and discussed the foregoing Compensation Discussion and Analysis with management. Based on this review and discussions, the Compensation Committee recommended to the Board of Directors that the section of this proxy statement entitled Compensation Discussion and Analysis be included in this proxy statement and incorporated by reference into the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

March 7, 2018

Louis P. Jenkins, Jr., Chair
Joseph V. Stone, Jr.
Austin J. Slater, Jr.
Kathryn Zabriskie

EXECUTIVE COMPENSATION

Summary Compensation Table. The following table provides information concerning total compensation earned or paid to the Chief Executive Officer, Chief Financial Officer and the three most highly compensated executive officers of the Company who served in such capacity as of December 31, 2017. These five officers are referred to as the named executive officers in this proxy statement.

Name and Principal Position	Year	Salary ($)	Bonus ($)[1]	Stock Awards ($)[2]	Non-qualified Deferred Compensation Earnings ($)[3]	All Other Compensation ($)[4]	Total ($)
William J. Pasenelli	2017	$412,000	$157,250	$18,905	$167,887	$48,466	$804,508
President and Chief Executive Officer	2016	408,000	97,920	62,707	151,044	59,240	778,911
	2015	423,692	67,320	76,420	137,026	60,638	765,096
Todd L. Capitani	2017	$285,000	$108,800	$12,503	$ 47,332	$26,124	$479,759
Executive Vice President and Chief Financial Officer	2016	278,154	64,751	47,559	42,548	24,212	457,224
	2015	285,992	41,807	56,076	38,154	20,244	442,273
James M. Burke	2017	$305,000	$116,450	$13,077	$ 47,923	$25,930	$508,380
Executive Vice President and Chief Risk Officer	2016	290,980	67,658	47,829	44,378	28,656	479,501
	2015	299,180	43,735	57,325	41,079	24,870	466,189
Gregory C. Cockerham	2017	$294,000	$112,200	$13,077	$ 92,581	$31,536	$543,394
Executive Vice President and Chief Lending Officer	2016	290,980	67,658	47,829	80,809	34,213	521,489
	2015	299,180	43,735	57,325	73,700	27,421	501,361
James F. Di Misa	2017	$294,000	$112,200	$13,077	$111,803	$32,553	$563,633
Executive Vice President and Chief Operating Officer	2016	290,980	67,658	47,829	66,263	21,727	494,457
	2015	299,180	43,735	57,325	61,122	24,451	485,813

(1) Includes incentive payments earned in 2017 under the Company's annual incentive plan as well as discretionary bonus amounts earned. See ''Compensation Discussion & Analysis'' for information on the 2017 discretionary bonuses.

(2) Represents the aggregate grant date fair value of the granting of 626, 414, 433, 433 and 433 shares of restricted stock awards to Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa respectively, computed in accordance with FASB ASC Topic 718 based on a per share price of $30.20**,** on the date of grant for awards under the annual incentive plan in 2017.

(3) Represents the sum of above-market earnings under the Community Bank of the Chesapeake Executive Deferred Compensation Plan and the aggregate change in the present value of accumulated benefits under the Supplemental Executive Retirement Plans (''SERPs'') and Salary Continuation Agreements (''SCAs'') from the prior completed fiscal year to the current fiscal year. Includes above market earnings under the Bank's Executive Deferred Compensation Plan in the amounts of $2,879 and $7,209 for Messrs. Pasenelli and Cockerham respectively. Includes an aggregate change in the present value of accumulated benefits under the SERPs and SCAs of $165,008, $47,332, $47,923, $85,372, and $111,803 for Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa, respectively.

(4) Details of the amounts reported in the ''All Other Compensation'' column for 2017 are provided in the table below.

Item	Pasenelli	Capitani	Burke	Cockerham	Di Misa
Directors' fees	$18,975	$ —	$ —	$ —	$ —
Market value of allocations under the employee stock ownership plan	3,654	3,654	3,654	3,654	3,654
Employer contribution to 401(k) Plan	17,351	13,550	16,454	18,896	20,046
Imputed income under split-dollar life insurance arrangement	1,620	476	408	1,023	835
Automobile	4,863	6,850	3,805	2,503	6,409
Club dues	—	—	—	3,851	—
Dividends paid on unvested restricted stock	1,780	1,371	1,386	1,386	1,386
Group term life benefit	223	223	223	223	223

Grants of Plan-Based Awards. The following table provides information concerning our grants of plan-based awards for the named executive officers during fiscal 2017 under The Community Financial Corporation 2015 Equity Compensation Plan.

		Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)			Estimated Future Payouts Under Equity Incentive Plan Awards			All Other Stock Awards:	Grant Date Fair Value of
Name	Grant Date	Threshold	Target	Maximum	Threshold	Target	Maximum	Number of Shares(2)	Stock Awards(3)
William J. Pasenelli		$74,160	$90,640	$123,600					
	2/09/2017							626	$18,905
Todd L. Capitani		49,875	59,850	79,800					
	2/09/2017							414	12,503
James M. Burke		53,375	64,050	85,400					
	2/09/2017							433	13,077
Gregory C. Cockerham		51,450	61,740	82,320					
	2/09/2017							433	13,077
James F. Di Misa		51,450	61,740	82,320					
	2/09/2017							433	13,077

(1) Total incentive opportunity under the annual executive incentive plan for 2017 performance. At the end of the plan year the incentive is determined based upon actual performance and 75% of the incentive amount will be paid in cash and 25% will be issued in restricted stock. Actual number of shares of restricted stock issued will be calculated after the end of the performance period based on the fair market value on the date of stock issuance.

(2) Represents number of shares of restricted stock earned under the annual incentive plan for the 2016 performance period and discretionary stock awards issued in 2017.

(3) Represents the grant date fair value of restricted stock awards earned under the annual incentive plan for the 2016 performance period and discretionary stock awards issued in 2017 based on a per share price of $30.20 on the date of grant for awards for Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa.

Employment Agreements. The Community Financial Corporation and Community Bank of the Chesapeake maintain employment agreements with each of the named executive officers. The term of the employment agreements with Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa are automatically extended by one day each day so that the term remains at three years, until either party gives notice to the other of its intent to stop the renewal of the term of the agreement or if the officer's employment with the Bank terminates, whether by resignation, discharge or otherwise. Among other things, the agreements provide for an annual salary, participation in any stock option plan or incentive compensation plan to the extent authorized by the Company's Board of Directors and for participation in pension, group life insurance, medical coverage and in other employee benefits applicable to senior executives of the Bank.

See *"Retirement Benefits"* and *"Other Potential Post-Termination Benefits"* for a discussion of benefits and payments the named executive officers may receive under the employment agreements upon their retirement or termination of their employment.

Outstanding Equity Awards at Fiscal Year End. The following table provides information concerning unexercised options for each of the named executive officers outstanding as of December 31, 2017.

	Option Awards(1)					Restricted Stock Awards	
Name	Grant Date	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Option Exercise Price ($)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested ($)(2)
William J. Pasenelli	01/13/2014	—	—	—	—	400(3)	$15,320
	01/23/2015	—	—	—	—	950(4)	36,385
	01/21/2016	—	—	—	—	2,015(5)	77,175
	02/09/2017	—	—	—	—	626(6)	23,976
Todd L. Capitani	01/13/2014	—	—	—	—	300(3)	$11,490
	01/23/2015	—	—	—	—	840(4)	32,172
	01/21/2016	—	—	—	—	1,529(5)	58,561
	02/09/2017	—	—	—	—	414(6)	15,856
James M. Burke	01/13/2014	—	—	—	—	300(3)	$11,490
	01/23/2015	—	—	—	—	850(4)	32,555
	01/21/2016	—	—	—	—	1,538(5)	58,905
	02/09/2017	—	—	—	—	433(6)	16,584
Gregory C. Cockerham	01/13/2014	—	—	—	—	300(3)	$11,490
	01/23/2015	—	—	—	—	850(4)	32,555
	01/21/2016	—	—	—	—	1,538(5)	58,905
	02/09/2017	—	—	—	—	433(6)	16,584
James F. Di Misa	01/13/2014	—	—	—	—	300(3)	$11,490
	01/23/2015	—	—	—	—	850(4)	32,555
	01/21/2016	—	—	—	—	1,538(5)	58,905
	02/09/2017	—	—	—	—	433(6)	16,584

(1) No options are outstanding as of December 31, 2017.

(2) Based upon the Company's closing stock price of $38.30 per share at December 29, 2017.

(3) Shares vest in five equal annual installments beginning on January 13, 2014.

(4) Shares vest in five equal annual installments beginning on January 23, 2015.

(5) Shares vest in three equal annual installments beginning on January 21, 2017.

(6) Shares vest in three equal installments beginning on February 9, 2018.

Option Exercises and Stock Vested. The following table provides information concerning the vesting of stock awards for each named executive officer, on an aggregate basis, during 2017.

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)[1]
William J. Pasenelli	4,344	$46,915	2,458	$73,609
Todd L. Capitani	—	—	1,787	53,511
James M. Burke	1,865	12,682	1,810	54,200
Gregory C. Cockerham	4,407	42,351	1,810	54,200
James F. Di Misa	1,865	13,615	1,810	54,200

(1) The value realized upon vesting is equal to the aggregate fair market value on the date of vesting, multiplied by the number of shares exercised.

Pension Benefits. The following table provides information about the participation of executive officers in our retirement programs as of December 31, 2017. See *"Retirement Benefits"* for a discussion of the material terms and conditions of payments under the salary continuation agreements and supplemental executive retirement plans.

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
William J. Pasenelli	Supplemental Executive Retirement Plan – 2011	7	$279.851	$—
	Supplemental Executive Retirement Plan – 2014	4	160,178	—
	Salary Continuation Agreement – 2003	17	403,045	—
	Salary Continuation Agreement – 2006	12	102,806	—
Todd L. Capitani	Supplemental Executive Retirement Plan – 2011	7	$100,041	—
	Supplemental Executive Retirement Plan – 2014	4	79,214	—
James M. Burke	Supplemental Executive Retirement Plan – 2011	7	$ 83,053	—
	Supplemental Executive Retirement Plan – 2014	4	9,295	—
	Salary Continuation Agreement – 2006	12	246,272	—
Gregory C. Cockerham	Supplemental Executive Retirement Plan – 2011	7	$ 79,700	—
	Supplemental Executive Retirement Plan – 2014	4	16,220	—
	Salary Continuation Agreement – 2003	29	570,007	—
	Salary Continuation Agreement – 2006	12	39,901	—

Name	Plan Name	Number of Years Credited Service (#)	Present Value of Accumulated Benefit ($)	Payments During Last Fiscal Year ($)
James F. Di Misa	Supplemental Executive Retirement Plan – 2011	7	$145,364	—
	Supplemental Executive Retirement Plan – 2014	4	18,579	—
	Salary Continuation Agreement – 2006	12	360,062	—

Nonqualified Deferred Compensation. The following table provides information with respect to the 2017 accrued balances for each of the named executive officers who participate in the Executive Deferred Compensation Plan. See *"Retirement Benefits"* for a discussion of this plan.

Name	Plan Name	Executive Contributions in Last FY ($)	Registrant Contributions in Last FY ($)	Aggregate Earnings in Last FY ($)	Aggregate Withdrawals/ Distributions ($)	Aggregate Balance at Last FYE ($)
William J. Pasenelli.	Executive Deferred Compensation Plan	$41,200	$—	$ 4,228	$32,629	$ 43,226
Gregory C. Cockerham . .	Executive Deferred Compensation Plan	58,475	—	10,541	—	146,044

PAY RATIO DISCLOSURE

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC adopted a rule requiring the annual disclosure of the ratio of the median employee's annual total compensation to the total compensation of the principal executive officer (''PEO''). This ratio is commonly referred to as the ''CEO Pay Ratio.'' The Company's PEO is Mr. Pasenelli, the Chief Executive Officer (''CEO'').

For 2017, the annual total compensation of our CEO was 21.1 times that of the Company's median employee, based on annual total compensation of $804,508 for Mr. Pasenelli and $38,124 for the median employee.

The median employee was identified using a listing of all employees as of December 31, 2017, and calculating the median amount of total 2017 compensation as it would be reported based on the IRS instructions for Box 5, Medicare wages and tips. Actual amounts reported on Box 5 for 2017 were used for all employees. As applicable, compensation reported on Box 5 included the amount paid in 2017 for salary, bonus, non-equity incentive plan (cash) awards, along with any amount deferred by the employee to the 401(k) Plan and Trust and the imputed value of the cost of group term life insurance and certain perquisites. Compensation reported on Box 5 also included any amounts that vested in 2017 for SERP benefits and for stock awards (based on the market value of the stock on the vesting date). Compensation deferred at the election of the Company' officers, and the amount of employer contributions to the ESOP Plan, were excluded from Box 5.

This pay ratio is a reasonable estimate calculated in a manner consistent with SEC rules based on our payroll and employment records and the methodology described above. The SEC rules for identifying the median compensated employee and calculating the pay ratio based on that employee's annual total compensation allow companies to adopt a variety of methodologies, to apply certain exclusions, and to make reasonable estimates and assumptions that reflect their compensation practices. As such, the pay ratio reported by other companies may not be comparable to the pay ratio reported above, as other companies may have different employment and compensation practices and may utilize different methodologies, exclusions, estimates and assumptions in calculating their own pay ratios.

RETIREMENT BENEFITS

The Bank maintains Salary Continuation Agreements (the ''SCAs'') with Messrs. Pasenelli, Burke, Cockerham and Di Misa to provide the executives with additional compensation at retirement or upon termination of employment due to death, disability or a change in control. Messrs. Pasenelli, Burke, Cockerham and Di Misa are entitled to a total annual benefit for a period of 15 years of $92,212, $101,000, $77,035, and $65,000 respectively, upon normal retirement at or after age 65. A reduced benefit is payable if the executive retires before normal retirement age. The annual benefits are payable on a monthly basis to the executives or their designated beneficiaries.

The Bank also maintains 2011 and 2014 supplemental executive retirement plans (the ''SERPs'') with each of Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa to provide the executives with additional compensation at retirement or upon termination of employment due to death, disability or a change in control. If he remains employed with the Bank until his normal retirement age of 65, Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa are entitled to receive an accrued retirement benefit payable annually for a period of 15 years of $124,974, $154,711, $77,434, $13,087, and $50,020, respectively. A reduced benefit is payable if the executive retires before normal retirement age or terminates service with the Bank for other reasons. See *''Other Potential Post-Termination Benefits''* for a discussion of benefits Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa may receive under his respective SERPs.

The Bank maintains an Executive Deferred Compensation Plan under which Messrs. Pasenelli, Capitani, Burke, Cockerham and Di Misa may defer all or any portion of their base salary. Deferred amounts may be credited annually with interest at a rate equal to the Company's consolidated return on equity for the calendar year or credited with earnings or losses based on the rate of return of mutual funds selected by the plan participants. The executive's account balance under this plan will be distributed to the executive following the executive's termination of service or on a specified date in either a lump sum or over a period of one to ten years, as elected by the executive.

OTHER POTENTIAL POST-TERMINATION BENEFITS

Payments Made Upon Termination for Cause. Under the named executive officer's employment agreements if the executive's employment is terminated for Cause, he will receive only his base salary or other compensation earned through the date of termination and any other compensation or vested benefits provided under applicable Bank plans or programs. All other obligations of the Bank terminate on the date of termination.

Under the 2011 and 2014 SERPs if the executive's employment is terminated for Cause, he will not be entitled to any benefits under the terms of his SERPs.

Under the SCAs if the executive's employment is terminated for Cause, he will not be entitled to any benefits under the terms of his SCAs.

Pursuant to the terms of the award agreements entered into under the 2005 Equity Compensation Plan, if the executive is terminated for Cause, all restricted stock awards and stock options expire immediately as of the effective date of termination.

Pursuant to the terms of the award agreements entered into under the 2015 Equity Compensation Plan, if the executive is terminated for Cause, all rights to any restricted stock granted under the plan and held by the terminated employee will expire as of the effective date of termination. No stock options have been granted under this plan.

Payments Made Upon Termination Without Cause. Under Mr. Pasenelli's employment agreement, if Mr. Pasenelli's employment is terminated Without Cause, he will receive a lump sum payment equal to three times his base salary and three times his most recent annual incentive compensation payment. Mr. Pasenelli would also receive medical, dental and life insurance benefits for 36 months. Under the employment agreement for Messrs. Capitani, Burke, Cockerham or Di Misa, if we terminate the executive's employment

Without Cause, he would receive a lump sum payment equal to two times his base salary and two times his most recent annual incentive compensation payment. The executive would also receive medical, dental and life insurance benefits for 36 months.

Pursuant to the terms of the award agreements entered into under the 2005 Equity Compensation Plan, if the executive's employment is terminated for reasons other than termination for Cause, death, disability, retirement or a change in control, all unvested shares of restricted stock and stock options are forfeited as of such termination date.

Pursuant to the terms of the award agreements entered into under the 2015 Equity Compensation Plan, if the executive's employment is terminated Without Cause all unvested shares of restricted stock are forfeited as of such termination date. No stock options have been granted under this plan.

Payments Made Upon Voluntary Termination by Executive. Under Messrs. Pasenelli's, Capitani's, Burke's, Cockerham's or Di Misa's employment agreement, if he voluntarily terminates his employment with the Bank, he would receive his base salary and other compensation and benefits provided under the Bank's benefit plans and programs as of the date of termination.

Pursuant to the terms of the award agreements entered into under the 2005 Equity Compensation Plan, if the executive's employment is terminated for reasons other than termination for Cause, death, disability, retirement or a change in control, all unvested shares of restricted stock and stock options are forfeited as of such termination date. In addition, upon the executive's retirement, all unvested shares of restricted stock will be forfeited as of his retirement date, unless the executive is immediately engaged as a consultant, advisor or director emeritus of the Company or the Bank. In which case, his restricted stock award would continue to vest.

Pursuant to the terms of the award agreements entered into under the 2015 Equity Compensation Plan, if the executive voluntarily terminates his employment, all unvested shares of restricted stock are forfeited as of the termination date. No stock options have been granted under this plan.

Payments Made Upon Disability. Under Messrs. Pasenelli's, Capitani's, Burke's, Cockerham's and Di Misa's employment agreements, if we terminate an executive due to disability pursuant to the terms of the agreement, the executive will receive the compensation and benefits provided for under his employment agreement for (1) any period during the term of his agreement and before the establishment of the executive's disability; or (2) any period of disability before the executive's termination of employment due to disability.

Under the 2011 and 2014 SERPs, if Messrs. Pasenelli, Capitani, Burke, Cockerham or Di Misa becomes disabled before he terminates his employment with the Bank or his retirement, and prior to a Change in Control, he is entitled to receive a disability benefit equal to his accrued benefit under the SERPs as of the date of determination of disability. Payment of the disability benefit will commence on the first day of the month following the earlier of the executive's 65^{th} birthday or death and is paid in 15 equal annual installments.

Under the salary continuation agreements dated September 6, 2003, as amended, upon termination of employment as a result of disability, Messrs. Pasenelli and Cockerham are entitled to an annual benefit for a period of 15 years of $74,112 and $72,235, respectively, commencing with the month following the executive attaining age 65. Under the salary continuation agreements dated August 21, 2006, as amended, Messrs. Pasenelli and Cockerham are entitled to an annual disability benefit ranging from $14,325 to $18,100 and $4,420 to $4,800, respectively, depending on the date of termination, commencing with the month following the executive attaining age 65. Under the salary continuation agreement dated August 21, 2006, as amended, Messrs. Burke and Di Misa are entitled to an annual disability benefit ranging from $62,746 to $101,000 and $48,544 to $65,000, respectively, on the date of termination, commencing with the month following the executive attaining age 65.

Pursuant to the terms of the award agreements under the 2005 Equity Compensation Plan, if we terminate the executive's employment with the Bank due to a disability, all unvested shares of restricted stock will immediately vest as of the date of such termination.

Pursuant to the terms of the award agreements under the 2015 Equity Compensation Plan, if we terminate the executive's employment with the Bank due to a disability, all outstanding restricted stock will immediately vest as of the date of such termination. No stock options have been granted under this plan.

Payments Made Upon Death. Under Messrs. Pasenelli's, Capitani's, Burke's, Cockerham's and Di Misa's employment agreements, upon the executive's death, the Company will pay his beneficiary or estate any compensation due to the executive through the end of the month in which his death occurred, plus any other compensation or benefits to be provided in accordance with the terms and provisions of the Bank's benefit plans and programs in which the executive participated as of the date of his death.

Under the 2011 and 2014 SERPs, if the executive dies while actively employed by the Bank and before reaching his normal retirement age of 65, the SERPs provide for a death benefit equal to the executive's accrued benefit under the SERPs, payable to the executive's beneficiary in 15 equal annual installments. If the executive dies after the commencement of his SERP benefit payments, the executive's beneficiary is entitled to the unpaid balance of the payments for the balance of 15 annual installments.

Under their salary continuation agreements, if the executive dies while in active service with the Bank, the executive's designated beneficiaries will receive an annual benefit, for a period of 15 years, of $92,212 for Mr. Pasenelli, $101,000 for Mr. Burke, $77,035 for Mr. Cockerham, and $65,000 for Mr. Di Misa commencing with the month following the executive's death. If the executive dies after his employment has terminated but before payments under the agreement have commenced, their designated beneficiary will be entitled to the same payments beginning on the first day of the month after the executive's death. If the executive dies after the benefit payments have commenced, but before receiving all payments, their designated beneficiary will be entitled to the remaining benefits that would have been paid to the executive if the executive had survived.

Pursuant to the terms of the award agreements under the 2005 Equity Compensation Plan, if an executive dies while employed with the Bank, all unvested shares of restricted stock will immediately vest as of the date of such termination.

Pursuant to the terms of the award agreements under the 2015 Equity Compensation Plan, if an executive dies while employed with the Bank, all outstanding restricted stock awards will immediately vest as of the date of such termination. No stock options have been granted under this plan.

Payments Made Upon a Change in Control. Mr. Pasenelli's employment agreement provides that if (1) the executive's employment is terminated without cause or without the executive's consent and for a reason other than cause in connection with or within 12 months after a change in control (as defined in the agreement); or (2) the executive voluntary terminates employment within 12 months following a change in control upon the occurrence of events described in the agreement, he will receive a lump sum payment equal to three times his annual base salary and three times his most recent annual incentive compensation payment, plus continued health and welfare benefits for 36 months following termination. Under Messrs. Capitani's, Burke's, Cockerham's and Di Misa's employment agreement, each will receive a lump sum payment equal to two times his annual base salary and two times his most recent annual incentive compensation payment, plus continued health and welfare benefits for 36 months following termination. Section 280G of the Internal Revenue Code provides that payments related to a change in control that equal or exceed three times the individual's "base amount" (defined as average annual taxable compensation over the five preceding calendar years) constitute "excess parachute payments." Messrs. Pasenelli's, Capitani's, Burke's, Cockerham's or Di Misa's employment agreements provide that if the value of the benefits provided under the agreements in connection with a change in control exceed his 280G Limit, his payment will be reduced or revised so that the aggregate payments do not exceed his 280G Limit.

The 2011 and 2014 SERPs provide that upon a Change in Control prior to Messrs. Pasenelli, Capitani, Burke, Cockerham or Di Misa (i) attaining age 65, (ii) his death, (iii) disability, (iv) retirement, or (v) Separation from Service, he will become 100% vested in his accrued retirement benefit under the SERPs. Payments will commence at the earliest of his attaining age 65 or his death. However, if the executive experiences a Separation from Service within 24 months following a Change in Control, the executive is entitled to his full accrued retirement benefit, with payments to commence no later than the second month following his

Separation from Service. Under the 2011 SERPs for Messrs. Capitani, Burke, Cockerham, and Di Misa, if the benefit payment would be treated as an "excess parachute payment" under Code Section 280G ("280G Limit"), the Bank will reduce such benefit payment to the extent necessary to avoid treating such benefit payment as an excess parachute payment. Mr. Pasenelli's 2011 SERP and the 2014 SERPs provide for an additional tax indemnification payment if payments under the SERP exceed the executive's 280G Limit.

Under the salary continuation agreements dated September 6, 2003, as amended, upon the termination of employment within 12 months subsequent to a change in control and before age 65, Mr. Pasenelli and Mr. Cockerham are entitled to an annual benefit for a period of 15 years of $74,112 and $72,235**,** respectively, commencing with the month following the executive attaining age 65. Each of Mr. Pasenelli's and Mr. Cockerham's salary continuation agreements dated September 6, 2003, as amended, provide that if the value of the benefits provided in connection with a change in control exceed his 280G Limit, his payment will be reduced or revised so that the aggregate payments do not exceed his 280G Limit. Under the salary continuation agreement dated August 21, 2006, as amended, Mr. Pasenelli is entitled to an additional annual benefit ranging from $13,813 to $18,100 (based on the date of termination) if his employment is terminated within 12 months subsequent to a change in control and before age 65. Under the salary continuation agreement dated August 21, 2006, as amended, Mr. Cockerham is entitled to an additional annual benefit equal to the present value of $4,800 using an interest factor of 5% upon the termination of employment within 12 months subsequent to a change in control and before age 65. Under the salary continuation agreement dated August 21, 2006, as amended, Messrs. Burke and Di Misa are entitled to an additional annual benefit ranging from $47,412 to $101,000 and $46,571 to 65,000, respectively, (based on the date of termination) if his employment is terminated within 12 months subsequent to a change in control and before age 65.

Under the Company's 2005 Equity Compensation Plan, upon a Change in Control all outstanding equity awards will immediately vest.

Under the 2015 Equity Compensation Plan, if the executive terminates his employment, other than for Cause, during the 12-month period following a Change on Control, unvested restricted stock awards will become fully vested and transferable to the executive.

Potential Post-Termination Benefits Table. The amount of compensation payable to each named executive officer upon the occurrence of certain events is provided in the table below. The amounts shown assume a termination date of December 31, 2017, and include amounts earned through such time and are estimates of the amounts that would be paid to the executives upon their termination. The actual amounts to be paid can only be determined at the time of such executive's separation from the Company. These amounts do not take into account any reductions that may be required in order to comply with the 280G cutback provisions in employment agreements or pension benefit agreements, if such cutback is applicable, and do not reflect the tax indemnification payments that may be made under certain arrangements in the event an executive exceeds his 280G limit.

	Termination for cause	Termination without cause	Voluntary Termination by Executive	Disability	Death	Change in Control
William J. Pasenelli						
Employment Agreement	$ —	$1,517,760	$ —	$ —	$ —	$1,517,760
Equity Awards	—	—	—	152,855	152,855	152,855
Supplemental Executive Retirement Plan 2011	—	279,851	279,851	279,851	279,851	995,595
Supplemental Executive Retirement Plan 2014	—	160,178	160,178	160,178	160,178	879,015
Salary Continuation Agreement 2003	—	855,990	855,990	1,111,680	1,111,680	1,111,680
Salary Continuation Agreement 2006	—	214,875	214,875	214,875	271,500	207,195

	Termination for cause	Termination without cause	Voluntary Termination by Executive	Disability	Death	Change in Control
Todd L. Capitani						
Employment Agreement	$ —	$ 787,600	$ —	$ —	$ —	$ 787,600
Equity Awards	—	—	—	118,079	118,079	118,079
Supplemental Executive Retirement Plan 2011	—	100,041	100,041	100,041	100,041	955,185
Supplemental Executive Retirement Plan 2014	—	79,214	79,214	79,214	79,214	1,365,480
James M. Burke						
Employment Agreement	$ —	$ 842,900	$ —	$ —	$ —	$ 842,900
Equity Awards	—	—	—	119,534	119,534	119,534
Supplemental Executive Retirement Plan 2011	—	83,053	83,053	83,053	83,053	963,840
Supplemental Executive Retirement Plan 2014	—	9,295	9,295	9,295	9,295	197,670
Salary Continuation Agreement 2006	—	941,190	941,190	941,190	1,515,000	711,180
Gregory C. Cockerham						
Employment Agreement	$ —	$ 812,400	$ —	$ —	$ —	$ 812,400
Equity Awards	—	—	—	119,534	119,534	119,534
Supplemental Executive Retirement Plan 2011	—	79,700	79,700	79,700	79,700	157,260
Supplemental Executive Retirement Plan 2014	—	16,220	16,220	16,220	16,220	39,045
Salary Continuation Agreement 2003	—	1,029,345	1,029,345	1,083,525	1,083,525	1,083,525
Salary Continuation Agreement 2006	—	66,300	66,300	66,300	72,000	66,525
James F. Di Misa						
Employment Agreement	$ —	$ 812,400	$ —	$ —	$ —	$ 812,400
Equity Awards	—	—	—	119,534	119,534	119,534
Supplemental Executive Retirement Plan 2011	—	145,364	145,364	145,364	145,364	622,875
Supplemental Executive Retirement Plan 2014	—	18,579	18,579	18,579	18,579	127,425
Salary Continuation Agreement 2006	—	728,160	728,160	728,160	780,000	698,565

OTHER INFORMATION RELATING TO DIRECTORS AND EXECUTIVE OFFICERS

Section 16(a) Beneficial Ownership Reporting Compliance. Pursuant to federal securities laws, the Company's officers, directors and persons who own more than 10% of the outstanding common stock are required to file reports detailing their ownership and changes of ownership in such common stock, and to furnish the Company with copies of all such reports. Based solely on its review of the copies of such reports received during the past fiscal year and written representations from such persons that no additional reports of changes in beneficial ownership were required, the Company believes that during 2017, all of its officers, directors and all of its stockholders owning in excess of 10% of the outstanding common stock of the Company, have complied with the reporting requirements with the exception of Joseph V. Stone, Jr. who filed one late report with respect to the exercise of stock options.

Policies and Procedures for Approval of Related Persons Transactions. We maintain a written policy and set of procedures for the review and approval or ratification of transactions involving related persons. Under the policy, related persons consist of directors, director nominees, executive officers, persons or entities known to us to be the beneficial owner of more than five percent of any outstanding class of the voting securities of the Company, or immediate family members or certain affiliated entities of any of the foregoing persons.

Transactions covered by the policy consist of any financial transaction, arrangement or relationship or series of similar transactions, arrangements or relationships, in which:

- the aggregate amount involved will or may be expected to exceed $50,000 in any calendar year;
- the Company is, will or may be expected to be a participant; and
- any related person has or will have a direct or indirect material interest.

The policy excludes certain transactions, including:

- any compensation paid to an executive officer of the Company if the Governance Committee of the Board approved (or recommended that the Board approve) such compensation;
- any compensation paid to a director of the Company if the Board or an authorized committee of the Board approved such compensation; and
- any transaction with a related person involving consumer and investor financial products and services provided in the ordinary course of the Company's business and on substantially the same terms as those prevailing at the time for comparable services provided to unrelated third parties or to the Company's employees on a broad basis (and, in the case of loans, in compliance with the Sarbanes-Oxley Act of 2002).

Related person transactions will be approved or ratified by the Audit Committee. In determining whether to approve or ratify a related person transaction, the Audit Committee will consider all relevant factors, including:

- whether the terms of the proposed transaction are at least as favorable to the Company as those that might be achieved with an unaffiliated third party;
- the size of the transaction and the amount of consideration payable to the related person;
- the nature of the interest of the related person;
- whether the transaction may involve a conflict of interest; and
- whether the transaction involves the provision of goods and services to the Company that are available from unaffiliated third parties.

A member of the Audit Committee who has an interest in the transaction will abstain from voting on approval of the transaction, but may, if so requested by the chair of the Audit Committee, participate in some or all of the discussion.

Relationships and Transactions with the Company and the Bank. The Sarbanes-Oxley Act of 2002 generally prohibits loans by the Company to its executive officers and directors. However, the Sarbanes-Oxley Act contains a specific exemption from such prohibition for loans by the Bank to its executive officers and directors in compliance with federal banking regulations. Federal regulations require that all loans or extensions of credit to executive officers and directors of insured financial institutions must be made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons not related to the Bank and must not involve more than the normal risk of repayment or present other unfavorable features. The Bank is therefore prohibited from making any new loans or extensions of credit to executive officers and directors at different rates or terms than those offered to the general public. Notwithstanding this rule, federal regulations permit the Bank to make loans to executive officers and directors at reduced interest rates if the loan is made under a benefit program generally available to all other employees and does not give preference to any executive officer or director over any other employee. The Bank does not currently have such a program in place. From time to time, the Bank makes loans and extensions of credit to its executive officers and directors, and members of their immediate families. The outstanding loans made to our directors and executive officers, and members of their immediate families, were made in the ordinary course of business, were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with persons not related to the Bank, and did not involve more than the normal risk of collectibility or present other unfavorable features. As of December 31, 2017**,** these loans were performing according to their original terms.

In accordance with banking regulations, the Board of Directors reviews all loans made to a director or executive officer in an amount that, when aggregated with the amount of all other loans to such person and his or her related interests, exceed the greater of $25,000 or 5% of the Company's capital and surplus (up to a maximum of $500,000), and such loan must be approved in advance by a majority of the disinterested members of the Board of Directors.

STOCKHOLDER PROPOSALS AND NOMINATIONS

To be eligible for inclusion in the Company's proxy materials for next year's annual meeting of stockholders, any stockholder proposal to take action at such meeting must be received at the Company's main office at 3035 Leonardtown Road, Waldorf, Maryland 20601 no later than November 29, 2018. If next year's annual meeting is held on a date more than 30 calendar days from May 16, 2019, a stockholder proposal must be received by a reasonable time before the Company begins to print and mail its proxy solicitation materials. Any stockholder proposals will be subject to the requirements of the proxy rules adopted by the Securities and Exchange Commission.

Stockholder proposals, other than those submitted above, and nominations must be submitted in writing, delivered or mailed by first class United States mail, postage pre-paid, to the Secretary of the Company not fewer than 30 days nor more than 60 days before any such meeting; provided, however, that if notice or public disclosure of the meeting is given fewer than 40 days before the meeting, such written notice shall be delivered or mailed to the Secretary of the Company not later than the close of the 10^{th} day following the day on which notice of the meeting was mailed to stockholders.

BOARD POLICIES REGARDING COMMUNICATIONS WITH THE BOARD OF DIRECTORS

The Board of Directors maintains a process for stockholders to communicate with the Board of Directors. Stockholders wishing to communicate with the Board of Directors should send any communication to the Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601. Any communication must state the number of shares beneficially owned by the stockholder making the communication. The Secretary will forward such communication to the full Board of Directors or to any individual director or directors to whom the communication is addressed unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case the Secretary has the authority to discard the communication or take appropriate legal action regarding the communication.

MISCELLANEOUS

The Company will pay the cost of this proxy solicitation. The Company will reimburse brokerage firms and other custodians, nominees and fiduciaries for reasonable expenses incurred by them in sending proxy materials to the beneficial owners of the common stock. In addition to conducting solicitations by mail, directors, officers and regular employees of the Company may solicit proxies personally or by telephone without additional compensation.

The Company's 2017 Annual Report to Stockholders, including financial statements, accompanies this proxy statement. Such Annual Report is not to be treated as a part of the proxy solicitation material nor as having been incorporated herein by reference. **A copy of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, as filed with the Securities and Exchange Commission, will be furnished without charge to stockholders as of March 19, 2018 upon written request to the Secretary, The Community Financial Corporation, 3035 Leonardtown Road, Waldorf, Maryland 20601.**

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-K

(Mark One)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2017

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission File No. **001-36094**

The Community Financial Corporation

(Exact name of registrant as specified in its charter)

Maryland	**52-1652138**
(State of other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3035 Leonardtown Road, Waldorf, Maryland	**20601**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(301) 645-5601**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	The NASDAQ Stock Market, LLC

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large Accelerated Filer ☐	Accelerated Filer ☒
Non-Accelerated Filer ☐	Smaller Reporting Company ☐
Emerging growth company ☐	

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.) Yes ☐ No ☒

The aggregate market value of voting stock held by non-affiliates of the registrant was approximately $148.0 million based on the closing price $38.50 per share at which the common stock was sold on the last business day of the Company's most recently completed second fiscal quarter. For purposes of this calculation only, the shares held by directors, executive officers and the Company's Employee Stock Ownership Plan of the registrant are deemed to be shares held by affiliates.

Number of shares of common stock outstanding as of March 2, 2018: 5,567,505

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2018 Annual Meeting of Stockholders. (Part III)

INDEX

PART I

This report contains certain "forward-looking statements" within the meaning of the federal securities laws. These statements are not historical facts, rather statements based on The Community Financial Corporation's current expectations regarding its business strategies, intended results and future performance. Forward-looking statements are preceded by terms such as "expects," "believes," "anticipates," "intends" and similar expressions.

Management's ability to predict results or the effect of future plans or strategies is inherently uncertain. Factors that could affect actual results include interest rate trends, the general economic climate in the market area in which The Community Financial Corporation operates, as well as nationwide, The Community Financial Corporation's ability to control costs and expenses, competitive products and pricing, changes in accounting principles, loan demand, loan delinquency rates, charge-offs, changes in federal and state legislation and regulation and effectively manage the risks the Company faces, including credit, operational and cyber security risks. These factors should be considered in evaluating the forward-looking statements and undue reliance should not be placed on such statements. The Community Financial Corporation assumes no obligation to update any forward-looking statement after the date of the statements or to reflect the occurrence of anticipated or unanticipated events.

Item 1. Business

Business

The Community Financial Corporation (the "Company') is a bank holding company organized in 1989 under the laws of the State of Maryland. It owns all the outstanding shares of capital stock of Community Bank of the Chesapeake (the "Bank"), a Maryland-chartered commercial bank. The Bank was organized in 1950 as Tri-County Building and Loan Association of Waldorf, a mutual savings and loan association, and in 1986 converted to a federal stock savings bank and adopted the name Tri-County Federal Savings Bank. In 1997, the Bank converted to a Maryland-chartered commercial bank and adopted the name Community Bank of Tri-County. Effective October 18, 2013, Community Bank changed its name to become Community Bank of the Chesapeake.

The Company engages in no significant activity other than holding the stock of the Bank and operating the business of the Bank. Accordingly, the information set forth in this 10-K, including financial statements and related data, relates primarily to the Bank and its subsidiaries.

The Bank maintains its main office and operations center in Waldorf, Maryland, in addition to its branch offices in Lexington Park, Leonardtown, La Plata, Dunkirk, Bryans Road, Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland; and downtown Fredericksburg, Virginia. The Company closed its Central Park Fredericksburg branch during the third quarter of 2017. This location continues to serve as a loan production office and the branch closure did not have a material effect on operations. During the third quarter of 2015, the Company agreed to sell its King George, Virginia branch building and equipment and the transaction closed on January 28, 2016. In addition, the Bank maintains five loan production offices ("LPOs") in La Plata, Prince Frederick, Leonardtown and Annapolis, Maryland and Central Park in Fredericksburg, Virginia. The Leonardtown LPO is co-located with the branch.

On January 1, 2018, the Company completed its previously announced merger of County First Bank ("County First") with and into the Bank, with the Bank as the surviving bank (the "Merger") pursuant to the Agreement and Plan of Merger, dated as of July 31, 2017, by and among the Company, the Bank and County First. County First had five branch offices in La Plata, Waldorf, New Market, Prince Frederick and California, Maryland. The Bank intends to keep the La Plata branch open and consolidate the remaining four branches with legacy Community Bank of the Chesapeake branch offices in May of 2018.

As of December 31, 2017, the Bank operated 15 automated teller machines which includes four stand-alone locations. The Bank offers telephone and internet banking services. The Bank is engaged in the commercial and retail banking business as authorized by the banking statutes of the States of Maryland and Virginia and applicable federal regulations, including the acceptance of deposits, and the origination of loans to individuals, associations, partnerships and corporations. The Bank's real estate loan portfolio consists of commercial mortgage loans, residential first and second mortgage loans and home equity lines of credit. Commercial lending consists of both secured and unsecured loans. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (''FDIC''), the Bank's primary federal regulator.

Market Area

The Bank considers its principal lending and deposit market area to consist of the tri-county area in Southern Maryland and the greater Fredericksburg market in Virginia. As a result of the Bank's expansion into the greater Fredericksburg market in 2013, Stafford County has become part of the Bank's principal lending and deposit market area. The Annapolis LPO opening in October 2014 provided additional market expansion opportunities in 2015. Our market area is one of the fastest growing regions in the country and is home to a mix of federal facilities, industrial and high-tech businesses.

The presence of several major federal facilities located within the Bank's footprint and in adjoining counties contribute to economic growth. Major federal facilities include the Patuxent River Naval Air Station in St. Mary's County, the Indian Head Division, Naval Surface Warfare Center in Charles County and the Naval Surface Warfare — Naval Support Facility in King George County. In addition, there are several major federal facilities located in adjoining markets including Andrews Air Force Base and Defense Intelligence Agency & Defense Intelligence Analysis Center in Prince Georges County, Maryland and the U.S. Marine Base Quantico, Drug Enforcement Administration Quantico facility and Federal Bureau of Investigation Quantico facility in Prince William County, Virginia. These facilities directly employ thousands of local employees and serve as an important player in the region's overall economic health.

The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector. Calvert County is home to the Dominion Power Cove Point Liquid Natural Gas Terminal, which is one of the nation's largest liquefied natural gas terminals and Dominion Power is currently constructing liquefaction facilities for exporting liquefied natural gas. Based on information from the U.S. Bureau of Labor Statistics, unemployment rates in the Company's footprint have historically remained well below the national average.

The Bank expanded into the greater Fredericksburg, Virginia market in August 2013. According to the Fredericksburg Regional Alliance, the Fredericksburg Region, including the City of Fredericksburg and the counties of Caroline, King George, Spotsylvania, and Stafford, Virginia, has been the fastest growing region in the Commonwealth of Virginia for the last five years.

The Bank's primary market areas also boast a strong median household income. According to SNL Financial, the median household income in our market area is $97,000 compared to $61,000 for the United States. According to SNL Financial, the Bank's market areas have strong demographics with below average unemployment rates. The Bank's primary market areas have unemployment rates below 3.6% with projected population growth in excess of 4.25% over the next five years.

Competition

The Bank faces strong competition in the attraction of deposits and in the origination of loans. Its most direct competition for deposits and loans comes from other banks and federal and state credit unions located in its primary market area. There are more than 25 FDIC-insured depository institutions as well as several large credit unions operating in the Bank's footprint including several large regional and national bank holding companies. The Bank also faces additional significant competition for customers' funds from mutual funds, brokerage firms, online Banks, and other financial service companies. The Bank competes for loans by providing competitive rates and flexibility of terms and service, including customer access to senior decision makers. It competes for deposits by offering depositors a wide variety of account types, convenient office locations and competitive rates. Other services offered include tax deferred retirement programs, brokerage services through an affiliation with Community Wealth Advisors, cash management services and safe deposit boxes. The Bank has used targeted direct mail, print and online advertising and community outreach to increase its market share of deposits, loans and other services in its market area. It provides ongoing training for its staff in an attempt to ensure high-quality service.

Lending Activities

General

The Bank offers a wide variety of real estate and commercial loans. The Bank's lending activities include commercial real estate loans, loans secured by residential rental property, construction loans, land acquisition and development loans, equipment financing, commercial and consumer loans. The Company exited the origination of owner-occupied residential mortgages in April 2015 and has established third party sources to supply its residential whole loan portfolio. Most of the Bank's customers are residents of or businesses located in the Bank's market area. The Bank's primary targets for commercial loans consist of small and medium-sized businesses with revenues of $5.0 million to $35.0 million as well as not-for-profits in Southern Maryland, the Annapolis area of Maryland and the greater Fredericksburg area of Virginia.

Commercial Real Estate (CRE) and Other Non-Residential Real Estate Loans

The permanent financing of commercial and other improved real estate projects, including office buildings, retail locations, churches, and other special purpose buildings, is the largest component of the Bank's loan portfolio. Commercial real estate loans amounted to $727.3 million or 63.3% of the loan portfolio and $667.1 million or 61.3% of the loan portfolio, respectively at December 31, 2017 and 2016. This portfolio has increased in both absolute size and as a percentage of the loan portfolio in each of the last six years. The CRE portfolio includes commercial construction balances. At December 31, 2017 and 2016, commercial construction balances were $44.8 million or 6.2% and $62.1 million or 9.3%, respectively, of the CRE portfolio.

The primary security on a commercial real estate loan is the real property and the leases or businesses that produce income for the real property. The Bank generally limits its exposure to a single borrower to 15% of the Bank's capital and participates with other lenders on larger projects. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price and have an initial contractual loan amortization period ranging from three to 20 years. Interest rates and payments on these loans typically adjust after an initial fixed-rate period, which is generally between three and ten years. Interest rates and payments on adjustable-rate loans are adjusted to a rate based on the United States Treasury Bill Index. Almost all the Bank's commercial real estate loans are secured by real estate located in the Bank's primary market area. At December 31, 2017 and 2016, the largest outstanding commercial real estate loans were $21.8 million and $12.8 million, respectively, which were secured by commercial real estate and performing according to their terms.

Loans secured by commercial real estate are larger and involve greater risks than one- to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation of the business or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. As a result of the greater emphasis that the Bank places on increasing its portfolio of commercial real estate loans, the Bank is increasingly exposed to the risks posed by this type of lending. To monitor cash flows on income properties, the Bank requires borrowers and loan guarantors, if any, to provide annual financial statements on multi-family or commercial real estate loans. In reaching a decision on whether to make a commercial real estate loan, the Bank considers the net operating income of the property, the borrower's expertise, credit history and profitability, and the value of the underlying property, as well as the borrower's global cash flows.

If a determination is made that there is a potential environmental hazard, the Bank will complete an Environmental Assessment Checklist. If this checklist or the appraisal indicates potential issues, a Phase 1 environmental survey will generally be required.

Residential First Mortgage Loans

Residential first mortgage loans are generally long-term loans, amortized on a monthly or bi-weekly basis, with principal and interest due each payment. These loans are secured by owner-occupied single-family homes. The initial contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank's experience indicates that residential real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty.

The Company stopped underwriting owner-occupied residential first mortgages in April 2015 and established third party sources to fund its residential whole loan portfolio. The third-party sources allow the Company to maintain a well-diversified residential portfolio while addressing the credit needs of the communities in its footprint. The Bank's practice has been to purchase individual residential first mortgage loans as well as purchase the right to service the loans acquired.

Total fixed-rate loans in our residential first mortgage portfolio amounted to $113.4 million and $125.4 million, respectively, as of December 31, 2017 and 2016. Fixed-rate loans may be packaged and sold to investors or retained in the Bank's loan portfolio. The Bank generally retains the right to service loans sold for a payment based upon a percentage (generally 0.25% of the outstanding loan balance). As of December 31, 2017 and 2016, the Bank serviced $43.7 million and $52.0 million, respectively, in residential mortgage loans for others.

Adjustable mortgages are generally adjustable on a one-, three- and five-year terms with limitations on upward adjustments per re-pricing period and an upward cap over the life of the loan. As of December 31, 2017 and 2016, the Bank had $59.9 million and $45.6 million, respectively, in adjustable-rate residential mortgage loans. At December 31, 2017 and 2016, the largest outstanding residential first mortgage loans were $2.1 million and $2.2 million, respectively, which were secured by residences located in the Bank's market area. The loans were performing according to terms.

Residential first mortgage loans with loan-to-value ratios in excess of 80% generally carry private mortgage insurance to lower the Bank's exposure to approximately 80% of the value of the property. The Bank had fewer than 10 loans with private mortgage insurance at December 31, 2017 and 2016.

All improved real estate that serves as security for a loan made by the Bank must be insured, in the amount and by such companies as may be approved by the Bank, against fire, vandalism, malicious mischief and other hazards. Such insurance must be maintained through the entire term of the loan and in an amount not less than that amount necessary to pay the Bank's indebtedness in full.

Longer-term fixed-rate and adjustable-rate residential mortgage loans are subject to greater interest-rate risk due to term and annual and lifetime limitations on interest rate adjustments that limit the increases in interest rates on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower.

Residential Rentals

Residential rental mortgage loans are amortizing, with principal and interest due each month. These loans are non-owner occupied and secured by income-producing 1-4 family units and apartments. The Bank originates both fixed-rate and adjustable-rate residential rental first mortgages. Loans secured by residential rental properties are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years. The primary security on a residential rental loan is the property and the leases that produce income.

Total fixed-rate loans in our residential rental first mortgage portfolio amounted to $16.8 million and $17.9 million, respectively, as of December 31, 2017 and 2016. As of December 31, 2017 and 2016, the Bank had $93.4 million and $84.0 million, respectively, in adjustable-rate residential rental mortgage loans. As of December 31, 2017 and 2016, $85.0 million and $84.9 million, respectively, were 1 – 4 family units and $25.2 million and $17.0 million, respectively, were apartment buildings.

At December 31, 2017 and 2016, the largest outstanding residential rental mortgage loan was $10.2 million and $10.5 million, respectively, which was secured by over 120 single family homes located in the Bank's market area. The loan was performing according to its terms at December 31, 2017 and 2016.

Loans secured by residential rental properties involve greater risks than 1 – 4 family residential mortgage loans. Although, there are similar risk characteristics shared with commercial real estate loans, the balances for the loans secured by residential rental properties are generally smaller. Because payments on loans secured by residential rental properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the rental real estate market or the economy than similar owner occupied properties.

Construction and Land Development Loans

The Bank offers construction loans for the construction of one- to four-family dwellings to home builders. Construction loans totaled $8.8 million and $12.1 million, respectively, at December 31, 2017 and 2016. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. Draws are made upon satisfactory completion of predefined stages of construction. The Bank will typically lend up to 80% of the lower of appraised value or the contract purchase price of the homes to be constructed. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building by individuals. Land acquisition and development loans totaled $19.1 million and $24.9 million, respectively, at December 31, 2017 and 2016. Bank policy requires that zoning and permits must be in place prior to making development loans. The Bank will typically lend up to the lower of 75% of the appraised value or cost. At December 31, 2017 and 2016, the largest outstanding construction and land development loans were $3.5 million and $4.9 million, respectively, which were secured by land in the Bank's market area.

The Bank's ability to originate residential construction and development loans is heavily dependent on the continued demand for single-family housing construction in the Bank's market area. The Bank's investment in these loans has declined in recent years. Construction and land development loans as a percentage of the total loan portfolio have been decreasing since 2008 from greater than 10% as of December 31, 2008 to 2.4% at December 31, 2017. If the demand for new houses being built from smaller builders in the Bank's market areas continues to decline, this portion of the loan portfolio may continue to decline. In addition, a decline in demand for new housing might adversely affect the ability of borrowers to repay these loans.

Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market makes it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of completed value proves to be inaccurate, the Bank may be confronted, at or before the maturity of the loan, with a project having a value that is insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, the Bank may not be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. Home equity loans, which totaled $20.0 million and $19.7 million, respectively at December 31, 2017 and 2016, are generally made in the form of lines of credit with minimum amounts of $5,000, have terms of up to 20 years, variable rates priced at the then current Wall Street Journal prime rate plus a margin, and require an 80% or 90% loan-to-value ratio (including any prior liens), depending on the specific loan program. Second mortgage loans, which totaled $1.4 million and $1.7 million, respectively at December 31, 2017 and 2016, are fixed or variable-rate loans that have original terms between five and 15 years. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk is heightened as the market value of residential property has not fully returned to pre-financial crisis levels and interest rates began to increase in 2017.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. The portfolio consists primarily of demand loans and lines of credit. Such loans can be made for terms of up to five years. However, most of the loans are originated for a term of two years or less. The Bank offers both fixed-rate and adjustable-rate loans (typically tied to the then current Wall Street Journal prime rate plus a margin with a floor) under these product lines. Commercial loans remain an important class of the Bank's loan portfolio. At $56.4 million and 4.9% of total loans and $50.5 million and 4.6% of total loans at December 31, 2017 and 2016, respectively, the commercial loan portfolio increased a modest $5.9 million compared to the prior year end balance.

When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business as well the borrower's global cash flows, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower's ability to service the debt. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank. The higher interest rates and shorter loan terms available on commercial lending make these products attractive to the Bank.

Commercial business loans entail greater risk than residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral would make full recovery from the sale of collateral unlikely. The Bank controls these risks by establishing guidelines that provide for loans with low loan-to-value ratios. At December 31, 2017 and 2016, the largest outstanding commercial loans were $4.4 million and $4.0 million, respectively, which was secured by commercial real estate (all of which were located in the Bank's market area), cash and investments. These loans were performing according to terms at December 31, 2017 and 2016.

Consumer Loans

The Bank has consumer loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans totaled $573,000 and $422,000, respectively, at December 31, 2017 and 2016. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

The Bank also maintains an amortizing commercial portfolio consisting primarily of commercial equipment loans. Commercial equipment loans totaled $35.9 million and $39.7 million, or 3.1% and 3.7% of the total loan portfolio, respectively, at December 31, 2017 and 2016. These loans consist primarily of fixed-rate, short-term loans collateralized by customers' equipment including trucks, cars, construction and other more specialized equipment. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. The higher interest rates and shorter loan terms available on commercial equipment lending make these products attractive to the Bank. These loans entail greater risk than loans such as residential mortgage loans. Unlike residential mortgage loans, which generally are made on the basis of the borrower's ability to make repayment from his or her employment or other income and which are secured by real property whose value tends to be more easily ascertainable, commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic. The Bank assesses the amount of collateral required for a loan based upon the credit worthiness of the borrowers.

Loan Portfolio Analysis

Set forth below is selected data relating to the composition of the Bank's loan portfolio by type of loan on the dates indicated.

	At December 31,									
	2017		2016		2015		2014		2013	
(dollars in thousands)	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Commercial real estate	$ 727,314	63.25%	$ 667,105	61.25%	$538,888	58.64%	$485,601	55.68%	$476,648	58.97%
Residential first mtgs.	170,374	14.81%	171,004	15.70%	131,401	14.30%	146,539	16.80%	159,147	19.69%
Residential rentals[1]	110,228	9.58%	101,897	9.36%	93,157	10.14%	81,777	9.38%	—	
Construction and land dev.	27,871	2.42%	36,934	3.39%	36,189	3.94%	36,370	4.17%	32,001	3.96%
Home equity and second mtgs.	21,351	1.86%	21,399	1.97%	21,716	2.36%	21,452	2.46%	21,692	2.68%
Commercial loans	56,417	4.91%	50,484	4.64%	67,246	7.32%	73,625	8.44%	94,176	11.65%
Consumer loans	573	0.05%	422	0.04%	366	0.04%	613	0.07%	838	0.10%
Commercial equipment	35,916	3.12%	39,737	3.65%	29,931	3.26%	26,152	3.00%	23,738	2.94%
Total Loans	1,150,044	100.00%	1,088,982	100.00%	918,894	100.00%	872,129	100.00%	808,240	100.00%
Deferred loan fees and premiums	(1,086)		(397)		1,154		1,239		972	
Allowance for loan losses	10,515		9,860		8,540		8,481		8,138	
Loans receivable, net	$1,140,615		$1,079,519		$909,200		$862,409		$799,130	

(1) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. See Note 6 of the Consolidated Financial Statements for more information. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2016, 2015 and 2014.

The following table sets forth for the periods indicated the average balances outstanding and average interest yields for each major category of loans.

	For the Years Ended December 31,									
	2017		2016		2015		2014		2013	
dollars in thousands	Average Balance	Average Yield	Average Balance	Average Yield	Average Balance	Average Yield	Average Balance	Average Yield	Average Balance	Average Yield
Commercial real estate	$ 699,349	4.42%	$602,648	4.50%	$518,329	4.64%	$460,014	4.84%	$434,889	5.08%
Residential first mortgages	176,186	3.77%	151,366	3.99%	134,728	4.35%	148,367	4.43%	169,671	4.68%
Residential rentals[1]	106,000	4.62%	96,611	4.69%	88,251	4.63%	75,104	4.65%	—	
Construction and land development	33,798	4.96%	36,938	4.58%	37,665	4.99%	29,921	4.68%	27,065	4.75%
Home equity and second mortgages	21,515	4.38%	21,781	4.08%	21,332	4.09%	21,426	4.21%	21,647	4.33%
Commercial and equipment loans[2]	86,871	5.21%	87,705	5.27%	81,957	5.61%	92,199	5.21%	95,316	5.11%
Consumer loans	477	7.76%	397	8.56%	465	8.82%	701	7.99%	954	7.23%
Allowance for loan losses	(10,374)	n/a	(9,157)	n/a	(8,541)	n/a	(8,351)	n/a	(8,173)	n/a
Net Average Loans	**$1,113,822**	**4.45%**	**$988,289**	**4.55%**	**$874,186**	**4.73%**	**$819,381**	**4.82%**	**$741,369**	**5.02%**

(1) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. See Note 6 of the Consolidated Financial Statements for more information. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2016, 2015 and 2014.

(2) Includes both commercial loans and commercial equipment loans.

Loan Originations, Purchases and Sales

The Bank solicits loan applications through marketing by commercial loan officers, its branch network, and referrals from customers. Loans are processed and approved according to guidelines established by the Bank. Loan requirements such as income verification, collateral appraisal, and credit reports vary by loan type. Additionally, residential mortgages are purchased from third party providers after reviewing loan documents, underwriting support, and completing other procedures, as necessary. During the years ended December 31, 2017 and 2016, the Bank purchased residential first mortgages of $25.5 million and $64.2 million, respectively

Loan processing functions are generally centralized except for small consumer loans. Depending on market conditions, residential mortgage loans may be classified with the intent to sell to third parties such as FHLMC. The Company sold no residential mortgage loans for the years ended December 31, 2017 and 2016. Residential mortgage loans in the amounts of $4.2 million were sold by the Bank for the years ended December 31, 2015. During the year ended December 31, 2017, the Company sold the guaranteed portion of a U.S. Small Business Administration (''SBA'') Loan for proceeds of $2.8 million and recognized a gain of $294,000.

To comply with internal and regulatory limits on loans to one borrower, the Bank may sell portions of commercial and commercial real estate loans to other lenders. In 2017, the Bank sold no other CRE participations except for the SBA guaranteed position of $2.8 million. CRE participations sold were $3.0 million in 2016 and $1.5 million in 2015. The Bank may also buy loans, portions of loans, or participation certificates from other lenders to limit overall exposure and to ensure that all participants remain below internal and regulatory limits. The Bank only purchases loans or portions of loans after reviewing loan documents, underwriting support, and completing other procedures, as necessary. The Bank participated in a commercial real estate commercial construction project during 2017 with $1.6 million advanced and outstanding at December 31, 2017 of a $4.5 million commitment. The Bank purchased no other commercial real estate or commercial loans during 2017, 2016 and 2015. Purchased participation loans are subject to the same regulatory and internal policy requirements as other loans in the Bank's portfolio as described below.

Loan Approvals, Procedures and Authority

Loan approval authority is established by Board policy. The Officer's Loan Committee (OLC) consists of the following members of the Bank's executive management; the Chief Executive Officer (''CEO''), President and Chief Risk Officer (''CRO''), Chief Operating Officer (''COO'') and the Chief Lending Officer (''CLO''). In addition, the OLC includes the Senior Credit Officer (''SCO'') and Senior Loan Officers (''SLO's''). The OLC must have three (3) members of Executive Management approve all loans presented above individual loan authorities granted to the SCO and the SLOs. The SCO and the SLOs have been granted individual loan authority up to $1.0 million. Loan approval authorities vary by individual. The individual lending authority of the other lenders is set by management and is based on their individual abilities.

All loans and loan relationships that exceed the Bank's in-house lending limit are required to be approved by at least three (3) members of the Bank's Credit Risk Committee (''CRC''). In addition, the Board of Directors or the CRC approve all loans required to be approved by regulation, such as Regulation O loans or commercial loans to employees. The in-house lending guideline is approved by the Board on an annual basis or as needed if more frequently and is less than the Bank's legal lending limit.

Depending on the loan and collateral type, conditions for protecting the Bank's collateral are specified in the loan documents. Typically, these conditions might include requirements to maintain hazard and title insurance and to pay property taxes.

The Credit Risk Committee of the Board, consisting of three or more directors, assists the Board in its oversight responsibilities. The Committee reviews the Bank's credit risk management, including the significant policies, procedures and practices employed to manage credit risk, and provides recommendations to the Board and strategic guidance to management on the assumption, management and mitigation of credit risk.

Loans to One Borrower

Under Maryland law, the maximum amount that the Bank is permitted to lend to any one borrower and his or her related interests may generally not exceed 10% of the Bank's unimpaired capital and surplus, which is defined to include the Bank's capital, surplus, retained earnings and 50% of its reserve for possible loan losses. Under this authority, the Bank would have been permitted to lend up to $14.4 million and $14.1 million, respectively, to any one borrower at December 31, 2017 and 2016. By interpretive ruling of the Maryland Commissioner, Maryland banks have the option of lending up to the amount that would be permissible for a national bank, which is generally 15% of unimpaired capital and surplus (defined to include a bank's total capital for regulatory capital purposes plus any loan loss allowances not included in regulatory capital). Under this formula, the Bank would have been permitted to lend up to $22.4 million and $21.9 million, respectively, to any one borrower at December 31, 2017 and 2016. At December 31, 2017 and 2016, the largest amount outstanding to any one borrower and borrower's related interests was $21.8 million and $12.8 million, respectively.

Loan Commitments

The Bank does not normally negotiate standby commitments for the construction and purchase of real estate. The Bank's outstanding commitments to originate loans at December 31, 2017 and 2016 were approximately $63.5 million and $67.0 million, respectively, excluding undisbursed portions of loans in process. It has been the Bank's experience that few commitments expire unfunded.

Maturity of Loan Portfolio

See Note 6 of the Consolidated Financial Statements for information regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity as of December 31, 2017 and 2016. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less.

Asset Classification

Federal regulations and our policies require that we utilize an internal asset classification system as a means of reporting on asset quality. We use an internal asset classification system, substantially consistent with Federal banking regulations, as a part of our credit monitoring system. Federal banking regulations set forth a classification scheme for problem and potential problem assets as ''substandard,'' ''doubtful'' or ''loss'' assets. An asset is considered ''substandard'' if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. ''Substandard'' assets include those characterized by the ''distinct possibility'' that the insured institution will sustain ''some loss'' if the deficiencies are not corrected. Assets classified as ''doubtful'' have all of the weaknesses inherent in those classified ''substandard'' with the added characteristic that the weaknesses present make ''collection or liquidation in full,'' on the basis of currently existing facts, conditions, and values, ''highly questionable and improbable.'' Assets classified as ''loss'' are those considered ''uncollectible'' and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted. Assets that do not currently expose the insured institution to sufficient risk to warrant classification in one of these categories but possess weaknesses are required to be designated ''special mention.''

When an insured institution classifies assets as ''substandard'' or ''doubtful,'' it is required that a specific valuation allowance for loan losses be established in an amount deemed prudent by management. When an insured institution classifies assets as ''loss,'' it is required either to establish a specific allowance for losses equal to 100% of the amount of the asset so classified or to charge off such amount.

The table below sets forth information on our classified assets and assets designated special mention at the dates indicated. Classified and special mention assets include loans, securities and other real estate owned.

(dollars in thousands)	December 31, 2017	December 31, 2016	December 31, 2015	December 31, 2014	December 31, 2013
Classified assets					
Substandard	$50,298	$39,109	$42,485	$54,022	$56,880
Doubtful	—	137	861	—	—
Loss	—	—	—	—	—
Total classified assets	50,298	39,246	43,346	54,022	56,880
Special mention assets	96	—	1,642	5,460	9,246
	$50,394	$39,246	$44,988	$59,482	$66,126

Delinquencies

The Bank's collection procedures provide that when a loan is 15 days delinquent, the borrower is contacted and payment is requested. If the delinquency continues, efforts will be made to contact the delinquent borrower and obtain payment. If these efforts prove unsuccessful, the Bank will pursue appropriate legal action including repossession of the collateral. In certain instances, the Bank will attempt to modify the loan or grant a limited moratorium on loan payments to enable the borrower to reorganize borrower's financial affairs. For an analysis of past due loans as of December 31, 2017 and 2016, respectively, refer to Note 6 in the Consolidated Financial Statements.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. The Bank evaluates substandard classified loans on an individualized basis to determine whether a loan is impaired. Classified doubtful and loss loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructures (''TDRs'') are generally considered impaired (See Notes 1 and 6 of the Consolidated Financial Statements).

Factors considered by management in determining impaired status include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, taking into consideration the circumstances surrounding the loan. These circumstances include the length of the delay, the reasons for the delay, the borrower's payment record and the amount of the shortfall in relation to the principal and interest owed. Loans not impaired are included in the pool of loans evaluated in the general component of the allowance.

If a specific loan is deemed to be impaired it is evaluated for impairment. Impairment is measured on a loan-by-loan basis for commercial and construction loans using one of three acceptable methods: the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. For loans that have an impairment, a specific allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than carrying value of that loan.

The Bank considers all TDRs to be impaired and defines TDRs as loans whose terms have been modified to provide for a reduction or a delay in the payment of either interest or principal because of deterioration in the financial condition of the borrower. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR. Once an obligation has been classified as a TDR it continues to be considered a TDR until paid in full or until the debt is refinanced at market rates with no debt forgiveness. TDRs are evaluated for impairment on a loan-by-loan basis in accordance with the Bank's impairment methodology. The Bank does not participate in any specific government or Bank-sponsored loan modification programs. All restructured loan agreements are individual contracts negotiated with a borrower.

Specific loan loss reserves of $1.0 million and $1.3 million, respectively, related to impaired loans at December 31, 2017 and 2016. The following table sets forth information with respect to the Bank's impaired loans at the dates indicated. The table includes a breakdown between impaired loans with and without an allowance:

	December 31,				
(dollars in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Recorded investment with no allowance	$39,028	$26,436	$35,171	$45,587	$28,220
Recorded investment with allowance	4,226	8,924	4,066	4,122	9,786
Total impaired loans	$43,254	$35,360	$39,237	$49,709	$38,006
Specific allocations of allowance	$ 1,024	$ 1,289	$ 1,608	$ 451	$ 985
Interest income recognized	$ 1,829	$ 1,309	$ 1,366	$ 1,841	$ 1,608

For additional information regarding impaired loans by class at December 31, 2017 and 2016, respectively, refer to Note 6 in the Consolidated Financial Statements.

The Bank closely monitors the payment activity of all its loans. The Bank periodically reviews the adequacy of the allowance for loan losses based on an analysis of the size of and composition of the loan portfolio; the Bank's historical loss experience; trends in delinquency, non-performing, classified loans and charge-offs; as well as economic conditions and the regulatory environment. Loan losses are charged off against the allowance when individual loans are deemed uncollectible. Subsequent recoveries, if any, are credited to the allowance. The Bank believes it has established its existing allowance for loan losses in accordance with accounting principles generally accepted in the United States of America and is in compliance with appropriate regulatory guidelines. However, the establishment of the level of the allowance for loan losses is highly subjective and dependent on incomplete information as to the ultimate disposition of loans. Accordingly, actual losses may vary from the amounts estimated. Additionally, our regulators as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase or decrease the allowance for loan losses, thereby affecting the Bank's financial condition and earnings. For a more complete discussion of the allowance for loan losses, see the section captioned *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies"* and Notes 1 and 6 of the Consolidated Financial Statements.

The following table allocates the allowance for loan losses by loan category at the dates indicated. The allocation of the allowance to each category is not necessarily indicative of future losses and does not restrict the use of the allowance to absorb losses in any category.

	At December 31,									
	2017		**2016**		**2015**		**2014**		**2013**	
(dollars in thousands)	**Amount**	**%(1)**	**Amount**	**%(1)**	**Amount**	**%(1)**	**Amount**	**%(1)**	**Amount**	**%(1)**
Commercial real estate	$ 6,451	63.25%	$5,212	61.25%	$3,465	58.64%	$3,528	55.68%	$3,051	58.97%
Residential first mtgs.	1,144	14.81%	1,406	15.70%	584	14.30%	1,047	16.80%	1,343	19.69%
Residential rentals(2)	512	9.58%	362	9.36%	538	10.14%	593	9.38%	532	
Construction and land dev.	462	2.42%	941	3.39%	1,103	3.94%	1,071	4.17%	584	3.96%
Home equity and second mtgs.	162	1.86%	138	1.97%	142	2.36%	173	2.46%	249	2.68%
Commercial loans	1,013	4.91%	794	4.64%	1,477	7.32%	1,677	8.44%	1,916	11.65%
Consumer loans	7	0.05%	3	0.04%	2	0.04%	3	0.07%	10	0.10%
Commercial equipment	764	3.12%	1,004	3.65%	1,229	3.26%	389	3.00%	453	2.94%
Total allowance for loan losses	$10,515	100.00%	$9,860	100.00%	$8,540	100.00%	$8,481	100.00%	$8,138	100.00%

(1) Percent of loans in each category to total loans

(2) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. See Note 6 of the Consolidated Financial Statements for more information. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2016, 2015 and 2014.

The following table sets forth an analysis of activity in the Bank's allowance for loan losses for the periods indicated.

	At December 31,				
(dollars in thousands)	2017	2016	2015	2014	2013
Balance at beginning of period	$ 9,860	$8,540	$8,481	$8,138	$8,247
Charge-offs:					
Commercial real estate	217	—	78	195	140
Residential first mtgs.	—	—	30	94	348
Residential rentals(1)	42	14	—	155	—
Construction and land dev.	26	526	—	992	36
Home equity and second mtgs.	14	—	100	59	111
Commercial loans	13	594	432	1,134	480
Consumer loans	2	1	—	3	12
Commercial equipment	168	34	818	10	35
Total Charge-offs	482	1,169	1,458	2,642	1,162
Recoveries:					
Commercial real estate	63	58	17	11	—
Residential first mtgs.	—	—	1	186	11
Residential rentals(1)	—	—	—		—
Construction and land dev.	—	1	32	84	1
Home equity and second mtgs.	1	5	—	10	17
Commercial loans	1	18	11	5	23
Consumer loans	—	.	—	11	3
Commercial equipment	62	48	23	25	58
Total Recoveries	127	130	84	332	113
Net Charge-offs	355	1,039	1,374	2,310	1,049
Provision for Loan Losses	1,010	2,359	1,433	2,653	940
Balance at end of period	$10,515	$9,860	$8,540	$8,481	$8,138
Allowance for loan losses to total loans	0.91%	0.91%	0.93%	0.97%	1.01%
Net charge-offs to average loans	0.03%	0.11%	0.16%	0.28%	0.14%

(1) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. See Note 6 of the Consolidated Financial Statements for more information. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at and for the years ended December 31, 2016, 2015 and 2014.

Non-performing Assets

The Bank's non-performing assets include other real estate owned, non-accrual loans and TDRs. Both non-accrual and TDR loans include loans that are paid current and are performing in accordance with the term of their original or modified contract terms. For a detailed discussion on asset quality see the section captioned *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Asset Quality."*

Other Real Estate Owned ("OREO")

Real estate acquired by the Bank as a result of foreclosure or by deed in lieu of foreclosure is classified as foreclosed real estate until such time as it is sold. When such property is acquired, it is recorded at its estimated fair value. Subsequent to foreclosure, the property is carried at the lower of cost or fair value less selling costs. Additional write-downs as well as carrying expenses of the foreclosed properties are charged to expenses in the current period. The Bank had foreclosed real estate with a carrying value of approximately $9.3 million and $7.8 million, respectively at December 31, 2017 and 2016. For a discussion of the accounting for foreclosed real estate, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Critical Accounting Policies — Other Real Estate Owned"* and Notes 1 and 8 in the Consolidated Financial Statements.

Non-accrual Loans

Loans are reviewed on a regular basis and are placed on non-accrual status when the collection of additional interest is doubtful. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Consumer loans are typically charged-off no later than 90 days past due. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Non-accrual loans are evaluated for impaired status on a loan by loan basis in accordance with the Company's impairment methodology.

All interest accrued but not collected from loans that are placed on non-accrual 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 status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. Non-accrual loans include certain loans that are current with all loan payments and are placed on non-accrual status due to customer operating results and cash flows. Interest is recognized on non-accrual loans on a cash-basis if the loans are not impaired or there is no impairment. For a discussion of the accounting for non-accrual loans, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Asset Quality"* and Notes 1 and 6 in the Consolidated Financial Statements.

The following table sets forth information with respect to the Bank's non-performing assets. There were no loans 90 days or more past due that were still accruing interest at the dates indicated.

	December 31,				
(dollars in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Non-accrual loans:					
Commercial real estate	$ 1,987	$ 2,371	$ 2,875	$ 3,824	$ 7,930
Residential first mtgs.	985	623	1,948	533	2,245
Residential rentals(3)	825	577	605	—	—
Construction and land dev.	—	3,048	3,555	3,634	2,968
Home equity and second mtgs.	257	61	48	399	115
Commercial loans	172	1,044	2,054	1,587	1,935
Consumer loans	—	—	—	—	24
Commercial equipment	467	650	348	286	234
Total non-accrual loans(1)	**4,693**	**8,374**	**11,433**	**10,263**	**15,451**
OREO	**9,341**	**7,763**	**9,449**	**5,883**	**6,797**
TDRs:(2)					
Commercial real estate	9,273	9,587	9,839	10,438	3,141
Residential first mtgs.	527	545	881	906	1,485
Residential rentals(3)	221	227	2,058		
Construction and land dev.	729	3,777	4,283	4,376	—
Home equity and second mtgs.	—	872	—	—	—
Commercial loans	4	—	1,384	2,262	—
Commercial equipment	36	113	123	154	67
Total TDRs	10,790	15,121	18,568	18,136	4,693
Total Accrual TDRs	**10,021**	**10,448**	**13,133**	**13,249**	**4,364**
Total non-accrual loans, OREO and Accrual TDRs	**$24,055**	**$26,585**	**$34,015**	**$29,395**	**$26,612**
Interest income due at stated rates, but not recognized on non-accruals	$ 185	$ 1,103	$ 987	$ 845	$ 599
Non-accrual loans to total loans	0.41%	0.77%	1.24%	1.18%	1.91%
Non-accrual loans and Accrual TDRs to total loans(2)	1.28%	1.73%	2.67%	2.70%	2.45%
Non-accrual loans, OREO and Accrual TDRs to total assets(2)	1.71%	1.99%	2.98%	2.71%	2.60%

(1) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer.

(2) TDR loans include both non-accrual and accruing performing loans. All TDR loans are included in the calculation of asset quality financial ratios. Non-accrual TDR loans are included in the non-accrual balance and accruing TDR loans are included in the accruing TDR balance.

(3) Loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios prior to a reclassification in 2016. See Note 6 of the Consolidated Financial Statements for more information. Comparative financial information was reclassified to conform to the classification presented in the Consolidated Financial Statements at December 31, 2016 and 2015.

Investment Activities

The Bank maintains a portfolio of investment securities to provide liquidity as well as a source of earnings. The Bank's investment securities portfolio consists primarily of asset-backed mortgage-backed (''MBS'') and collateralized mortgage obligations (''CMOs'') and other securities issued by U.S. government-sponsored enterprises (''GSEs''), including FNMA and FHLMC. The Bank also has smaller holdings of privately issued mortgage-backed securities, U.S. Treasury obligations, and other equity and debt securities. The Bank is required to maintain investments in the Federal Home Loan Bank based upon levels of borrowings.

The following table sets forth the carrying value of the Company's investment securities portfolio and FHLB of Atlanta and Federal Reserve Bank stock at the dates indicated. HTM securities and FHLB of Atlanta and Federal Reserve Bank stock are carried at amortized cost and AFS securities are carried at fair value. At December 31, 2017, 2016, 2015, 2014 and 2013, their estimated fair value was $173.6 million, $168.3 million, $151.4 million, $133.3 million and $139.9 million, respectively. On April 18, 2016, the Bank terminated its membership in the Federal Reserve System and cancelled its stock in the Federal Reserve Bank of Richmond effective as of that date.

	At December 31,				
(dollars in thousands)	**2017**	**2016**	**2015**	**2014**	**2013**
Asset-backed securities:					
Freddie Mac, Fannie Mae and Ginnie Mae	$135,142	$136,206	$138,267	$119,762	$126,607
U.S. Agencies	21,177	16,889	—	—	—
Other	651	884	1,093	1,472	3,120
Total asset-backed securities	156,970	153,979	139,360	121,234	129,727
Corporate equity securities	37	37	39	40	41
Bond mutual funds	4,507	4,413	4,387	4,321	4,130
Callable GSE Agency Bonds	5,017	3,001	—	—	—
Treasury bills	1,000	850	750	850	750
Total investment securities	167,531	162,280	144,536	126,445	134,648
FHLB and FRB stock	7,276	7,235	6,931	6,434	5,593
Total investment securities and FHLB and FRB stock	$174,807	$169,515	$151,467	$132,879	$140,241

The maturities and weighted average yields for investment securities available for sale ("AFS") and held to maturity ("HTM") at December 31, 2017 and 2016 are shown below.

	One year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years	
December 31, 2017 (dollars in thousands)	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**
AFS Investment securities:								
Asset-backed securities	$ 9,852	2.47%	$28,832	2.46%	$20,358	2.50%	$ 6,369	2.59%
Mutual funds	4,480	1.97%	—	0.00%	—	0.00%	—	0.00%
Total AFS investment securities	$14,332	2.31%	$28,832	2.46%	$20,358	2.50%	$ 6,369	2.59%
HTM Investment securities:								
Asset-backed securities	$18,722	2.57%	$41,433	2.59%	$25,309	2.63%	$12,782	2.64%
U.S. government obligations	1,000	0.00%	—	0.00%	—	0.00%	—	0.00%
Other investments	—	0.00%	—	0.00%	—	0.00%	—	0.00%
Total HTM investment securities	$19,722	2.44%	$41,433	2.59%	$25,309	2.63%	$12,782	2.64%

	One year or Less		After One Through Five Years		After Five Through Ten Years		After Ten Years	
December 31, 2016 (dollars in thousands)	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**	**Amortized Cost**	**Average Yield**
AFS Investment securities:								
Asset-backed securities	$ 7,879	2.17%	$21,481	2.15%	$13,093	2.05%	$ 7,689	1.91%
Mutual funds	4,386	2.01%	—	0.00%	—	0.00%	—	0.00%
Total AFS investment securities	$12,265	2.11%	$21,481	2.15%	$13,093	2.05%	$ 7,689	1.91%
HTM Investment securities:								
Asset-backed securities	$18,844	2.35%	$47,168	2.34%	$29,803	2.29%	$12,582	2.41%
U.S. government obligations	850	0.00%	—	0.00%	—	0.00%	—	0.00%
Other investments	—	0.00%	—	0.00%	—	0.00%	—	0.00%
Total HTM investment securities	$19,694	2.25%	$47,168	2.34%	$29,803	2.29%	$12,582	2.41%

The Bank's investment policy provides that securities that will be held for indefinite periods of time, including securities that will be used as part of the Bank's asset/liability management strategy and that may be sold in response to changes in interest rates, prepayments and similar factors are classified as available for sale and accounted for at fair value. Held to maturity (HTM") securities are reported at amortized cost. HTM securities are classified as such based on management's intent and ability to hold these securities until maturity. Certain of the Company's asset-backed securities are issued by private issuers (defined as an issuer that is not a government or a government-sponsored entity). The Company had no investments in any private issuer's securities that aggregate to more than 10% of the Company's equity. For a discussion of investments see *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Asset Quality"* and Notes 1 and 5 in the Consolidated Financial Statements.

Deposits and Other Sources of Funds

General

The funds needed by the Bank to make loans are primarily generated by deposit accounts solicited from its market area. Total deposits were $1,106.2 million and $1,038.8 million, respectively, as of December 31, 2017 and 2016. The Company uses both traditional brokered deposits and reciprocal brokered deposits. Traditional brokered deposits at December 31, 2017 and December 31, 2016 were $118.9 million and $131.0 million, respectively. Reciprocal brokered deposits at December 31, 2017 and December 31, 2016 were $92.9 million and $70.7 million, respectively. The reciprocal brokered deposits have many characteristics of core deposits and are used to maximize FDIC insurance available to our customers.

Deposits

The Bank's deposit products include savings, money market, demand deposit, IRA, SEP, and time deposit accounts. Variations in service charges, terms and interest rates are used to target specific markets. Ancillary products and services for deposit customers include safe deposit boxes, night depositories, cash vaults, automated clearinghouse transactions, wire transfers, ATMs, online and telephone banking, retail and business mobile banking, remote deposit capture, merchant card services, investment services, positive pay, payroll services, account reconciliation, bill pay, credit cards and lockbox. The Bank is a member of ACCEL, Master Card, Allpoint and Star ATM networks.

The following table sets forth for the periods indicated the average balances outstanding and average interest rates for each major category of deposits.

	For the Years Ended December 31,									
	2017		2016		2015		2014		2013	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$ 53,560	0.05%	$ 48,878	0.08%	$ 44,963	0.10%	$ 40,104	0.10%	$ 37,540	0.10%
Interest-bearing demand and money market accounts	419,817	0.35%	380,592	0.30%	322,717	0.28%	281,960	0.27%	268,832	0.33%
Certificates of deposit	443,181	1.00%	409,621	0.86%	378,179	0.85%	389,641	0.97%	392,675	1.19%
Total interest-bearing deposits	916,558	0.65%	839,091	0.56%	745,859	0.56%	711,705	0.64%	699,047	0.80%
Noninterest-bearing demand deposits	154,225		142,116		120,527		100,783		87,649	
	$1,070,783	0.56%	$981,207	0.48%	$866,386	0.48%	$812,488	0.56%	$786,696	0.71%

The following table indicates the amount of the Bank's certificates of deposit and other time deposits of $100,000 or more and $250,000 or more by time remaining until maturity as of December 31, 2017 and 2016.

	At December 31, 2017	
Time Deposit Maturity Period	$100,000 or More	$250,000 or More
(dollars in thousands)		
Three months or less	$ 88,714	$ 60,383
Three through six months	54,590	37,497
Six through twelve months	99,263	37,605
Over twelve months	78,392	31,989
Total	$320,959	$167,474

	At December 31, 2016	
Time Deposit Maturity Period	$100,000 or More	$250,000 or More
(dollars in thousands)		
Three months or less	$ 86,282	$ 61,832
Three through six months	45,703	23,134
Six through twelve months	87,695	46,476
Over twelve months	67,917	22,415
Total	$287,597	$153,857

For a discussion of deposits, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Liabilities"* and Notes 1 and 10 in the Consolidated Financial Statements. Note 10 includes the scheduled contractual maturities of total certificates of deposits of $451.6 million and $432.8 million, respectively at December 31, 2017 and 2016.

Borrowings

Deposits are the primary source of funds for the Bank's lending and investment activities and for its general business purposes. The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and also by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and commercial banks. Long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. For a discussion of borrowing, see *"Management's Discussion and Analysis of Financial Condition and Results of Operations — Liabilities"* and Notes 1, 11, 16 and 17 in the Consolidated Financial Statements.

Subsidiary Activities

The Company has two direct subsidiaries other than the Bank. In July 2004, Tri-County Capital Trust I was established as a statutory trust under Delaware law as a wholly-owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust I issued $7.0 million of trust preferred securities on July 22, 2004. In June 2005, Tri-County Capital Trust II was also established as a statutory trust under Delaware law as a wholly owned subsidiary of the Company to issue trust preferred securities. Tri-County Capital Trust II issued $5.0 million of trust preferred securities on June 15, 2005. For more information regarding these entities, see Note 16 in the Consolidated Financial Statements. In April 1997, the Bank formed a wholly owned subsidiary, Community Mortgage Corporation of Tri-County, to offer mortgage banking, brokerage, and other services to the public. This corporation is currently inactive.

Supervision and Regulation

Regulation of the Company

General

As a bank holding company, the Company is subject to comprehensive regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the "BHCA"), and the regulations of the Federal Reserve Board. The Federal Reserve Board also has extensive enforcement authority over bank holding companies, including, among other things, the ability to assess civil money penalties, to issue cease and desist or removal orders, and to require that a holding company divest subsidiaries (including its bank subsidiaries). In general, enforcement actions may be initiated for violations of law and regulations and unsafe or unsound practices.

The following discussion summarizes certain of the regulations applicable to the Company but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Acquisition of Control

A bank holding company, with certain exceptions, must obtain Federal Reserve Board approval before (1) acquiring ownership or control of another bank or bank holding company if it would own or control more than 5% of such shares or (2) acquiring all or substantially all of the assets of another bank or bank holding company; or (3) merging with another bank holding company. In evaluating such application, the Federal Reserve Board considers factors such as the financial condition and managerial resources of the companies involved, the convenience and needs of the communities to be served and competitive factors. Federal law provides that no person may acquire "control" of a bank holding company or insured bank without the approval of the appropriate federal regulator. Control is defined to mean direct or indirect ownership, control of 25% or more of any class of voting stock, control of the election of a majority of the bank's directors or a determination by the Federal Reserve Board that the acquirer has or would have the power to exercise a controlling influence over the management or policies of the institution.

The Maryland Financial Institutions Code additionally prohibits any person from acquiring more than 10% of the outstanding shares of any class of securities of a bank or bank holding company, or electing a majority of the directors or directing the management or policies of any such entity, without 60 days prior notice to the Commissioner. The Commissioner may deny approval of the acquisition if the Commissioner determines it to be anti-competitive or to threaten the safety or soundness of a banking institution.

Permissible Activities

A bank holding company is limited in its activities to banking, managing or controlling banks, or providing services for its subsidiaries. Other permitted non-bank activities have been identified as closely related to banking. Bank holding companies that are ''well capitalized'' and ''well managed'' and whose financial institution subsidiaries have satisfactory Community Reinvestment Act records can elect to become ''financial holding companies,'' which are permitted to engage in a broader range of financial activities than are permitted to bank holding companies. The Company has not opted to become a financial holding company.

The Federal Reserve Board has the power to order a holding company or its subsidiaries to terminate any activity, or to terminate its ownership or control of any subsidiary, when it has reasonable cause to believe that the continuation of such activity or such ownership or control constitutes a serious risk to the financial safety, soundness or stability of any bank subsidiary of that holding company.

Dividend

The Federal Reserve Board has the power to prohibit dividends by bank holding companies if their actions constitute unsafe or unsound practices. The Federal Reserve Board has issued a policy statement on the payment of cash dividends by bank holding companies, which expresses the Federal Reserve Board's view that a bank holding company should pay cash dividends only to the extent that the company's net income for the past year is sufficient to cover both the cash dividends and a rate of earnings retention that is consistent with the company's capital needs, asset quality and overall financial condition. The Federal Reserve Board also indicated that it would be inappropriate for a bank holding company experiencing serious financial problems to borrow funds to pay dividends. Under the prompt corrective action regulations adopted by the Federal Reserve Board, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company's bank subsidiary is classified as ''undercapitalized.'' See ''*Regulation of the Bank — Capital Adequacy*.''

Sources of Strength

The Dodd-Frank Act codified the source of strength doctrine requiring bank holding companies to serve as a source of strength for their depository subsidiaries, by providing capital, liquidity and other support in times of financial stress. The regulatory agencies are required, under the Act, to issue implementing regulations.

Stock Repurchases

The Company is required to give the Federal Reserve Board prior written notice of any purchase or redemption of its outstanding equity securities if the gross consideration for the purchase or redemption, when combined with the net consideration paid for all such purchases or redemptions during the preceding 12 months, is equal to 10% or more of the Company's consolidated net worth. The Federal Reserve Board may disapprove such a purchase or redemption. This requirement does not apply to bank holding companies that are ''well capitalized,'' ''well-managed'' and are not the subject of any unresolved supervisory issues.

Capital Requirement

Bank holding companies are required to maintain on a consolidated basis, specified minimum ratios of capital to total assets and capital to risk-weighted assets. These requirements, which generally apply to bank holding companies with consolidated assets of $1 billion or more, such as the Company, are substantially similar to those applicable to the Bank. See ''*— Regulation of the Bank — Capital Adequacy*.'' The Dodd-Frank Act required the Federal Reserve Board to adopt consolidated capital requirements for holding companies that are equally as stringent as those applicable to the depository institution subsidiaries. That means that certain instruments that had previously been includable in Tier 1 capital for bank holding companies, such as trust preferred securities, will no longer be eligible for inclusion. The revised capital requirements are subject to certain grandfathering and transition rules. The Company is currently considered a grandfathered institution under these rules.

Regulation of the Bank

General

The Bank is a Maryland commercial bank and its deposit accounts are insured by the Deposit Insurance Fund of the Federal Deposit Insurance Corporation (''FDIC''). On April 18, 2016, the Bank terminated its membership in the Federal Reserve System and cancelled its stock in the Federal Reserve Bank of Richmond. Accordingly, as of that date, the Bank's primary regulator became the FDIC. The Bank currently is subject to supervision, examination and regulation by the Commissioner of Financial Regulation of the State of Maryland (the ''Commissioner'') and the FDIC.

The Dodd-Frank Act established the Consumer Financial Protection Bureau (''CFPB'') as an independent bureau of the Federal Reserve System. The CFPB assumed responsibility for implementing federal consumer financial protection and fair lending laws and regulations, a function formerly handled by federal bank regulatory agencies. However, institutions of less than $10 billion, such as the Bank, will continue to be examined for compliance with consumer protection or fair lending laws and regulations by, and be subject to enforcement authority of their primary federal regulators.

The following discussion summarizes regulations applicable to the Bank but does not purport to be a complete description of such regulations and is qualified in its entirety by reference to the actual laws and regulations involved.

Capital Adequacy

On July 9, 2013, the federal bank regulatory agencies issued a final rule that revised their risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act (the ''Basel III Capital Rules'').

On January 1, 2015, the Company and Bank became subject to the Basel III Capital Rules with full compliance with all of the final rules' requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The Basel III Capital Rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio (''Min. Ratio'') of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer (''CCB'') is also established above the regulatory minimum capital requirements. This capital conservation buffer began being phased-in January 1, 2016 at 0.625% of risk-weighted assets and increases each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, total capital, and risk-weighted assets.

In September 2017, the Federal Reserve Board, the FDIC, and the Office of the Comptroller of the Currency (OCC) proposed a rule intended to reduce regulatory burden by simplifying several requirements in the agencies' regulatory capital rule. Most aspects of the proposed rule would apply only to banking organizations that are not subject to the ''advanced approaches'' in the capital rule, which are generally firms with less than $250 billion in total consolidated assets and less than $10 billion in total foreign exposure. The proposal would simplify and clarify a number of the more complex aspects of the existing capital rule. Specifically, the proposed rule simplifies the capital treatment for certain acquisition, development, and construction loans, mortgage servicing assets, certain deferred tax assets, investments in the capital instruments of unconsolidated financial institutions, and minority interest. A final rule has not yet been issued.

Prompt Corrective Regulatory Action

Federal law requires, among other things, that federal bank regulatory authorities take ‘‘prompt corrective action’’ with respect to institutions that do not meet minimum capital requirements. For such purposes, the law establishes five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized.

As a result of the Basel III Capital Rules (discussed further above), effective January 1, 2015, an institution is deemed to be ‘‘well capitalized’’ if it has a total risk-based capital ratio of 10% or greater, a Tier 1 risk-based capital ratio of 8% or greater, a common equity Tier 1 risk-based capital ratio of 6.5% or greater, and a leverage capital ratio of 5% or greater, and is not subject to a regulatory order, agreement, or directive to meet and maintain a specific capital level for any capital measure. An institution is deemed to be ‘‘adequately capitalized’’ if it has a total risk-based capital ratio of 8% or greater, a Tier 1 risk-based capital ratio of 6% or greater, a common equity Tier 1 risk-based capital ratio of 4.5% or greater and generally a leverage capital ratio of 4% or greater. An institution is deemed to be ‘‘undercapitalized’’ if it has a total risk-based capital ratio of less than 8%, a Tier 1 risk-based capital ratio of less than 6%, a common equity Tier 1 risk-based capital ratio of less than 4.5% or generally a leverage capital ratio of less than 4%. An institution is deemed to be ‘‘significantly undercapitalized’’ if it has a total risk-based capital ratio of less than 6%, a Tier 1 risk-based capital ratio of less than 4%, a common equity Tier 1 risk-based capital ratio of less than 3% or a leverage capital ratio of less than 3%. An institution is deemed to be ‘‘critically undercapitalized’’ if it has a ratio of tangible equity (as defined in the regulations) to total assets that is equal to or less than 2%.

‘‘Undercapitalized’’ institutions are subject to growth, capital distribution (including dividend), and other limitations, and are required to submit a capital restoration plan. An institution’s compliance with such a plan is required to be guaranteed by any company that controls the undercapitalized institution in an amount equal to the lesser of 5% of the bank’s total assets when deemed undercapitalized or the amount necessary to achieve the status of adequately capitalized. If an undercapitalized institution fails to submit an acceptable plan, it is treated as if it is ‘‘significantly undercapitalized.’’ Significantly undercapitalized institutions are subject to one or more additional restrictions including, but not limited to, a regulatory order requiring them to sell sufficient voting stock to become adequately capitalized; requirements to reduce total assets, cease receipt of deposits from correspondent banks, or dismiss directors or officers; and restrictions on interest rates paid on deposits, compensation of executive officers, and capital distributions by the parent holding company.

Beginning 60 days after becoming ‘‘critically undercapitalized,’’ critically undercapitalized institutions also may not make any payment of principal or interest on certain subordinated debt, extend credit for a highly leveraged transaction, or enter into any material transaction outside the ordinary course of business. In addition, subject to a narrow exception, the appointment of a receiver is required for a critically undercapitalized institution within 270 days after it obtains such status.

Branching

Maryland law provides that, with the approval of the Commissioner, Maryland banks may establish branches within Maryland and may establish branches in other states by any means permitted by the laws of such state or by federal law. The FDIC may approve interstate branching by merger in any state that did not opt out and *de novo* in states that specifically allow for such branching.

Dividend Limitations

Maryland banks may only pay cash dividends from undivided profits or, with the prior approval of the Commissioner, their surplus in excess of 100% of required capital stock. Maryland banks may not declare a stock dividend unless their surplus, after the increase in capital stock, is equal to at least 20% of the outstanding capital stock as increased. If the surplus of the bank, after the increase in capital stock, is less than 100% of its capital stock as increased, the commercial bank must annually transfer to surplus at least 10% of its net earnings until the surplus is 100% of its capital stock as increased.

Insurance of Deposit Accounts

The Bank’s deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC. The deposit insurance per account owner is currently $250,000.

Under the Federal Deposit Insurance Corporation's risk-based assessment system, insured institutions are assigned to one of four risk categories based on supervisory evaluations, regulatory capital levels and certain other factors, with less risky institutions paying lower assessments. An institution's assessment rate depends upon the category to which it is assigned. The initial base assessment rate ranges from five to 35 basis points. The rate schedules will automatically adjust in the future when the Deposit Insurance Fund reaches certain milestones. No institution may pay a dividend if in default of the federal deposit insurance assessment.

Insurance of deposits may be terminated by the Federal Deposit Insurance Corporation upon a finding that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the Federal Deposit Insurance Corporation or its prudential banking regulator. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Reserve Requirements

Under federal regulations, the Bank is required to maintain non-interest earning reserves against their transaction accounts (primarily Negotiable Order of Withdrawal (NOW) and regular checking accounts). The regulations required that that reserves be maintained against aggregate transaction accounts as follows for 2017: a 3% reserve ratio was assessed on net transaction accounts up to and including $115.1 million; a 10% reserve ratio is applied above $115.1 million. The first $15.5 million of otherwise reservable balances (subject to adjustments by the Federal Reserve Board) are exempted from the reserve requirements. The amounts are adjusted annually and, for 2018, will require a 3% ratio for up to $122.3 million and an exemption of $16.0 million. At December 31, 2017, the Bank met applicable reserve requirements.

Transactions with Affiliates

A state nonmember bank, such as the Bank, is limited in the amount of ''covered transactions'' with any affiliate. Covered transactions must also be on terms substantially the same, or at least as favorable, to the Bank or subsidiary as those provided to a non-affiliate. The term ''covered transaction'' includes the making of loans, purchase of assets, issuance of a guarantee and similar types of transactions. Certain covered transactions, such as loans to affiliates, must meet collateral requirements. At December 31, 2017, we had no transactions with affiliates.

Loans to directors, executive officers and principal stockholders of a state nonmember bank must be made on substantially the same terms as those prevailing for comparable transactions with persons who are not executive officers, directors, principal stockholders or employees of the bank. Loans to any executive officer, director and principal stockholder together with all other outstanding loans to such person and affiliated interests generally may not exceed 15% of the Bank's unimpaired capital and surplus and all loans to such persons may not exceed the institution's unimpaired capital and unimpaired surplus. Loans to directors, executive officers and principal stockholders, and their respective affiliates, in excess of the greater of $25,000 or 5% of capital and surplus, or any loans cumulatively aggregating $500,000 or more, must be approved in advance by a majority of the board of directors of the Bank with any ''interested'' director not participating in the voting. State nonmember banks are prohibited from paying the overdrafts of any of their executive officers or directors unless payment is made pursuant to a written, pre-authorized interest-bearing extension of credit plan that specifies a method of repayment or transfer of funds from another account at the Bank. In addition, loans to executive officers may not be made on terms more favorable than those afforded other borrowers and are restricted as to type, amount and terms of credit.

Enforcement

The Commissioner has extensive enforcement authority over Maryland banks. This includes the ability to issue cease and desist orders and civil money penalties and to remove directors or officers. The Commissioner may also take possession of a Maryland bank whose capital is impaired and seek to have a receiver appointed by a court.

The FDIC has primary federal enforcement responsibility over state banks under its jurisdiction, including the authority to bring enforcement action against all ''institution-related parties,'' including stockholders, and any attorneys, appraisers and accountants who knowingly or recklessly participate in wrongful action likely to have an adverse effect on an institution. Formal enforcement action may range from the issuance of capital directive or a cease and desist order for the removal of officers and/or directors, receivership, conservatorship or termination of deposit insurance. Civil money penalties cover a wide range of violations and actions, and range up to $25,000 per day or even up to $1 million per day (in the most egregious cases). Criminal penalties for most financial institution crimes include fines of up to $1 million and imprisonment for up to 30 years.

Other Regulations

The Bank's operations are also subject to federal laws applicable to credit transactions, including the:

- Truth-In-Lending Act, governing disclosures of credit terms to consumer borrowers;
- Real Estate Settlement Procedures Act, requiring that borrowers for mortgage loans for one- to four-family residential real estate receive various disclosures, including good faith estimates of settlement costs, lender servicing and escrow account practices, and prohibiting certain practices that increase the cost of settlement services;
- Bank Secrecy Act of 1970, requiring financial institutions to assist U.S. government agencies to detect and prevent money laundering;
- Home Mortgage Disclosure Act of 1975, requiring financial institutions to provide information to enable the public and public officials to determine whether a financial institution is fulfilling its obligation to help meet the housing needs of the community it serves;
- Equal Credit Opportunity Act, prohibiting discrimination on the basis of race, creed or other prohibited factors in extending credit;
- Fair Credit Reporting Act of 1978, governing the use and provision of information to credit reporting agencies; and
- Fair Debt Collection Act, governing the manner in which consumer debts may be collected by collection agencies; and rules and regulations of the various federal agencies charged with the responsibility of implementing such federal laws.

The operations of the Bank also are subject to laws such as the:

- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Electronic Funds Transfer Act and Regulation E promulgated thereunder, which govern automatic deposits to and withdrawals from deposit accounts and customers' rights and liabilities arising from the use of automated teller machines and other electronic banking services; and
- Check Clearing for the 21st Century Act (also known as "Check 21"), which gives "substitute checks," such as digital check images and copies made from that image, the same legal standing as the original paper check.
- Gramm-Leach-Bliley Act privacy statute which requires each depository institution to disclose its privacy policy, identify parties with whom certain nonpublic customer information is shared and provide customers with certain rights to "opt out" of disclosure to certain third parties;
- Title III of The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (referred to as the "USA PATRIOT Act"), which significantly expands the responsibilities of financial institutions in preventing the use of the United States financial system to fund terrorist activities. Among other things, the USA PATRIOT Act and the related regulations requires banks operating in the United States to develop anti-money laundering compliance programs, due diligence policies and controls to facilitate the detection and reporting of money laundering;

- The Fair and Accurate Reporting Act of 2003, as an amendment to the Fair Credit Reporting Act, as noted previously, which includes provisions to help reduce identity theft by providing procedures for the identification, detection, and response to patterns, practices, or specific activities — known as ‘‘red flags’’; and
- Truth in Savings Act, which establishes the requirement for clear and uniform disclosure of terms and conditions regarding deposit interest and fees to help promote economic stability, competition between depository institutions, and allow the consumer to make informed decisions.

Management

Chief Officers

Our executive officers are elected by the Board of Directors and serve at the Board’s discretion. Executive officers of the Bank also serve as executive officers of the Company. The executive officers of the Company are as follows:

William J. Pasenelli, 59, is President and Chief Executive Officer of the Company. He also serves as the Bank’s Chief Executive Officer. Mr. Pasenelli joined the Bank as Chief Financial Officer in 2000 and was named President of the Bank in 2010 and President of the Company in May 2012. He relinquished the position of Chief Financial Officer of the Bank in March 2013 and President in July 2016. Before joining the Bank, Mr. Pasenelli had been Chief Financial Officer of Acacia Federal Savings Bank, Annandale, Virginia, since 1987. Mr. Pasenelli has over 30 years of banking experience. He serves on the Board of Directors of the Maryland Bankers Association and the Maryland Chamber of Commerce. Mr. Pasenelli is a member of the American Institute of Certified Public Accountants, the Greater Washington Society of Certified Public Accountants and other civic groups. Mr. Pasenelli is a graduate of the National School of Banking and holds a Bachelor of Arts from Duke University. He also attended the Harvard Business School Program on Negotiation.

Gregory C. Cockerham, 63, joined the Bank in 1988. He serves as Executive Vice President and Chief Lending Officer of the Company and the Bank. Before joining the Bank, he was Vice President of Maryland National Bank. Mr. Cockerham has over 40 years of banking experience. Mr. Cockerham serves as Emeritus and Past Chair of the Board of Directors for the College of Southern Maryland Foundation, Past Chair and Current Board member of Maryland Title Center. He presently serves as the Potomac Baptist Association Finance Chair, is a Paul Harris Fellow, Foundation Chair and Past President of the Rotary Club of Charles County, President of the Rotary Foundation Board, Chair of the Charles County Board of Education CRD Program and serves on various civic boards. Mr. Cockerham is a Maryland Bankers School graduate and holds a Bachelor of Science from West Virginia University. He also attended the Harvard Business School Program on Negotiation.

James M. Burke, 49, joined the Bank in 2005. He serves as the Bank’s President and Chief Risk Officer of the Company and the Bank. Before his appointment as President of the Bank in 2016, he served as Executive Vice President and Chief Risk Officer. Before joining the Bank, Mr. Burke served as Executive Vice President and Senior Loan Officer of Mercantile Southern Maryland Bank. Mr. Burke has over 20 years of banking experience. Mr. Burke is the former Chairman of the Board of Directors of University of Maryland Charles Regional Medical Center, serves on the Board of Directors for the ARC of Southern Maryland, Trustee for St. Mary’s Ryken High School, Trustee for Historic Sotterley Plantation and is active in other civic groups. Mr. Burke is a Maryland Bankers School graduate and holds a Bachelor of Arts from High Point University. He is also a graduate of the East Carolina Advanced School of Commercial Lending and attended the Harvard Business School Program on Negotiation.

James F. Di Misa, 58, joined the Bank in 2005. He serves as Executive Vice President, Chief Operating Officer of the Company and the Bank. Before joining the Bank, Mr. Di Misa served as Executive Vice President of Mercantile Southern Maryland Bank. Mr. Di Misa has over 30 years of banking experience. Mr. Di Misa is former Chairman of the Board of Trustees for the Maryland Bankers School, a Paul Harris Fellow, Foundation Secretary, Past President of the Rotary Club of Charles County Chairman of Charles County Rotary Scholarships Program, Adjunct Instructor for the College of Southern Maryland, Governor Appointment to the Tri-County Work Force Investment Board (2008 – 2014), President and Founder of the La

Plata Business Association (2002 – 2010) and of the Board of Trustees for the Maryland Bankers School (2002 – 2016). He is also a member of several other civic and professional groups. Mr. Di Misa is a Stonier Graduate School of Banking graduate and holds a Masters of Business Administration from Mount St. Mary's College and a Bachelor of Science from George Mason University. He also attended the Harvard Business School Program on Negotiation.

Todd L. Capitani, 51, joined the Bank in 2009. He serves as Executive Vice President, Chief Financial Officer of the Company and the Bank. Before joining the Bank, Mr. Capitani served as a Senior Finance Manager at Deloitte Consulting and as Chief Financial Officer at Ruesch International, Inc. Mr. Capitani has over 25 years of experience in corporate finance, controllership and external audit. Mr. Capitani is involved with several local charities, religious and community organizations. Mr. Capitani is a member of the American Institute of Certified Public Accountants and other civic groups. Mr. Capitani is a Certified Public Accountant and holds a Bachelor of Arts from the University of California at Santa Barbara. He also attended the Harvard Business School Program on Negotiation and the Yale School of Management Strategic Leadership Conference.

Christy M Lombardi, 41, joined the Bank in 1998. She serves as Executive Vice President, Chief Administrative Officer of the Company and the Bank. Ms. Lombardi is responsible for administrative and corporate governance matters for the Company, and oversees human resources and shareholder relations. Ms. Lombardi has 20 years of banking experience. She serves as Immediate Past Chair for the Calvert County Chamber of Commerce Board of Directors, on the Advisory Board of the Maryland Banker's Association Council of Professional Women in Banking and Finance and on the Southern Maryland Workforce Development Board. She is a Maryland Bankers School graduate and holds a Masters in Management from University of Maryland University College as well as a Master's in Business Administration. Ms. Lombardi also attended the Harvard Business School Program on Negotiation.

Item 1A. Risk Factors

Risks

An investment in shares of our common stock involves various risks. Our business, financial condition and results of operations could be harmed by any of the following risks or by other risks that have not been identified or that we may believe are immaterial or unlikely. The value or market price of our common stock could decline due to any of these risks, and you may lose all or part of your investment. The risks discussed below also include forward-looking statements, and our actual results may differ substantially from those discussed in these forward-looking statements.

Our increased emphasis on commercial lending may expose us to increased lending risks.

At December 31, 2017 and 2016, our loan portfolio included $727.3 million, or 63.3%, and $667.1 million, or 61.3%, respectively, of commercial real estate loans, $110.3 million, or 9.6%, and $101.9 million, or 9.4%, respectively, of residential rental loans, $56.4 million, or 4.9% and $50.5 million, or 4.6%, respectively of commercial business loans and $35.9 million, or 3.1% and $39.7 million, or 3.7%, respectively, of commercial equipment loans. We intend to maintain our emphasis on these types of loans. These types of loans generally expose a lender to greater risk of non-payment and loss and require a commensurately higher loan loss allowance than owner-occupied one- to four-family residential mortgage loans because repayment of the loans often depends on the successful operation of the property and the income stream of the borrowers. Such loans typically involve larger loan balances compared to one- to four-family residential mortgage loans. Commercial business and equipment loans expose us to additional risks since they typically are made on the basis of the borrower's ability to make repayments from the cash flows of the borrower's business and are secured by non-real estate collateral that may depreciate over time. Also, many of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one- to four-family residential mortgage loan. At December 31, 2017 and 2016, $3.5 million, or 73.5% and $4.6 million, or 55.4%, respectively, of our non-accrual loans of $4.7 million and $8.4 million, respectively, consisted of commercial loans.

Our provision for loan losses has been improving as the Company's credit metrics have improved. We may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future. Further, our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

For the years ended December 31, 2017 and 2016, we recorded a provision for loan losses of $1.0 million and $2.4 million, respectively. We also recorded net loan charge-offs of $355,000 and $1.0 million for the years ended December 31, 2017 and 2016, respectively. Our non-accrual loans, OREO and accruing TDRs aggregated $24.1 million, or 1.71% of total assets and $26.6 million, or 1.99% of total assets, respectively, at December 31, 2017 and 2016. Additionally, loans that were classified as special mention and substandard were $40.4 million and $30.4 million, respectively, at December 31, 2017 and 2016. We had $0 and $137,000 in loans classified as doubtful and no loans classified as loss at December 31, 2017 and 2016. If the economy and/or the real estate market weakens, more of our classified loans may become non-performing and we may be required to take additional provisions to increase our allowance for loan losses for these assets as the value of the collateral may be insufficient to pay any remaining net loan balance, which would have a negative effect on our results of operations. We maintain an allowance for loan losses to provide for loans in our portfolio that may not be repaid in their entirety. We believe that our allowance for loan losses is maintained at a level adequate to absorb probable losses inherent in our loan portfolio as of the corresponding balance sheet date. However, our allowance for loan losses may not be sufficient to cover actual loan losses, and future provisions for loan losses could materially adversely affect our operating results.

In evaluating the adequacy of our allowance for loan losses, we consider numerous factors, including our historical charge-off experience, growth of our loan portfolio, changes in the composition of our loan portfolio and the volume of delinquent, non-accrual and classified loans, TDRs and foreclosed real estate. In addition, we use information about specific borrower situations, including their financial position and estimated collateral values, to estimate the risk and amount of loss for those borrowers. Finally, we also consider other qualitative factors, including general and economic business conditions, anticipated duration of the current business cycle, current general market collateral valuations, and trends apparent in any of the factors we take into account. Our estimates of the risk of loss and amount of loss on any loan are complicated by the significant uncertainties surrounding our borrowers' abilities to successfully execute their business models through changing economic environments, competitive challenges and other factors. Because of the degree of uncertainty and susceptibility of these factors to change, our actual losses may vary from our current estimates.

Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by recognizing additional provisions for loan losses charged to expense, or to decrease our allowance for loan losses by recognizing loan charge-offs. Any such additional provisions for loan losses or charge-offs, as required by our regulators, could have a material adverse effect on our financial condition and results of operations.

If we do not effectively manage our credit risk, we may experience increased levels of non-performing loans, charge-offs and delinquencies, which would require additional increases in our provision for loan losses.

There are risks inherent in making any loan, including risks inherent in dealing with individual borrowers, risks of non-payment, risks resulting from uncertainties as to the future value of collateral and cash flows available to service debt and risks resulting from changes in economic and market conditions. Our credit risk approval and monitoring procedures may not reduce these credit risks, and they cannot be expected to completely eliminate our credit risks. If the overall economic climate in the United States, generally, or our market areas, specifically, fails to improve, or even if it does improve, our borrowers may experience difficulties in repaying their loans, and the level of non-performing loans, charge-offs and delinquencies could rise and require further increases in the provision for loan losses, which would cause our net income and return on equity to decrease.

Non-performing and classified assets could take significant time to resolve and adversely affect our results of operations and financial condition, and could result in further losses in the future.

At December 31, 2017 and 2016, our non-accrual loans totaled $4.7 million, or 0.41% of our loan portfolio and $8.4 million, or 0.77% of our loan portfolio, respectively. At December 31, 2017 and 2016, our non-accrual loans, OREO and accruing TDRs totaled $24.1 million, or 1.71% of total assets and $26.6 million, or 1.99% of total assets, respectively. Our non-performing assets adversely affect our net income in various ways. We do not accrue interest income on non-accrual loans or foreclosed properties, thereby adversely affecting our net income and returns on assets and equity, increasing our loan administration costs and adversely affecting our efficiency ratio. When we take collateral in foreclosure and similar proceedings, we are required to mark the collateral to its then fair market value, less estimated selling costs, which may result in a loss. These non-performing loans and foreclosed properties also increase our risk profile and the amount of capital our regulators believe is appropriate to maintain in light of such risks. The resolution of non-performing assets requires significant time commitments from management and can be detrimental to the performance of their other responsibilities. If we experience increases in non-performing loans and non-performing assets, our net interest income will be negatively impacted and our loan administration costs could increase, each of which could have an adverse effect on our net income and related ratios, such as return on assets and equity.

At December 31, 2017 and 2016 our total classified assets were $50.3 million and $39.2 million, respectively. While we continue to accrue interest income on classified loans that are performing, classified loans and other classified assets may negatively impact profitability by requiring additional management attention and regular monitoring. Increased monitoring of these assets by management may impact our management's ability to focus on opportunistic growth, potentially adversely impacting future profitability.

Our residential mortgage loans and home equity loans expose us to a risk of loss due to declining real estate values.

At December 31, 2017 and 2016, $170.4 million, or 14.8%, of our total loan portfolio, and $171.0 million, or 15.7%, of our total loan portfolio, respectively, consisted of owner-occupied one- to four-family residential mortgage loans. At December 31, 2017 and 2016, $21.4 million, or 1.9%, of our total loan portfolio and $21.4 million, or 2.0%, of our total loan portfolio, respectively, consisted of home equity loans and lines of credit. Declines in the housing market could result in declines in real estate values in our market area. A decline in real estate values could cause some of our mortgage and home equity loans to be inadequately collateralized, which would expose us to a greater risk of loss if we seek to recover on defaulted loans by selling the real estate collateral.

We may be adversely affected by recent changes in U.S. tax laws and regulations.

Changes in tax laws contained in the Tax Cuts and Jobs Act, which was enacted in December 2017, include a number of provisions that will have an impact on the banking industry, borrowers and the market for residential real estate. Included in this legislation was a reduction of the corporate income tax rate from 35% to 21%. In addition, other changes included: (i) a lower limit on the deductibility of mortgage interest on single-family residential mortgage loans, (ii) the elimination of interest deductions for home equity loans, (iii) a limitation on the deductibility of business interest expense and (iv) a limitation on the deductibility of property taxes and state and local income taxes.

The recent changes in the tax laws may have an adverse effect on the market for, and valuation of, residential properties, and on the demand for such loans in the future, and could make it harder for borrowers to make their loan payments. In addition, these recent changes may also have a disproportionate effect on taxpayers in states with high residential home prices and high state and local taxes, such as Maryland. If home ownership becomes less attractive, demand for mortgage loans could decrease. The value of the properties securing loans in our loan portfolio may be adversely impacted as a result of the changing economics of home ownership, which could require an increase in our provision for loan losses, which would reduce our profitability and could materially adversely affect our business, financial condition and results of operations.

Negative developments in the financial industry, the domestic and international credit markets, and the economy in general pose significant challenges for our industry and us and could adversely affect our business, financial condition and results of operations.

Negative developments that began in the latter half of 2007 and that have continued since then in the global credit and securitization markets have resulted in unprecedented volatility and disruption in the financial markets, a general economic downturn and a tepid economic recovery, both nationally and in our primary markets. As a result, commercial as well as consumer loan portfolio performances deteriorated at many institutions and have not fully recovered, and the competition for deposits and quality loans has increased significantly. In addition, the values of real estate collateral supporting many commercial loans and home mortgages have declined and may continue to decline. As a result, we may face the following risks:

- Economic conditions that negatively affect housing prices and the job market may cause the credit quality of our loan portfolios to deteriorate;
- Market developments that affect consumer confidence may cause adverse changes in payment patterns by our customers, causing increases in delinquencies and default rates on loans and other credit facilities;
- The processes that we use to estimate our allowance for loan losses and reserves may no longer be reliable because they rely on judgments, such as forecasts of economic conditions, that may no longer be capable of accurate estimation;
- The value of our securities portfolio may decline; and
- We face increased regulation of our industry, and the costs of compliance with such regulation may increase.

These conditions or similar ones may continue to persist or worsen, causing us to experience continuing or increased adverse effects on our business, financial condition, results of operations and the price of our common stock.

Changes in interest rates could reduce our net interest income and earnings.

Our largest component of earnings is net interest income, which could be negatively affected by changes in interest rates. Changing interest rates impact customer actions and may limit the options available to the Company to maximize earnings or increase the costs to minimize risk. We do not have control over market interest rates and the Company's focus to mitigate potential earnings risk centers on controlling the composition of our assets and liabilities.

Our net interest income is the interest we earn on loans and investments less the interest we pay on our deposits and borrowings. Our net interest margin is net interest income divided by average interest-earning assets. Changes in interest rates could adversely affect our net interest margin and, as a result, our net interest income. Although the yield we earn on our assets and our funding costs tend to move in the same direction in response to changes in interest rates, one can rise or fall faster than the other, causing our net interest margin to increase or decrease. Our liabilities tend to be shorter in duration than our assets, so they may adjust faster in response to changes in interest rates. As a result, when interest rates rise, our funding costs may rise faster than the yield we earn on our assets, causing our net interest margin to contract until the yield catches up. Changes in the slope of the "yield curve" — or the spread between short-term and long-term interest rates — could also reduce our net interest margin. Normally, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. Because our liabilities tend to be shorter in duration than our assets, when the yield curve flattens or inverts, we could experience pressure on our net interest margin as our cost of funds increases relative to the yield we can earn on our assets. Our procedures for managing exposure to falling net interest income involve modeling possible scenarios of interest rate increases and decreases to interest-earning assets and interest-bearing liabilities.

Changes in interest rates also can affect: (1) our ability to originate loans; (2) the value of our interest-earning assets; (3) our ability to obtain and retain deposits in competition with other available investment alternatives; and (4) the ability of our borrowers to repay their loans, particularly adjustable or variable rate loans.

Monetary policies and regulations of the Federal Reserve could adversely affect our business, financial condition and results of operations.

In addition to being affected by general economic conditions, our earnings and growth are affected by the policies of the Federal Reserve. In recent years, various significant economic and monetary stimulus measures were implemented by the U.S. Congress and the Federal Reserve pursued a highly accommodative monetary policy aimed at keeping interest rates at historically low levels although the Federal Reserve has begun to modify certain aspects of this policy by gradually increasing short-term interest rates and reducing its balance sheet. U.S. economic activity has significantly improved, but there can be no assurance that this progress will continue or will not reverse.

An important function of the Federal Reserve is to regulate the money supply and credit conditions. Among the instruments used by the Federal Reserve to implement these objectives are open market operations in U.S. government securities, adjustments of the discount rate and changes in reserve requirements against bank deposits. These instruments are used in varying combinations to influence overall economic growth and the distribution of credit, bank loans, investments and deposits. Their use also affects interest rates charged on loans or paid on deposits. The monetary policies and regulations of the Federal Reserve have had a significant effect on the operating results of commercial banks in the past and are expected to continue to do so in the future. The effects of such policies upon our business, financial condition and results of operations cannot be predicted.

Our financial condition and results of operations could be negatively affected if we fail to timely and effectively execute our strategic plan or manage the growth called for in our strategic plan. We have grown through our January 1, 2018 acquisition of County First Bank and may continue to grow through acquisitions. To be successful as a larger institution, we must successfully integrate the operations and retain the customers of acquired institutions, attract and retain the management required to successfully manage larger operations, and control costs.

Among other things, our strategic plan currently calls for reducing the amount of our non-performing assets, growing assets through commercial lending and generating transaction deposit accounts to reduce our funding costs and improve our net interest margin. Our ability to increase profitability in accordance with this plan will depend on a variety of factors including the identification of desirable business opportunities, competitive responses from financial institutions in our market area and our ability to manage liquidity and funding sources. While we believe we have the management resources and internal systems in place to successfully manage our strategic plan, opportunities may not be available and that the strategic plan may not be successful or effectively managed.

In implementing our strategic plan, we may expand into additional communities or attempt to strengthen our position in our current markets through opportunistic acquisitions of whole banks or branch locations. On January 1, 2018, we acquired County First Bank. Future results of operations will be impacted by our ability to successfully integrate the operations of County First Bank and any other acquired institutions and retain the customers of those institutions. If we are unable to successfully manage the integration of the separate cultures, customer bases and operating systems of the acquired institutions, and any other institutions that may be acquired in the future, our results of operations could be negatively impacted. As a result of the County First Bank acquisition and to the extent that we undertake additional acquisitions, we are likely to experience the effects of higher operating expenses relative to operating income from the new operations during the integration period, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. In addition, if we undertake substantial growth, we may need to increase non-interest expenses through additional personnel, occupancy expense and data processing costs, among others. In order to successfully manage growth, we may need to adopt and effectively implement policies, procedures and controls to maintain credit quality, control costs and oversee operations. No assurance can be given that we will be successful in this strategy. Other effects of engaging in such growth strategies may include potential diversion of our management's time and attention and general disruption to our business. We may not be able to adequately, timely and profitably achieve the intended benefits or our growth strategies or manage anticipated growth.

Finally, substantial growth may stress regulatory capital levels, and may require us to raise additional capital. No assurance can be given that we will be able to raise any required capital, or that it will be able to raise capital on terms that are beneficial to stockholders.

We are a community bank and our ability to maintain our reputation is critical to the success of our business and the failure to do so may materially adversely affect our performance.

We are a community bank, and our reputation is one of the most valuable components of our business. As such, we strive to conduct our business in a manner that enhances our reputation. This is done, in part, by recruiting, hiring and retaining employees who share our core values of being an integral part of the communities we serve, delivering superior service to our customers and caring about our customers and associates. If our reputation is negatively affected, by the actions of our employees or otherwise, our business and, therefore, our operating results may be adversely affected.

Our asset valuation may include methodologies, estimations and assumptions that are subject to differing interpretations and could result in changes to asset valuations that may materially adversely affect our results of operations or financial condition.

We must use estimates, assumptions, and judgments when financial assets and liabilities are measured and reported at fair value. Assets and liabilities carried at fair value inherently result in a higher degree of financial statement volatility. Fair values and the information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices and/or other observable inputs provided by independent third-party sources, when available. When such third-party information is not available, we estimate fair value primarily by using cash flows and other financial modeling techniques utilizing assumptions such as credit quality, liquidity, interest rates and other relevant inputs. Changes in underlying factors, assumptions, or estimates in any of these areas could materially impact our future financial condition and results of operations.

During periods of market disruption, including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value some of our assets if trading becomes less frequent and market data becomes less observable. There may be asset classes that were in active markets with significant observable data that become illiquid due to the financial environment. In such cases, asset valuation may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation.

Strong competition within our market area could hurt our profits and slow growth.

We face intense competition both in making loans and attracting deposits. Our competition for loans and deposits includes banks, savings institutions, mortgage banking companies, credit unions and non-banking financial institutions. We compete with regional and national financial institutions that have a substantial presence in our market area, many of which have greater liquidity, higher lending limits, greater access to capital, more established market recognition and more resources and collective experience than us. Furthermore, tax-exempt credit unions operate in our market area and aggressively price their products and services to a large portion of the market. This competition may make it more difficult for us to originate new loans and may force us to offer higher deposit rates than we currently offer. Price competition for loans and deposits might result in lower interest rates earned on our loans and higher interest rates paid on our deposits, which would reduce net interest income. Our profitability depends upon our continued ability to compete successfully in our market area.

If the value of real estate in our market area were to decline, a significant portion of our loan portfolio could become under-collateralized, which could have a material adverse effect on us.

Declines in local economic conditions could adversely affect the value of the real estate collateral securing our loans. A decline in property values would diminish our ability to recover on defaulted loans by selling the real estate collateral, making it more likely that we would suffer losses on defaulted loans. Additionally, a decrease in asset quality could require additions to our allowance for loan losses through increased provisions for loan losses, which would hurt our profits. Real estate values are affected by various factors in addition to local economic conditions, including, among other things, changes in general or regional economic conditions, governmental rules or policies and natural disasters.

We may be adversely affected by economic conditions in our market area, which is significantly dependent on federal government and military employment and programs.

Our marketplace is primarily in the counties of Charles, Calvert, St. Mary’s and Anne Arundel, Maryland and neighboring communities, and the Fredericksburg area of Virginia. Many, if not most, of our customers live and/or work in those counties or in the greater Washington, DC metropolitan area. Because our services are concentrated in this market, we are affected by the general economic conditions in the greater Washington, DC area. Changes in the economy may influence the growth rate of our loans and deposits, the quality of the loan portfolio and loan and deposit pricing. A significant decline in economic conditions caused by inflation, recession, unemployment or other factors beyond our control could decrease the demand for banking products and services generally and/or impair the ability of existing borrowers to repay their loans, which could negatively affect our financial condition and performance.

A significant portion of the population in our market area is affiliated with or employed by the federal government or at military facilities located in the area which contribute to the local economy. As a result, a reduction in federal government or military employment or programs could have a negative impact on local economic conditions and real estate collateral values, and could also negatively affect the Company’s profitability.

We operate in a highly regulated environment and we may be adversely affected by changes in laws and regulations.

The Company and the Bank are subject to extensive regulation, supervision and examination as noted in the "*Supervision and Regulation*" section of this report. The regulation and supervision by the Maryland Commissioner, the Federal Reserve and the FDIC are not intended to protect the interests of investors in The Community Financial Corporation common stock. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the imposition of restrictions on our operations, the classification of our assets and determination of the level of our allowance for loan losses. Laws and regulations now affecting us may be changed at any time, and the interpretation of such laws and regulations by bank regulatory authorities is also subject to change. Any change in such regulation and oversight, whether in the form of regulatory policy, regulations, legislation or supervisory action, may have a material impact on our operations.

Regulation of the financial services industry is undergoing major changes and future legislation could increase our cost of doing business or harm our competitive position.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has created a significant shift in the way financial institutions operate. The key effects of the Dodd-Frank Act on our business are:

- Changes to regulatory capital requirements;
- Creation of new government regulatory agencies (such as the Financial Stability Oversight Council, which oversees systemic risk, and the Consumer Financial Protection Bureau, which develops and enforces rules for bank and non-bank providers of consumer financial products);
- Potential limitations on federal preemption;
- Changes to deposit insurance assessments;
- Regulation of debit interchange fees we earn;
- Changes in retail banking regulations, including potential limitations on certain fees we may charge; and
- Changes in regulation of consumer mortgage loan origination and risk retention.

In addition, the Dodd-Frank Act restricts the ability of banks to engage in certain proprietary trading or to sponsor or invest in private equity or hedge funds. The Dodd-Frank Act also contains provisions designed to limit the ability of insured depository institutions, their holding companies and their affiliates to conduct certain swaps and derivatives activities and to take certain principal positions in financial instruments.

Certain changes resulting from the Dodd-Frank Act may impact the profitability of our business activities, require changes to certain of our business practices, impose upon us more stringent capital, liquidity and leverage requirements or otherwise adversely affect our business. These changes may also require us to invest significant management attention and resources to evaluate and make any changes necessary to comply with new statutory and regulatory requirements. Failure to comply with the requirements may negatively impact our results of operations and financial condition.

Basel III capital rules generally require insured depository institutions and their holding companies to hold more capital. The impact of the new rules on our financial condition and operations is uncertain but could be materially adverse.

New capital rules adopted by the Federal Reserve substantially amended the regulatory risk-based capital rules applicable to us. The rule includes new risk-based capital and leverage ratios, which became effective January 1, 2015, and revise the definition of what constitutes "capital" for purposes of calculating those ratios. The rules apply to the Company as well as to the Bank. Beginning in the first quarter of 2015, our minimum capital requirements were (i) a common Tier 1 equity ratio of 4.5%, (ii) a Tier 1 capital (common Tier 1 capital plus Additional Tier 1 capital) of 6% (up from 4%) and (iii) a total capital ratio of 8%. Our leverage ratio requirement will remain at the 4% level. Finally, the new capital rules limit capital distributions and certain discretionary bonus payments if the banking organization does not hold a ‘‘capital conservation buffer’’ consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements. The capital conservation buffer requirement was phased in beginning January 1, 2016, at 0.625% of risk-weighted assets, increasing each year until fully implemented at 2.5% on January 1, 2019.

We are periodically subject to examination and scrutiny by a number of banking agencies and, depending upon the findings and determinations of these agencies, we may be required to make adjustments to our business that could adversely affect us.

Federal and state banking agencies periodically conduct examinations of our business, including compliance with applicable laws and regulations. If, as a result of an examination, a federal banking agency was to determine that the financial condition, capital resources, asset quality, asset concentration, earnings prospects, management, liquidity, sensitivity to market risk or other aspects of any of our operations has become unsatisfactory, or that we or our management is in violation of any law or regulation, it could take a number of different remedial actions as it deems appropriate. These actions include the power to enjoin ‘‘unsafe or unsound’’ practices, to require affirmative actions to correct any conditions resulting from any violation or practice, to issue an administrative order that can be judicially enforced, to direct an increase in our capital, to restrict our growth, to change the asset composition of our portfolio or balance sheet, to assess civil monetary penalties against our officers or directors, to remove officers and directors and, if it is concluded that such conditions cannot be corrected or there is an imminent risk of loss to depositors, to terminate our deposit insurance. If we become subject to such regulatory actions, our business, results of operations and reputation may be negatively impacted.

The Company is a bank holding company and its sources of funds necessary to meet its obligations are limited.

The Company is a bank holding company, and its operations are primarily conducted by the Bank, which is subject to significant federal and state regulation. Cash available to pay dividends to our common and preferred stockholders, pay our obligations and meet our debt service requirements is derived primarily from our existing cash flow sources, dividends received from the Bank, or a combination thereof. Future dividend payments by the Bank to us will require generation of future earnings by the Bank and are subject to certain regulatory guidelines. If the Bank is unable to pay dividends to us, we may not have the resources or cash flow to pay or meet all of our obligations.

Our internal control systems are inherently limited.

Our systems of internal controls, disclosure controls and corporate governance policies and procedures are inherently limited. The inherent limitations of our system of internal controls include the use of judgment in decision-making that can be faulty; breakdowns can occur because of human error or mistakes; and controls can be circumvented by individual acts or by collusion of two or more people. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and any design may not succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitation of a cost-effective control system, misstatements due to error or fraud may occur and may not be detected, which may have an adverse effect on our business, results of operations or financial condition. Additionally, any plans of remediation for any identified limitations may be ineffective in improving our internal controls.

The market price and liquidity of our common stock could be adversely affected if the economy were to weaken or the capital markets were to experience volatility.

The market price of our common stock could be subject to significant fluctuations due to changes in sentiment in the market regarding our operations or business prospects. Among other factors, these risks may be affected by:

- Operating results that vary from the expectations of our management or of securities analysts and investors;
- Developments in our business or in the financial services sector generally;
- Regulatory or legislative changes affecting our industry generally or our business and operations;
- Operating and securities price performance of companies that investors consider to be comparable to us;
- Changes in estimates or recommendations by securities analysts or rating agencies;
- Announcements of strategic developments, acquisitions, dispositions, financings, and other material events by us or our competitors;
- Changes or volatility in global financial markets and economies, general market conditions, interest or foreign exchange rates, stock, commodity, credit, or asset valuations; and
- Significant fluctuations in the capital markets.

Economic or market turmoil could occur in the near or long term, which could negatively affect our business, our financial condition, and our results of operations, as well as volatility in the price and trading volume of our common stock.

Provisions of our articles of incorporation, bylaws and Maryland law, as well as state and federal banking regulations, could delay or prevent a takeover of us by a third party.

Provisions in our articles of incorporation and bylaws and Maryland corporate law could delay, defer or prevent a third party from acquiring us, despite the possible benefit to our shareholders, or otherwise adversely affect the price of our common stock. These provisions include: supermajority voting requirements for certain business combinations; the election of directors to staggered terms of three years; and advance notice requirements for nominations for election to our board of directors and for proposing matters that shareholders may act on at shareholder meetings. In addition, we are subject to Maryland laws, including one that prohibits us from engaging in a business combination with any interested shareholder for a period of five years from the date the person became an interested shareholder unless certain conditions are met. These provisions may discourage potential takeover attempts, discourage bids for our common stock at a premium over market price or adversely affect the market price of, and the voting and other rights of the holders of, our common stock. These provisions could also discourage proxy contests and make it more difficult for shareholders to elect directors other than the candidates nominated by our Board.

We rely on other companies to provide key components of our business infrastructure.

Third party vendors provide key components of our business infrastructure such as core data processing systems, internet connections, network access and fund distribution. While we have selected these third-party vendors carefully, we cannot control their actions. Any problems caused by these third parties, including those which result from their failure to provide services for any reason or their poor performance of services, could adversely affect our ability to deliver products and services to its customers and otherwise to conduct its business. Replacing these third-party vendors could also entail significant delay and expense.

We are dependent on our information technology and telecommunications systems and third-party servicers, and systems failures, interruptions or breaches of security could have a material adverse effect on us.

Our business is dependent on the successful and uninterrupted functioning of our information technology and telecommunications systems and third-party servicers. The failure of these systems, or the termination of a third-party software license or service agreement on which any of these systems is based, could interrupt our operations. Because our information technology and telecommunications systems interface with and depend on third-party systems, we could experience service denials if demand for such services exceeds capacity or such third-party systems fail or experience interruptions. If significant, sustained or repeated, a system failure or service denial could compromise our ability to operate effectively, damage our reputation, result in a loss of customer business, and/or subject us to additional regulatory scrutiny and possible financial liability, any of which could have a material adverse effect on us.

In addition, we provide our customers with the ability to bank remotely, including over the Internet and the telephone. The secure transmission of confidential information over the Internet and other remote channels is a critical element of remote banking. Despite instituted safeguards and monitoring, our network could be vulnerable to unauthorized access, computer viruses, phishing schemes and other security breaches. We may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses. To the extent that our activities or the activities of our customers involve the storage and transmission of confidential information, physical and cyber security breaches and viruses could expose us to claims, regulatory scrutiny, litigation and other possible liabilities. Any inability to prevent security breaches or computer viruses could also cause existing customers to lose confidence in our systems and could materially and adversely affect us.

We are subject to a variety of operational risks, environmental, legal and compliance risks, and the risk of fraud or theft by employees or outsiders, which may adversely affect our business and results of operations.

We are exposed to many types of operational risks, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, and unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer, telecommunications systems, cyber security breaches and other disruptive problems caused by the Internet or other users. Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions of other entities, and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers and can expose us to litigation and regulatory action. Actual or alleged conduct by the Bank can also result in negative public opinion about our other businesses.

If personal, non-public, confidential or proprietary information of customers in our possession were to be misappropriated, mishandled or misused, we could suffer significant regulatory consequences, reputational damage and financial loss. Such mishandling or misuse could include, for example, erroneously providing such information to parties who are not permitted to have the information, either by fault of our systems, employees, or counterparties, or the interception or inappropriate acquisition of such information by third parties.

Because the nature of the financial services business involves a high volume of transactions, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process transactions and our large transaction volume may further increase the risk that technical flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We also may be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages, or natural disasters, disease pandemics or other damage to property or physical assets) which may give rise to disruption of service to customers and to financial loss or liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate. The occurrence of any of these risks could result in our diminished ability to operate our business (for example, by requiring us to expend significant resources to correct the defect), as well as potential liability to clients, reputational damage and regulatory intervention, which could adversely affect our business, financial condition or results of operations, perhaps materially.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The federal Bank Secrecy Act, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the "PATRIOT Act") and other laws and regulations require financial institutions, among other duties, to institute and maintain effective anti-money laundering programs and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network, established by the U.S. Treasury Department to administer the Bank Secrecy Act, is authorized to impose significant civil money penalties for violations of those requirements and has recently engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration and Internal Revenue Service. Federal and state bank regulators also have begun to focus on compliance with Bank Secrecy Act and anti-money laundering regulations. If our policies, procedures and systems are deemed deficient or the policies, procedures and systems of the financial institutions that we may acquire in the future are deficient, we would be subject to liability, including fines and regulatory actions such as restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan, including our acquisition plans, which would negatively impact our business, financial condition and results of operations. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us.

Security breaches and other disruptions could compromise our information and expose us to liability, which would cause our business and reputation to suffer.

In the ordinary course of our business, we collect and store sensitive data, including our proprietary business information and that of our customers, suppliers and business partners; and personally identifiable information of our customers and employees. The secure processing, maintenance and transmission of this information is critical to our operations and business strategy. We, our customers, and other financial institutions with which we interact, are subject to ongoing, continuous attempts to penetrate key systems by individual hackers, organized criminals, and in some cases, state-sponsored organizations. Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. Despite our security measures and monitoring, our information technology and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. Any such breach could compromise our networks and the information stored there could be accessed, publicly disclosed, lost or stolen. Any such unauthorized access, disclosure or other loss of information could result in significant costs to us, which may include fines and penalties, potential liabilities from governmental or third party investigations, proceedings or litigation, legal, forensic and consulting fees and expenses, costs and diversion of management attention required for investigation and remediation actions, and the negative impact on our reputation and loss of confidence of our customers and others, any of which could have a material adverse impact on our business, revenues, financial condition and competitive position. As cyber threats continue to evolve, we may be required to spend significant capital and other resources to protect against the threat of security breaches and computer viruses, or to alleviate problems caused by security breaches or viruses.

If our information technology is unable to keep pace with industry developments, our business and results of operations may be adversely affected.

Financial products and services have become increasingly technology-driven. Our ability to meet the needs of our customers competitively, and in a cost-efficient manner, is dependent on the ability to keep pace with technological advances and to invest in new technology as it becomes available. Many of our competitors have greater resources to invest in technology than we do and may be better equipped to market new technology-driven products and services. The ability to keep pace with technological change is important, and the failure to do so could have a material adverse impact on our business and therefore on our financial condition and results of operations.

Exiting or entering new lines of business or new products and services may subject us to additional risk.

From time to time, we may exit an existing line of business or implement new lines of business or offer new products and services within existing lines of business. There are substantial risks and uncertainties associated with these efforts. When exiting a line of business or product we may have difficulty replacing the revenue stream and may have to take certain actions to make up for the line of business or product. For example, we recently discontinued the origination of residential mortgage loans and instead now purchase residential mortgage loans for our loan portfolio from other sources. If those sources are not available or the cost for such purchases increases our results of operations may be adversely affected. We also may face increased credit risk with respect to purchased loans relative to the credit risks we faced in connection with the origination of loans. In developing and marketing new lines of business and/or new products and services, we may invest significant time and resources. Initial timetables for the introduction and development of new lines of business and/or new products or services may not be achieved and price and profitability targets may not prove feasible. External factors, such as compliance with regulations, competitive alternatives, and shifting market preferences, may also impact the successful implementation of a new line of business and/or a new product or service. Furthermore, any new line of business and/or new product or service could have a significant impact on the effectiveness of our system of internal controls. Failure to successfully manage these risks in the development and implementation of new lines of business and/or new products or services could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

The amount of interest payable on our 6.25% Fixed to Floating Rate Subordinated Notes due 2025 will vary after February 15, 2020.

The interest rate on our 6.25% Fixed to Floating Rate Subordinated Notes due 2025 will vary after February 15, 2020. From and including the issue date of such notes but excluding February 15, 2020, the notes will bear interest at a fixed rate of 6.25% per year. From and including February 15, 2020, to but excluding the maturity date, the notes will bear interest at an annual floating rate equal to the three-month LIBOR plus 479 basis points for any interest period. If interest rates rise, the cost of our subordinated notes may increase, negatively affecting our net income.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

The Bank maintains its main office and operations center in Waldorf, Maryland, in addition to its branch offices in Lexington Park, Leonardtown, La Plata, Dunkirk, Bryans Road, Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland and one branch in Fredericksburg, Virginia. The Bank owns all of its branches except for the Dunkirk, Maryland branch, the Fredericksburg Central Park, Virginia branch and the land on which the Waldorf, Charlotte Hall, Prince Frederick and Lusby, Maryland branches are located. In addition, the Bank maintains five loan production offices (''LPOs'') in La Plata, Prince Frederick, Leonardtown and Annapolis, Maryland; and Fredericksburg, Virginia. The Leonardtown LPO is co-located with branches. Lease expiration dates range from 2019 to 2035 with renewal options of 5 to 10 years. Lease expiration dates range from 2019 to 2035 with renewal options of 5 to 10 years. The net book value of premises, which included land, building and improvements, totaled $19.1 million and $19.5 million, respectively, at December 31, 2017 and 2016.

Item 3. Legal Proceedings

Neither the Company, the Bank, nor any subsidiary is engaged in any legal proceedings of a material nature at the present time. From time to time, the Bank is a party to legal proceedings in the ordinary course of business.

Item 4. Mine Safety Disclosures

Not applicable.

PART II

Item 5 — Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Price and Dividends on Registrant's and Related Stockholder Matters.

Market Information

The following table sets forth high and low bid quotations reported for the Company's common stock for each quarter during 2017 and 2016 and the dividends declared per share for common stock. These quotes reflect inter-dealer prices without retail mark-up, mark-down or commission and may not necessarily reflect actual transactions.

Quarter Ended	High	Low	Dividends Per Share
December 31, 2017	$40.44	$35.14	$0.10
September 30, 2017	40.69	32.06	0.10
June 30, 2017	40.00	32.24	0.10
March 31, 2017	36.00	27.16	0.10
December 31, 2016	30.40	22.61	0.10
September 30, 2016	23.97	21.80	0.10
June 30, 2016	23.76	20.60	0.10
March 31, 2016	21.84	19.19	0.10

Holders

The common stock of the Company is traded on the NASDAQ Stock Exchange (Symbol: TCFC). The number of stockholders of record of the Company at March 2, 2018 was 649**.**

Dividends

During 2017 and 2016, the Company declared and paid four quarters of dividends at $0.10 per share. The Board of Directors considers on a quarterly basis the feasibility of paying a cash dividend to its stockholders. Under the Company's general practice, dividends, if declared during the quarter, are paid prior to the end of the subsequent quarter.

The Company's ability to pay dividends is governed by the policies and regulations of the Federal Reserve Board (the ''FRB''), which prohibits the payment of dividends under certain circumstances dependent on the Company's financial condition and capital adequacy. The Company's ability to pay dividends is also dependent on the receipt of dividends from the Bank.

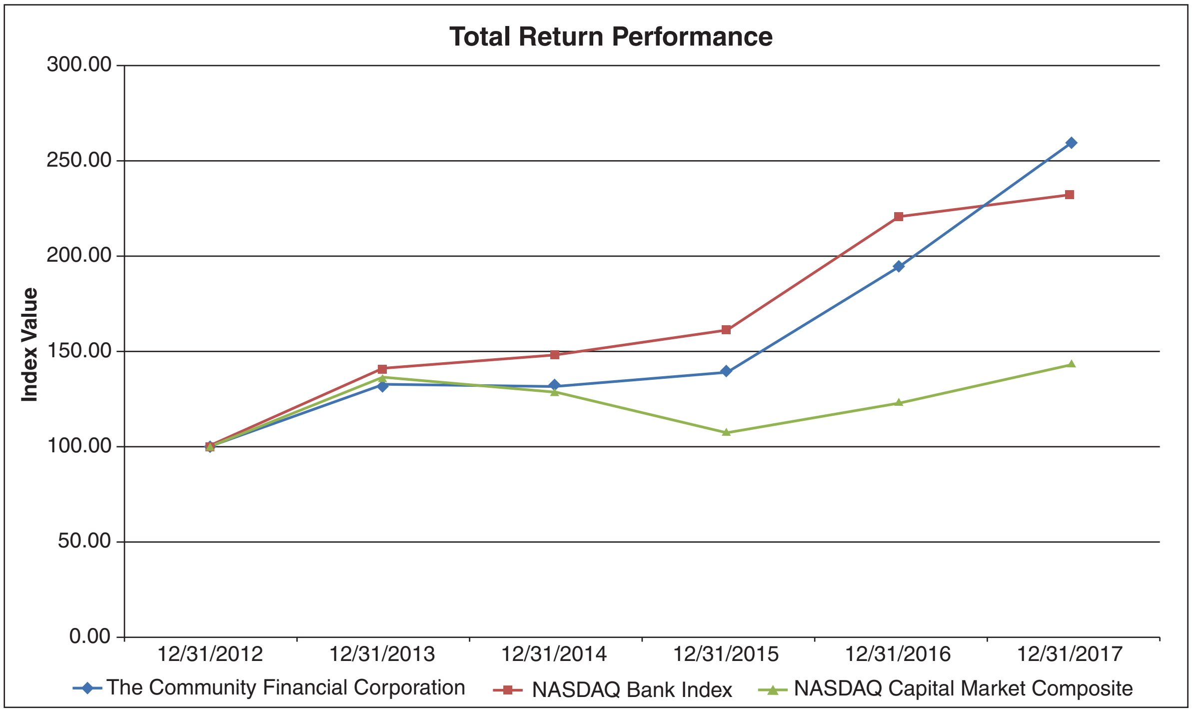
Federal regulations impose limitations on the payment of dividends and other capital distributions by the Bank. The Bank's ability to pay dividends is governed by the Maryland Financial Institutions Code and the regulations of the Federal Deposit Insurance Corporation (''FDIC''). Under the Maryland Financial Institutions Code, a Maryland bank (1) may only pay dividends from undivided profits or, with prior regulatory approval, its surplus in excess of 100% of required capital stock and, (2) may not declare dividends on its common stock until its surplus funds equals the amount of required capital stock, or if the surplus fund does not equal the amount of capital stock, in an amount in excess of 90% of net earnings.

Without the approval of the FDIC, a nonmember bank may not declare or pay a dividend if the total of all dividends declared during the year exceeds its net income during the current calendar year and retained net income for the prior two years. The Bank is further prohibited from making a capital distribution if it would not be adequately capitalized thereafter. In addition, the Bank may not make a capital distribution that would reduce its net worth below the amount required to maintain the liquidation account established for the benefit of its depositors at the time of its conversion to stock form.

Stock Performance Graph

The following graph and table show the cumulative total return on the common stock of the Company over the last five years, compared with the cumulative total return of a broad stock market index (the NASDAQ Capital Market Composite), and a narrower index of the NASDAQ Bank Index. Cumulative total return on the stock or the index equals the total increase in value since December 31, 2012, assuming reinvestment of all dividends paid into the stock or the index.

The graph and table were prepared assuming that $100 was invested on December 31, 2012, in the common stock and the securities included in the indexes.



Source: Bloomberg

	Year Ended					
Index	**12/31/2012**	**12/31/2013**	**12/31/2014**	**12/31/2015**	**12/31/2016**	**12/31/2017**
The Community Financial Corporation	100.00	132.72	131.19	138.97	194.93	260.13
NASDAQ Bank Index	100.00	141.31	148.11	161.09	221.04	232.84
NASDAQ Capital Market Composite	100.00	136.61	128.96	107.08	122.74	143.36

Recent Sales of Unregistered Securities

Not applicable.

Purchases of Equity Securities by the Issuer

On May 4, 2015, the Board of Directors approved a repurchase plan ("2015 repurchase plan). The 2015 repurchase plan authorizes the repurchase of up to 250,000 shares of outstanding common stock. The 2015 repurchase plan will continue until it is completed or terminated by the Company's Board of Directors. During the quarter ended December 31, 2015, the 2015 repurchase plan began with the termination of the 2008 repurchase program. As of December 31, 2017, 188,558 shares were available to be repurchased under the 2015 repurchase program. The following schedule shows the repurchases during the three months ended December 31, 2017.

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 – 31, 2017	—	$—	—	188,558
November 1 – 30, 2017	—	—	—	188,558
December 1 – 31, 2017	—	—	—	188,558
Total	—	$—	—	188,558

Item 6 — Selected Financial Data

SUMMARY OF SELECTED FINANCIAL DATA

The following table shows selected historical consolidated financial data for the Company as of and for each of the five years ended December 31, 2017, which has been derived from our audited consolidated financial statements. You should read this table together with our consolidated financial statements and related notes included elsewhere in this Annual 10-K report.

	At or for the Years Ended December 31,				
(dollars in thousands, except per share amounts)	**2017**	**2016**	**2015**	**2014**	**2013**
FINANCIAL CONDITION DATA					
Total assets	$1,405,961	$1,334,257	$1,143,332	$1,082,878	$1,023,824
Loans receivable, net	1,140,615	1,079,519	909,200	862,409	799,130
Investment securities	167,531	162,280	144,536	126,445	134,648
Deposits	1,106,237	1,038,825	906,899	869,384	821,295
Borrowings	142,998	144,559	91,617	76,672	70,476
Junior subordinated debentures	12,000	12,000	12,000	12,000	12,000
Subordinated notes – 6.25%	23,000	23,000	23,000	—	—
Stockholders' equity – preferred	—	—	—	20,000	20,000
Stockholders' equity – common	109,957	104,426	99,783	96,559	90,730
OPERATING DATA					
Interest and dividend income	$ 53,570	$ 48,047	$ 43,873	$ 41,759	$ 39,678
Interest expenses	10,182	8,142	7,345	6,698	7,646
Net interest income (NII)	43,388	39,905	36,528	35,061	32,032
Provision for loan losses	1,010	2,359	1,433	2,653	940
NII after provision for loan losses	42,378	37,546	35,095	32,408	31,092
Noninterest income	4,084	3,360	3,299	4,093	4,174
Noninterest expenses	30,097	29,159	28,418	26,235	24,844
Income before income taxes	16,365	11,747	9,976	10,266	10,422
Income taxes	9,157	4,416	3,633	3,776	3,771
Net income	7,208	7,331	6,343	6,490	6,651
Preferred stock dividends declared	—	—	23	200	200
Income available to common shares	$ 7,208	$ 7,331	$ 6,320	$ 6,290	$ 6,451
COMMON SHARE DATA					
Basic earnings per common share	$ 1.56	$ 1.59	$ 1.36	$ 1.35	$ 1.90
Diluted earnings per common share	1.56	1.59	1.35	1.35	1.88
Dividends declared per common share	0.40	0.40	0.40	0.40	0.40
Book value per common share[1]	23.65	22.54	21.48	20.53	19.52
Common shares outstanding at end of period	4,649,658	4,633,868	4,645,429	4,702,715	4,647,407
Basic weighted average common shares	4,627,776	4,599,502	4,676,748	4,646,424	3,402,432
Diluted weighted average common shares	4,629,228	4,599,502	4,676,748	4,655,127	3,426,793
OTHER DATA					
Number of:					
Full-time equivalent employees	165	162	171	172	165
Full-service offices	11	12	12	12	11
Loan Production Offices	5	5	5	5	4
REGULATORY CAPITAL RATIOS (consolidated)					
Tier 1 capital to average assets (Leverage)	8.79%	9.02%	10.01%	12.24%	12.50%
Tier 1 common capital to risk-weighted assets	9.51	9.54	10.16	n/a	n/a
Tier 1 capital to risk-weighted assets	10.53	10.62	11.38	14.26	14.66
Total risk-based capital to risk-weighted assets	13.40	13.60	14.58	15.21	15.62

(dollars in thousands, except per share amounts)	At or for the Years Ended December 31, 2017	2016	2015	2014	2013
KEY OPERATING RATIOS					
Return on average assets	0.52%	0.60%	0.58%	0.63%	0.69%
Return on average total equity	6.55	7.09	6.21	5.69	7.49
Return on average common equity	6.55	7.09	6.33	6.69	9.38
Interest rate spread	3.24	3.35	3.48	3.55	3.45
Net interest margin	3.37	3.48	3.60	3.68	3.56
Efficiency ratio(2)	63.40	67.40	71.35	67.00	68.62
Common dividend payout ratio	25.64	25.16	29.41	29.63	21.05
Non-interest expense to average assets	2.19	2.37	2.60	2.56	2.56
Net operating expense to average assets(3)	1.89	2.10	2.30	2.16	2.13
Avg. int-earning assets to avg. int-bearing liabilities	116.95	117.56	117.71	118.83	114.57
SELECTED ASSET QUALITY DATA					
Gross loans	$1,150,044	$1,088,982	$918,894	$872,129	$808,240
Classified assets	50,298	39,246	43,346	54,022	56,880
Allowance for loan losses	10,515	9,860	8,540	8,481	8,138
Nonperforming loans (>=90 Days)(4)	2,483	7,705	10,740	10,263	11,170
Non-accrual loans(5)	4,693	8,374	11,433	10,263	15,451
Accruing troubled debt restructures (TDRs)(6)	10,021	10,448	13,133	13,249	4,364
Other Real Estate Owned (OREO)	9,341	7,763	9,449	5,883	6,797
Non-accrual loans, OREO and TDRs	$ 24,055	$ 26,585	$ 34,015	$ 29,395	$ 26,612
SELECTED ASSET QUALITY RATIOS					
Average total equity to average total assets	7.99%	8.41%	9.35%	11.11%	9.16%
Classified assets to total assets	3.58	2.94	3.79	4.99	5.56
Classified assets to risk-based capital	32.14	26.13	30.19	39.30	43.11
Allowance for loan losses to total loans	0.91	0.91	0.93	0.97	1.01
Allowance for loan losses to nonperforming loans	423.48	127.97	79.52	82.64	72.86
Net charge-offs to avg. outstanding loans	0.03	0.11	0.16	0.28	0.14
Nonperforming loans to total loans	0.22	0.71	1.17	1.18	1.38
Non-accrual loans to total loans	0.41	0.77	1.24	1.18	1.91
Non-accrual loans and TDRs to total loans	1.28	1.73	2.67	2.70	2.45
Non-accrual loans and OREO to total assets	1.00	1.21	1.83	1.49	2.17
Non-accrual loans, OREO and TDRs to total assets	1.71	1.99	2.98	2.71	2.60

(1) The Company had no intangible assets as of the dates indicated. Thus, tangible book value per share is the same as book value per share for each of the periods indicated.

(2) Efficiency ratio is noninterest expense divided by the sum of net interest income and noninterest income.

(3) Net operating expense is the sum of non-interest expense offset by non-interest income.

(4) Nonperforming loans include all loans that are 90 days or more delinquent.

(5) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer.

(6) TDR loans include both non-accrual and accruing performing loans. All TDR loans are included in the calculation of asset quality financial ratios. Non-accrual TDR loans are included in the non-accrual balance and accruing TDR loans are included in the accruing TDR balance.

Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

This report contains forward-looking statements that are based on assumptions and may describe future plans, strategies and expectations of The Community Financial Corporation (the ''Company'') and Community Bank of the Chesapeake (the ''Bank''). Forward-looking statements can generally be identified by the fact that they do not relate strictly to historical or current facts. They often include words like ''believe,'' ''expect,'' ''anticipate,'' ''estimate'' and ''intend'' or future or conditional verbs such as ''will,'' ''would,'' ''should,'' ''could'' or ''may.'' Statements in this Report that are not strictly historical are forward-looking and are based upon current expectations that may differ materially from actual results. These forward-looking statements include, without limitation, those relating to the Company's and Community Bank of the Chesapeake's future growth and management's outlook or expectations for revenue, assets, asset quality, profitability, business prospects, net interest margin, non-interest revenue, allowance for loan losses, the level of credit losses from lending, liquidity levels, capital levels, or other future financial or business performance strategies or expectations.

These forward-looking statements may also include: any statements of the plans and objectives of management for future operations products or services, including the execution of integration plans relating to the County First acquisition; plans regarding branch closings or consolidation; any statement of expectation or belief; projections related to certain financial metrics; and any statement of assumptions underlying the foregoing. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those anticipated by the statements made herein. These risks and uncertainties involve general economic trends, changes in interest rates; loss of deposits and loan demand to other financial institutions; substantial changes in financial markets; changes in real estate value and the real estate market; regulatory changes; the possibility of unforeseen events affecting the industry generally; the uncertainties associated with newly developed or acquired operations; the outcome of litigation that may arise; market disruptions and other effects of terrorist activities; and the matters described in ''Item 1A Risk Factors'' in this Annual Report on Form 10-K for the Year Ended December 31, 2017, and in the Company's other Reports filed with the Securities and Exchange Commission (the ''SEC'').

The Company's forward-looking statements may also be subject to other risks and uncertainties, including those that the Company may discuss elsewhere in this Report or in its other filings with the SEC, accessible on the SEC's Web site at www.sec.gov. The Company undertakes no obligation to update these forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unforeseen events, except as required under the rules and regulations of the SEC.

Use of Non-GAAP Financial Measures

Statements included in management's discussion and analysis include non-GAAP financial measures and should be read along with the accompanying tables, which provide a reconciliation of non-GAAP financial measures to GAAP financial measures. The Company's management uses these non-GAAP financial measures, and believes that non-GAAP financial measures provide additional useful information that allows readers to evaluate the ongoing performance of the Company. Non-GAAP financial measures should not be considered as an alternative to any measure of performance or financial condition as promulgated under GAAP, and investors should consider the Company's performance and financial condition as reported under GAAP and all other relevant information when assessing the performance or financial condition of the Company. Non-GAAP financial measures have limitations as analytical tools, and investors should not consider them in isolation or as a substitute for analysis of the results or financial condition as reported under GAAP. See Non-GAAP reconciliation schedule that immediately follows: Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are defined as those that involve significant judgments and uncertainties and could potentially result in materially different results under different assumptions and conditions. The Company considers its determination of the allowance for loan losses, the valuation of foreclosed real estate (OREO) and the valuation of deferred tax assets to be critical accounting policies.

The Company's Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States of America and the general practices of the United States banking industry. Application of these principles requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements and accompanying notes. These estimates, assumptions and judgments are based on information available as of the date of the financial statements. Accordingly, as this information changes, the financial statements could reflect different estimates, assumptions and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions and judgments and, as such, have a greater possibility of producing results that could be materially different than originally reported.

Estimates, assumptions and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the financial statements at fair value warrants an impairment write-down or valuation reserve to be established or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities at fair value inherently results in more financial statement volatility. The fair values and the information used to record valuation adjustments for certain assets and liabilities are based either on quoted market prices or are provided by other third-party sources, when available. When these sources are not available, management makes estimates based upon what it considers to be the best available information.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the losses that exist in the loan portfolio. The allowance is based on two principles of accounting: (1) Financial Accounting Standards Board (''FASB'') Accounting Standards Codification (''ASC'') Topic 450 ''Contingencies,'' which requires that losses be accrued when they are probable of occurring and are estimable and (2) FASB ASC 310 ''Receivables,'' which requires that losses be accrued when it is probable that the Company will not collect all principal and interest payments according to the contractual terms of the loan. The loss, if any, is determined by the difference between the loan balance and the value of collateral, the present value of expected future cash flows and values observable in the secondary markets.

The allowance for loan loss balance is an estimate based upon management's evaluation of the loan portfolio. The allowance includes a specific and a general component. The specific component consists of management's evaluation of certain classified and non-accrual loans and their underlying collateral. Management assesses the ability of the borrower to repay the loan based upon all information available. Loans are examined to determine a specific allowance based upon the borrower's payment history, economic conditions specific to the loan or borrower and other factors that would impact the borrower's ability to repay the loan on its contractual basis. Depending on the assessment of the borrower's ability to pay and the type, condition and value of collateral, management will establish an allowance amount specific to the loan.

Management uses a risk scale to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are risk rated. Residential first mortgages, home equity and second mortgages and consumer loans are monitored on an ongoing basis based on borrower payment history. Consumer loans and residential real estate loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned or higher risk rating due to a delinquent payment history.

The Company's commercial loan portfolio is periodically reviewed by regulators and independent consultants engaged by management.

In establishing the general component of the allowance, management analyzes non-impaired loans in the portfolio including changes in the amount and type of loans. This analysis reviews trends by portfolio segment in charge-offs, delinquency, classified loans, loan concentrations and the rate of portfolio segment growth. Qualitative factors also include an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends. Based upon this analysis a loss factor is applied to each loan category and the Bank adjusts the loan loss allowance by increasing or decreasing the provision for loan losses.

Management has significant discretion in making the judgments inherent in the determination of the allowance for loan losses, including the valuation of collateral, assessing a borrower's prospects of repayment and in establishing loss factors on the general component of the allowance. Changes in loss factors have a direct impact on the amount of the provision and on net income. Errors in management's assessment of the global factors and their impact on the portfolio could result in the allowance not being adequate to cover losses in the portfolio, and may result in additional provisions. At December 31, 2017 and 2016, the allowance for loan losses was $10.5 million and $9.9 million, respectively, or 0.91% and 0.91%, respectively, of total loans. An increase or decrease in the allowance could result in a charge or credit to income before income taxes that materially impacts earnings.

For additional information regarding the allowance for loan losses, refer to Notes 1 and 6 of the Consolidated Financial Statements and the discussion the discussion in this MD&A.

Other Real Estate Owned ("OREO")

The Company maintains a valuation allowance on its other real estate owned. As with the allowance for loan losses, the valuation allowance on OREO is based on FASB ASC 450 "Contingencies," as well as the accounting guidance on impairment of long-lived assets. These statements require that the Company establish a valuation allowance when it has determined that the carrying amount of a foreclosed asset exceeds its fair value. Fair value of a foreclosed asset is measured by the cash flows expected to be realized from its subsequent disposition. These cash flows include the costs of selling or otherwise disposing of the asset.

In estimating the fair value of OREO, management must make significant assumptions regarding the timing and amount of cash flows. For example, in cases where the real estate acquired is undeveloped land, management must gather the best available evidence regarding the market value of the property, including appraisals, cost estimates of development and broker opinions. Due to the highly subjective nature of this evidence, as well as the limited market, long time periods involved and substantial risks, cash flow estimates are highly subjective and subject to change. Errors regarding any aspect of the costs or proceeds of developing, selling or otherwise disposing of foreclosed real estate could result in the allowance being inadequate to reduce carrying costs to fair value and may require an additional provision for valuation allowances.

For additional information regarding OREO, refer to Notes 1 and 8 of the Consolidated Financial Statements.

Deferred Tax Assets

The Company accounts for income taxes in accordance with FASB ASC 740, "Income Taxes," which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. FASB ASC 740 requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or the entire deferred tax asset will not be realized.

Management periodically evaluates the ability of the Company to realize the value of its deferred tax assets. If management were to determine that it was not more likely than not that the Company would realize the full amount of the deferred tax assets, it would establish a valuation allowance to reduce the carrying value of the deferred tax asset to the amount it believes would be realized. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax-planning strategies that could be implemented to realize the net deferred tax assets.

Failure to achieve forecasted taxable income might affect the ultimate realization of the net deferred tax assets. Factors that may affect the Company's ability to achieve sufficient forecasted taxable income include, but are not limited to, the following: increased competition, a decline in net interest margin, a loss of market share, decreased demand for financial services and national and regional economic conditions.

The Company's provision for income taxes and the determination of the resulting deferred tax assets and liabilities involve a significant amount of management judgment and are based on the best information available at the time. The Company operates within federal and state taxing jurisdictions and is subject to audit in these jurisdictions.

For additional information regarding income taxes and deferred tax assets, refer to Notes 1 and 12 of the Consolidated Financial Statements.

OVERVIEW

Community Bank of the Chesapeake (the ''Bank'') is headquartered in Southern Maryland with branches located in Maryland and Virginia. The Bank is a wholly owned subsidiary of The Community Financial Corporation (the ''Company'').

The Company's branches are located at its main office in Waldorf, Maryland, and 10 branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Fredericksburg, Virginia. The Company maintains five loan production offices (''LPOs'') in Annapolis, La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown LPO is co-located with the branch.

The Bank has increased assets primarily with organic loan growth. During the past five years the Bank's loan portfolio has increased $341.8 million from $808.2 million at December 31, 2013 to $1,150.0 million at December 31, 2017. The Bank believes that its ability to offer fast, flexible, local decision-making will continue to attract significant new business relationships. The Bank focuses its business generation efforts on targeting small and medium sized commercial businesses with revenues between $5.0 million and $35.0 million as well as local municipal agencies and not-for-profits. The Bank's marketing is also directed towards increasing its balances of transactional deposit accounts, which are all deposit accounts other than certificates of deposit. The Bank believes that increases in these account types will lessen the Bank's dependence on higher-cost funding, such as certificates of deposit and borrowings. Although management believes that this strategy will increase financial performance over time, increasing the balances of certain products, such as commercial lending and transaction accounts, may also increase the Bank's noninterest expense. The Bank recognizes that certain lending and deposit products increase the possibility of losses from credit and other risks.

2017 Operations Summary

Net income for year ended December 31, 2017 was $7.2 million or $1.56 per diluted share after the inclusion of the additional tax expense under the recently enacted Tax Cuts and Jobs Act and the expenses associated with the acquisition of County First Bank. The additional income tax and merger and acquisition costs of $724,000, net of tax, resulted in a reduction of earnings per share of approximately $0.75 per share for 2017. Net income for the year ended December 31, 2016 was $7.3 million or $1.59 per diluted share.

Income before taxes (pretax income) increased $619,000 or 18.3% to $4.0 million for the three months ended December 31, 2017 compared to $3.4 million for the three months ended December 31, 2016. The Company's pretax returns on average assets and common stockholders' equity for the fourth quarter of 2017 were 1.14% and 14.15%, respectively, compared to 1.04% and 12.84%, respectively, for the fourth quarter of 2016. The Company's after-tax returns on average assets and common stockholders' equity for the fourth quarter of 2017 were (0.13%) and (1.62%), respectively, compared to 0.62% and 7.68%, respectively, for the fourth quarter of 2016. Pretax income increased $4.6 million or 39.3% to $16.3 million for the year ended December 31, 2017 compared to $11.7 million for the year ended December 31, 2016. The Company's pretax returns on average assets and common stockholders' equity for 2017 were 1.19% and 14.88%, respectively, compared to 0.96% and 11.36%, respectively, for 2016. The Company's after-tax returns on average assets and common stockholders' equity for 2017 were 0.52% and 6.55%, respectively, compared to 0.60% and 7.09%, respectively, for 2016.

On January 1, 2018, we completed the legal merger with County First Bank adding total assets of approximately $227 million, which included approximately $143 million in loans and $200 million in deposits. The acquisition should complement the Company's strategy to enhance net interest income and remain focused on creating operating leverage by growing top line revenue faster than operating expenses. Acquired cash, securities and deposits positively impacted the Company's liquidity. Cash and securities acquired of approximately $72 million will allow the Bank to pay down more costly wholesale funding in 2018. Approximately $160 million of the acquired deposits were stable low-cost transaction accounts that will fund planned loan growth in 2018. The closing of four of the five acquired branches this spring should begin to positively impact the Company's operating expense run rate in the second half of 2018. The details of the transaction are more fully described below the 2017 Operations Summary.

Although the increased tax expense related to the deferred tax revaluation and merger and acquisition costs decreased net income, earnings per share and returns on average assets and common equity for the year, management believes the reduced federal income tax rate and the efficiencies from the County First acquisition will be accretive in 2018. The Company completed a very strong 2017 with operating net income[(1)] growing at a record pace for the Company. Operating earnings per share increased to $2.31 per share, an increase of $0.72 or 45% from $1.59 per share in 2016. Operating return on average assets and operating return on average common equity increased to 0.78% and 9.70%, respectively, compared to 0.60% and 7.09% in 2016.

We accomplished the increased profitability primarily by controlling expense growth and improving asset quality. The Company's efficiency ratio[(2)] averaged in the low 60s for the year ended December 31, 2017. The Company's cost control efforts and continued asset growth continued to create operating leverage[(3)] in 2017.

Average loans increased $125.5 million or 12.7% from $988.3 million for the year ended December 31, 2016 to $1,113.8 million for the year ended December 31, 2017. Overall, end of period loan growth for 2017 of $61.1 million or 5.6% was lower than the Company's planned 8% to 9% growth. The Company's two largest portfolios, commercial real estate and residential rentals grew $60.2 million or 9.0% to $727.3 million and $8.3 million or 8.2% to $110.2 million, respectively, for the year ended December 31, 2017. Other portfolios decreased a net of $7.5 million or 2.3% to $312.5 million. The decrease in other portfolios included a $630,000 decrease in the residential first mortgage portfolio to $170.4 million and a $9.1 million decrease in the construction and land development to $27.9 million. During 2017, management directed its focus to higher yielding commercial real estate and construction loans and deemphasized residential first mortgage lending.

Deposits increased by 6.5%, or $67.4 million, to $1,106.2 million at December 31, 2017 compared to $1,038.8 million at December 31, 2016. During 2017, balance sheet growth was balanced, with deposit growth of $67.4 million slightly exceeding loan growth of $61.1 million. Retail deposits, which include all deposits except traditional brokered deposits, increased a total of $79.4 million, comprised of increases in transaction accounts of $48.6 million and time deposits of $30.8 million. These retail increases to deposits were partially offset by a decrease to brokered deposits of $12.0 million.

Acquisition of County First Bank

On January 1, 2018, the Company completed its previously announced merger of County First Bank ("County First") with and into the Bank, with the Bank as the surviving bank (the "Merger") pursuant to the Agreement and Plan of Merger, dated as of July 31, 2017, by and among the Company, the Bank and County First. Pursuant to the Merger Agreement, at the effective time of the Merger (the "Effective Time"), each share of common stock, par value $1.00 per share, of County First issued and outstanding immediately prior to the Effective Time was converted into the right to receive 0.9543 shares of Company common stock and $2.20 in cash (the "Merger Consideration"). The $2.20 in cash represents the sum of (i) $1.00 in cash consideration (the "Cash Consideration") plus (ii) $1.20 in Contingent Cash Consideration that was determined before the completion of the Merger in accordance with the terms of the Merger Agreement. The aggregate merger consideration consisted of approximately 919,000 shares of the Company's common stock

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(1) The Company defines operating net income as net income before merger and acquisition costs and the deferred tax adjustment for Tax Cuts and Jobs Act. Operating earnings per share, operating return on average assets and operating return on average common equity is calculated using adjusted operating net income. See Non-GAAP reconciliation schedule that immediately follows: Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations.

(2) **Efficiency Ratio —** noninterest expense divided by the sum of net interest income and noninterest income.

(3) **Operating leverage** occurs when the Company increases its assets, and by extension its net interest income, while limiting increases in noninterest expense. In order for this to be effective, the Company must simultaneously pursue the following: increase the asset size while maintaining asset quality, increase funding at an economically viable cost, and control noninterest expense growth.

and approximately $2.1 million in cash. Based upon the $38.78 per share closing price of the Company's common stock on December 28, 2017, the transaction value was approximately $37.7 million.

The County First Bank acquisition is being accounted for under the acquisition method of accounting with the Company treated as the acquirer. Under the acquisition method of accounting, the assets and liabilities of County First Bank, as of January 1, 2018, will be recorded by the Company at their respective fair values, and the excess of the merger consideration over the fair value of County First Bank's net assets will be allocated to goodwill. At December 31, 2017, County First had total assets of approximately $227 million, total loans of $143 million and total deposits of $200 million. County First had five branch offices in La Plata, Waldorf, New Market, Prince Frederick and California, Maryland. The Bank intends to keep the La Plata branch open and consolidate the remaining four branches with legacy Community Bank of the Chesapeake branch offices in May of 2018. The calculations to determine fair values were not complete at the time of filing of the 2017 Annual Report on Form 10-K. Until the determination of the fair values is complete, it is impractical to include disclosures related to the fair value of the assets acquired and liabilities assumed as required by the accounting guidance.

Merger related costs, which included mainly professional fees and investment banking costs, for the year ended December 31, 2017 were $829,000.

2016 Operations Summary

During 2016, the Company planned to increase the loan portfolio by at least 10% and control expenses. Due to the low interest rate environment for most of 2016, and its effect on net interest margin, the Company continued restructuring of operations to reduce costs. In the first quarter of 2016, the Company completed a redesign of the branch system. This redesign, combined with the closure of the King George facility allowed the Company to reduce branch employees by 15% from 73 at March 31, 2015 to 62 at March 31, 2016. The Company focused on reducing other expenses by streamlining internal processes and FTEs as well as by reviewing vendor relationships. The Company's cost control efforts and continued asset growth created operating leverage(4) and increased its earnings per share, return on average assets and return on equity.

The focus on expense control is a continuing initiative and during the second quarter of 2017, the Company announced the closing of its Central Park Fredericksburg branch. The branch closed in the third quarter of 2017. This location continues to serve as a loan production office and the branch closure did not have a material effect on operations. The Company offered branch employees open positions. Changing customer banking preferences, along with the opening of our downtown Fredericksburg branch influenced the decision to close the Central Park branch.

The Company's efficiency ratio improved in every quarter of 2016. The efficiency ratio improved from 73.67% for the fourth quarter of 2015 to 64.38% for the fourth quarter of 2016. Year over year, the efficiency ratio improved 395 basis points to 67.40% from 71.35% for the years ended December 31, 2016 and 2015, respectively. The rate of expense growth was controlled at 2.6% during 2016 compared to 8.3% expense growth in 2015.

During the year ended December 31, 2016 loan growth was very strong with end of period gross loans increasing $170.1 million, or 18.5% from $918.9 million at December 31, 2015 to $1,089.0 million at December 31, 2016. The increase in loan balances resulted in net interest income growing faster than operating expenses. Net interest income increased $3.4 million or 9.2%, compared to noninterest expense growth of $741,000 or 2.6%.

Economy

The presence of federal government agencies, as well as significant government facilities, and the related private sector support for these entities, has led to faster economic growth in our market and lower unemployment compared to the nation as a whole. In addition, the Bank's entry into the greater Annapolis and Fredericksburg markets has provided the Bank with additional loan and deposit opportunities. These opportunities have positively impacted the Bank's organic growth.

In 2017, the national economy continued to improve throughout the year. The economy (GDP) grew 2.30% in 2017, an increase from 1.50% GDP growth in 2016. Consumer confidence has increased due to positive economic trends such as lower unemployment, increased housing metrics and solid performance in the financial markets. The Mid-Atlantic region in which the Company operates continued to experience continued improved regional economic performance. The presence of several major federal facilities located within the Bank's footprint and in adjoining counties contribute to economic growth. Major federal facilities include the Patuxent River Naval Air Station in St. Mary's County, the Indian Head Division, Naval Surface Warfare Center in Charles County and the Naval Surface Warfare — Naval Support Facility in King George County. In addition, there are several major federal facilities located in adjoining markets including Andrews Air Force Base and Defense Intelligence Agency & Defense Intelligence Analysis Center in Prince Georges County, Maryland and the U.S. Marine Base Quantico, Drug Enforcement Administration Quantico facility and Federal Bureau of Investigation Quantico facility in Prince William County, Virginia. These facilities directly employ thousands of local employees and serve as an important player in the region's overall economic health.

The economic health of the region, while stabilized by the influence of the federal government, is not solely dependent on this sector. Calvert County is home to the Dominion Power Cove Point Liquid Natural Gas Terminal, which is one of the nation's largest liquefied natural gas terminals and Dominion Power is currently constructing liquefaction facilities for exporting liquefied natural gas. Based on information from the U.S. Bureau of Labor Statistics, unemployment rates and household income in the Company's footprint have historically performed better than the national average. According to SNL Financial, the median household income in our market area is $97,000 compared to $61,000 for the United States. According to SNL Financial, the Bank's market areas have strong demographics with below average unemployment rates. The Bank's primary market areas have unemployment rates below 3.6% with projected population growth in excess of 4.25% over the next five years.

The greater Fredericksburg area, the Bank's newest area of expansion (2013), continued to experience economic growth. According to the Fredericksburg Regional Alliance, the Fredericksburg Region, including the City of Fredericksburg and the counties of Caroline, King George, Spotsylvania, and Stafford, Virginia, has been the fastest growing region in the Commonwealth of Virginia for the last five years.

COMPARISON OF RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016

Earnings Summary

Net income for year ended December 31, 2017 was $7.2 million or $1.56 per diluted share after the inclusion of the additional tax expense of $2.7 million under the recently enacted Tax Cuts and Jobs Act and merger and acquisition costs of $724,000, net of tax, associated with the acquisition of County First Bank. The combined impact of the deferred tax adjustment and merger and acquisition costs, resulted in a reduction of earnings per share of approximately $0.75 per share for 2017. Net income for the year ended December 31, 2016 was $7.3 million or $1.59 per diluted share. The Company's after-tax returns on average assets and common stockholders' equity for 2017 were 0.52% and 6.55%, respectively, compared to 0.60% and 7.09%, respectively, for 2016.

Although the increased tax expense related to the deferred tax revaluation and merger and acquisition costs decreased net income, earnings per share and returns on average assets and common equity for the year ended December 31, 2017, the Company believes the reduced federal income tax rate and the efficiencies from the County First acquisition will be accretive in 2018.

The Company has pursued a strategy of increasing operating leverage over the last several years. This occurs when the Company increases its assets, and by extension its net interest income, while limiting increases in noninterest expense. In order for this to be effective, the Company must simultaneously pursue the following; increase the asset size while maintaining asset quality, increase funding at an economically viable cost, and control noninterest expense growth.

The Company completed a very strong 2017 with pretax net income growing at a record pace. Income before taxes (pretax net income) increased $4.6 million or 39.3% to $16.3 million for the year ended December 31, 2017 compared to $11.7 million for the year ended December 31, 2016. The Company's pretax returns on average assets and common stockholders' equity for 2017 were 1.19% and 14.88%, respectively, compared to 0.96% and 11.36%, respectively, for 2016.

- The increase in operating income and operating leverage in 2017 was primarily due to the following:
  - Net interest income was $43.4 million in 2017, an increase of $3.5 million, or 8.7%, compared to 2016.
    - ○ Interest income increased $5.5 million. The increase was driven by increased average interest-earning assets including increased average loan balances. The Bank increased average net loan balances $125.5 million to $1,113.8 million in 2017 from $988.3 million in 2016. The effect of loan volume on interest income was partially offset by yield declines.
    - ○ Interest expense increased $2.0 million which partially offset increased interest income. The primary reason for the increase in interest expense was larger average interest-bearing liability balances and an increase in the cost of wholesale and time-based funding.
      - The average balances of interest-bearing liabilities increased $127.7 million to $1,102.1 million in 2017 from $974.4 million for 2016.
      - The Company's cost of funds, which includes noninterest-bearing funding, increased by eight basis points from the 2016 comparable period to 0.81% for the year ended December 31, 2017.

        Wholesale and time-based funding rates are typically more sensitive to rising interest rates than transactional deposits. Compared to the year ended December 31, 2016, interest rates in 2017 increased by 14 basis points to 1.00% on certificates of deposit, while interest-bearing transactional deposits increased by five basis points to 0.32%. Federal Home Loan Bank ("FHLB") short-term borrowings increased by 66 basis points to 1.15% for the year ended December 31, 2017 compared to 0.49% for the year ended December 31, 2016. The Company's increases in transaction deposits during the last twelve months have decreased downward pressure on net interest margin. The ability to increase transaction deposits faster than wholesale funding could mitigate possible downward pressure on net interest margin in a rising rate environment.
  - The Company controlled expense growth. Noninterest expense increased $938,000, or 3.2%, to $30.1 million for the year ended December 31, 2016 compared to $29.2 million the prior year. Merger and acquisition costs (M&A costs) of $829,000 were incurred in 2017. These costs were not incurred in 2016 and excluding M&A costs in 2017, noninterest expense was $29.3 million, an increase of $109,000, or 0.37%, compared to 2016.

    During 2017 net operating expense as a percentage of average assets and the efficiency ratio declined (improved) compared to the prior year to 1.89% and 63.40%, respectively for the year ended December 31, 2017 from 2.10% and 67.40%, respectively for the year ended December 31, 2016.
  - The Company's continued improvement in asset quality as well as slower 2017 loan growth, have positively impacted pretax earnings. The Company's improving credit metrics have partially offset the provisioning required to provide for loan growth. The provision for loan losses decreased $1.3 million, or 57.2%, to $1.0 million for the year ended December 31, 2017 compared to $2.4 million for the year ended December 31, 2017.

Overall credit metrics improved during 2017; this improvement with more modest loan growth of 5.6% (compared to 18.5% in 2016) kept the loan loss provision below the prior year. Net charge-offs of 0.03% of average loans were the lowest since before the financial crisis (2007 was 0.04%). Nonaccrual loans and OREO decreased $2.2 million to $14.0 million from $16.2 million at December 31, 2016; this is a reduction from 1.21% of assets at December 31, 2016 to 1.00% of assets at December 31, 2017. Although the overall credit trend was positive, the third and fourth quarter of 2017 saw increases to substandard and special mention loans and delinquency. Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as slower portfolio growth, were offset by increases in other qualitative factors, such as concentration to capital factors and increased classified assets. Management believes that the allowance is adequate.

A more detailed analysis comparing the results of operations for the years ended December 31, 2017 and 2016 follows.

Net Interest Income

The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.

Net interest income increased 8.7% or $3.5 million to $43.4 million for the year ended December 31, 2017 compared to $39.9 million for the year ended December 31, 2016. Net interest margin at 3.37% for the year ended December 31, 2017 decreased 11 basis points from 3.48% for the year ended December 31, 2016. Average interest-earning assets were $1,288.8 million for the full year of 2017, an increase of $143.3 million, or 12.5%, compared to $1,145.5 million for the full year of 2016.

The following table shows the components of net interest income and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Interest and Dividend Income				
Loans, including fees	$49,611	$44,919	$4,692	10.4%
Taxable interest and dividends on investment securities	3,906	3,108	798	25.7%
Interest on deposits with banks	53	20	33	165.0%
Total Interest and Dividend Income	53,570	48,047	5,523	11.5%
Interest Expenses				
Deposits	5,946	4,695	1,251	26.6%
Short-term borrowings	1,057	196	861	439.3%
Long-term debt	3,179	3,251	(72)	(2.2)%
Total Interest Expenses	10,182	8,142	2,040	25.1%
Net Interest Income (NII)	$43,388	$39,905	$3,483	8.7%

Net interest income increased during 2017 compared to the prior year as the positive impacts of average interest-earning asset growth and increased investment yields outpaced the negative impacts of declining loan yields, increasing funding costs and growth in the average balances of interest-bearing liabilities.

The net interest margin was 3.37% for the year ended December 31, 2017, an 11 basis point decrease from 3.48% for the year ended December 31, 2016. The decrease in net interest margin was largely the result of an increase in the cost of funding (eight basis points) and a decrease in interest-earning asset yields (three basis points). Net interest margin declined during the year ended December 31, 2017, primarily due to reduced yields on loans and an increase in cost of funds. Yields on the loan portfolio decreased from 4.55% for the year ended December 31, 2016 to 4.45% for year ended December 31, 2017. Yields were reduced compared to the prior year due primarily to the Bank's increased investment in residential mortgages during 2016, competition for commercial real estate loans and other commercial loans and the timing of scheduled repricing of the Bank's loan portfolios.

An increase in the cost of funds impacted net interest margin for the comparable periods. The cost of funds increased eight basis points to 0.81% for the year ended December 31, 2017 compared to 0.73% for the year ended December 31, 2016. The Company continued to control deposit costs by increasing transaction deposits as a percentage of overall deposits. Average transaction deposits, which include savings, money market, interest-bearing demand and noninterest bearing demand accounts, for the years ended December 31, 2017 increased $56.0 million, or 9.8%, to $627.6 million compared to $571.6 million for the comparable period in 2016. Average transaction accounts as a percentage of total deposits remained stable at 58.3% for the year ended December 31, 2016 compared to 58.6% for the years ended December 31, 2017. The increase in average transaction deposits included growth in noninterest bearing demand deposits of $12.1 million, or 8.5%, from $142.1 million for the year ended December 31, 2016 to $154.2 million for the year ended December 31, 2017.

Interest and dividend income increased by $5.5 million to $53.5 million for the year ended December 31, 2017 compared to $48.0 million for the year ended December 31, 2016, primarily due to growth in the average balance of loans and investments. Interest and dividend income also increased due to increased investment yields. Interest and dividend income on loans increased $5.6 million due to growth of $125.5 million, or 12.7%, in the average balance of loans from $988.3 million for the year ended December 31, 2016 to $1,113.8 million for the year ended December 31, 2017. Interest and dividend income on investments increased $831,000 during 2017 compared to the prior year as average interest-earning investment balances increased $17.9 million and average yields increased from 1.99% to 2.26%. These increases to interest and dividend income were partially offset by decreased income from reduced yields on loans. Average loan yields declined 10 basis points from 4.55% for the year ended December 31, 2016 to 4.45% for the year ended December 31, 2017, which resulted in a decrease in interest and dividend income of $899,000.

Interest expense increased $2.0 million to $10.2 million for the year ended December 31, 2017 compared to the year ended December 31, 2016 due to an increase in the average balances of interest-bearing liabilities and increased funding costs between the comparable periods. During the year ended December 31, 2017, interest expense increased $1.0 million due to larger average balances of interest-bearing transaction deposit accounts, time deposits and short-term FHLB borrowings compared to the year ended December 31, 2016. Additionally, interest expense increased $1.1 million due to increased rates on interest-bearing deposit accounts, short-term borrowings and junior subordinated debentures ("TRUPS"). These increases to interest expense were partially offset by a reduction in interest expense for long-term debt of $143,000 due to a $1.8 million decrease in average long-term debt balances to $58.7 million and a lower average interest rate of 2.24%.

As a result of an increase in average short-term borrowings, the average rate paid on debt, which includes long-term debt, TRUPS, subordinated notes, and short-term borrowings, decreased from 2.55% for the year ended December 31, 2016 to 2.28% for the year ended December 31, 2017.

Changes in the components of net interest income due to changes in average balances of assets and liabilities and to changes caused by changes in interest rates are presented in the rate volume analysis included below. The table below presents information on average balances and rates for deposits.

(dollars in thousands)	For the Years Ended December 31, 2017 Average Balance	2017 Average Rate	2016 Average Balance	2016 Average Rate
Savings	$ 53,560	0.05%	$ 48,878	0.08%
Interest-bearing demand and money market accounts	419,817	0.35%	380,592	0.30%
Certificates of deposit	443,181	1.00%	409,621	0.86%
Total interest-bearing deposits	916,558	0.65%	839,091	0.56%
Noninterest-bearing demand deposits	154,225		142,116	
	$1,070,783	0.56%	$981,207	0.48%

The following table shows the change in funding sources and the cost of funds for the comparable periods.

(dollars in thousands)	For the Years Ended December 31, 2017 Average Balance	2017 Average Rate	2017 Percentage Funding	2016 Average Balance	2016 Average Rate	2016 Percentage Funding
Interest-bearing deposits	$ 916,558	0.65%	72.96%	$ 839,091	0.56%	75.15%
Debt	185,501	2.28%	14.77%	135,305	2.55%	12.12%
Total interest-bearing Liabilities	1,102,059	0.92%	87.72%	974,396	0.84%	87.27%
Noninterest-bearing demand deposits	154,225		12.28%	142,116		12.73%
Total funds	$1,256,284	0.81%	100.00%	$1,116,512	0.73%	100.00%

The table below illustrates changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

dollars in thousands	For the Year Ended December 31, 2017 compared to the Year Ended December 31, 2016 Volume	Due to Rate	Total
Interest income:			
Loan portfolio[1]	$5,591	$ (899)	$4,692
Investment securities, federal funds sold and interest bearing deposits	404	427	831
Total interest-earning assets	$5,995	$ (472)	$5,523
Interest-bearing liabilities:			
Savings	2	(14)	(12)
Interest-bearing demand and money market accounts	138	215	353
Certificates of deposit	336	574	910
Long-term debt	(40)	(103)	(143)
Short-term borrowings	599	262	861
Subordinated notes	—	—	—
Guaranteed preferred beneficial interest in junior subordinated debentures	—	71	71
Total interest-bearing liabilities	$1,035	$ 1,005	$2,040
Net change in net interest income	$4,960	$(1,477)	$3,483

(1) Average balance includes non-accrual loans

	For the Years Ended December 31,					
	2017			2016		
dollars in thousands	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets						
Interest-earning assets:						
Commercial real estate	$ 699,349	$30,897	4.42%	$ 602,648	$27,110	4.50%
Residential first mortgages	176,186	6,636	3.77%	151,366	6,041	3.99%
Residential rentals	106,000	4,897	4.62%	96,611	4,530	4.69%
Construction and land development	33,798	1,677	4.96%	36,938	1,693	4.58%
Home equity and second mortgages	21,515	943	4.38%	21,781	889	4.08%
Commercial and equipment loans	86,871	4,524	5.21%	87,705	4,622	5.27%
Consumer loans	477	37	7.76%	397	34	8.56%
Allowance for loan losses	(10,374)	—	0.00%	(9,157)	—	0.00%
Loan portfolio(1)	1,113,822	49,611	4.45%	988,289	44,919	4.55%
Investment securities, federal funds sold and interest-bearing deposits	175,027	3,959	2.26%	157,173	3,128	1.99%
Total Interest-Earning Assets	1,288,849	53,570	4.16%	1,145,462	48,047	4.19%
Cash and cash equivalents	15,012			11,858		
Other assets	73,122			72,151		
Total Assets	**$1,376,983**			**$1,229,471**		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Savings	$ 53,560	$ 27	0.05%	$ 48,878	$ 39	0.08%
Interest-bearing demand and money market accounts	419,817	1,481	0.35%	380,592	1,128	0.30%
Certificates of deposit	443,181	4,438	1.00%	409,621	3,528	0.86%
Long-term debt	58,704	1,313	2.24%	60,503	1,456	2.41%
Short-term borrowings	91,797	1,057	1.15%	39,802	196	0.49%
Subordinated Notes	23,000	1,438	6.25%	23,000	1,438	6.25%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	428	3.57%	12,000	357	2.98%
Total Interest-Bearing Liabilities	1,102,059	10,182	0.92%	974,396	8,142	0.84%
Noninterest-bearing demand deposits	154,225			142,116		
Other liabilities	10,720			9,562		
Stockholders' equity	109,979			103,397		
Total Liabilities and Stockholders' Equity	**$1,376,983**			**$1,229,471**		
Net interest income		$43,388			$39,905	
Interest rate spread			3.24%			3.35%
Net yield on interest-earning assets			3.37%			3.48%
Ratio of average interest-earning assets to average interest bearing liabilities			116.95%			117.56%
Cost of funds			0.81%			0.73%
Cost of deposits			0.56%			0.48%
Cost of debt			2.28%			2.55%

(1) Average balance includes non-accrual loans

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

(dollars in thousands)	Years Ended December 31, 2017	2016	$ Change	% Change
Provision for loan losses	$1,010	$2,359	$(1,349)	(57.2)%

The provision for loan losses decreased $1.3 million to $1.0 million for the year ended December 31, 2017 compared to $2.4 million for the year ended December 31, 2016. The Company's continued improvement in asset quality as well as slower 2017 loan growth required lower provisioning compared to 2016. During the year ended December 31, 2017, end of period gross loans increased $61.1 million, or 5.6%, to $1,150.0 million compared to an increase of $170.1 million, or 18.5%, to $1,089.0 million at December 31, 2016. Net charge-offs decreased $684,000 from $1.0 million for the year ended December 31, 2016 to $355,000 for the year ended December 31, 2017. Net charge-offs of 0.03% of average loans were the lowest since before the financial crisis (2007 was 0.04%). Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as slower portfolio growth, were offset by increases in other qualitative factors, such as concentration to capital factors and increased classified assets. Overall, these changes resulted in a lower provision for loan losses for the comparable periods. The specific allowance is based on management's estimate of realizable value for particular loans and has decreased as specific credits have been resolved through a return to performance, charge-offs or additions to OREO. Management believes that the allowance is adequate.

See further discussion of the provision under the caption ''Asset Quality'' in the Comparison of Financial Condition section of Management's Discussion and Analysis.

Noninterest Income

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Years Ended December 31, 2017	2016	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 157	$ 289	$(132)	(45.7)%
Gain on sale of assets	47	12	35	291.7%
Net gains (losses) on sale of OREO	43	(436)	479	(109.9)%
Net gains on sale of investment securities	175	31	144	464.5%
Income from bank owned life insurance	773	789	(16)	(2.0)%
Service charges	2,595	2,675	(80)	(3.0)%
Gain on sale of loans held for sale	294	—	294	n/a
Total Noninterest Income	$4,084	$3,360	$ 724	21.5%

Noninterest income increased by $724,000 to $4.1 million for the year ended December 31, 2017 compared to $3.4 million for the year ended December 31, 2016. The increase in income for the year was principally due to OREO losses recognized in 2016 not recognized in 2017 and gains on loans held for sale in 2017 and investment gains, partially offset by a small reduction in service charge income. The Company sold the guaranteed portion of a U.S. Small Business Administration Loan for proceeds of $2.8 million and recognized a gain of $294,000 during the third quarter of 2017.

The Company disposed of five residential properties and multiple residential lots for proceeds of $1.5 million and a gain of $43,000 for the year ended December 31, 2017. The Company recognized net losses on OREO disposals of $436,000 for the year ended December 31, 2016. Disposals consisted of properties with the following carrying values; $337,000 for seven residential lots, $584,000 for four residential properties, $501,000 for two commercial properties, $138,000 for a commercial lot and $2.2 million for an apartment and condominium property.

During the year ended December 31, 2017 the Company recognized net gains on the sale of securities of $175,000. The Company sold three AFS securities with aggregate carrying values of $3.7 million and nine HTM securities with aggregate carrying values of $4.8 million, recognizing gains of $9,000 and $166,000, respectively. During the year ended December 31, 2016 the Company recognized net gains on the sale of securities of $31,000. The Company sold five AFS securities with aggregate carrying values of $6.5 million and one HTM security with a carrying value of $698,000, recognizing gains of $23,000 and $8,000, respectively. The sale of HTM securities was permitted under ASC 320 ''Investments — Debt and Equity Securities.'' ASC 320 permits the sale of HTM securities for certain changes in circumstances.

Noninterest Expense

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Noninterest Expense				
Salary and employee benefits	$16,758	$16,810	$ (52)	(0.3)%
Occupancy expense	2,632	2,488	144	5.8%
Advertising	543	647	(104)	(16.1)%
Data processing expense	2,354	2,267	87	3.8%
Professional fees	1,662	1,568	94	6.0%
Merger and acquisition costs	829	—	829	n/a
Depreciation of premises and equipment	786	812	(26)	(3.2)%
Telephone communications	191	174	17	9.8%
Office supplies	119	136	(17)	(12.5)%
FDIC Insurance	638	739	(101)	(13.7)%
OREO valuation allowance and expenses	746	861	(115)	(13.4)%
Other	2,839	2,657	182	6.8%
Total Noninterest Expense	$30,097	$29,159	$ 938	3.2%

	Years Ended December 31,			
(dollars in thousands)	**2017**	**2016**	**$ Change**	**% Change**
Salary and employee benefits	$16,758	$16,810	$ (52)	(0.3)%
OREO valuation allowance and expenses	746	861	(115)	(13.4)%
Merger and acquisition costs	829	—	829	n/a
Operating expenses	11,764	11,488	276	2.4%
Total Noninterest Expense	$30,097	$29,159	$ 938	3.2%

Noninterest expense averaged just below $7.3 million per quarter during 2016. During 2016, the Company focused on controlling the growth of expenses by streamlining internal processes and reviewing vendor relationships. These efforts resulted in a reduction in nine FTEs, from 171 employees to 162 employees, during the year ended December 31, 2016. The Company's strategy to create operating leverage through continued asset growth combined with controlling the growth in expenses continued during 2017.

For the year ended December 31, 2017, noninterest expense increased 3.2%, or $938,000, to $30.1 million from $29.2 million for the comparable period in 2016. Noninterest expense averaged $7.5 million per quarter during 2017. Merger and acquisition costs (M&A costs) of $829,000 were incurred in 2017. These costs were not incurred in 2016 and excluding M&A costs in 2017, noninterest expense was $29.3 million, an increase of $109,000, or 0.37%, compared to 2016. The Company controlled growth in 2017 in salary and employee benefits, reducing expense $52,000 or 0.3%, compared to the same period in the prior year. The Company's 2016 total growth in salary and employee benefit costs was 2.7% or $444,000. Other operating expenses increased $276,000 or 2.4% in 2017 compared to $495,000 or 4.5% in 2016. The moderate increase in operating expenses for both years was primarily due to the increased asset size of the Bank, and included the addition of new products and services for commercial customers, increased costs of proxy related activities and the Bank's increased investment in risk management, including cyber-security and internal audit functions.

The Company's efficiency ratio for the year ended December 31, 2017 and 2016 was 63.40% and 67.40%, respectively. The Company's net operating expense ratio as a percentage of average assets for the year ended December 31, 2017 and 2016 was 1.89% and 2.10%, respectively.

Income Tax Expense

For the years ended December 31, 2017 and 2016, the Company recorded income tax expense of $9.2 million and $4.4 million, respectively. The Company's 2017 income tax expense increased $2.7 million from the revaluation of deferred tax assets because of the reduction in the corporate income tax rate under the enacted Tax Cuts and Jobs Act which was enacted on December 22, 2017. In addition, income tax expense was impacted by non-deductible facilitative merger and acquisition costs of $724,000. The Company's effective tax rates for the years ended December 31, 2017 and 2016 were 55.95% and 37.59%, respectively. The increase in the effective tax rate was primarily the result of the revaluation of deferred tax assets. In addition, the Company's federal tax rate increased from 34% in 2016 to 35% in 2017. An increase in non-deductible expenses and tax-exempt income being relatively lower to total income for 2017 compared to 2016 also slightly increased the effective tax rate. See Note 12 for additional information.

COMPARISON OF RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015

Earnings Summary

Net income available to common shareholders for 2016 increased $1.0 million to $7.3 million, or 16.0%, compared to 2015. Diluted earnings per share (''EPS'') were $1.59 in 2016, an increase of $0.24 compared to 2015. The Company's return on average assets was 0.60% in 2016, an increase of two basis points from 2015. The Company's return on average common stockholders' equity was 7.09% in 2016, an increase of 76 basis points from 2015.

Pretax operating income increased $1.7 million, or 17.8%, to $11.7 million in 2016 compared to $10.0 million in 2015.

- The increase in operating income and operating leverage in 2016 was primarily due to the following:
  - Net interest income was $39.9 million in 2016 an increase of $3.4 million, or 9.2%, compared to 2015.
    - Interest income increased $4.2 million. The increase was driven by increased average interest-earning assets including increased average loan balances. The Bank increased average net loan balances $114.1 million to $988.3 million in 2016 from $874.2 million in 2015. The effect of loan volume on interest income was partially offset by yield declines.
    - Interest expense increased $797,000 which partially offset increased interest income. The primary reason for the increase in interest expense was larger average interest-bearing liability balances. The average balances of interest-bearing liabilities increased $113.4 million to $974.4 million in 2016 from $861.0 million in 2015.

      The increase in interest expense was restrained by the Company's cost of interest-bearing liabilities decreasing one basis point to 0.84% in 2016 compared to 0.85% in 2015. Further, the Company's cost of funds, which includes noninterest-bearing funding, decreased two basis points from the comparable period to 0.73% for the year ended December 31, 2016.
  - The Company controlled expense growth. Noninterest expense increased $741,000, or 2.6%, to $29.2 million for the year ended December 31, 2016 compared to the prior year.

    During 2016 net operating expense as a percentage of average assets and the efficiency ratio declined (improved) compared to the prior year to 2.10% and 67.40%, respectively for the year ended December 31, 2016 from 2.30% and 71.35%, respectively for the year ended

December 31, 2015. The net operating expense and efficiency ratios improved in each successive quarter during 2016. The Company's net operating expense ratio improved to 1.98% for the three months ended December 31, 2016 from 2.38% for the three months ended December 31, 2015. The Company's efficiency ratio improved to 64.38% for the three months ended December 31, 2016 from 73.67% for the three months ended December 31, 2015.

- The positive impact of operating leverage on operating income was partially offset by an increased loan loss provision.

  The provision for loan losses increased $926,000 to $2.4 million in 2016 due primarily to loan growth. The additions to the provision for loan growth were partially offset by improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in other qualitative factors, such as reductions in delinquency and classified assets.

A more detailed analysis comparing the results of operations for the years ended December 31, 2016 and 2015 follows.

Net Interest Income

The primary component of the Company's net income is its net interest income, which is the difference between income earned on assets and interest paid on the deposits and borrowings used to fund them. Net interest income is affected by the difference between the yields earned on the Company's interest-earning assets and the rates paid on interest-bearing liabilities, as well as the relative amounts of such assets and liabilities. Net interest income, divided by average interest-earning assets, represents the Company's net interest margin.

Net interest income increased 9.2% or $3.4 million to $39.9 million for the year ended December 31, 2016 compared to $36.5 million for the year ended December 31, 2015. Net interest margin at 3.48% for the year ended December 31, 2016 decreased 12 basis points from 3.60% for the year ended December 31, 2015. Average interest-earning assets were $1,145.5 million for the full year of 2016, an increase of $132.1 million, or 13.0%, compared to $1,013.4 million for the full year of 2015.

The following table shows the components of net interest income and the dollar and percentage changes for the periods presented.

	Years Ended December 31,			
(dollars in thousands)	**2016**	**2015**	**$ Change**	**% Change**
Interest and Dividend Income				
Loans, including fees	$44,919	$41,386	$3,533	8.5%
Taxable interest and dividends on investment securities	3,108	2,473	635	25.7%
Interest on deposits with banks	20	14	6	42.9%
Total Interest and Dividend Income	48,047	43,873	4,174	9.5%
Interest Expenses				
Deposits	4,695	4,152	543	13.1%
Short-term borrowings	196	37	159	429.7%
Long-term debt	3,251	3,156	95	3.0%
Total Interest Expenses	8,142	7,345	797	10.9%
Net Interest Income (NII)	$39,905	$36,528	$3,377	9.2%

Net interest income increased during 2016 compared to the prior year due to the negative impacts of declining loan yields being outpaced by the positive impacts of interest-earning asset growth, increased investment yields and a stable cost of funds.

The net interest margin was 3.48% for the year ended December 31, 2016, a 12 basis point decrease from 3.60% for the year ended December 31, 2015. Net interest margin declined during 2016, primarily due to reduced yields on loans. Yields on the loan portfolio decreased from 4.73% for the year ended December 31, 2015 to 4.55% for the year ended December 31, 2016. Yields were reduced compared to the prior year due to the Bank's increased investment in residential mortgages, increased competition in the Bank's market area and low intermediate term interest rates. Residential first mortgages increased from 14.30% of the loan portfolio at December 31, 2015 to 15.70% of the portfolio at December 31, 2016. The Bank's commercial loan portfolios are primarily indexed to rates in the five to ten year range of U.S. Treasuries. These rates remained below 2015 average rates for most of 2016, with the ten year U.S. Treasury rate as low as 1.37% (July 8, 2016).

Net interest margin was positively impacted by a reduction in its cost of funds during 2016, which decreased two basis points from 0.75% for the year ended December 31, 2015 to 0.73% for the year ended December 31, 2016. The Company continued to make progress in controlling deposit costs by increasing transaction deposits as a percentage of overall deposits. Average transaction deposits, which include savings, money market, interest-bearing demand and noninterest bearing demand accounts, for the year ended December 31, 2016 increased $83.4 million, or 17.1%, to $571.6 million compared to $488.2 million for the comparable period in 2015. Average transaction accounts as a percentage of total deposits increased from 56.3% for the year ended December 31, 2015 to 58.3% for the year ended December 31, 2016. The increase in average transaction deposits included growth in noninterest bearing demand deposits of $21.6 million, or 17.9%, from $120.5 million for the year ended December 31, 2015 to $142.1 million for the year ended December 31, 2016.

Interest and dividend income increased by $4.2 million to $48.0 million for the year ended December 31, 2016 compared to $43.8 million for the year ended December 31, 2015, primarily due to growth in the average balance of loans and investments. Interest and dividend income also increased due to increased investment yields. Interest and dividend income on loans increased $5.2 million due to growth of $114.1 million, or 13.1%, in the average balance of loans from $874.2 million for the year ended December 31, 2015 to $988.3 million for the year ended December 31, 2016. Interest and dividend income on investments increased $641,000 during 2016 compared to the prior year as average interest-earning investment balances increased $17.9 million and average yields increased from 1.79% to 1.99%. These increases to interest and dividend income were partially offset by decreased income from reduced yields on loans. Average loan yields declined 18 basis points from 4.73% for the year ended December 31, 2014 to 4.55% for the year ended December 31, 2015, which resulted in a decrease in interest and dividend income of $1.7 million.

Interest expense increased $797,000 to $8.1 million for the year ended December 31, 2016 compared to the year ended December 31, 2015 due to an increase in the average balances of interest-bearing liabilities and a change in the composition of interest-bearing liabilities between the comparable periods. During the year ended December 31, 2016, interest expense increased $718,000 due to larger average balances of interest-bearing transaction deposit accounts, time deposits, short-term borrowings and subordinated notes compared to the year ended December 31, 2015. Additionally, interest expense increased $282,000 due to increased rates on interest-bearing deposit accounts and debt. These increases to interest expense were partially offset by a reduction in interest expense of $203,000 due to a $8.4 million decrease in average long-term debt balances from the comparable period to $60.5 million for the year ended December 31, 2016. The average rate paid on debt, which includes long-term debt, trust preferred junior subordinated debentures ("TRUPS"), subordinated notes, and short-term borrowings, decreased from 2.77% for the year ended December 31, 2015 to 2.55% for the year ended December 31, 2016. Interest expense for the year ended December 31, 2016 was $148,000 greater than the comparable period as a result of the timing of the funding of the subordinated notes in February 2015.

Changes in the components of net interest income due to changes in average balances of assets and liabilities and to changes caused by changes in interest rates are presented in the rate volume analysis included below. The table below presents information on average balances and rates for deposits.

	For the Years Ended December 31,			
	2016		2015	
(dollars in thousands)	Average Balance	Average Rate	Average Balance	Average Rate
Savings	$ 48,878	0.08%	$ 44,963	0.10%
Interest-bearing demand and money market accounts	380,592	0.30%	322,717	0.28%
Certificates of deposit	409,621	0.86%	378,179	0.85%
Total interest-bearing deposits	839,091	0.56%	745,859	0.56%
Noninterest-bearing demand deposits	142,116		120,527	
	$981,207	0.48%	$866,386	0.48%

The following table shows the change in funding sources and the cost of funds for the comparable periods.

	For the Years Ended December 31,					
	2016			2015		
(dollars in thousands)	Average Balance	Average Rate	Percentage Funding	Average Balance	Average Rate	Percentage Funding
Interest-bearing deposits	$ 839,091	0.56%	75.15%	$745,859	0.56%	75.99%
Debt	135,305	2.55%	12.12%	115,119	2.77%	11.73%
Total interest-bearing Liabilities	974,396	0.84%	87.27%	860,978	0.85%	87.72%
Noninterest-bearing demand deposits	142,116		12.73%	120,527		12.28%
Total funds	$1,116,512	0.73%	100.00%	$981,505	0.75%	100.00%

The table below illustrates changes in interest income and interest expense of the Bank for the periods indicated. For each category of interest-earning asset and interest-bearing liability, information is provided on changes attributable to (1) changes in volume (changes in volume multiplied by old rate); and (2) changes in rate (changes in rate multiplied by old volume). Changes in rate-volume (changes in rate multiplied by the change in volume) have been allocated to changes due to volume.

	For the Year Ended December 31, 2016 compared to the Year Ended December 31, 2015		
dollars in thousands	Volume	Due to Rate	Total
Interest income:			
Loan portfolio(1)	$5,186	$(1,653)	$3,533
Investment securities, federal funds sold and interest-bearing deposits	357	284	641
Total interest-earning assets	$5,543	$(1,369)	$4,174
Interest-bearing liabilities:			
Savings	3	(9)	(6)
Interest-bearing demand and money market accounts	172	52	224
Certificates of deposit	271	54	325
Long-term debt	(203)	102	(101)
Short-term borrowings	130	29	159
Subordinated notes	142	6	148
Guaranteed preferred beneficial interest in junior subordinated debentures	—	48	48
Total interest-bearing liabilities	$ 515	$ 282	$ 797
Net change in net interest income	$5,028	$(1,651)	$3,377

(1) Average balance includes non-accrual loans

dollars in thousands	For the Years Ended December 31, 2016 Average Balance	2016 Interest	2016 Average Yield/ Cost	2015 Average Balance	2015 Interest	2015 Average Yield/ Cost
Assets						
Interest-earning assets:						
Commercial real estate	$ 602,648	$27,110	4.50%	$ 518,329	$24,053	4.64%
Residential first mortgages	151,366	6,041	3.99%	134,728	5,861	4.35%
Residential rentals	96,611	4,530	4.69%	88,251	4,084	4.63%
Construction and land development	36,938	1,693	4.58%	37,665	1,879	4.99%
Home equity and second mortgages	21,781	889	4.08%	21,332	872	4.09%
Commercial and equipment loans	87,705	4,622	5.27%	81,957	4,596	5.61%
Consumer loans	397	34	8.56%	465	41	8.82%
Allowance for loan losses	(9,157)	—	0.00%	(8,541)	—	0.00%
Loan portfolio[1]	988,289	44,919	4.55%	874,186	41,386	4.73%
Investment securities, federal funds sold and interest-bearing deposits	157,173	3,128	1.99%	139,256	2,487	1.79%
Total Interest-Earning Assets	1,145,462	48,047	4.19%	1,013,442	43,873	4.33%
Cash and cash equivalents	11,858			12,192		
Other assets	72,151			67,272		
Total Assets	**$1,229,471**			**$1,092,906**		
Liabilities and Stockholders' Equity						
Interest-bearing liabilities:						
Savings	$ 48,878	$ 39	0.08%	$ 44,963	$ 45	0.10%
Interest-bearing demand and money market accounts	380,592	1,128	0.30%	322,717	904	0.28%
Certificates of deposit	409,621	3,528	0.86%	378,179	3,203	0.85%
Long-term debt	60,503	1,456	2.41%	68,924	1,557	2.26%
Short-term borrowings	39,802	196	0.49%	13,463	37	0.27%
Subordinated Notes	23,000	1,438	6.25%	20,732	1,290	6.22%
Guaranteed preferred beneficial interest in junior subordinated debentures	12,000	357	2.98%	12,000	309	2.58%
Total Interest-Bearing Liabilities	974,396	8,142	0.84%	860,978	7,345	0.85%
Noninterest-bearing demand deposits	142,116			120,527		
Other liabilities	9,562			9,244		
Stockholders' equity	103,397			102,157		
Total Liabilities and Stockholders' Equity	**$1,229,471**			**$1,092,906**		
Net interest income		$39,905			$36,528	
Interest rate spread			3.35%			3.48%
Net yield on interest-earning assets			3.48%			3.60%
Ratio of average interest-earning assets to average interest bearing liabilities			117.56%			117.71%
Cost of funds			0.73%			0.75%
Cost of deposits			0.48%			0.48%
Cost of debt			2.55%			2.77%

(1) Average balance includes non-accrual loans

Provision for Loan Losses

The following table shows the dollar and percentage changes for the provision for loan losses for the periods presented.

(dollars in thousands)	Years Ended December 31, 2016	2015	$ Change	% Change
Provision for loan losses	$2,359	$1,433	$926	64.6%

The provision for loan losses increased $926,000 to $2.4 million for the year ended December 31, 2016 compared to $1.4 million for the year ended December 31, 2015 due primarily to loan growth. During the year ended December 31, 2016 end of period gross loans increased $170.1 million, or 18.5%, from $918.9 million at December 31, 2015 to $1,089.0 million at December 31, 2016. Net charge-offs decreased $335,000 from $1.4 million for the year ended December 31, 2015 to $1.0 million for the year ended December 31, 2016. Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as reductions in classified assets and delinquency, were offset by increases in other qualitative factors, such as increased loan growth. Overall, these changes resulted in a higher provision for loan losses for the comparable periods. The specific allowance is based on management's estimate of realizable value for particular loans and has decreased as specific credits have been resolved through a return to performance, charge-offs or additions to OREO.

See further discussion of the provision under the caption ''Asset Quality'' in the Comparison of Financial Condition section of Management's Discussion and Analysis.

Noninterest Income

The following table shows the components of noninterest income and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Years Ended December 31, 2016	2015	$ Change	% Change
Noninterest Income				
Loan appraisal, credit, and miscellaneous charges	$ 289	$ 315	$ (26)	(8.3)%
Gain on sale of asset	12	19	(7)	(36.8)%
Net losses on sale of OREO	(436)	(20)	(416)	2080.0%
Net gains on sale of investment securities	31	4	27	675.0%
Loss on premises and equipment held for sale	—	(426)	426	(100.0)%
Income from bank owned life insurance	789	815	(26)	(3.2)%
Service charges	2,675	2,488	187	7.5%
Gain on sale of loans held for sale	—	104	(104)	(100.0)%
Total Noninterest Income	$3,360	$3,299	$ 61	1.8%

Noninterest income increased by $61,000 to $3.4 million for the year ended December 31, 2016 compared to $3.3 million for the year ended December 31, 2015. Noninterest income was up $187,000 compared to the prior year due to higher service charge income from the growth in the number of customer accounts, wealth services and rental income on other real estate owned (''OREO'') properties. In addition, there were no losses recognized in 2016 for the sale of branch assets. During the third quarter 2015, the Bank recorded an expense of $426,000 to account for the loss on the sale of the King George, Virginia branch building and equipment. These increases to noninterest income were partially offset by decreases to noninterest income from the Company's exit from the origination of residential first mortgage loans during the second quarter of 2015. There were no gains on residential loans held for sale in the year ended December 31, 2016 compared to $104,000 for the year ended December 31, 2015. In addition, the Company recognized losses of $436,000 on the disposition of OREO for the year ended December 31, 2016 compared to $20,000 in OREO losses recognized for the comparable period.

Noninterest Expense

The following tables show the components of noninterest expense and the dollar and percentage changes for the periods presented.

(dollars in thousands)	Years Ended December 31, 2016	2015	$ Change	% Change
Noninterest Expense				
Salary and employee benefits	$16,810	$16,366	$ 444	2.7%
Occupancy expense	2,488	2,427	61	2.5%
Advertising	647	583	64	11.0%
Data processing expense	2,267	2,044	223	10.9%
Professional fees	1,568	1,323	245	18.5%
Depreciation of premises and equipment	812	810	2	0.2%
Telephone communications	174	188	(14)	(7.4)%
Office supplies	136	157	(21)	(13.4)%
FDIC Insurance	739	799	(60)	(7.5)%
OREO valuation allowance and expenses	861	1,059	(198)	(18.7)%
Other	2,657	2,662	(5)	(0.2)%
Total Noninterest Expense	$29,159	$28,418	$ 741	2.6%

(dollars in thousands)	Years Ended December 31, 2016	2015	$ Change	% Change
Salary and employee benefits	$16,810	$16,366	$ 444	2.7%
OREO valuation allowance and expenses	861	1,059	(198)	(18.7)%
Operating expenses	11,488	10,993	495	4.5%
Total Noninterest Expense	$29,159	$28,418	$ 741	2.6%

For the year ended December 31, 2016, noninterest expense was controlled at an average run rate of just below $7.3 million per quarter. Noninterest expense increased 2.6%, or $741,000, to $29.2 million in 2016 from $28.4 million for the comparable period in 2015. The Company remained focused during 2016 on controlling the growth of expenses by streamlining internal processes and reviewing vendor relationships. The Company's strategy to create operating leverage through continued interest-earning asset growth combined with controlling the growth in expenses is expected to continue during 2017. The Company's efficiency ratio for the year ended December 31, 2016 and 2015 was 67.40% and 71.35%, respectively. The Company's noninterest expense ratio as a percentage of average assets for the year ended December 31, 2016 and 2015 was 2.37% and 2.60%, respectively.

The Company's 2016 total growth in salary and employee benefit costs was 2.7% or $444,000 compared to 3.2% or $515,000 of growth during 2015. Salary and employee benefit costs have increased from the comparable period as incentive compensation has increased due to interest-earning asset growth as well as higher self-insured health insurance claims. The Company has controlled the growth of salary and benefit costs by restructuring our branch organization and better aligning incentives with Company performance. These efforts resulted in a reduction in nine FTEs from 171 employees at December 31, 2015 to 162 employees at December 31, 2016.

Data processing costs have increased primarily due to the increased asset size of the Bank, and included the addition of new products and services for commercial customers. Professional fees increased over the prior year due to increased costs of proxy related activities and the Bank' increased investment in risk management, including cyber-security and internal audit functions.

Income Tax Expense

For the years ended December 31, 2016 and 2015, the Company recorded income tax expense of $4.4 million and $3.6 million, respectively. The Company's effective tax rates for the years ended December 31, 2016 and 2015 were 37.59% and 36.42%, respectively. The increase in the effective tax rate was the result of tax-exempt income being relatively lower to total income and an increase in state income taxes due to higher Bank net income for 2016 compared to 2015.

COMPARISON OF FINANCIAL CONDITON AT DECEMBER 31, 2017 AND 2016

Assets

Total assets at December 31, 2017 were $1.40 billion, an increase of $71.7 million or 5.4%, compared to total assets of $1.33 billion at December 31, 2016. The increase in total assets was primarily attributable to growth in loans. Net loans increased $61.1 million, or 5.7%, from $1,079.5 million at December 31, 2016 to $1,140.6 million at December 31, 2017, principally due to increases in the commercial real estate and residential rentals portfolios. The increase in total assets was primarily attributable to growth in cash, securities and loans.

The following table shows the Company's assets and the dollar and percentage changes for the periods presented.

(dollars in thousands)	December 31, 2017	December 31, 2016	$ Change	% Change
Cash and due from banks	$ 13,315	$ 9,948	$ 3,367	33.8%
Interest-bearing deposits with banks	2,102	1,315	787	59.8%
Securities available for sale (AFS), at fair value	68,285	53,033	15,252	28.8%
Securities held to maturity (HTM), at amortized cost	99,246	109,247	(10,001)	(9.2)%
FHLB stock – at cost	7,276	7,235	41	0.6%
Loans receivable – net of ALLL	1,140,615	1,079,519	61,096	5.7%
Premises and equipment, net	21,391	22,205	(814)	(3.7)%
Premises and equipment held for sale	—	345	(345)	(100.0)%
Other real estate owned (OREO)	9,341	7,763	1,578	20.3%
Accrued interest receivable	4,511	3,979	532	13.4%
Investment in bank owned life insurance	29,398	28,625	773	2.7%
Other assets	10,481	11,043	(562)	(5.1)%
Total Assets	$1,405,961	$1,334,257	$ 71,704	5.4%

The differences in allocations between the cash and investment categories reflect operational needs. Details of the Company's loan portfolio are presented below:

(dollars in thousands)	December 31, 2017	%	December 31, 2016	%	$ Change	% Change
Commercial real estate	$ 727,314	63.25%	$ 667,105	61.25%	$60,209	9.0%
Residential first mortgages	170,374	14.81%	171,004	15.70%	(630)	(0.4)%
Residential rentals	110,228	9.58%	101,897	9.36%	8,331	8.2%
Construction and land development	27,871	2.42%	36,934	3.39%	(9,063)	(24.5)%
Home equity and second mortgages	21,351	1.86%	21,399	1.97%	(48)	(0.2)%
Commercial loans	56,417	4.91%	50,484	4.64%	5,933	11.8%
Consumer loans	573	0.05%	422	0.04%	151	35.8%
Commercial equipment	35,916	3.12%	39,737	3.65%	(3,821)	(9.6)%
	1,150,044	100.00%	1,088,982	100.00%	61,062	5.6%
Less:						
Deferred loan fees and premiums	(1,086)	-0.09%	(397)	-0.04%	(689)	173.6%
Allowance for loan losses	10,515	0.91%	9,860	0.91%	655	6.6%
	9,429		9,463		(34)	(0.4)%
	$1,140,615		$1,079,519		$61,096	5.7%

Prior to April 1, 2016, loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios. Beginning in the second quarter of 2016, the Company segregated loans secured by residential rental property into a new loan portfolio segment. Residential rental property includes income producing properties comprising 1-4 family units and apartment buildings. The Company's decision to segregate the residential rental property portfolio for financial reporting was based on the growth and size of the portfolio and risk characteristics unique to residential rental properties. Comparative financial information was reclassified to conform to the classification presented in 2016.

Asset Quality

(dollars in thousands, except per share amounts)	December 31, 2017	December 31, 2016	$ Change	% Change
SELECTED ASSET QUALITY DATA				
Gross loans	$1,150,044	$1,088,982	$61,062	5.6%
Classified assets	50,298	39,246	11,052	28.2
Allowance for loan losses	10,515	9,860	655	6.6
Nonperforming loans (>=90 Days)[1]	2,483	7,705	(5,222)	(67.8)
Non-accrual loans[2]	4,693	8,374	(3,681)	(44.0)
Accruing troubled debt restructures (TDRs)[3]	10,021	10,448	(427)	(4.1)
Other Real Estate Owned (OREO)	9,341	7,763	1,578	20.3
Non-accrual loans, OREO and TDRs	$ 24,055	$ 26,585	(2,530)	(9.5)
SELECTED ASSET QUALITY RATIOS				
Average total equity to average total assets	7.99%	8.41%		
Classified assets to total assets	3.58	2.94		
Classified assets to risk-based capital	32.14	26.13		
Allowance for loan losses to total loans	0.91	0.91		
Allowance for loan losses to nonperforming loans	423.48	127.97		
Net charge-offs to avg. outstanding loans	0.03	0.11		
Nonperforming loans to total loans	0.22	0.71		
Non-accrual loans to total loans	0.41	0.77		
Non-accrual loans and TDRs to total loans	1.28	1.73		
Non-accrual loans and OREO to total assets	1.00	1.21		
Non-accrual loans, OREO and TDRs to total assets	1.71	1.99		

(1) Nonperforming loans include all loans that are 90 days or more delinquent.

(2) Non-accrual loans include all loans that are 90 days or more delinquent and loans that are non-accrual due to the operating results or cash flows of a customer.

(3) TDR loans include both non-accrual and accruing performing loans. All TDR loans are included in the calculation of asset quality financial ratios. Non-accrual TDR loans are included in the non-accrual balance and accruing TDR loans are included in the accruing TDR balance.

The Company continues to pursue its approach of maximizing contractual rights with individual classified customer relationships. The objective is to expeditiously resolve non-performing or substandard credits that are not likely to become performing or passing credits in a reasonable timeframe. Management believes this strategy is in the best long-term interest of the Company. Because of these efforts, non-accrual loans and OREO to total assets have decreased from 1.83% at December 31, 2015, to 1.21% at December 31, 2016, and to 1.00% at December 31, 2017. Non-accrual loans, OREO and TDRs to total assets decreased from 2.98% at December 31, 2015, to 1.99%, at December 31, 2016, and to 1.71% at December 31, 2017. Classified assets increased $9.8 million from $30.6 million at December 31, 2016 to $40.4 million at December 31, 2017. The net increase was primarily due to two customer relationships that that are well-secured by commercial real estate that were downgraded to substandard in the third quarter ($4.9 million) and fourth quarter ($10.4 million) of 2017. There was no impairment on these relationships based on our analysis at December 31, 2017.

Management considers classified assets to be an important measure of asset quality. The following is a breakdown of the Company's classified and special mention assets at December 31, 2017, 2016, 2015, 2014 and 2013, respectively:

Classified Assets and Special Mention Assets

(dollars in thousands)	As of December 31, 2017	As of December 31, 2016	As of December 31, 2015	As of December 31, 2014	As of December 31, 2013
Classified loans					
Substandard	$40,306	$30,463	$31,943	$46,735	$47,645
Doubtful	—	137	861	—	—
Loss	—	—	—	—	—
Total classified loans	40,306	30,600	32,804	46,735	47,645
Special mention loans	96	—	1,642	5,460	9,246
Total classified and special mention loans	$40,402	$30,600	$34,446	$52,195	$56,891
Classified loans	40,306	30,600	32,804	46,735	47,645
Classified securities	651	883	1,093	1,404	2,438
Other real estate owned	9,341	7,763	9,449	5,883	6,797
Total classified assets	$50,298	$39,246	$43,346	$54,022	$56,880
Total classified assets as a percentage of total assets	**3.58%**	**2.94%**	**3.79%**	**4.99%**	**5.56%**
Total classified assets as a percentage of Risk Based Capital	**32.14%**	**26.13%**	**30.19%**	**39.30%**	**43.11%**

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) decreased $3.7 million from $8.4 million or 0.77% of total loans at December 31, 2016 to $4.7 million or 0.41% of total loans at December 31, 2017. Non-accrual only loans are loans classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. In accordance with the Company's policy, interest income is recognized on a cash basis or cost-recovery method, until qualifying for return to accrual status.

At December 31, 2017, non-accrual loans of $4.7 million included 24 loans, of which $3.3 million, or 71% represented 10 loans and five customer relationships. During the year ended December 31, 2017 non-accrual loans decreased $3.0 million due to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Before the foreclosure, the loans in this relationship were troubled debt restructures ("TDRs"). Additionally, during the third quarter of 2017, non-accrual loans decreased $607,000 due to the foreclosure of a commercial office building. At December 31, 2016, non-accrual loans of $8.4 million included 29 loans, of which $6.4 million, or 77% of represented 15 loans and six customer relationships. Non-accrual loans included one TDR totaling $769,000 at December 31, 2017 and six TDRs totaling $4.7 million at December 31, 2016. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Loan delinquency (90 days or greater delinquent and 31-89 days delinquent) increased $3.0 million from $8.7 million, or 0.80% of loans, at December 31, 2016 to $11.7 million, or 1.02% of loans, at December 31, 2017.

TDRs decreased $4.3 million from $15.1 million at December 31, 2016 to $10.8 million at December 31, 2017. TDRs that are included in non-accrual are classified solely as non-accrual loans for the calculation of financial ratios. The Company had specific reserves of $413,000 on seven TDRs totaling $3.0 million at December 31, 2017 and $844,000 on nine TDRs totaling $5.7 million at December 31, 2016. During the year ended December 31, 2017, TDR disposals, which included payoffs and refinancing decreased by seven loans totaling $3.9 million, of which $3.0 million related to the foreclosure of the stalled residential development project mentioned previously. TDR loan principal curtailment was $385,000 for the year ended December 31, 2017. There were no TDRs added during the year ended December 31, 2017.

During the year ended December 31, 2016 the Company added one TDR loan totaling $196,000. TDR disposals, which included payoffs and refinancing for the year ended December 31, 2016 decreased by nine loans or $2.1 million. TDR loan principal curtailment was $1.6 million for the year ended December 31, 2016.

The following is a breakdown by loan classification of the Company's TDRs at December 31, 2017 and December 31, 2016:

	December 31, 2017		December 31, 2016	
(dollars in thousands)	**Dollars**	**Number of Loans**	**Dollars**	**Number of Loans**
Commercial real estate	$ 9,273	9	$ 9,587	8
Residential first mortgages	527	2	545	2
Residential rentals	221	1	227	1
Construction and land development	729	2	3,777	4
Commercial loans	4	1	872	5
Commercial equipment	36	1	113	2
Total TDRs	$10,790	16	$15,121	22
Less: TDRs included in non-accrual loans	(769)	(1)	(4,673)	(6)
Total accrual TDR loans	$10,021	15	$10,448	16

The OREO balance was $9.3 million at December 31, 2017, an increase of $1.5 million compared to $7.8 million at December 31, 2016. During the year ended December 31, 2017, additions of $3.6 million consisted of $3.0 million related to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Further, additions included $103,000 for residential lots and $495,000 for a commercial office building. The Company disposed of five residential properties and multiple residential lots for proceeds of $1.5 million and a gain of $43,000 for the year ended December 31, 2017. The Bank provided $200,000 in financing for one residential property and the three residential lots during the first quarter of 2017. The transaction qualified for full accrual sales treatment under ASC Topic 360-20-40 "Property Plant and Equipment — Derecognition".

The Company recognized net losses on OREO disposals of $436,000 for the year ended December 31, 2016. Disposals consisted of properties with the following carrying values; $337,000 for seven residential lots, $584,000 for four residential properties, $501,000 for two commercial properties, $138,000 for a commercial lot and $2.2 million for an apartment and condominium property. The Bank provided financing for the apartment and condominium purchase and the transaction qualified for full accrual sales treatment under ASC Topic 360-20-40 "Property Plant and Equipment — Derecognition". In addition, the Company transferred one commercial condominium with a carrying value of $372,000 into premises for commercial lending office space.

Additions to the OREO valuation allowances of $600,000 and $574,000, respectively, were taken to adjust properties to current appraised values for the years ended December 31, 2017 and 2016. OREO carrying amounts reflect management's estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs.

The allowance for loan losses was 0.91% of gross loans at December 31, 2017 and December 31, 2016. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to: overall loss experience; current economic conditions; size, growth and composition of the loan portfolio; financial condition of the borrowers; current appraised values of underlying collateral and other relevant factors that, in management's judgment, warrant recognition in determining an adequate allowance. Improvements to baseline charge-off factors for the periods used to evaluate the adequacy of the allowance as well as improvements in some qualitative factors, such as slower portfolio growth, were offset by increases in other qualitative factors, such as concentration to capital factors and increased classified assets. The specific allowance is based on management's estimate of realizable value for particular loans. Management believes that the allowance is adequate.

The following is a breakdown of the Company's general and specific allowances as a percentage of gross loans at December 31, 2017 and December 31, 2016, respectively:

(dollar in thousands)	December 31, 2017	% of Gross Loans	December 31, 2016	% of Gross Loans
General Allowance	$ 9,491	0.82%	$8,571	0.79%
Specific Allowance	1,024	0.09%	1,289	0.12%
Total Allowance	$10,515	0.91%	$9,860	0.91%

The historical loss experience factor is tracked over various time horizons for each portfolio segment. The following table provides a five-year trend of net charge-offs as a percentage of average loans.

	Years Ended December 31,				
(dollars in thousands)	2017	2016	2015	2014	2013
Average loans	$1,113,822	$988,288	$874,186	$819,381	$741,369
Net charge-offs	355	1,039	1,374	2,309	1,049
Net charge-offs to average loans	**0.03%**	**0.11%**	**0.16%**	**0.28%**	**0.14%**

At December 31, 2017, 99.6%, or $162.3 million of the asset-backed securities and bonds issued by GSEs and U.S. Agencies and others were rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency compared to 99.4%, or $156.9 million, at December 31, 2016. Debt securities are evaluated quarterly to determine whether a decline in their value is OTTI. No OTTI charge was recorded for the years ended December 31, 2017 and 2016, respectively. Classified securities decreased $232,000 from $883,000 at December 31, 2016 to $651,000 at December 31, 2017.

Gross unrealized losses on HTM and AFS securities decreased from $3.3 million at December 31, 2016 to $3.1 million at December 31, 2017 (see Note 5) in Consolidated Financial Statements). Gross unrealized losses at December 31, 2017 and 2016 for AFS securities were $1.7 million and $1.6 million, respectively, of amortized cost of $69.9 million and $54.6 million, respectively. Gross unrealized losses at December 31, 2017 and 2016 for HTM securities were $1.4 million and $1.7 million, respectively, of amortized cost of $99.2 million and $109.2 million, respectively. The change in unrealized losses was the result of changes in interest rates, while credit risks remained stable. The Bank holds over 96% of its AFS and HTM securities as asset-backed securities of GSEs or U.S. Agencies, GSE agency bonds or U.S. government obligations. The Company intends to, and has the ability to, hold both AFS and HTM securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. The Company believes that the AFS and HTM securities with unrealized losses will either recover in market value or be paid off as agreed.

Liabilities

The following table shows the Company's liabilities and the dollar and percentage changes for the periods presented.

(dollars in thousands)	December 31, 2017	December 31, 2016	$ Change	% Change
Deposits				
Non-interest-bearing deposits	$ 159,844	$ 144,877	$ 14,967	10.3%
Interest-bearing deposits	946,393	893,948	52,445	5.9%
Total deposits	1,106,237	1,038,825	67,412	6.5%
Short-term borrowings	87,500	79,000	8,500	10.8%
Long-term debt	55,498	65,559	(10,061)	(15.3)%
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000	—	0.0%
Subordinated notes – 6.25%	23,000	23,000	—	0.0%
Accrued expenses and other liabilities	11,769	11,447	322	2.8%
Total Liabilities	$1,296,004	$1,229,831	$ 66,173	5.4%

The following is a breakdown of the Company's deposit portfolio at December 31, 2017 and December 31, 2016:

	December 31,					
	2017		2016			
(dollars in thousands)	Balance	%	Balance	%	$ Change	% Change
Noninterest-bearing demand	$ 159,844	14.45%	$ 144,877	13.95%	$ 14,967	10.3%
Interest-bearing:						
Demand	215,447	19.48%	162,823	15.67%	52,624	32.3%
Money market deposits	226,351	20.46%	248,049	23.88%	(21,698)	(8.7)%
Savings	52,990	4.79%	50,284	4.84%	2,706	5.4%
Certificates of deposit	451,605	40.82%	432,792	41.66%	18,813	4.3%
Total interest-bearing	946,393	85.55%	893,948	86.05%	52,445	5.9%
Total Deposits	$1,106,237	100.00%	$1,038,825	100.00%	$ 67,412	6.5%
Transaction accounts	**$ 654,632**	**59.18%**	**$ 606,033**	**58.34%**	**$ 48,599**	**8.0%**

Deposits and Borrowings

Deposits increased by 6.5%, or $67.4 million, to $1,106.2 million at December 31, 2017 compared to $1,038.8 million at December 31, 2016. During 2017, balance sheet growth was balanced, with deposit growth of $67.4 million slightly exceeding loan growth of $61.1 million. Retail deposits, which include all deposits except traditional brokered deposits, increased a total of $79.4 million, comprised of increases in transaction accounts of $48.6 million and time deposits of $30.8 million. These retail increases to deposits were partially offset by a decrease to brokered deposits of $12.0 million. The Company uses both traditional and reciprocal brokered deposits. Traditional brokered deposits at December 31, 2017 and December 31, 2016 were $119.0 million and $131.0 million, respectively. Reciprocal brokered deposits are used to maximize FDIC insurance available to our customers. Reciprocal brokered deposits at December 31, 2017 and December 31, 2016 were $92.9 million and $70.7 million, respectively.

Long-term debt and short-term borrowings decreased $1.6 million from $144.6 million at December 31, 2016 to $143.0 million at December 31, 2017. During the year ended December 31, 2017, the Bank paid off $20.1 million of maturing long-term debt and added $10.0 million in fixed-rate advances maturing in 2018. During the year ended December 31, 2016, the Bank paid off $5.0 million of maturing long-term debt and added one $15.0 million fixed-rate advances maturing in 2018. The Company uses brokered deposits and other wholesale funding to supplement funding when loan growth exceeds core deposit growth and for asset-liability management purposes.

The more moderate interest-earning asset growth in 2017 compared to 2016, combined with increases in retail transaction and time deposits allowed the Bank to decrease wholesale funding during 2017. Wholesale funding decreased $13.7 million from $275.6 million or 20.65% of assets at December 31, 2016 to $261.9 million or 18.63% of assets at December 31, 2017.

The Bank uses advances from the FHLB of Atlanta to supplement the supply of funds it may lend and to meet deposit withdrawal requirements. Advances from the FHLB are secured by the Bank's stock in the FHLB, a portion of the Bank's loan portfolio and certain investments. Generally, the Bank's ability to borrow from the FHLB of Atlanta is limited by its available collateral and by an overall limitation of 30% of assets. Further, short-term credit facilities are available at the Federal Reserve Bank of Richmond and commercial banks. Long-term debt consists of adjustable-rate advances with rates based upon LIBOR, fixed-rate advances, and convertible advances. At December 31, 2017 and 2016, 100% of the Bank's long-term debt was fixed for rate and term, as the conversion optionality of the advances have either been exercised or expired.

The following table sets forth information about long-term debt and short-term borrowings for the years indicated. Junior subordinated debentures of $12 million and subordinated notes of $23.0 million are not included in the table. For more information on borrowings, see Notes 11, 16 and 17 in the Consolidated Financial Statements.

(dollars in thousands)	At or for the Year Ended December 31, 2017	2016	2015
Long-term debt			
Long-term debt outstanding at end of period	$ 55,498	$65,559	$55,617
Weighted average rate on outstanding long-term debt	2.38%	2.27%	2.47%
Maximum outstanding long-term debt of any month end	65,554	65,593	74,668
Average outstanding long-term debt	58,704	60,503	68,924
Approximate average rate paid on long-term debt	2.24%	2.41%	2.26%
Short-term borrowings			
Short-term borrowings outstanding at end of period	$ 87,500	$79,000	$36,000
Weighted average rate on short-term borrowings	1.34%	0.71%	0.38%
Maximum outstanding short-term borrowings at any month end	109,000	79,000	36,000
Average outstanding short-term borrowings	91,797	39,802	13,463
Approximate average rate paid on short-term borrowings	1.15%	0.49%	0.27%

Stockholders' Equity

The following table shows the Company's equity and the dollar and percentage changes for the periods presented.

(dollars in thousands)	December 31, 2017	December 31, 2016	$ Change	% Change
Common Stock at par of $0.01	$ 46	$ 46	$ —	0.0%
Additional paid in capital	48,209	47,377	832	1.8%
Retained earnings	63,648	58,100	5,548	9.5%
Accumulated other comprehensive loss	(1,191)	(928)	(263)	28.3%
Unearned ESOP shares	(755)	(169)	(586)	346.7%
Total Stockholders' Equity	$109,957	$104,426	$5,531	5.3%

During the year ended December 31, 2017, stockholders' equity increased $5.5 million to $110.0 million. The increase in stockholders' equity was due to net income of $7.2 million, net stock related activities related to stock-based compensation of $670,000 and a net fair market value adjustment of $110,000 for leveraged ESOP shares. These increases to capital were partially offset by quarterly common dividends paid of $1.8 million, a current year increase in accumulated other comprehensive loss of $67,000 and the net increase in unearned ESOP shares of $586,000. During the year ended December 31, 2017, $237,000 or 10,157 ESOP shares were allocated with the payment of promissory notes. This was offset by the purchase of 23,503 shares of the Company's common shares for $823,000 by the Employee Stock Ownership Plan (''ESOP'') during the third quarter of 2017. The ESOP has promissory notes with the Company for the purchase of TCFC common stock for the benefit of the participants in the Plan. Loan terms are at prime rate plus one-percentage point and amortize over seven (7) years. As principal is repaid, common shares are allocated to participants based on the participant account allocation rules described in the Plan. The Bank is a guarantor of the ESOP debt with the Company. Unencumbered shares held by the ESOP are treated as outstanding in computing earnings per share. Shares issued to the ESOP but pledged as collateral for loans obtained to provide funds to acquire the shares are not treated as outstanding in computing earnings per share.

Common stockholders' equity of $110.0 million at December 31, 2017 resulted in a book value of $23.65 per common share compared to $22.54 at December 31, 2016. The Company remains well-capitalized at December 31, 2017 with a Tier 1 capital to average assets ratio of 8.79%.

LIQUIDITY AND CAPITAL RESOURCES

Capital Resources

The Company has no business other than holding the stock of the Bank and does not currently have any material funding requirements, except for the payment of dividends on common stock, and the payment of interest on subordinated debentures and subordinated notes, and noninterest expense.

The Company evaluates capital resources by our ability to maintain adequate regulatory capital ratios. The Company and the Bank annually update a three-year strategic capital plan. In developing its plan, the Company considers the impact to capital of asset growth, income accretion, dividends, holding company liquidity, investment in markets and people and stress testing.

During the years ended December 31, 2017 and 2016, the Company performed ongoing assessments using the new regulatory capital ratios and determined that the Company meets the new requirements specified in the Basel III rules upon full adoption of such requirements. In addition, our subsidiary bank made the election to continue to exclude most accumulated other comprehensive income (“AOCI”) from capital in connection with its March 31, 2015 quarterly financial filing and, in effect, to retain the AOCI treatment under the prior capital rules.

Federal banking regulations require the Company and the Bank to maintain specified levels of capital. As of December 31, 2017 and 2016, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the new Basel III Capital Rules. Management believes, as of December 31, 2017 and 2016, that the Company and the Bank met all capital adequacy requirements to which they were subject. See Note 18 of the Consolidated Financial Statements.

Liquidity

Liquidity is our ability to meet cash demands as they arise. Such needs can develop from loan demand, deposit withdrawals or acquisition opportunities. Potential obligations resulting from the issuance of standby letters of credit and commitments to fund future borrowings to our loan customers are other factors affecting our liquidity needs. Many of these obligations and commitments are expected to expire without being drawn upon; therefore, the total commitment amounts do not necessarily represent future cash requirements affecting our liquidity position.

Based on management’s going concern evaluation, we believe that there are no conditions or events, considered in the aggregate, that raise substantial doubt about the Company’s or the Bank’s ability to continue as a going concern, within one year of the date of the issuance of the financial statements.

Asset liquidity is provided by cash and assets which are readily marketable or which will mature in the near future. Liquid assets include cash, federal funds sold, and short-term investments in cash deposits with other banks. Liquidity is also provided by access to funding sources, which include core depositors and brokered deposits. Other sources of funds include our ability to borrow, such as purchasing federal funds from correspondent banks, sales of securities under agreements to repurchase and advances from the FHLB.

At December 31, 2017 and 2016, the Bank had $65.6 million and $67.0 million, respectively, in loan commitments outstanding. In addition, at December 31, 2017 and 2016, the Bank had $17.9 million and $17.7 million, respectively, in letters of credit and approximately $162.2 million and $135.3 million, respectively, available under lines of credit. Certificates of deposit due within one year of December 31, 2017 and 2016 totaled $312.4 million or 69.2% and $306.1 million, or 70.7%, respectively, of total certificates of deposit outstanding. If maturing deposits do not remain, the Bank will be required to seek other sources of funds, including other certificates of deposit and borrowings. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposits. We believe, however, based on past experience that a significant portion of our certificates of deposit will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

The Company’s principal sources of liquidity are cash on hand and dividends received from the Bank. The Bank is subject to various regulatory restrictions on the payment of dividends.

The Bank’s principal sources of funds for investment and operations are net income, deposits, sales of loans, borrowings, principal and interest payments on loans, principal and interest received on investment securities and proceeds from the maturity and sale of investment securities. The Bank's principal funding commitments are for the origination or purchase of loans, the purchase of securities and the payment of maturing deposits. Deposits are considered the primary source of funds supporting the Bank's lending and investment activities. The Bank also uses borrowings from the FHLB of Atlanta to supplement deposits. The amount of FHLB advances available to the Bank is limited to the lower of 30% of Bank assets or the amount supportable by eligible collateral including FHLB stock, loans and securities. In addition, the Bank has established unsecured and secured lines of credit with the Federal Reserve Bank and commercial banks. For a discussion of these agreements including collateral see Note 11 in the Consolidated Financial Statements.

The Bank's most liquid assets are cash, cash equivalents and federal funds sold. The levels of such assets are dependent on the Bank's operating, financing and investment activities at any given time. The variations in levels of cash and cash equivalents are influenced by deposit flows and anticipated future deposit flows.

Comparison for the Years Ending December 31, 2017 and 2016

Cash and cash equivalents as of December 31, 2017 totaled $15.4 million, an increase of $4.1 million from the December 31, 2016 total of $11.3 million. Ending cash balances were stable compared to the prior year end as net cash provided by operating activities was similar and decreased cash used in investing activities in 2017 compared to 2016 nearly offset decreased cash provided by financing activities in 2017 compared to 2016. Changes to the level of cash and cash equivalents have minimal impact on operational needs as the Bank has substantial sources of funds available from other sources.

During the year ended December 31, 2017, all financing activities provided $63.6 million in cash compared to $182.3 million in cash provided for the same period in 2016. The Company was provided $118.7 million less cash from financing activities compared to the prior year, primarily due to reduced deposit growth and slower growth in net borrowings. Net deposits increased $67.4 million in 2017 compared to $131.9 million in 2016. Long-term debt decreased a net of $10.1 million from $65.6 million at December 31, 2016 to $55.5 million at December 31, 2017 and provided $20.0 million less cash in 2017 compared to 2016. Short-term borrowings increased a net of $8.5 million from $79.0 million at December 31, 2016 to $87.5 million at December 31, 2017, but increased at a slower rate than 2016. Short-term borrowings provided $34.5 million less cash in 2017 compared to 2016. The Company was provided a net increase in cash of $297,000 for stock related activities in 2017 compared to 2016. Net cash provided in 2017 compared to 2016 from the exercise of stock options, no 2017 repurchases of common stock and a small decrease in common dividends paid on 2017 was partially offset by a net change in unearned ESOP shares due primarily to an increase in ESOP stock purchases in 2017.

The Bank's principal use of cash has been in investing activities including its investments in loans, investment securities and other assets. In 2017, the level of net cash used in investing decreased to $69.6 million from $195.1 million in 2016. The decrease in cash used of $125.5 million was primarily the result of net decreases in cash used of $3.2 million for purchases of premises and equipment, $14.0 million from securities transactions and $112.1 million from loan activities. The Company purchased more premises and equipment in 2016 compared to the same period in 2017, mainly due to the construction of a new branch in downtown Fredericksburg, Virginia during the first half of 2016. 2015. The Company's cash used decreased $14.0 million due to net purchases of securities of $5.6 million for the year ended December 31, 2017 compared to $19.6 million for the year ended December 31, 2016. Cash used decreased as principal received on loans in 2017 increased over the prior year comparable period. Principal collected on loans increased $25.7 million from $234.6 million for the year ended December 31, 2016 to $260.3 million for the year ended December 31, 2017. Additionally, cash used decreased for the funding of loans originated, which decreased $86.4 million from $411.6 for the year ended December 31, 2016 to $325.2 million for the year ended December 31, 2017. These reductions in the amount of cash used were partially offset by a decrease in cash provided of $3.8 million from the 2016 sales of the King George branch and OREO compared to less significant sales activity in 2017. Net cash provided decreased from $5.5 million for the year ended December 31, 2016 to $1.7 million for the year ended December 31, 2017

Operating activities provided cash of $10.1 million for the year ended December 31, 2017 compared to $12.9 million of cash provided for the same period of 2016.

Comparison for the Years Ending December 31, 2016 and 2015

Cash and cash equivalents as of December 31, 2016 totaled $11.3 million, an increase of $124,000 from the December 31, 2015 total of $11.1 million. Ending cash balances were stable compared to the prior year end as net cash provided by operating activities was similar and increased cash used in investing activities in 2016 compared to 2015 nearly offset cash provided by financing activities in 2016 compared to 2015. Changes to the level of cash and cash equivalents have minimal impact on operational needs as the Bank has substantial sources of funds available from other sources.

During the year ended December 31, 2016, all financing activities provided $182.3 million in cash compared to $51.9 million in cash provided for the same period in 2015. The Company provided $130.5 million more cash from financing activities in the year ended December 31, 2016 compared to the year ended December 31, 2015, primarily due to increases in deposits of $94.4 million and net increases of $38.0 million in long-term debt and short-term borrowings. Additionally, the Company used $963,000 less cash to repurchase common stock during 2016 and dividends were reduced by $101,000 due to the refinancing of SBLF in the first quarter of 2015. These increases to cash were offset by a $3.0 million reduction in cash due to net proceeds received during the first quarter 2015 for the subordinated notes issued of $23.0 million offset by the SBLF payoff of $20 million.

The Bank's principal use of cash has been in investing activities including its investments in loans, investment securities and other assets. In 2016, the level of net cash used in investing increased to $195.1 million from $74.6 million in 2015. The increase in cash used in investing activity of $120.5 million in 2016 was primarily due to a net increase in cash used of $123.2 million for loan activities. More cash was used to fund loans as loans originated or acquired increased $152.7 million from $258.9 million for the year ended December 31, 2015 to $411.6 million for the year ended December 31, 2016. This increase in cash used was partially offset as principal collected on loans increased $29.5 million from $205.1 million for the year ended December 31, 2015 to $234.6 million for the year ended December 31, 2016. Additional cash of $520,000 was used to purchase premises and equipment in the year ended December 31, 2016 compared to 2015. The Company's cash used increased $1.0 million due to net purchases of securities of $19.6 million for the year ended December 31, 2016 compared to $18.6 million for the year ended December 31, 2015. These increases in cash used were partially offset by an increase in net proceeds from the sale of OREO and other assets of $4.2 million compared to the prior year.

Operating activities provided cash of $12.9 million for the year ended December 31, 2016 compared to $12.5 million of cash provided for the same period of 2015.

QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Interest rate risk is defined as the exposure to changes in net interest income and capital that arises from movements in interest rates. Depending on the composition of the balance sheet, increasing or decreasing interest rates can negatively affect the Company's results of operations and financial condition.

The Company measures interest rate risk over the short and long term. The Company measures interest rate risk as the change in net interest income (''NII'') caused by a change in interest rates over twelve and twenty-four months. The Company's NII simulations provide information about short-term interest rate risk exposure. The Company also measures interest rate risk by measuring changes in the values of assets and liabilities due to changes in interest rates. The economic value of equity (''EVE'') is defined as the present value of future cash flows from existing assets, minus the present value of future cash flows from existing liabilities. EVE simulations reflect the interest rate sensitivity of assets and liabilities over a longer time period, considering the maturities, average life and duration of all balance sheet accounts.

The Board of Directors has established an interest rate risk policy, which is administered by the Bank's Asset Liability Committee (''ALCO''). The policy establishes limits on risk, which are quantitative measures of the percentage change in NII and EVE resulting from changes in interest rates. Both NII and EVE simulations assist in identifying, measuring, monitoring and controlling interest rate risk and are used by management and the ALCO Committee to ensure that interest rate risk exposure will be maintained within Board policy guidelines. The ALCO Committee reports quarterly to the Board of Directors. Mitigating strategies are used to maintain interest rate risk within established limits.

The Company's interest rate risk (''IRR'') model uses assumptions which include factors such as call features, prepayment options and interest rate caps and floors included in investment and loan portfolio contracts. Additionally, the IRR model estimates the lives and interest rate sensitivity of the Company's non-maturity deposits. These assumptions have a significant effect on model results. The assumptions are developed primarily based upon historical behavior of Bank customers. The Company also considers industry and regional data in developing IRR model assumptions. There are inherent limitations in the Company's IRR model and underlying assumptions. When interest rates change, actual movements of interest-earning assets and interest-bearing liabilities, loan prepayments, and withdrawals of time and other deposits, may deviate significantly from assumptions used in the model.

The Company prepares a current base case and several alternative simulations at least quarterly. Current interest rates are shocked by +/- 100, 200, 300, and 400 basis points (''bp''). In addition, the Company simulates additional rate curve scenarios (e.g., bear flattener). The Company may elect not to use particular scenarios that it determines are impractical in a current rate environment.

The Company's internal limits for parallel shock scenarios are as follows:

Shock in Basis Points	Net Interest Income (''NII'')	Economic Value of Equity (''EVE'')
+ - 400	25%	40%
+ - 300	20%	30%
+ - 200	15%	20%
+ - 100	10%	10%

It is management's goal to manage the portfolios of the Bank so that net interest income at risk over twelve-month and twenty-four month periods and the economic value of equity at risk do not exceed policy guidelines at the various interest rate shock levels. As of December 31, 2017 and 2016, the Company did not exceed any Board approved sensitivity limits. Measures of net interest income at risk produced by simulation analysis are indicators of an institution's short-term performance in alternative rate environments. The below schedule estimates the changes in net interest income over a twelve-month period for parallel rate shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Net Interest Income			
Change in Interest Rates:	**+ 200 bp**	**+ 100 bp**	**- 100 bp**
Policy Limit	(15.00)%	(10.00)%	(10.00)%
December 31, 2017	(1.28)%	(0.54)%	(1.30)%
December 31, 2016	(2.19)%	(1.10)%	1.51%

Measures of equity value at risk indicate the ongoing economic value of the Company by considering the effects of changes in interest rates on all of the Company's cash flows, and by discounting the cash flows to estimate the present value of assets and liabilities. The below schedule estimates the changes in the economic value of equity at parallel shocks for up 200, 100 and down 100 scenarios:

Estimated Changes in Economic Value of Equity (EVE)			
Change in Interest Rates:	**+ 200 bp**	**+ 100 bp**	**- 100 bp**
Policy Limit	(20.00)%	(10.00)%	(10.00)%
December 31, 2017	(13.15)%	(6.01)%	18.35%
December 31, 2016	(13.22)%	(5.64)%	0.63%

OFF-BALANCE SHEET ARRANGEMENTS

In the normal course of operations, we engage in a variety of financial transactions that, in accordance with accounting principles generally accepted in the United States of America and to general practices within the banking industry, are not recorded in our financial statements. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are used primarily to manage customers' requests for funding and take the form of loan commitments, letters of credit and lines of credit. For a discussion of these agreements, including collateral and other arrangements, see Note 13 in the Consolidated Financial Statements.

For the years ended December 31, 2017 and 2016, the Company did not engage in any off-balance sheet transactions reasonably likely to have a material effect on its financial condition, results of operations or cash flows.

CONTRACTUAL OBLIGATIONS

In the normal course of its business, the Bank commits to make future payments to others to satisfy contractual obligations. These obligations include commitments to repay short and long-term borrowings and commitments incurred under operating lease agreements. The following schedules provide detail of contractual obligations as of December 31, 2017 and 2016:

		Payments due by period			
	Total	Less than One Year	One to Three Years	Three to Five Years	More Than 5 Years
At December 31, 2017 (In thousands)					
Short-term debt obligations	$ 87,500	$ 87,500	$ —	$ —	$ —
Long-term debt obligations	55,498	25,000	10,000	10,302	10,196
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000				12,000
Subordinated notes – 6.25%	23,000				23,000
Time deposits	451,605	312,417	123,384	15,804	—
Operating lease obligations[1]	6,809	747	1,139	904	4,019
Purchase Obligations[2]	4,320	2,129	2,191	—	—
Total	$640,732	$427,793	$136,714	$27,010	$49,215

(1) Payments are for lease of real property.

(2) Represents payments under contract based on average monthly service charges for 2017.

		Payments due by period			
	Total	Less than One Year	One to Three Years	Three to Five Years	More Than 5 Years
At December 31, 2016 (In thousands)					
Short-term debt obligations	$ 79,000	$ 79,000	$ —	$ —	$ —
Long-term debt obligations	65,559	20,000	25,000	10,000	10,559
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000				12,000
Subordinated notes – 6.25%	23,000				23,000
Time deposits	432,792	306,089	111,395	15,308	—
Operating lease obligations[1]	7,622	739	1,377	1,049	4,457
Purchase Obligations[2]	6,459	2,092	4,367	—	—
Total	$626,432	$407,920	$142,139	$26,357	$50,016

(1) Payments are for lease of real property.

(2) Represents payments under contract based on average monthly service charges for 2016.

IMPACT OF INFLATION AND CHANGING PRICES

The Consolidated Financial Statements and notes thereto presented herein have been prepared in accordance with accounting principles generally accepted in the United States of America and general practices within the banking industry, which require the measurement of financial position and operating results in terms of historical dollars without considering the changes in the relative purchasing power of money over time due to inflation. Unlike most industrial companies, nearly all of the Company's assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on the Company's performance than do the effects of general levels of inflation. Interest rates do not necessarily move in the same direction or to the same extent as the prices of goods and services.

THE COMMUNITY FINANCIAL CORPORATION
RECONCILIATION OF GAAP AND NON-GAAP FINANCIAL MEASURES

Reconciliation of US GAAP Net Income, Earnings Per Share (EPS), Return on Average Assets (ROAA) and Return on Average Common Equity (ROACE) to Non-GAAP Operating Net Income, EPS, ROAA and ROACE[(a)]

The Company's management discussion and analysis contains financial information determined by methods other than in accordance with generally accepted accounting principles, or GAAP. This financial information includes certain operating performance measures, which exclude merger and acquisition costs, primarily the additional income tax expense from the revaluation of deferred tax assets as a result of the reduction in the corporate income tax rate under the recently enacted Tax Cuts and Jobs Act, that are not considered part of recurring operations, such as ''operating net income,'' ''operating earnings per share,'' ''operating return on average assets,'' and ''operating return on average common equity.'' These non-GAAP measures are included because the Company believes they may provide useful supplemental information for evaluating the underlying performance trends of the Company.

	Years Ended	
	December 31, 2017	December 31, 2016
GAAP Net (loss) income	$ 7,208	$ 7,331
Impact of Tax Cuts and Jobs Act	2,740	—
Merger and acquisition costs (net of tax)	724	—
Non-GAAP Operating Net income before merger and acquisition costs and deferred tax adjustment for Tax Cuts and Jobs Act	$ 10,672	$ 7,331
GAAP diluted EPS	$ 1.56	$ 1.59
Non-GAAP Operating diluted EPS before merger and acquisition costs and deferred tax adjustment for Tax Cuts and Jobs Act	$ 2.31	$ 1.59
GAAP ROAA	0.52%	0.60%
Non-GAAP Operating ROAA before merger and acquisition costs and deferred tax adjustment for Tax Cuts and Jobs Act	0.78%	0.60%
GAAP ROACE	6.55%	7.09%
Non-GAAP Operating ROACE before merger and acquisition costs and deferred tax adjustment for Tax Cuts and Jobs Act	9.70%	7.09%
Weighted average common shares outstanding:	4,629,228	4,599,502
Average Assets	$1,376,983	$1,229,470
Average Equity	109,979	103,397

(a) There were no merger and acquisition costs or deferred tax adjustments for the year ended December 31, 2016.

Item 8 — Financial Statements and Supplementary Data

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of The Community Financial Corporation (the ''Company'') is responsible for the preparation, integrity and fair presentation of the financial statements included in this Annual Report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and reflect management's judgments and estimates concerning the effects of events and transactions that are accounted for or disclosed.

Management is also responsible for establishing and maintaining effective internal control over financial reporting. The Company's internal control over financial reporting includes those policies and procedures that pertain to the Company's ability to record, process, summarize and report reliable financial data. The internal control system contains monitoring mechanisms, and appropriate actions taken to correct identified deficiencies. Management believes that internal controls over financial reporting, which are subject to scrutiny by management and the Company's internal auditors, support the integrity and reliability of the financial statements. Management recognizes that there are inherent limitations in the effectiveness of any internal control system, including the possibility of human error and the circumvention or overriding of internal controls. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. In addition, because of changes in conditions and circumstances, the effectiveness of internal control over financial reporting may vary over time. The Audit Committee of the Board of Directors (the ''Committee''), is comprised entirely of outside directors who are independent of management. The Committee is responsible for the appointment and compensation of the independent auditors and makes decisions regarding the appointment or removal of members of the internal audit function. The Committee meets periodically with management, the independent auditors, and the internal auditors to ensure that they are carrying out their responsibilities. The Committee is also responsible for performing an oversight role by reviewing and monitoring the financial, accounting, and auditing procedures of the Company in addition to reviewing the Company's financial reports. The independent auditors and the internal auditors have full and unlimited access to the Audit Committee, with or without the presence of management, to discuss the adequacy of internal control over financial reporting, and any other matters which they believe should be brought to the attention of the Audit Committee.

Management assessed the Company's system of internal control over financial reporting as of December 31, 2017. This assessment was conducted based on the Committee of Sponsoring Organizations (''COSO'') of the Treadway Commission ''Internal Control — Integrated Framework (2013).'' Based on this assessment, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2017. Management's assessment concluded that there were no material weaknesses within the Company's internal control structure. There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15 under the Securities Act of 1934) during the quarter ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The 2017 financial statements have been audited by the independent registered public accounting firm of Dixon Hughes Goodman LLP (''DHG''). Personnel from DHG were given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees thereof. Management believes that all representations made to all the independent auditors were valid and appropriate. The resulting report from DHG accompanies the financial statements. DHG has also issued a report on the effectiveness of internal control over financial reporting. This report has also been made a part of this Annual Report.

/s/ William J. Pasenelli	/s/ Todd L. Capitani
William J. Pasenelli President and Chief Executive Officer March 12, 2018	Todd L. Capitani Executive Vice President and Chief Financial Officer March 12, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors
The Community Financial Corporation

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of The Community Financial Corporation (the ''Company'') as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows, for each of the two years in the period ended December 31, 2017, and the related notes (collectively referred to as the ''financial statements''). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of two years in the period ended December 31, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (''PCAOB''), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 12, 2018 expressed an unqualified opinion thereon.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Dixon Hughes Goodman LLP

We have served as the Company's auditor since 2016.

Baltimore, Maryland
March 12, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Stockholders and Board of Directors
The Community Financial Corporation

Opinion on Internal Control Over Financial Reporting

We have audited The Community Financial Corporation (the ''Company'')'s internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, The Community Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017 based on criteria established in *Internal Control — Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (''PCAOB''), the consolidated financial statements of The Community Financial Corporation as of December 31, 2017 and 2016 and for each of the years in the two years ended December 31, 2017, and our report dated March 12, 2018, expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ Dixon Hughes Goodman LLP

Baltimore, Maryland
March 12, 2018

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
The Community Financial Corporation
Waldorf, Maryland

We have audited the consolidated statement of income, comprehensive income, changes in stockholders' equity, and cash flows of The Community Financial Corporation (the ''Company'') for the year ended December 31, 2015. The Company's management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the Company's results of operations and cash flows for the year ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America.

/s/ Stegman & Company

Baltimore, Maryland
March 10, 2016

CONSOLIDATED BALANCE SHEETS

(dollars in thousands, except per share amounts)	December 31, 2017	December 31, 2016
Assets		
Cash and due from banks	$ 13,315	$ 9,948
Interest-bearing deposits with banks	2,102	1,315
Securities available for sale (AFS), at fair value	68,285	53,033
Securities held to maturity (HTM), at amortized cost	99,246	109,247
Federal Home Loan Bank (FHLB) stock – at cost	7,276	7,235
Loans receivable – net of allowance for loan losses of $10,515 and $9,860	1,140,615	1,079,519
Premises and equipment, net	21,391	22,205
Premises and equipment held for sale	—	345
Other real estate owned (OREO)	9,341	7,763
Accrued interest receivable	4,511	3,979
Investment in bank owned life insurance	29,398	28,625
Other assets	10,481	11,043
Total Assets	$1,405,961	$1,334,257
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Non-interest-bearing deposits	$ 159,844	$ 144,877
Interest-bearing deposits	946,393	893,948
Total deposits	1,106,237	1,038,825
Short-term borrowings	87,500	79,000
Long-term debt	55,498	65,559
Guaranteed preferred beneficial interest in junior subordinated debentures (TRUPs)	12,000	12,000
Subordinated notes – 6.25%	23,000	23,000
Accrued expenses and other liabilities	11,769	11,447
Total Liabilities	1,296,004	1,229,831
Stockholders' Equity		
Common stock – par value $.01; authorized – 15,000,000 shares; issued 4,649,658 and 4,633,868 shares, respectively	46	46
Additional paid in capital	48,209	47,377
Retained earnings	63,648	58,100
Accumulated other comprehensive loss	(1,191)	(928)
Unearned ESOP shares	(755)	(169)
Total Stockholders' Equity	109,957	104,426
Total Liabilities and Stockholders' Equity	$1,405,961	$1,334,257

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF INCOME

(dollars in thousands, except per share amounts)	Years Ended December 31, 2017	2016	2015
Interest and Dividend Income			
Loans, including fees	$49,611	$44,919	$41,386
Interest and dividends on investment securities	3,906	3,108	2,473
Interest on deposits with banks	53	20	14
Total Interest and Dividend Income	53,570	48,047	43,873
Interest Expense			
Deposits	5,946	4,695	4,152
Short-term borrowings	1,057	196	37
Long-term debt	3,179	3,251	3,156
Total Interest Expense	10,182	8,142	7,345
Net Interest Income	43,388	39,905	36,528
Provision for loan losses	1,010	2,359	1,433
Net Interest Income After Provision For Loan Losses	42,378	37,546	35,095
Noninterest Income			
Loan appraisal, credit, and miscellaneous charges	157	289	315
Gain on sale of assets	47	12	19
Net gains (losses) on sale of OREO	43	(436)	(20)
Net gains on sale of investment securities	175	31	4
Loss on premises and equipment held for sale	—	—	(426)
Income from bank owned life insurance	773	789	815
Service charges	2,595	2,675	2,488
Gain on sale of loans held for sale	294	—	104
Total Noninterest Income	4,084	3,360	3,299
Noninterest Expense			
Salary and employee benefits	16,758	16,810	16,366
Occupancy expense	2,632	2,488	2,427
Advertising	543	647	583
Data processing expense	2,354	2,267	2,044
Professional fees	1,662	1,568	1,323
Merger and acquisition costs	829	—	—
Depreciation of premises and equipment	786	812	810
Telephone communications	191	174	188
Office supplies	119	136	157
FDIC Insurance	638	739	799
OREO valuation allowance and expenses	746	861	1,059
Other	2,839	2,657	2,662
Total Noninterest Expense	30,097	29,159	28,418
Income before income taxes	16,365	11,747	9,976
Income tax expense	9,157	4,416	3,633
Net Income	$ 7,208	$ 7,331	$ 6,343
Preferred stock dividends	—	—	23
Net Income Available to Common Stockholders	$ 7,208	$ 7,331	$ 6,320
Earnings Per Common Share			
Basic	$ 1.56	$ 1.59	$ 1.36
Diluted	$ 1.56	$ 1.59	$ 1.35
Cash dividends paid per common share	$ 0.40	$ 0.40	$ 0.40

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(dollars in thousands)	Years Ended December 31, 2017	2016	2015
Net Income	$7,208	$7,331	$6,343
Net unrealized holding (losses) gains arising during period, net of tax (benefit) expense of $(41), $(433) and $85, respectively	(62)	(662)	131
Reclassification adjustment for losses included in net income, net of tax benefit of $3, $7 and $2, respectively	(5)	(15)	(4)
Comprehensive Income	$7,141	$6,654	$6,470

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2017, 2016 and 2015

(dollars in thousands)	SBLF Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance at January 1, 2015	**$ 20,000**	**$47**	**$46,416**	**$50,936**	**$(378)**	**$(462)**	**$116,559**
Comprehensive Income							
Net Income	—	—	—	6,343	—	—	6,343
Unrealized holding gain on investment securities net of tax of $83	—	—	—	—	127	—	127
Total Comprehensive Income							6,470
Cash dividend at $0.40 per common share	—	—	—	(1,843)	—	—	(1,843)
Preferred stock dividends	—	—	—	(73)	—	—	(73)
Dividend reinvestment	—	—	42	(42)	—	—	—
Redemption of SBLF Loan	(20,000)	—	—	—	—	—	(20,000)
Net change in unearned ESOP shares	—	—	—	—	—	146	146
Repurchase of common stock	—	(1)	—	(1,826)	—	—	(1,827)
Stock based compensation	—	—	319	—	—	—	319
Tax effect of the ESOP dividend	—	—	32	—	—	—	32
Balance at December 31, 2015	**$ —**	**$46**	**$46,809**	**$53,495**	**$(251)**	**$(316)**	**$ 99,783**

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2017, 2016 and 2015
(continued)

(dollars in thousands)	SBLF Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance at January 1, 2016	**$—**	**$46**	**$46,809**	**$53,495**	**$(251)**	**$(316)**	**$ 99,783**
Comprehensive Income							
Net Income	—	—	—	7,331	—	—	7,331
Unrealized holding loss on investment securities net of tax of $440	—	—	—	—	(677)	—	(677)
Total Comprehensive Income							6,654
Cash dividend at $0.40 per common share	—	—	—	(1,814)	—	—	(1,814)
Dividend reinvestment	—	—	47	(47)	—	—	—
Net change in unearned ESOP shares	—	—	—	—	—	147	147
Repurchase of common stock	—	—	—	(865)	—	—	(865)
Stock based compensation	—	—	489	—	—	—	489
Tax effect of the ESOP dividend	—	—	32	—	—	—	32
Balance at December 31, 2016	**$—**	**$46**	**$47,377**	**$58,100**	**$(928)**	**$(169)**	**$104,426**

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2017, 2016 and 2015
(continued)

(dollars in thousands)	SBLF Preferred Stock	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Unearned ESOP Shares	Total
Balance at January 1, 2017	**$—**	**$46**	**$47,377**	**$58,100**	**$ (928)**	**$(169)**	**$104,426**
Comprehensive Income							
Net Income	—	—	—	7,208	—	—	7,208
Unrealized holding loss on investment securities net of tax of $44	—	—	—	—	(67)	—	(67)
Reclassification due to Accounting Standards Update (ASU 2018-02)	—	—	—	196	(196)	—	—
Total Comprehensive Income							7,141
Cash dividend at $0.40 per common share	—	—	—	(1,804)	—	—	(1,804)
Excess of fair market value over cost of leveraged ESOP shares released	—	—	110	—	—	—	110
Dividend reinvestment	—	—	52	(52)	—	—	—
Exercise of stock options	—	—	155	—	—	—	155
Net change in unearned ESOP shares	—	—	—	—	—	(586)	(586)
Repurchase of common stock	—	—	—	—	—	—	—
Stock based compensation	—	—	515	—	—	—	515
Balance at December 31, 2017	**$—**	**$46**	**$48,209**	**$63,648**	**$(1,191)**	**$(755)**	**$109,957**

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	Years Ended December 31, 2017	2016	2015
Cash Flows from Operating Activities			
Net income	$ 7,208	$ 7,331	$ 6,343
Adjustments to reconcile net income to net cash provided by operating activities			
Provision for loan losses	1,010	2,359	1,433
Depreciation and amortization	1,598	1,544	1,439
Provision for loss on premises held for sale	—	—	426
Loans originated for resale	(2,529)	—	(4,192)
Proceeds from sale of loans originated for sale	2,823	—	4,296
Gain on sale of loans held for sale	(294)	—	(104)
Net (gains) loss on the sale of OREO	(43)	436	20
Gains on sales of investment securities	(175)	(31)	(4)
Gain on sale of assets	(47)	(12)	(19)
Net amortization of premium/discount on investment securities	393	509	245
Increase in OREO valuation allowance	599	574	664
Increase in cash surrender value of bank owned life insurance	(773)	(789)	(815)
Decrease (increase) in deferred income tax benefit	1,887	(555)	(750)
Increase in accrued interest receivable	(532)	(761)	(182)
Stock based compensation	515	489	319
Compensation expense due to excess of fair market value over cost of leveraged ESOP shares released	110	—	—
(Increase) decrease in net deferred loan premiums	(689)	(1,552)	85
Increase in accrued expenses and other liabilities	322	1,414	1,770
(Increase) decrease in other assets	(1,281)	1,959	1,523
Net Cash Provided by Operating Activities	10,102	12,915	12,497
Cash Flows from Investing Activities			
Purchase of AFS investment securities	(26,251)	(31,312)	(2,084)
Proceeds from redemption or principal payments of AFS investment securities	7,110	5,653	8,986
Purchase of HTM investment securities	(13,135)	(24,504)	(42,949)
Proceeds from maturities or principal payments of HTM investment securities	18,048	23,564	17,860
Proceeds from sale of HTM investment securities	4,947	710	66
Proceeds from sale of AFS investment securities	3,702	6,546	—
Net increase of FHLB and FRB stock	(41)	(303)	(497)
Loans originated or acquired	(325,155)	(411,564)	(258,844)
Principal collected on loans	260,303	234,587	205,100
Purchase of premises and equipment	(779)	(3,970)	(3,450)
Proceeds from sale of OREO	1,300	3,423	1,184
Proceeds from disposal of asset	387	2,044	34
Net Cash Used in Investing Activities	(69,564)	(195,126)	(74,594)

See notes to Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

(dollars in thousands)	Years Ended December 31, 2017	2016	2015
Cash Flows from Financing Activities			
Net increase in deposits	$ 67,412	$131,925	$ 37,515
Proceeds from long-term debt	10,000	15,000	—
Payments of long-term debt	(20,061)	(5,058)	(19,055)
Net increase in short term borrowings	8,500	43,000	34,000
Exercise of stock options	155	—	—
Proceeds from subordinated notes	—	—	23,000
Redemption of Small Business Lending Fund Preferred Stock	—	—	(20,000)
Dividends paid	(1,804)	(1,814)	(1,916)
Net change in unearned ESOP shares	(586)	147	146
Repurchase of common stock	—	(865)	(1,827)
Net Cash Provided by Financing Activities	63,616	182,335	51,863
Increase (Decrease) in Cash and Cash Equivalents	$ 4,154	$ 124	$(10,234)
Cash and Cash Equivalents – January 1	11,263	11,139	21,373
Cash and Cash Equivalents – December 31	$ 15,417	$ 11,263	$ 11,139
Supplemental Disclosures of Cash Flow Information			
Cash paid during the period for			
Interest	$ 10,001	$ 7,993	$ 6,799
Income taxes	$ 7,435	$ 5,325	$ 3,604
Supplemental Schedule of Non-Cash Operating Activities			
Issuance of common stock for payment of compensation	$ 203	$ 575	$ 319
Transfer from loans to OREO	$ 3,634	$ 3,120	$ 5,436
Financed amount of sale of OREO	$ 200	$ 2,176	$ —
Transfer of OREO to premises and equipment	$ —	$ 372	$ —
Transfer from premises and equipment to premises and equipment held for sale	$ —	$ 345	$ 2,426

See notes to Consolidated Financial Statements

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The Consolidated Financial Statements include the accounts of The Community Financial Corporation and its wholly owned subsidiary Community Bank of the Chesapeake (the ''Bank''), and the Bank's wholly owned subsidiary Community Mortgage Corporation of Tri-County (collectively, the ''Company''). All significant intercompany balances and transactions have been eliminated in consolidation. The accounting and reporting policies of the Company conform with accounting principles generally accepted in the United States of America and to general practices within the banking industry.

Reclassification

Certain reclassifications have been made in the Consolidated Financial Statements for 2016 to conform to the classification presented in 2017. Reclassifications had no effect on net income.

Nature of Operations

The Company provides a variety of financial services to individuals and businesses through its offices in Southern Maryland and Annapolis, Maryland, and Fredericksburg, Virginia. Its primary deposit products are demand, savings and time deposits, and its primary lending products are commercial and residential mortgage loans, commercial loans, construction and land development loans, home equity and second mortgages and commercial equipment loans.

The Bank conducts business through its main office in Waldorf, Maryland, and ten branch offices in Waldorf, Bryans Road, Dunkirk, Leonardtown, La Plata, Charlotte Hall, Prince Frederick, Lusby, California, Maryland; and Fredericksburg, Virginia. The Company maintains five loan production offices (''LPOs'') in Annapolis, La Plata, Prince Frederick and Leonardtown, Maryland; and Fredericksburg, Virginia. The Leonardtown and Fredericksburg LPOs are co-located with branches.

The Company closed its Central Park Fredericksburg branch during the third quarter of 2017. This location continues to serve as a loan production office and the branch closure did not have a material effect on operations. The Company offered branch employees open positions.

On July 31, 2017, the Company and Community Bank of the Chesapeake entered into an Agreement and Plan of Merger with County First Bank (''County First''). Merger related costs, which included mainly professional fees and investment banking costs, for the twelve months ended December 31, 2017 were $829,000. Regulatory approval and County First shareholder approvals, were obtained and the merger closed on January 1, 2018. For additional information see Note 23 — Subsequent Events.

Use of Estimates

In preparing Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses and the valuation of OREO and deferred tax assets.

Significant Group Concentrations of Credit Risk

Most of the Company's activities are with customers located in the Fredericksburg area of Virginia and the Southern Maryland counties of Calvert, Charles and St. Mary's. Notes 5 and 6 discuss the types of securities and loans held by the Company. The Company does not have significant concentration in any one customer or industry.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments with original maturities of three months or less when purchased to be cash equivalents.

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Securities

Debt securities that management has the positive intent and ability to hold to maturity are classified as held to maturity (''HTM'') and recorded at amortized cost. Securities purchased and held principally for trading in the near term are classified as ''trading securities'' and are reported at fair value, with unrealized gains and losses included in earnings. The Company held no trading securities for the years ended December 31, 2017, 2016, and 2015. Securities not classified as held to maturity or trading securities, including equity securities with readily determinable fair values, are classified as available for sale (''AFS'') and recorded at estimated fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the estimated fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other than temporary impairment losses, management considers: (1) the length of time and the extent to which the fair value has been less than cost; (2) the financial condition and near-term prospects of the issuer; and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. Investments in Federal Reserve Bank and Federal Home Loan Bank of Atlanta stocks are recorded at cost and are considered restricted as to marketability. The Bank is required to maintain investments in the Federal Home Loan Bank based upon levels of borrowings. During 2016, the Bank's primary regulator became the Federal Deposit Insurance Corporation (''FDIC'') and the Federal Reserve Bank stock was cancelled as it was no longer needed as a condition of membership (see Note 18 for further information).

Debt securities are evaluated quarterly to determine whether a decline in their value is other-than-temporary impairment (''OTTI''). The term other-than-temporary is not necessarily intended to indicate a permanent decline in value. It means that the prospects for near term recovery of value are not necessarily favorable, or that there is a lack of evidence to support fair values equal to, or greater than, the carrying value of the investment. Under accounting guidance, for recognition and presentation of other-than-temporary impairments the amount of other-than-temporary impairment that is recognized through earnings for debt securities is determined by comparing the present value of the expected cash flows to the amortized cost of the security. The discount rate used to determine the credit loss is the expected book yield on the security. The Company does not evaluate declines in the value of securities of Government Sponsored Enterprises (''GSEs'') or investments backed by the full faith and credit of the United States government (e.g. US Treasury Bills), for other-than-temporary impairment.

Loans Held for Sale

Residential mortgage loans intended for sale in the secondary market are carried at the lower of cost or estimated fair value, in the aggregate. Fair value is derived from secondary market quotations for similar instruments. Net unrealized losses, if any, are recognized through a valuation allowance by charges to income.

Residential mortgage loans held for sale are generally sold with the mortgage servicing rights retained by the Company. The carrying value of mortgage loans sold is reduced by the cost allocated to the associated servicing rights. Gains or losses on sales of mortgage loans are recognized based on the difference between the selling price and the carrying value of the related mortgage loans sold, using the specific identification method.

The Company exited the residential mortgage origination line of business in April 2015 for individual owner occupied residential first mortgages and established third party sources to supply its residential whole loan portfolio. The Company continues to underwrite loans for non-owner occupied residential rental properties. The Company may sell certain loans forward into the secondary market at a specified price with a specified date on a best efforts basis. These forward sales are derivative financial instruments. The Company does not recognize gains or losses due to interest rate changes for loans sold forward on a best efforts basis. The Bank had no loans held for sale at December 31, 2017 and 2016, respectively., and sold no 1-4 family residential mortgage loans for the year ended December 31, 2017.

During the year ended December 31, 2017, the Company sold the guaranteed portion of a U.S. Small Business Administration (''SBA'') Loan for proceeds of $2.8 million and recognized a gain of $294,000.

Loans Receivable

The Company originates real estate mortgages, construction and land development loans, commercial loans and consumer loans. The Company purchases residential owner-occupied first mortgages from established third-parties. A substantial portion of the loan portfolio is comprised of loans throughout Southern Maryland and the Fredericksburg area of Virginia. The ability of the Company's debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area.

Loans that the Company has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are reported at their outstanding unpaid principal balances, adjusted for the allowance for loan losses and any deferred fees or premiums. Interest income is accrued on the unpaid principal balance. Loan origination fees and premiums, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans are reviewed on a regular basis and are placed on non-accrual status when, in the opinion of management, the collection of additional interest is doubtful. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in the process of collection. Non-accrual loans include certain loans that are current with all loan payments and are placed on non-accrual status due to customer operating results and cash flows. Non-accrual loans are evaluated for impairment on a loan-by-loan basis in accordance with the Company's impairment methodology. Interest is recognized on non-accrual loans on a cost recovery or cash-basis.

Consumer loans are typically charged-off no later than 90 days past due. Mortgage and commercial loans are fully or partially charged-off when in management's judgment all reasonable efforts to return a loan to performing status have occurred. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected from loans that are placed on non-accrual 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 status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Allowance for Loan Losses and Impaired Loans

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

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

The allowance for loan losses consists of a general and a specific component. The general component is based upon historical loss experience and a review of qualitative risk factors by portfolio segment (See Note 6 for a description of portfolio segments). The historical loss experience factor is tracked over various time horizons for each portfolio segment. The Company considers qualitative factors in addition to the loss experience factor. These include trends by portfolio segment in charge-offs, delinquencies, classified loans, loan concentrations and the rate of portfolio segment growth. Qualitative factors also include an assessment of the current regulatory environment, the quality of credit administration and loan portfolio management and national and local economic trends.

The specific component of the allowance for loan losses relates to individual impaired loans with an identified impairment loss. The Company evaluates substandard and doubtful classified loans, loans delinquent 90 days or greater, non-accrual loans and troubled debt restructured loans (''TDRs'') to determine whether a loan is impaired. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, taking into consideration the circumstances surrounding the loan. These circumstances include the length of the delay, the reasons for the delay, the borrower's payment record and the amount of the shortfall in relation to the principal and interest owed. Loans not impaired are included in the pool of loans evaluated in the general component of the allowance.

If a specific loan is deemed to be impaired it is evaluated for impairment. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral, if the loan is collateral dependent. An allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than carrying value of the loan.

The Company considers all TDRs to be impaired and defines TDRs as loans whose terms have been modified to provide for a reduction or a delay in the payment of either interest or principal because of deterioration in the financial condition of the borrower. A loan extended or renewed at a stated interest rate equal to the current interest rate for new debt with similar risk is not considered a TDR. Once an obligation has been classified as a TDR it continues to be considered a TDR until paid in full or until the debt is refinanced at market rates with no debt forgiveness. TDRs are evaluated for impairment on a loan-by-loan basis in accordance with the Company's impairment methodology. The Company does not participate in any specific government or Company-sponsored loan modification programs. All restructured loan agreements are individual contracts negotiated with a borrower.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. Generally, purchased servicing rights are capitalized at the cost to acquire the rights. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing based on relative estimated fair value. Estimated fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. Capitalized servicing rights are reported in other assets and are amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing assets are evaluated for impairment based upon the estimated fair value of the rights as compared to amortized cost. Impairment is determined by stratifying rights into tranches based on predominant risk characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that 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.

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

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

Premises and Equipment

Land is carried at cost. Premises, improvements and equipment are carried at cost, less accumulated depreciation and amortization, computed by the straight-line method over the estimated useful lives of the assets, which are as follows:

Buildings and Improvements: 10 to 50 years
Furniture and Equipment: three to 15 years
Automobiles: four to five years

Maintenance and repairs are charged to expense as incurred, while improvements that extend the useful life of premises and equipment are capitalized.

Other Real Estate Owned ("OREO")

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the estimated fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or estimated fair value less the cost to sell. Based on updated valuations, the Bank has the ability to reverse a valuation allowance that was recorded subsequent to the initial carrying value up to the amount of the initial recorded carrying value (initial cost basis). Revenues and expenses from operations and changes in the valuation allowance are included in noninterest expense. Gains or losses on disposition are included in noninterest income

Transfers of Financial Assets

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

Advertising Costs

The Company expenses advertising costs as incurred.

Income Taxes

The Company files a consolidated federal income tax return with its subsidiaries. Deferred tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws and when it is considered more likely than not that deferred tax assets will be realized. It is the Company's policy to recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense.

Off Balance Sheet Credit Related Financial Instruments

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

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

Stock-Based Compensation

The Company has stock-based incentive arrangements to attract and retain key personnel in order to promote the success of the business. In May 2015, the 2015 Equity Compensation Plan (the "2015 plan") was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees.

Compensation cost for all stock-based awards is measured at fair value on date of grant and recognized over the vesting period. Such value is recognized as expense over the service period, net of estimated forfeitures. The estimation of stock awards that ultimately vest requires judgment, and to the extent actual results or updated estimates differ from our current estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. The Company considers many factors when estimating expected forfeitures, including types of awards, employee class and historical experience.

The Company and the Bank currently maintain incentive compensation plans which provide for payments to be made in cash or other share-based compensation. The Company has accrued the full amounts due under these plans.

Earnings Per Common Share ("EPS")

Basic earnings per common share represent income available to common stockholders, divided by the weighted average number of common shares outstanding during the period. Unencumbered shares held by the Employee Stock Ownership Plan ("ESOP") are treated as outstanding in computing earnings per share. Shares issued to the ESOP but pledged as collateral for loans obtained to provide funds to acquire the shares are not treated as outstanding in computing earnings per share.

Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential dilutive common shares are determined using the treasury stock method and include incremental shares issuable upon the exercise of stock options and other share-based compensation awards. The Company excludes from the diluted EPS calculation anti-dilutive options, because the exercise price of the options were greater than the average market price of the common shares.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as components of comprehensive income as a separate statement in the Consolidated Statements of Comprehensive Income. Additionally, the Company discloses accumulated other comprehensive income as a separate component in the equity section of the balance sheet.

Recent Accounting Pronouncements

Financial Accounting Standards Board ("FASB") Accounting Standards Update ("ASU").

ASU 2014-09 — *Revenue from Contracts with Customers*. In May 2014, the FASB issued ASU 2014-09 which is a new standard related to revenue recognition. Under the new standard, revenue is recognized when a customer obtains control of promised goods or services and is recognized in an amount that reflects the consideration the entity expects to receive in exchange for those good or services. This new standard supersedes and replaces nearly all existing revenue recognition guidance, establishes a new control-based revenue recognition model, changes the basis for deciding when revenue is recognized over time or at a point in time, provides new and more detailed guidance on specific topics and expands and improves disclosures about revenue. In addition, this new standard specifies the accounting for some costs to obtain or fulfill a contract with a customer.

The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method) or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective). We currently anticipate adopting the standard using the modified retrospective method.

The guidance in the Accounting Standards Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. This ASU does not apply to revenue associated with financial instruments including loans and securities that are accounted for under U.S. GAAP. Consequently, adoption of the ASU is not expected to have a significant impact on the Company's consolidated financial statements and related disclosures since the primary source of revenue is derived from interest and dividends earned on loans, investment securities and other financial instruments that are outside the scope of the ASU. However, the Company has assessed its revenue streams and reviewed its contracts with customers that are potentially affected by the new guidance. This includes fees on deposits, gains and losses on the sale of other real estate owned, credit and debit card interchange fees, administrative services for customer deposit accounts (i.e. ATM and wire transfer transactions) and rental income. This assessment included the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. Based on this assessment the Company anticipates that ASC 606 will require us to estimate income from the sale of OREO property that is under contract at year end. As a result, the Company will recognize revenue earlier under ASC 606 than we have done so under current guidance. At December 31, 2017 there were no contracts for the sale of OREO property. The Company's' revenue recognition pattern for revenue streams within the scope of ASU is not expected to change significantly from current practice as the sale from OREO properties and resulting gain is immaterial to our financial statements. The new standard will be effective for us beginning January 1, 2018.

ASU 2016-01 — *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. ASU 2016-1, among other things, (i) requires equity investments, with certain exceptions, to be measured at fair value with changes in fair value recognized in net income, (ii) simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment, (iii) eliminates the requirement for public business entities to disclose the methods and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet, (iv) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes, (v) requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments, (vi) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements and (viii) clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale. The Company's management has engaged a third-party expert in the field of valuation and reporting and is creating a process to ensure adequate documentation of financial controls and analysis performed in its review of ''exit pricing'' of the fair values of loans, deposits and other financial instruments. ASU 2016-1 will be effective on January 1, 2018 and will not have a significant impact on the Company's consolidated financial statements.

ASU 2016-02 — *Leases (Topic 842*). In February 2016, the FASB amended existing guidance that requires lessees recognize the following for all leases (with the exception of short term leases) at the commencement date (1) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Leases will be classified as either finance or operating with classification affecting the pattern of expense recognition in the income statement. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers.

Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach.

The Company is currently evaluating the impact of this new accounting standard on the consolidated financial statements. Based on leases outstanding at December 31, 2017, the Company does not expect the updates to have a material impact on the income statement but does anticipate an increase in assets and liabilities. The Company will continue to evaluate the potential impact of ASU 2016-02 during 2018. This new standard will be effective for the Company beginning January 1, 2019.

ASU 2016-05 — *Derivatives and Hedging (Topic 815) Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships.* ASU 2016-05 clarifies that a change in the counterparty to a derivative instrument that has been designated as the hedging instrument under ASC Topic 815 does not, in and of itself, require designation of that hedging relationship provided that all other hedge accounting criteria continue to be met. ASU 2016-05 became effective on January 1, 2017 and did not have a significant impact on the consolidated financial statements.

ASU 2016-09 — *Compensation — Stock Compensation (Topic 718) — Improvements to Employee Share-Based Payment Accounting.* ASU 2016-09 is intended to simplify how share-based payments are accounted for and presented in the financial statements. The key provisions include: (i) a company will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (''APIC''). Instead all excess tax benefits and tax deficiencies will be reported as income tax expense or benefit in the income statement, and APIC pools will be eliminated. The guidance also eliminates the requirement that excess tax benefits be realized before companies can recognize them. In addition, the guidance requires companies to present excess tax benefits as an operating activity on the statement of cash flows rather than as a financing activity; (ii) a company can increase the amount of withholding to cover income taxes on awards and still qualify for the exception to liability classification for shares used to satisfy the employer's statutory income tax withholding obligation. The new guidance will also require an employer to classify the cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation as a financing activity on its statement of cash flows (current guidance did not specify how these cash flows should be classified); and (iii) a company can elect an accounting policy election for the impact of forfeitures on the recognition of expense for share-based payment awards. Forfeitures can be estimated, as required today, or recognized when they occur. ASU No. 2016-09 is effective for interim and annual reporting periods beginning after December 15, 2016. ASU 2016-09 became effective on January 1, 2017 and did not have a significant impact on the consolidated financial statements.

ASU 2016-13 — *Financial Instruments — Credit Losses (Topic 326) — Measurement of Credit Losses on Financial Instruments.* ASU No. 2016-13 significantly changes how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. The standard will replace today's ''incurred loss'' approach with an ''expected loss'' model. The new model, referred to as the current expected credit loss (''CECL'') model, will apply to: (1) financial assets subject to credit losses and measured at amortized cost, and (2) certain off-balance sheet credit exposures. This includes, but is not limited to, loans, leases, held-to-maturity securities, loan commitments, and financial guarantees. The CECL model does not apply to available-for-sale (''AFS'') debt securities. For AFS debt securities with unrealized losses, entities will measure credit losses in a manner similar to what they do today, except that the losses will be recognized as allowances rather than reductions in the amortized cost of the securities. As a result, entities will recognize improvements to estimated credit losses immediately in earnings rather than as interest income over time, as they do today. The ASU also simplifies the accounting model for purchased credit-impaired debt securities and loans. ASU 2016-13 also expands the disclosure requirements regarding an entity's assumptions, models, and methods for estimating the allowance for loan and lease losses. In addition, entities will need to disclose the amortized cost balance for each class of financial asset by credit quality indicator, disaggregated by the year of origination. Entities will apply the standard's provisions as a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the guidance is effective (i.e., modified retrospective approach).

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

The Company has formed a CECL committee that is assessing data and system needs in order to evaluate the impact of adopting the new standard. We expect to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the beginning of the first reporting period in which the new standard is effective. We expect the adoption will result in a material increase to the allowance for loan losses balance. At this time, the impact is being evaluated.

ASU No. 2016-13 is effective for interim and annual reporting periods beginning after December 15, 2019, early adoption is permitted for interim and annual reporting periods beginning after December 15, 2018. This new standard will be effective for us beginning January 1, 2020.

ASU 2016-15 — *Statement of Cash Flows (Topic 230) — Classification of Certain Cash Receipts and Cash Payments*. ASU 2016-15 is intended to reduce 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. Early adoption is permitted, provided that all of the amendments are adopted in the same period. Entities will be required to apply the guidance retrospectively. If it is impracticable to apply the guidance retrospectively for an issue, the amendments related to that issue would be applied prospectively. As this guidance only affects the classification within the statement of cash flows, ASU 2016-15 is not expected to have a material impact on the Company's Consolidated Financial Statements

ASU 2016-16, "Income Taxes (Topic 740) — Intra-Entity Transfers of Assets Other Than Inventory." ASU 2016-16 provides guidance stating that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2016-18, "Statement of Cash Flows (Topic 230) — Restricted Cash." ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2017-01, "Business Combinations (Topic 805) — Clarifying the Definition of a Business." ASU 2017-01 clarifies the definition and provides a more robust framework to use in determining when a set of assets and activities constitutes a business. ASU 2017-01 is intended to provide guidance when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. ASU 2017-01 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2017-04, "Intangibles — Goodwill and Other (Topic 350) — Simplifying the Test for Goodwill Impairment." ASU 2017-04 eliminates Step 2 from the goodwill impairment test which required entities to compute the implied fair value of goodwill. Under ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. ASU 2017-04 will be effective for us on January 1, 2020, with earlier adoption permitted and is not expected to have a significant impact on our financial statements.

ASU 2017-05, "Other Income — Gains and Losses from the Derecognition of Nonfinancial Assets (Subtopic 610-20) — Clarifying the Scope of Asset Derecognition Guidance and Accounting for Partial Sales of Nonfinancial Assets." ASU 2017-05 clarifies the scope of Subtopic 610-20 and adds guidance for partial sales of nonfinancial assets, including partial sales of real estate. Historically, U.S. GAAP contained several different accounting models to evaluate whether the transfer of certain assets qualified for sale treatment. ASU 2017-05 reduces the number of potential accounting models that might apply and clarifies which model does apply in various circumstances. ASU 2017-05 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – (continued)

ASU 2017-08, "Receivables — Nonrefundable Fees and Other Costs (Subtopic 310-20) — Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to require such premiums to be amortized to the earliest call date unless applicable guidance related to certain pools of securities is applied to consider estimated prepayments. Under prior guidance, entities were generally required to amortize premiums on individual, non-pooled callable debt securities as a yield adjustment over the contractual life of the security. ASU 2017-08 does not change the accounting for callable debt securities held at a discount. ASU 2017-08 will be effective for us on January 1, 2019, with early adoption permitted. We are currently evaluating the potential impact of ASU 2017-08 on our financial statements.

ASU 2017-09, "Compensation — Stock Compensation (Topic 718) — Scope of Modification Accounting." ASU 2017-09 clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under ASU 2017-09, an entity will not apply modification accounting to a share-based payment award if all of the following are the same immediately before and after the change: (i) the award's fair value, (ii) the award's vesting conditions and (iii) the award's classification as an equity or liability instrument. ASU 2017-09 will be effective for us on January 1, 2018 and is not expected to have a significant impact on our financial statements.

ASU 2017-12, Derivatives and Hedging (Topic 815) — Targeted Improvements to Accounting for Hedging Activities." ASU 2017-12 amends the hedge accounting recognition and presentation requirements in ASC 815 to improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities to better align the entity's financial reporting for hedging relationships with those risk management activities and to reduce the complexity of and simplify the application of hedge accounting. ASU 2017-12 will be effective for us on January 1, 2019 and is not expected to have a significant impact on our financial statements.

ASU 2018-02 "Income Statement — Reporting Comprehensive Income" (Topic 220) ASU 2018-02. On December 22, 2017, the Tax Cuts and Job Act (Tax Act) was signed into law. Under current U.S. GAAP, deferred tax assets and liabilities are to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date. This accounting treatment resulted in the tax effect of items within accumulated other comprehensive income (loss) not reflecting the appropriate tax rate. This ASU allows stranded tax effects resulting from the Tax Act to be reclassified from accumulated other comprehensive income (loss) to retained earnings. The Company early adopted this guidance during the quarter ended December 31, 2017, resulting in a reclassification of $196,000 from accumulated other comprehensive loss to retained earnings to adjust the tax effect of items within accumulated other comprehensive loss to reflect the newly enacted federal corporate income tax rate. Refer to Note 2, Accumulated Other Comprehensive Income, for additional information.

NOTE 2 — ACCUMULATED OTHER COMPREHENSIVE INCOME

The following table presents the components of comprehensive (loss) income for the years ended December 31, 2017, 2016 and 2015. The Company's comprehensive gains and losses and reclassification adjustments were solely for securities for the years ended December 31, 2017, 2016 and 2015. Reclassification adjustments are recorded in non-interest income.

	December 31, 2017			December 31, 2016			December 31, 2015		
Years Ended (dollars in thousands)	**Before Tax**	**Tax Effect**	**Net of Tax**	**Before Tax**	**Tax Effect**	**Net of Tax**	**Before Tax**	**Tax Effect**	**Net of Tax**
Net unrealized holding (losses) gains	$(103)	$(41)	$(62)	$(1,095)	$(433)	$(662)	$216	$85	$131
Reclassification adjustments	(8)	(3)	(5)	(22)	(7)	(15)	(6)	(2)	(4)
Other comprehensive (loss) income	$(111)	$(44)	$(67)	$(1,117)	$(440)	$(677)	$210	$83	$127

NOTE 2 — ACCUMULATED OTHER COMPREHENSIVE INCOME – (continued)

The following table presents the changes in each component of accumulated other comprehensive (loss) income, net of tax, for the years ended December 31, 2017, 2016 and 2015.

	Year Ended December 31, 2017	Year Ended December 31, 2016	Year Ended December 31, 2015
(dollars in thousands)	Net Unrealized Gains And Losses	Net Unrealized Gains And Losses	Net Unrealized Gains And Losses
Beginning of period	$ (928)	$(251)	$(378)
Other comprehensive (losses) gains, net of tax before reclassifications	(62)	(662)	131
Amounts reclassified from accumulated other comprehensive loss	(5)	(15)	(4)
Net other comprehensive (loss) income	(67)	(677)	127
Reclassification due to Accounting Standards Update (ASU2018-02)	(196)	—	—
End of period	$(1,191)	$(928)	$(251)

The FASB issued ASU 2018-02 allowing companies to reclassify stranded tax effects resulting from the Tax Cuts and Job Act from accumulated other comprehensive income (loss) to retained earnings. The Company early adopted this guidance during the quarter ended December 31, 2017 and utilizing the portfolio method reclassified $196,000 from accumulated other comprehensive loss to retained earnings to eliminate the stranded tax effects.

NOTE 3 — EARNINGS PER SHARE

Basic earnings per common share represent income available to common shareholders, divided by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may have been issued by the Company related to outstanding stock options and were determined using the treasury stock method. The Company has not granted any stock options since 2007 and all outstanding options expired on July 17, 2017.

As of December 31, 2017, 2016 and 2015, there were 0, 15,081 and 21,211 options, respectively, which were excluded from the calculation as their effect would be anti-dilutive, because the exercise price of the options was greater than the average market price of the common shares. Basic and diluted earnings per share have been computed based on weighted-average common and common equivalent shares outstanding as follows:

	Years Months Ended December 31,		
(dollars in thousands)	2017	2016	2015
Net Income	$ 7,208	$ 7,331	$ 6,343
Less: dividends paid and accrued on preferred stock	—	—	(23)
Net income available to common shareholders	$ 7,208	$ 7,331	$ 6,320
Average number of common shares outstanding	4,627,776	4,599,502	4,676,748
Dilutive effect of common stock equivalents	1,452	—	—
Average number of shares used to calculate diluted EPS	4,629,228	4,599,502	4,676,748
Earnings Per Common Share			
Basic	$ 1.56	$ 1.59	1.36
Diluted	1.56	1.59	1.35

NOTE 4 — RESTRICTIONS ON CASH AND AMOUNTS DUE FROM BANKS

The Bank is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2017 and 2016, these reserve balances amounted to $915,000 and $1.1 million, respectively.

NOTE 5 — SECURITIES

(dollars in thousands)	December 31, 2017 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential Mortgage Backed Securities (“MBS”)	$ 7,265	$ —	$ 178	$ 7,087
Residential Collateralized Mortgage Obligations (“CMOs”)	45,283	12	1,158	44,137
U.S. Agency	12,863	—	346	12,517
Corporate equity securities	37	—	—	37
Bond mutual funds	4,480	27	—	4,507
Total securities available for sale	$69,928	$ 39	$1,682	$68,285
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential MBS	$29,113	$135	$ 261	$28,987
Residential CMOs	54,805	62	845	54,022
U.S. Agency	8,660	—	235	8,425
Asset-backed securities issued by Others:				
Residential CMOs	651	—	52	599
Callable GSE Agency Bonds	5,017	—	43	4,974
U.S. government obligations	1,000	—	—	1,000
Total securities held to maturity	$99,246	$197	$1,436	$98,007

(dollars in thousands)	December 31, 2016 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities available for sale (AFS)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential MBS	$ 4,377	$ —	$ 194	$ 4,183
Residential CMOs	35,176	18	966	34,228
U.S. Agency	10,589	—	417	10,172
Corporate equity securities	37	—	—	37
Bond mutual funds	4,386	27	—	4,413
Total securities available for sale	$ 54,565	$ 45	$1,577	$ 53,033
Securities held to maturity (HTM)				
Asset-backed securities issued by GSEs and U.S. Agencies				
Residential MBS	$ 34,735	$367	$ 569	$ 34,533
Residential CMOs	63,060	135	802	62,393
U.S. Agency	6,717	—	253	6,464
Asset-backed securities issued by Others:				
Residential CMOs	884	—	81	803
Callable GSE Agency Bonds	3,001	—	10	2,991
U.S. government obligations	850	—	—	850
Total securities held to maturity	$109,247	$502	$1,715	$108,034

At December 31, 2017, securities with an amortized cost of $31.5 million were pledged to secure certain customer deposits. At December 31, 2017, securities with an amortized cost of $4.0 million were pledged as collateral for advances from the Federal Home Loan Bank (“FHLB”) of Atlanta.

NOTE 5 — SECURITIES – (continued)

At December 31, 2017, greater than 99% of the asset-backed securities and agency bond portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs and U.S. Agencies had an average life of 4.74 years and average duration of 4.22 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs and U.S. Agencies had an average life of 4.95 years and average duration of 4.39 years and are guaranteed by their issuer as to credit risk.

At December 31, 2016, certain asset-backed securities with an amortized cost of $21.5 million were pledged to secure certain deposits. At December 31, 2016, asset-backed securities with an amortized cost of $1.6 million were pledged as collateral for advances from the Federal Home Loan Bank (''FHLB'') of Atlanta.

At December 31, 2016, 99% of the asset-backed securities and agency bond portfolio was rated AAA by Standard & Poor's or the equivalent credit rating from another major rating agency. AFS asset-backed securities issued by GSEs and U.S. Agencies had an average life of 4.96 years and average duration of 4.43 years and are guaranteed by their issuer as to credit risk. HTM asset-backed securities issued by GSEs and U.S. Agencies had an average life of 5.30 years and average duration of 4.71 years and are guaranteed by their issuer as to credit risk.

Management believes that AFS securities with unrealized losses will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity. Because our intention is not to sell the investments and it is not more likely than not that the Company will be required to sell the investments, management considers the unrealized losses in the AFS portfolio to be temporary.

The Company intends to, and has the ability to, hold the HTM securities with unrealized losses until they mature, at which time the Company will receive full value for the securities. Because our intention is not to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, management considers the unrealized losses in the held-to-maturity portfolio to be temporary.

No charges related to other-than-temporary impairment were made during for the years ended December 31, 2017, 2016 and 2015.

During the year ended December 31, 2017 the Company recognized net gains on the sale of securities of $175,000. The Company sold three AFS securities with aggregate carrying values of $3.7 million and nine HTM securities with aggregate carrying values of $4.8 million, recognizing gains of $9,000 and $166,000, respectively. During the year ended December 31, 2016 the Company recognized net gains on the sale of securities of $31,000. The Company sold five AFS securities with aggregate carrying values of $6.5 million and one HTM security with a carrying value of $698,000, recognizing gains of $23,000 and $8,000, respectively. During the year ended December 31, 2015, the Company recognized net gains on the sale of securities of $4,000, which consisted of the sale of one HTM security with a carrying value of $67,000 and the call of an AFS agency bond with a carrying value of $2.0 million. These sales resulted in a loss of $1,000 for the HTM security and a gain of $5,000 for the AFS security.

The sale of HTM securities was permitted under ASC 320 ''Investments — Debt and Equity Securities.'' ASC 320 permits the sale of HTM securities for certain changes in circumstances. The Company will dispose of HTM securities using the safe harbor rule that allows for the sale of HTM securities that have principal payments paid down to less than 15% of original purchased par. ASC 320 10-25-15 indicates that a sale of a debt security after a substantial portion of the principal has been collected is equivalent to holding the security to maturity. In addition, the Company may dispose of HTM securities under ASC 320-10-25-6 due to a significant deterioration in the issues' creditworthiness.

NOTE 5 — SECURITIES – (continued)

AFS Securities

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at December 31, 2017 were as follows:

December 31, 2017 (dollars in thousands)	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs and U.S. Agencies	$24,571	$328	$38,428	$1,354	$62,999	$1,682

At December 31, 2017, the AFS investment portfolio had an estimated fair value of $68.3 million, of which $63.0 million of the securities had some unrealized losses from their amortized cost.

AFS asset-backed securities issued by GSEs are guaranteed by the issuer and AFS U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. Total unrealized losses on the portfolio were $1.7 million of the portfolio amortized cost of $65.4 million. AFS asset-backed securities issued by GSEs and U.S. Agencies with unrealized losses had an average life of 4.71 years and an average duration of 4.20 years. Management believes that the securities will either recover in market value or be paid off as agreed.

Gross unrealized losses and estimated fair value by length of time that the individual AFS securities have been in a continuous unrealized loss position at December 31, 2016 were as follows:

December 31, 2016 (dollars in thousands)	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs and U.S. Agencies	$34,262	$1,110	$11,846	$467	$46,108	$1,577

At December 31, 2016, the AFS investment portfolio had an estimated fair value of $53.0 million, of which $46.1 million of the securities had some unrealized losses from their amortized cost.

AFS asset-backed securities issued by GSEs are guaranteed by the issuer and AFS U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. Total unrealized losses on the portfolio were $1.6 million of the portfolio amortized cost of $50.1 million. AFS asset-backed securities issued by GSEs and U.S. Agencies with unrealized losses had an average life of 4.91 years and an average duration of 4.37 years. Management believes that the securities will either recover in market value or be paid off as agreed.

HTM Securities

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2017 were as follows: (dollars in thousands)

December 31, 2017 (dollars in thousands)	Less Than 12 Months		More Than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Losses
Asset-backed securities issued by GSEs and U.S. Agencies	36,607	254	45,119	1,130	81,726	1,384
Asset-backed securities issued by Others	—	—	599	52	599	52
	$36,607	$254	$45,718	$1,182	$82,325	$1,436

NOTE 5 — SECURITIES – (continued)

At December 31, 2017, the HTM investment portfolio had an estimated fair value of $98.0 million, of which $82.3 million of the securities had some unrealized losses from their amortized cost. Of these securities, $81.7 million were asset-backed securities issued by GSEs and U.S. Agencies and $599,000 were asset-backed securities issued by others.

HTM asset-backed securities issued by GSEs and GSE agency bonds are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. Total unrealized losses on the portfolio were $1.4 million of the portfolio amortized cost of $98.6 million. The securities with unrealized losses had an average life of 5.02 years and an average duration of 4.43 years. Management believes that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $52,000 of the portfolio amortized cost of $651,000. HTM asset-backed securities issued by others with unrealized losses had an average life of 3.20 years and an average duration of 2.66 years.

Gross unrealized losses and estimated fair value by length of time that the individual HTM securities have been in a continuous unrealized loss position at December 31, 2016 were as follows:

	Less Than 12 Months		More Than 12 Months		Total	
December 31, 2016 (dollars in thousands)	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Loss**	**Fair Value**	**Unrealized Losses**
Asset-backed securities issued by GSEs and U.S. Agencies	$77,879	$1,452	$6,340	$182	$84,219	$1,634
Asset-backed securities issued by Others	—	—	803	81	803	81
	$77,879	$1,452	$7,143	$263	$85,022	$1,715

At December 31, 2016, the HTM investment portfolio had an estimated fair value of $108.0 million, of which $85.0 million of the securities had some unrealized losses from their amortized cost. Of these securities, $84.2 million were asset-backed securities issued by GSEs and U.S. Agencies. The remaining $803,000 were asset-backed securities issued by others.

HTM asset-backed securities issued by GSEs are guaranteed by the issuer and HTM U.S. government agency securities and bonds are guaranteed by the full faith and credit of the U.S. government. Total unrealized losses on the portfolio were $1.6 million of the portfolio amortized cost of $108.4 million. The securities with unrealized losses had an average life of 5.06 years and an average duration of 4.49 years. Management believes that the securities will either recover in market value or be paid off as agreed. The Company intends to, and has the ability to, hold these securities to maturity.

HTM asset-backed securities issued by others are collateralized mortgage obligation securities. The securities have credit support tranches that absorb losses prior to the tranches that the Company owns. The Company reviews credit support positions on its securities regularly. Total unrealized losses on the asset-backed securities issued by others were $81,000 of the portfolio amortized cost of $884,000. HTM asset-backed securities issued by others with unrealized losses had an average life of 4.15 years and an average duration of 3.29 years.

Maturities

The amortized cost and estimated fair value of debt securities at December 31, 2017 and 2016 by contractual maturity, are shown below. The Company has allocated the asset-backed securities into the four maturity groups listed below using the expected average life of the individual securities based on statistics provided by industry sources. Expected maturities will differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

December 31, 2017 (dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year				
Bond mutual funds	$ 4,480	$ 4,507	$ —	$ —
U.S. government obligations	—	—	1,000	1,000
Asset-backed securities & U.S. Agencies				
Within one year	9,853	9,601	18,722	22,512
Over one year through five years	28,832	28,096	41,433	38,813
Over five years through ten years	20,357	19,838	25,309	23,709
After ten years	6,369	6,206	12,782	11,973
Total asset-backed securities	65,411	63,741	98,246	97,007
	$69,891	$68,248	$99,246	$98,007

December 31, 2016 (dollars in thousands)	Available for Sale		Held to Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Within one year				
Bond mutual funds	$ 4,386	$ 4,413	$ —	$ —
U.S. government obligations	—	—	850	850
Asset-backed securities & U.S. Agencies				
Within one year	7,879	7,634	18,844	21,104
Over one year through five years	21,481	20,813	47,168	45,339
Over five years through ten years	13,093	12,686	29,803	28,647
After ten years	7,689	7,450	12,582	12,094
Total asset-backed securities	50,142	48,583	108,397	107,184
	$54,528	$52,996	$109,247	$108,034

Credit Quality of Asset-Backed Securities

The tables below present the Standard & Poor's ("S&P") or equivalent credit rating from other major rating agencies for AFS and HTM asset-backed securities issued by GSEs and U.S. Agencies and others or bonds issued by GSEs or U.S. government agencies at December 31, 2017 and 2016 by carrying value. The Company considers noninvestment grade securities rated BB+ or lower as classified assets for regulatory and financial reporting. GSE asset-backed securities and GSE agency bonds with S&P AA+ ratings were treated as AAA based on regulatory guidance.

December 31, 2017		December 31, 2016	
Credit Rating	Amount	Credit Rating	Amount
	(dollars in thousands)		
AAA	$162,336	AAA	$156,947
BB	651	BB	411
B+	—	B+	472
Total	$162,987	Total	$157,830

NOTE 6 — LOANS

Loans consist of the following:

(dollars in thousands)	December 31, 2017	%	December 31, 2016	%
Commercial real estate	$ 727,314	63.25%	$ 667,105	61.25%
Residential first mortgages	170,374	14.81%	171,004	15.70%
Residential rentals	110,228	9.58%	101,897	9.36%
Construction and land development	27,871	2.42%	36,934	3.39%
Home equity and second mortgages	21,351	1.86%	21,399	1.97%
Commercial loans	56,417	4.91%	50,484	4.64%
Consumer loans	573	0.05%	422	0.04%
Commercial equipment	35,916	3.12%	39,737	3.65%
	1,150,044	100.00%	1,088,982	100.00%
Less:				
Deferred loan fees and premiums	(1,086)	-0.09%	(397)	-0.04%
Allowance for loan losses	10,515	0.91%	9,860	0.91%
	9,429		9,463	
	$1,140,615		$1,079,519	

At December 31, 2017 and 2016, the Bank's allowance for loan losses totaled $10.5 million and $9.9 million, or 0.91% and 0.91%, respectively, of loan balances. Management's determination of the adequacy of the allowance is based on a periodic evaluation of the portfolio with consideration given to the overall loss experience, current economic conditions, size, growth and composition of the loan portfolio, financial condition of the borrowers and other relevant factors that, in management's judgment, warrant recognition in providing an adequate allowance.

Net deferred loan fees and premiums of $1.1 million at December 31, 2017 included net deferred fees paid by customers of $2.8 million offset by net deferred premiums paid for the purchase of residential first mortgages and deferred costs of $3.9 million. Net deferred loan fees and premiums of $397,000 at December 31, 2016 included net deferred fees paid by customers of $2.7 million offset by net deferred premiums paid for the purchase of residential first mortgages and deferred costs of $3.1 million.

Prior to April 1, 2016, loans secured by residential rental property were included in the residential first mortgage and commercial real estate loan portfolios. Beginning in the second quarter of 2016, the Company segregated loans secured by residential rental property into a new loan portfolio segment. Residential rental property includes income producing properties comprising 1-4 family units and apartment buildings. The Company's decision to segregate the residential rental property portfolio for financial reporting was based on the growth and size of the portfolio and risk characteristics unique to residential rental properties. Comparative financial information was reclassified to conform to the classification presented in 2016.

Risk Characteristics of Portfolio Segments

The Company manages its credit products and exposure to credit losses (credit risk) by the following specific portfolio segments (classes), which are levels at which the Company develops and documents its allowance for loan loss methodology. These segments are:

Commercial Real Estate ("CRE")

Commercial and other real estate projects include office buildings, retail locations, churches, other special purpose buildings and commercial construction. Commercial construction balances were 6.2% and 9.3% of the CRE portfolio at December 31, 2017 and December 31, 2016, respectively. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. The primary security on a commercial real estate loan is the real property and the leases that produce income for the real property. Loans secured by commercial real estate are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years.

Loans secured by commercial real estate are larger and involve greater risks than one-to four-family residential mortgage loans. Because payments on loans secured by such properties are often dependent on the successful operation or management of the properties, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy.

Residential First Mortgages

Residential first mortgage loans are generally long-term loans, amortized on a monthly basis, with principal and interest due each month. The contractual loan payment period for residential loans typically ranges from ten to 30 years. The Bank's experience indicates that real estate loans remain outstanding for significantly shorter time periods than their contractual terms. Borrowers may refinance or prepay loans at their option, without penalty. The Bank's residential portfolio has both fixed-rate and adjustable-rate residential first mortgages. During the years ended December 31, 2017 and 2016, the Bank purchased residential first mortgages of $25.5 million and $64.2 million, respectively.

The annual and lifetime limitations on interest rate adjustments may limit the increases in interest rates on these loans. There are also credit risks resulting from potential increased costs to the borrower as a result of repricing of adjustable-rate mortgage loans. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank's adjustable rate residential first mortgage portfolio was $56.9 million or 5.0% of total gross loans of $1.15 billion at December 31, 2017 compared to $45.6 million or 4.2% of total gross loans of $1.09 billion at December 31, 2016.

Residential Rentals

Residential rental mortgage loans are amortizing, with principal and interest due each month. The loans are secured by income-producing 1-4 family units and apartments. As of December 31, 2017 and December 31, 2016, $85.0 million and $84.9 million, respectively, were 1-4 family units and $25.2 million and $17.0 million, respectively, were apartment buildings. Loans secured by residential rental properties are generally limited to 80% of the lower of the appraised value or sales price at origination and have an initial contractual loan payment period ranging from three to 20 years. The primary security on a residential rental loan is the property and the leases that produce income. During periods of rising interest rates, the risk of default on adjustable-rate mortgage loans may increase due to the upward adjustment of interest cost to the borrower. The Bank's adjustable rate residential rental portfolio was $93.4 million or 8.1% of total gross loans of $1.15 billion at December 31, 2017 compared to $84.0 million or 7.7% of total gross loans of $1.09 billion at December 31, 2016.

Loans secured by residential rental properties involve greater risks than 1-4 family residential mortgage loans. Although, there are similar risk characteristics shared with commercial real estate loans, the balances for the loans secured by residential rental properties are generally smaller. Because payments on loans secured by residential rental properties are often dependent on the successful operation or management of the properties, repayment of these loans may be subject to a greater extent to adverse conditions in the rental real estate market or the economy than similar owner-occupied properties.

Construction and Land Development

The Bank offers loans for the construction of one-to-four family dwellings. Generally, these loans are secured by the real estate under construction as well as by guarantees of the principals involved. In addition, the Bank offers loans to acquire and develop land, as well as loans on undeveloped, subdivided lots for home building.

A decline in demand for new housing might adversely affect the ability of borrowers to repay these loans. Construction and land development loans are inherently riskier than providing financing on owner-occupied real estate. The Bank's risk of loss is affected by the accuracy of the initial estimate of the market value of the completed project as well as the accuracy of the cost estimates made to complete the project. In addition, the volatility of the real estate market has made it increasingly difficult to ensure that the valuation of land associated with these loans is accurate. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction costs proves to be inaccurate, the Bank may be required to advance funds beyond the amount originally committed to permit completion of the development. If the estimate of value proves to be inaccurate, a project's value might be insufficient to assure full repayment. As a result of these factors, construction lending often involves the disbursement of substantial funds with repayment dependent, in part, on the success of the project rather than the ability of the borrower or guarantor to repay principal and interest. If the Bank forecloses on a project, there can be no assurance that the Bank will be able to recover all of the unpaid balance of, and accrued interest on, the loan as well as related foreclosure and holding costs.

Home Equity and Second Mortgage Loans

The Bank maintains a portfolio of home equity and second mortgage loans. These products contain a higher risk of default than residential first mortgages as in the event of foreclosure, the first mortgage would need to be paid off prior to collection of the second mortgage. This risk is heightened as the market value of residential property has not fully returned to pre-financial crisis levels and interest rates began to increase in 2017.

Commercial Loans

The Bank offers commercial loans to its business customers. The Bank offers a variety of commercial loan products including term loans and lines of credit. Such loans are generally made for terms of five years or less. The Bank offers both fixed-rate and adjustable-rate loans under these product lines. When making commercial business loans, the Bank considers the financial condition of the borrower, the borrower's payment history of both corporate and personal debt, the projected cash flows of the business, the viability of the industry in which the borrower operates, the value of the collateral, and the borrower's ability to service the debt from income. These loans are primarily secured by equipment, real property, accounts receivable or other security as determined by the Bank.

Commercial loans are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself.

Consumer Loans

Consumer loans consist of loans secured by automobiles, boats, recreational vehicles and trucks. The Bank also makes home improvement loans and offers both secured and unsecured personal lines of credit. Consumer loans entail greater risk from other loan types due to being secured by rapidly depreciating assets or the reliance on the borrower's continuing financial stability.

Commercial Equipment Loans

These loans consist primarily of fixed-rate, short-term loans collateralized by a commercial customer's equipment or secured by real property, accounts receivable, or other security as determined by the Bank. When making commercial equipment loans, the Bank considers the same factors it considers when underwriting a commercial business loan. Commercial loans are of higher risk and typically are made on the basis of the borrower's ability to make repayment from the cash flows of the borrower's business. As a result, the availability of funds for the repayment of commercial loans may depend substantially on the success of the business itself. In the case of business failure, collateral would need to be liquidated to provide repayment for the loan. In many cases, the highly specialized nature of collateral equipment would make full recovery from the sale of collateral problematic.

NOTE 6 — LOANS – (continued)

Non-accrual and Past Due Loans

Non-accrual loans as of December 31, 2017 and December 31, 2016 were as follows:

	December 31, 2017					
(dollars in thousands)	90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$1,148	4	$ 839	3	$1,987	7
Residential first mortgages	478	3	507	1	985	4
Residential rentals	84	1	741	3	825	4
Home equity and second mortgages	134	3	123	1	257	4
Commercial loans	172	2	—	—	172	2
Commercial equipment	467	3	—	—	467	3
	$2,483	16	$2,210	8	$4,693	24

	December 31, 2016					
(dollars in thousands)	90 or Greater Days Delinquent	Number of Loans	Non-accrual Only Loans	Number of Loans	Total Non-accrual Loans	Total Number of Loans
Commercial real estate	$2,371	7	$ —	—	$2,371	7
Residential first mortgages	623	4	—	—	623	4
Residential rentals	577	4	—	—	577	4
Construction and land development	3,048	2	—	—	3,048	2
Home equity and second mortgages	61	2	—	—	61	2
Commercial loans	375	3	669	2	1,044	5
Commercial equipment	650	5	—	—	650	5
	$7,705	27	$669	2	$8,374	29

Non-accrual loans (90 days or greater delinquent and non-accrual only loans) decreased $3.7 million from $8.4 million or 0.77% of total loans at December 31, 2016 to $4.7 million or 0.41% of total loans at December 31, 2017. Non-accrual only loans are loans classified as non-accrual due to customer operating results or payment history. All interest accrued but not collected from loans that are placed on non-accrual or charged-off is reversed against interest income. In accordance with the Company's policy, interest income is recognized on a cash basis or cost-recovery method, until qualifying for return to accrual status.

At December 31, 2017, non-accrual loans of $4.7 million included 24 loans, of which $3.3 million, or 71% represented 10 loans and five customer relationships. During the year ended December 31, 2017 non-accrual loans decreased $3.0 million due to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Before the foreclosure, the loans in this relationship were troubled debt restructures (''TDRs''). Additionally, during the third quarter of 2017, non-accrual loans decreased $607,000 due to the foreclosure of a commercial office building. At December 31, 2016, non-accrual loans of $8.4 million included 29 loans, of which $6.4 million, or 77% of represented 15 loans and six customer relationships. Non-accrual loans included one TDR totaling $769,000 at December 31, 2017 and six TDRs totaling $4.7 million at December 31, 2016. These loans are classified solely as non-accrual loans for the calculation of financial ratios.

Non-accrual loans on which the recognition of interest has been discontinued, which did not have a specific allowance for impairment, amounted to $3.8 million and $7.8 million at December 31, 2017 and 2016, respectively. Interest due but not recognized on these balances at December 31, 2017 and 2016 was $85,000 and $947,000, respectively. Non-accrual loans with a specific allowance for impairment on which the

NOTE 6 — LOANS – (continued)

recognition of interest has been discontinued amounted to $876,000 and $575,000 at December 31, 2017 and 2016, respectively. Interest due but not recognized on these balances at December 31, 2017 and 2016 was $100,000 and $156,000, respectively.

An analysis of past due loans as of December 31, 2017 and 2016 was as follows:

	December 31, 2017					
(dollars in thousands)	Current	31 – 60 Days	61 – 89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$ 719,455	$ —	$6,711	$1,148	$ 7,859	$ 727,314
Residential first mortgages	169,828	—	68	478	546	170,374
Residential rentals	109,937	—	207	84	291	110,228
Construction and land dev.	27,871	—	—	—	—	27,871
Home equity and second mtg.	21,180	19	18	134	171	21,351
Commercial loans	55,054	892	299	172	1,363	56,417
Consumer loans	572	—	1	—	1	573
Commercial equipment	34,437	1,012	—	467	1,479	35,916
Total	$1,138,334	$1,923	$7,304	$2,483	$11,710	$1,150,044

	December 31, 2016					
(dollars in thousands)	Current	31 – 60 Days	61 – 89 Days	90 or Greater Days	Total Past Due	Total Loan Receivables
Commercial real estate	$ 664,250	$ —	$484	$2,371	$2,855	$ 667,105
Residential first mortgages	170,381	—	—	623	623	171,004
Residential rentals	101,309	—	11	577	588	101,897
Construction and land dev.	33,886	—	—	3,048	3,048	36,934
Home equity and second mtg.	21,175	130	33	61	224	21,399
Commercial loans	49,778	331	—	375	706	50,484
Consumer loans	420	—	2	—	2	422
Commercial equipment	39,044	42	1	650	693	39,737
Total	$1,080,243	$503	$531	$7,705	$8,739	$1,088,982

There were no loans greater than 90 days still accruing interest at December 31, 2017 and 2016, respectively.

Impaired Loans and Troubled Debt Restructures ("TDRs")

Impaired loans, including TDRs, at December 31, 2017 and 2016 were as follows:

	December 31, 2017						
(dollars in thousands)	Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial real estate	$33,180	$30,921	$2,008	$32,929	$ 370	$33,575	$1,379
Residential first mortgages	2,455	1,978	459	2,437	2	2,479	91
Residential rentals	2,389	1,981	395	2,376	18	2,432	111
Construction and land dev.	729	—	729	729	163	729	26
Home equity and second mtg.	317	317	—	317	—	318	12
Commercial loans	3,010	2,783	168	2,951	168	3,048	137
Commercial equipment	1,538	1,048	467	1,515	303	1,578	73
Total	$43,618	$39,028	$4,226	$43,254	$1,024	$44,159	$1,829

NOTE 6 — LOANS – (continued)

(dollars in thousands)	December 31, 2016 Unpaid Contractual Principal Balance	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
Commercial real estate	$22,195	$14,896	$7,081	$21,977	$ 806	$22,303	$ 908
Residential first mortgages	2,436	1,938	475	2,413	7	2,445	90
Residential rentals	3,440	2,850	178	3,028	36	3,486	134
Construction and land dev.	4,304	2,926	851	3,777	178	3,867	16
Home equity and second mtg.	170	170	—	170	—	176	7
Commercial loans	3,285	3,004	200	3,204	123	3,442	137
Commercial equipment	855	652	139	791	139	815	17
Total	$36,685	$26,436	$8,924	$35,360	$1,289	$36,534	$1,309

TDRs, included in the impaired loan schedules above, as of December 31, 2017 and 2016 were as follows:

(dollars in thousands)	December 31, 2017 Dollars	December 31, 2017 Number of Loans	December 31, 2016 Dollars	December 31, 2016 Number of Loans
Commercial real estate	$ 9,273	9	$ 9,587	8
Residential first mortgages	527	2	545	2
Residential rentals	221	1	227	1
Construction and land development	729	2	3,777	4
Commercial loans	4	1	872	5
Commercial equipment	36	1	113	2
Total TDRs	$10,790	16	$15,121	22
Less: TDRs included in non-accrual loans	(769)	(1)	(4,673)	(6)
Total accrual TDR loans	$10,021	15	$10,448	16

TDRs decreased $4.3 million from $15.1 million at December 31, 2016 to $10.8 million at December 31, 2017. TDRs that are included in non-accrual are classified solely as non-accrual loans for the calculation of financial ratios. The Company had specific reserves of $413,000 on seven TDRs totaling $3.0 million at December 31, 2017 and $844,000 on nine TDRs totaling $5.7 million at December 31, 2016. During the year ended December 31, 2017, TDR disposals, which included payoffs and refinancing decreased by seven loans totaling $3.9 million, of which $3.0 million related to the foreclosure of the stalled residential development project mentioned previously. TDR loan principal curtailment was $385,000 for the year ended December 31, 2017. There were no TDRs added during the year ended December 31, 2017.

During the year ended December 31, 2016 the Company added one TDR loan totaling $196,000. TDR disposals, which included payoffs and refinancing for the year ended December 31, 2016 decreased by nine loans or $2.1 million. TDR loan principal curtailment was $1.6 million for the year ended December 31, 2016.

Interest income in the amount of $327,000 and $357,000 was recognized on outstanding TDR loans for the years ended December 31, 2017 and 2016, respectively.

NOTE 6 — LOANS – (continued)

Allowance for Loan Losses

The following tables detail activity in the allowance for loan losses at and for the years ended December 31, 2017, 2016 and 2015, respectively. An allocation of the allowance to one category of loans does not prevent the Company from using that allowance to absorb losses in a different category.

Year Ended (dollars in thousands)	December 31, 2017 Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$5,212	$(217)	$ 63	$1,393	$ 6,451
Residential first mortgages	1,406	—	—	(262)	1,144
Residential rentals	362	(42)	—	192	512
Construction and land development	941	(26)	—	(453)	462
Home equity and second mortgages	138	(14)	1	37	162
Commercial loans	794	(13)	1	231	1,013
Consumer loans	3	(2)	—	6	7
Commercial equipment	1,004	(168)	62	(134)	764
	$9,860	$(482)	$127	$1,010	$10,515

Year Ended (dollars in thousands)	December 31, 2016 Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$3,465	$ —	$ 58	$1,689	$5,212
Residential first mortgages	584	—	—	822	1,406
Residential rentals	538	(14)	—	(162)	362
Construction and land development	1,103	(526)	1	363	941
Home equity and second mortgages	142	—	5	(9)	138
Commercial loans	1,477	(594)	18	(107)	794
Consumer loans	2	(1)	—	2	3
Commercial equipment	1,229	(34)	48	(239)	1,004
	$8,540	$(1,169)	$130	$2,359	$9,860

Year Ended (dollars in thousands)	December 31, 2015 Beginning Balance	Charge-offs	Recoveries	Provisions	Ending Balance
Commercial real estate	$3,528	$ (78)	$17	$ (2)	$3,465
Residential first mortgages	1,047	(30)	1	(434)	584
Residential rentals	593	—	—	(55)	538
Construction and land development	1,071	—	32	—	1,103
Home equity and second mortgages	173	(100)	—	69	142
Commercial loans	1,677	(432)	11	221	1,477
Consumer loans	3	—	—	(1)	2
Commercial equipment	389	(818)	23	1,635	1,229
	$8,481	$(1,458)	$84	$1,433	$8,540

NOTE 6 — LOANS – (continued)

The following tables detail loan receivable and allowance balances disaggregated on the basis of the Company's impairment methodology at December 31, 2017 and 2016, respectively.

	December 31, 2017			December 31, 2016		
(dollars in thousands)	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Total	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Total
Loan Receivables:						
Commercial real estate	$32,929	$ 694,385	$ 727,314	$21,977	$ 645,128	$ 667,105
Residential first mortgages	2,437	167,937	170,374	2,413	168,591	171,004
Residential rentals	2,376	107,852	110,228	3,028	98,869	101,897
Construction and land development	729	27,142	27,871	3,777	33,157	36,934
Home equity and second mortgages	317	21,034	21,351	170	21,229	21,399
Commercial loans	2,951	53,466	56,417	3,204	47,280	50,484
Consumer loans	—	573	573	—	422	422
Commercial equipment	1,515	34,401	35,916	791	38,946	39,737
	$43,254	$1,106,790	$1,150,044	$35,360	$1,053,622	$1,088,982
Allowance for loan losses:						
Commercial real estate	$ 370	$ 6,081	$ 6,451	$ 806	$ 4,406	$ 5,212
Residential first mortgages	2	1,142	1,144	7	1,399	1,406
Residential rentals	18	494	512	36	326	362
Construction and land development	163	299	462	178	763	941
Home equity and second mortgages	—	162	162	—	138	138
Commercial loans	168	845	1,013	123	671	794
Consumer loans	—	7	7	—	3	3
Commercial equipment	303	461	764	139	865	1,004
	$ 1,024	$ 9,491	$ 10,515	$ 1,289	$ 8,571	$ 9,860

During the fourth quarter of 2016, the Company expanded its factor scoring categories from three levels to five levels to capture additional movements in qualitative factors used to calculate the general allowance of each portfolio segment. No additional qualitative factors were added to the Company's methodology as part of this change. There were no material changes to the existing allowance for loan losses by portfolio segment or in the aggregate as a result of the change.

Credit Quality Indicators

Credit quality indicators as of December 31, 2017 and 2016 were as follows:

Credit Risk Profile by Internally Assigned Grade

	Commercial Real Estate		Construction and Land Dev.		Residential Rentals	
(dollars in thousands)	12/31/2017	12/31/2016	12/31/2017	12/31/2016	12/31/2017	12/31/2016
Unrated	$ 75,581	$ 51,503	$ 1,775	$ 1,632	$ 28,428	$ 25,563
Pass	619,604	594,768	25,367	31,525	80,279	74,989
Special mention	—	—	—	—	—	—
Substandard	32,129	20,834	729	3,777	1,521	1,345
Doubtful	—	—	—	—	—	—
Loss	—	—	—	—	—	—
Total	$727,314	$667,105	$27,871	$36,934	$110,228	$101,897

NOTE 6 — LOANS – (continued)

(dollars in thousands)	Commercial Loans 12/31/2017	Commercial Loans 12/31/2016	Commercial Equipment 12/31/2017	Commercial Equipment 12/31/2016	Total Commercial Portfolios 12/31/2017	Total Commercial Portfolios 12/31/2016
Unrated	$14,356	$11,266	$10,856	$11,769	$130,996	$101,733
Pass	39,118	36,221	23,581	27,290	787,949	764,793
Special mention	—	—	—	—	—	—
Substandard	2,943	2,997	1,479	541	38,801	29,494
Doubtful	—	—	—	137	—	137
Loss	—	—	—	—	—	—
Total	$56,417	$50,484	$35,916	$39,737	$957,746	$896,157

Credit Risk Profile Based on Payment Activity

(dollars in thousands)	Residential First Mortgages 12/31/2017	Residential First Mortgages 12/31/2016	Home Equity and Second Mtg. 12/31/2017	Home Equity and Second Mtg. 12/31/2016	Consumer Loans 12/31/2017	Consumer Loans 12/31/2016
Performing	$169,896	$170,381	$21,217	$21,338	$573	$422
Nonperforming	478	623	134	61	—	—
Total	$170,374	$171,004	$21,351	$21,399	$573	$422

A risk grading scale is used to assign grades to commercial relationships, which include commercial real estate, residential rentals, construction and land development, commercial loans and commercial equipment loans. Loans are graded at inception, annually thereafter when financial statements are received and at other times when there is an indication that a credit may have weakened or improved. Only commercial loan relationships with an aggregate exposure to the Bank of $1,000,000 or greater are subject to being risk rated.

Home equity and second mortgages and consumer loans are evaluated for creditworthiness in underwriting and are monitored based on borrower payment history. Residential first mortgages are evaluated for creditworthiness during credit due diligence before being purchased. Residential first mortgages, home equity and second mortgages and consumer loans are classified as unrated unless they are part of a larger commercial relationship that requires grading or are troubled debt restructures or nonperforming loans with an Other Assets Especially Mentioned (“OAEM”) or higher risk rating due to a delinquent payment history.

Management regularly reviews credit quality indicators as part of its individual loan reviews and on a monthly and quarterly basis. The overall quality of the Bank’s loan portfolio is assessed using the Bank’s risk grading scale, the level and trends of net charge-offs, nonperforming loans and delinquencies, the performance of troubled debt restructured loans and the general economic conditions in the Company’s geographical market. This review process is assisted by frequent internal reporting of loan production, loan quality, concentrations of credit, loan delinquencies and nonperforming and potential problem loans. Credit quality indicators and allowance factors are adjusted based on management’s judgment during the monthly and quarterly review process. Loans subject to risk ratings are graded on a scale of one to ten. The Company considers loans classified substandard, doubtful and loss as classified assets for regulatory and financial reporting.

Ratings 1 thru 6 — Pass

Ratings 1 thru 6 have asset risks ranging from excellent low risk to adequate. The specific rating assigned considers customer history of earnings, cash flows, liquidity, leverage, capitalization, consistency of debt service coverage, the nature and extent of customer relationship and other relevant specific business factors such as the stability of the industry or market area, changes to management, litigation or unexpected events that could have an impact on risks.

Rating 7 — OAEM (Other Assets Especially Mentioned) — Special Mention

These credits, while protected by the financial strength of the borrowers, guarantors or collateral, have reduced quality due to economic conditions, less than adequate earnings performance or other factors which require the lending officer to direct more than normal attention to the credit. Financing alternatives may be limited and/or command higher risk interest rates. OAEM loans are the first adversely classified assets on our watch list. These relationships will be reviewed at least quarterly.

NOTE 6 — LOANS – (continued)

Rating 8 — Substandard

Substandard assets are assets that are inadequately protected by the sound worth or paying capacity of the borrower or of the collateral pledged. These assets have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Bank will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard assets, does not have to exist in individual assets classified substandard. The loans may have a delinquent history or combination of weak collateral, weak guarantor strength or operating losses. When a loan is assigned to this category the Bank may estimate a specific reserve in the loan loss allowance analysis. These assets listed may include assets with histories of repossessions or some that are non-performing bankruptcies. These relationships will be reviewed at least quarterly.

Rating 9 — Doubtful

Doubtful assets have many of the same characteristics of Substandard with the exception that the Bank has determined that loss is not only possible but is probable and the risk is close to certain that loss will occur. When a loan is assigned to this category the Bank will identify the probable loss and the loan will receive a specific reserve in the loan loss allowance analysis. These relationships will be reviewed at least quarterly.

Rating 10 — Loss

Once an asset is identified as a definite loss to the Bank, it will receive the classification of ‘‘loss’’. There may be some future potential recovery; however it is more practical to write off the loan at the time of classification. Losses will be taken in the period in which they are determined to be uncollectable.

Maturity of Loan Portfolio

The following table sets forth certain information at December 31, 2017 and 2016 regarding the dollar amount of loans maturing in the Bank's portfolio based on their contractual terms to maturity. Demand loans, loans having no stated schedule of repayments and no stated maturity, and overdrafts are reported as due in one year or less.

December 31, 2017 (dollars in thousands) Description of Asset	**Due within one year after December 31, 2017**	**Due after one year through five years from December 31, 2017**	**Due more than five years from December 31, 2017**
Real Estate Loans			
Commercial	$ 67,951	$150,075	$509,288
Residential first mortgage	8,596	35,208	126,570
Residential rentals	4,288	21,627	84,313
Construction and land development	21,226	6,645	—
Home equity and second mortgage	242	811	20,298
Commercial loans	56,417	—	—
Consumer loans	200	307	66
Commercial equipment	12,113	18,051	5,752
Total loans	$171,033	$232,724	$746,287

NOTE 6 — LOANS – (continued)

December 31, 2016 (dollars in thousands) Description of Asset	Due within one year after December 31, 2016	Due after one year through five years from December 31, 2016	Due more than five years from December 31, 2016
Real Estate Loans			
Commercial	$ 86,782	$128,431	$451,892
Residential first mortgage	8,501	34,592	127,911
Residential rentals	3,847	17,911	80,139
Construction and land development	23,674	10,212	3,048
Home equity and second mortgage	296	877	20,226
Commercial loans	50,484	—	—
Consumer loans	163	164	95
Commercial equipment	10,049	18,812	10,876
Total loans	$183,796	$210,999	$694,187

The following table sets forth the dollar amount of all loans due after one year from December 31, 2017 and 2016, which have predetermined interest rates and have floating or adjustable interest rates.

December 31, 2017 (dollars in thousands) Description of Asset	Fixed Rates	Floating or Adjustable Rates	Total
Real Estate Loans			
Commercial	$157,667	$501,696	$659,363
Residential first mortgage	106,792	54,986	161,778
Residential rentals	16,974	88,966	105,940
Construction and land development	3,521	3,124	6,645
Home equity and second mortgage	1,285	19,824	21,109
Commercial loans	—	—	—
Consumer loans	373	—	373
Commercial equipment	21,924	1,879	23,803
	$308,536	$670,475	$979,011

December 31, 2016 (dollars in thousands) Description of Asset	Fixed Rates	Floating or Adjustable Rates	Total
Real Estate Loans			
Commercial	$124,549	$455,774	$580,323
Residential first mortgage	118,205	44,298	162,503
Residential rentals	17,499	80,551	98,050
Construction and land development	4,533	8,727	13,260
Home equity and second mortgage	1,454	19,649	21,103
Commercial loans	—	—	—
Consumer loans	259	—	259
Commercial equipment	24,635	5,053	29,688
	$291,134	$614,052	$905,186

NOTE 6 — LOANS – (continued)

Related Party Loans

Included in loans receivable were loans made to executive officers and directors of the Bank. These loans were made in the ordinary course of business at substantially the same terms and conditions as those prevailing at the time for comparable transactions with persons not affiliated with the Bank and are not considered to involve more than the normal risk of collectability. For the years ended December 31, 2017, 2016 and 2015, all loans to directors and executive officers of the Bank performed according to original loan terms. Activity in loans outstanding to executive officers and directors are summarized as follows:

	At and For the Years Ended December 31,		
(dollars in thousands)	**2017**	**2016**	**2015**
Balance, beginning of period	$26,464	$28,105	$24,403
Loans and additions	3,699	2,547	6,822
Change in Directors' status	—	2,299	(642)
Repayments	(3,687)	(6,487)	(2,478)
Balance, end of period	$26,476	$26,464	$28,105

NOTE 7 — LOAN SERVICING

Loans serviced for others are not reflected in the accompanying balance sheets. The unpaid principal balances of mortgages serviced for others were $43.7 million and $52.0 million at December 31, 2017 and 2016, respectively.

Servicing loans for others generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and foreclosure processing. Loan servicing income is recorded on an accrual basis and includes servicing fees from investors and certain charges collected from borrowers, such as late payment fees. The following table presents the activity of the mortgage servicing rights.

	Years Ended December 31,		
(dollars in thousands)	**2017**	**2016**	**2015**
Balance, beginning of the year	$128	$219	$ 295
Additions	—	—	31
Amortization	(74)	(91)	(107)
Balance, end of the year	$ 54	$128	$ 219

NOTE 8 — OTHER REAL ESTATE OWNED ("OREO")

OREO assets are presented net of the allowance for losses. The Company considers OREO as classified assets for regulatory and financial reporting. OREO carrying amounts reflect management's estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs. An analysis of the activity follows.

	Years Ended December 31,		
(dollars in thousands)	**2017**	**2016**	**2015**
Balance at beginning of year	$ 7,763	$ 9,449	$ 5,883
Additions of underlying property	3,634	3,120	5,436
Disposals of underlying property	(1,456)	(3,860)	(1,206)
Transfers to premises and equipment	—	(372)	—
Valuation allowance	(600)	(574)	(664)
Balance at end of period	$ 9,341	$ 7,763	$ 9,449

NOTE 8 — OTHER REAL ESTATE OWNED (“OREO”) – (continued)

During the year ended December 31, 2017, additions of $3.6 million consisted of $3.0 million related to the foreclosure of a stalled residential development project. The Bank is working with a construction manager to stabilize and market the project. Further, additions included $103,000 for residential lots and $495,000 for a commercial office building. The Company disposed of five residential properties and multiple residential lots for proceeds of $1.5 million and a gain of $43,000 for the year ended December 31, 2017. The Bank provided $200,000 in financing for one residential property and the three residential lots during the first quarter of 2017. The transaction qualified for full accrual sales treatment under ASC Topic 360-20-40 ‘‘Property Plant and Equipment — Derecognition’’.

The Company recognized net losses on OREO disposals of $436,000 for the year ended December 31, 2016. Disposals consisted of properties with the following carrying values; $337,000 for seven residential lots, $584,000 for four residential properties, $501,000 for two commercial properties, $138,000 for a commercial lot and $2.2 million for an apartment and condominium property. The Bank provided financing for the apartment and condominium purchase and the transaction qualified for full accrual sales treatment under ASC Topic 360-20-40 ‘‘Property Plant and Equipment — Derecognition’’. In addition, the Company transferred one commercial condominium with a carrying value of $372,000 into premises for commercial lending office space.

The Company had $122,000 and $353,000 of impaired loans secured by residential real estate for which formal foreclosure proceedings were in process as of December 31, 2017 and 2016, respectively.

Additions to the valuation allowances of $600,000, $574,000 and $664,000 were taken to adjust properties to current appraised values for the years ended December 31, 2017, 2016 and 2015, respectively. OREO carrying amounts reflect management’s estimate of the realizable value of these properties incorporating current appraised values, local real estate market conditions and related costs. Expenses applicable to OREO assets included the following..

	Years Ended December 31,		
(dollars in thousands)	2017	2016	2015
Valuation allowance	$600	$574	$ 664
Operating expenses	146	287	395
	$746	$861	$1,059

NOTE 9 — PREMISES AND EQUIPMENT AND HELD FOR SALE PREMISES AND EQUIPMENT

A summary of the cost and accumulated depreciation of premises and equipment at December 31, 2017 and 2016 follows:

	December 31,	
(dollars in thousands)	2017	2016
Land	$ 4,172	$ 4,172
Building and improvements	23,038	22,586
Furniture and equipment	9,225	8,989
Automobiles	303	313
Total cost	36,738	36,060
Less accumulated depreciation	15,347	13,855
Premises and equipment, net	$21,391	$22,205

NOTE 9 — PREMISES AND EQUIPMENT AND HELD FOR SALE PREMISES AND EQUIPMENT – (continued)

Certain Bank facilities are leased under various operating leases. Rent expense was $761,000, $723,000 and $701,000 for the years ended December 31, 2017, 2016 and 2015, respectively. Future minimum rental commitments under non-cancellable operating leases are as follows at December 31, 2017:

(dollar in thousands)	
2018	$ 747
2019	625
2020	514
2021	489
2022	415
Thereafter	4,019
Total	$6,809

As of December 31, 2016, the Company had a small office condo under contract held for sale with a fair value of $345,000 that was recorded as a non-recurring Level 2 asset at December 31, 2016. The contract on the property was cancelled during the three months ended March 31, 2017, and the asset was transferred and recorded as a non-recurring Level 3 asset. During the three months ended June 30, 2017, the property was sold for net proceeds of $392,000 with a gain on the sale of $47,000.

During the year ended December 31, 2015, the Company agreed to sell its King George, Virginia branch building and equipment to a credit union. The required conditions were met during the third quarter of 2015 to classify the asset as held for sale (''HFS'') under FASB 360-10-45-9 which addresses accounting and reporting for long-lived assets to be disposed of by sale. FASB ASC 360-10-35-43 states that a long-lived asset classified as HFS should be measured at the lower of carrying amount or fair value less cost to sell. Based on the contracted sales price, the Company recorded an impairment of $426,000 during the third quarter of 2015. The transaction closed on January 28, 2016.

NOTE 10 — DEPOSITS

Deposits consist of the following:

	December 31,	
(dollars in thousands)	2017	2016
Noninterest-bearing demand	$ 159,844	$ 144,877
Interest-bearing:		
Demand	215,447	162,823
Money market deposits	226,351	248,049
Savings	52,990	50,284
Certificates of deposit	451,605	432,792
Total interest-bearing	946,393	893,948
Total Deposits	$1,106,237	$1,038,825

As of December 31, 2017 and 2016, there were $9.2 million and $6.2 million, respectively in deposit accounts held by executive officers and directors of the Bank and Company.

The aggregate amount of certificates of deposit in denominations of $100,000 or more at December 31, 2017 and 2016 was $321.0 million and $287.6 million, respectively. The aggregate amount of certificates of deposit in denominations of $250,000 or more at December 31, 2017, and 2016 was $167.5 million and $153.9 million, respectively.

NOTE 10 — DEPOSITS – (continued)

At December 31, 2017 and 2016, the scheduled contractual maturities of certificates of deposit are as follows:

(dollars in thousands)	December 31, 2017	2016
Within one year	$312,417	$306,089
Year 2	93,723	79,474
Year 3	29,661	31,921
Year 4	4,327	8,353
Year 5	11,477	6,955
	$451,605	$432,792

NOTE 11 — SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The Bank's long-term debt and short-term borrowings consist of advances from the FHLB of Atlanta. The Bank classifies debt based upon original maturity and does not reclassify debt to short-term status during its life. Long-term debt and short-term borrowings include fixed-rate long-term advances, short-term advances, daily advances, fixed-rate convertible advances, and variable-rate convertible advances.

Rates and maturities on long-term advances and short-term borrowings were as follows:

	Fixed-Rate	Fixed-Rate Convertible	Variable Convertible
December 31, 2017			
Highest rate	2.83%	3.47%	4.00%
Lowest rate	0.95%	3.47%	4.00%
Weighted average rate	1.42%	3.47%	4.00%
Matures through	2036	2018	2020
December 31, 2016			
Highest rate	2.83%	3.47%	4.00%
Lowest rate	0.54%	3.47%	4.00%
Weighted average rate	1.05%	3.47%	4.00%
Matures through	2036	2018	2020

Average rates of long-term debt and short-term borrowings were as follows:

	At or for the Year Ended December 31,		
(dollars in thousands)	2017	2016	2015
Long-term debt			
Long-term debt outstanding at end of period	$ 55,498	$65,559	$55,617
Weighted average rate on outstanding long-term debt	2.38%	2.27%	2.47%
Maximum outstanding long-term debt of any month end	65,554	65,593	74,668
Average outstanding long-term debt	58,704	60,503	68,924
Approximate average rate paid on long-term debt	2.24%	2.41%	2.26%
Short-term borrowings			
Short-term borrowings outstanding at end of period	$ 87,500	$79,000	$36,000
Weighted average rate on short-term borrowings	1.34%	0.71%	0.38%
Maximum outstanding short-term borrowings at any month end	109,000	79,000	36,000
Average outstanding short-term borrowings	91,797	39,802	13,463
Approximate average rate paid on short-term borrowings.	1.15%	0.49%	0.27%

NOTE 11 — SHORT-TERM BORROWINGS AND LONG-TERM DEBT – (continued)

The Bank's fixed-rate debt generally consists of advances with monthly interest payments and principal due at maturity.

The Bank's fixed-rate convertible long-term debt is callable by the issuer, after an initial period ranging from six months to five years. The instruments are callable at the end of the initial period. As of December 31, 2017 and 2016, all fixed-rate convertible debt has passed its call date. All advances have a prepayment penalty, determined based upon prevailing interest rates.

Variable convertible advances have an initial variable rate based on a discount to LIBOR. Variable convertible debt is scheduled to mature in 2020. As of December 31, 2017 and 2016, all variable convertible debt has passed its call date and is fixed at 4.0%.

During the year ended December 31, 2017, the Bank paid off $20.1 million of maturing long-term debt and added one $10.0 million fixed-rate advance maturing in 2018 at 1.38%. During the year ended December 31, 2016, the Bank paid off $5.0 million of maturing long-term debt and added one $15.0 million fixed-rate advances maturing in 2018 at 0.95%.

At December 31, 2017 and 2016, $55.5 million or 100% and $65.6 million or 100%, respectively, of the Bank's long-term debt was fixed for rate and term, as the conversion optionality of the advances have either been exercised or expired. The contractual maturities of long-term debt were as follows at December 31, 2017 and 2016:

	December 31, 2017			
(dollars in thousands)	Fixed-Rate	Fixed-Rate Convertible	Variable Convertible	Total
Due in 2018	$25,000	$10,000	$ —	$35,000
Due in 2019	—	—	—	—
Due in 2020	—	—	10,000	10,000
Due in 2021	—	—	—	—
Due in 2022	10,302	—	—	10,302
Thereafter	196	—	—	196
	$35,498	$10,000	$10,000	$55,498

	December 31, 2016			
(dollars in thousands)	Fixed-Rate	Fixed-Rate Convertible	Variable Convertible	Total
Due in 2017	$20,000	$ —	$ —	$20,000
Due in 2018	15,000	10,000	—	25,000
Due in 2019	—	—	—	—
Due in 2020	—	—	10,000	10,000
Due in 2021	—	—	—	—
Thereafter	10,559	—	—	10,559
	$45,559	$10,000	$10,000	$65,559

The Bank also has daily advances outstanding and short-term advances with terms of less than one year, which are classified as short-term borrowings. Daily advances are repayable at the Bank's option at any time and are re-priced daily. Daily advances were $6.0 million and $19.0 million at December 31, 2017 and 2016, respectively. The Bank had short-term advances of $81.5 million and $60.0 million, respectively, at December 31, 2017 and 2016.

Under the terms of an Agreement for Advances and Security Agreement with Blanket Floating Lien (the "Agreement"), the Bank maintains collateral with the FHLB consisting of one-to four-family residential first mortgage loans, second mortgage loans, commercial real estate and securities. The Agreement limits total advances to 30% of assets, which were $420.3 million and $399.6 million at December 31, 2017 and 2016, respectively.

NOTE 11 — SHORT-TERM BORROWINGS AND LONG-TERM DEBT – (continued)

At December 31, 2017, $584.6 million of loans and securities were pledged or in safekeeping at the FHLB. Loans and securities are subject to collateral eligibility rules and are adjusted for market value and collateral value factors to arrive at lendable collateral values. At December 31, 2017, FHLB lendable collateral was valued at $452.6 million. At December 31, 2017, the Bank had total lendable pledged collateral at the FHLB of $330.1 million of which $187.1 million was available to borrow in addition to outstanding advances of $143.0 million. Unpledged lendable collateral was $122.5 million, bringing total available borrowing capacity to $309.6 million at December 31, 2017.

At December 31, 2016, $521.3 million of loans and securities were pledged or in safekeeping at the FHLB. Loans and securities are subject to collateral eligibility rules and are adjusted for market value and collateral value factors to arrive at lendable collateral values. At December 31, 2016, FHLB lendable collateral was valued at $405.7 million. At December 31, 2016, the Bank had total lendable pledged collateral at the FHLB of $275.1 million of which $130.6 million was available to borrow in addition to outstanding advances of $144.6 million. Unpledged lendable collateral was $130.5 million, bringing total available borrowing capacity to $261.1 million at December 31, 2016.

The Bank has established a short-term credit facility with the Federal Reserve Bank of Richmond under its Borrower in Custody program. The Bank had segregated collateral sufficient to draw $7.5 million and $8.6 million under this agreement at December 31, 2017 and 2016, respectively. In addition, the Bank has established unsecured short-term credit facilities with other commercial banks totaling $22.0 million and $12.0 million, respectively, at December 31, 2017 and 2016. Additionally, the Bank secured a $40.0 million repurchase credit facility during 2017 with a commercial bank. The repurchase facility requires the pledging of securities as collateral. No amounts were outstanding under the Borrower in Custody or the unsecured and secured commercial lines at December 31, 2017 and 2016.

NOTE 12 — INCOME TAXES

Allocation of federal and state income taxes between current and deferred portions is as follows:

	Years Ended December 31,		
	2017	2016	2015
Current			
Federal	$5,584	$3,675	$3,255
State	1,686	1,296	1,128
	7,270	4,971	4,383
Deferred			
Federal	1,894	(460)	(643)
State	(7)	(95)	(107)
	1,887	(555)	(750)
Income tax expense	$9,157	$4,416	$3,633

NOTE 12 — INCOME TAXES – (continued)

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	2017		2016		2015	
	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income	Amount	Percent of Pre-Tax Income
Expected income tax expense at federal tax rate	$5,728	35.00%	$3,994	34.00%	$3,392	34.00%
State taxes net of federal benefit	1,096	6.70%	796	6.78%	647	6.49%
Nondeductible expenses	255	1.56%	37	0.31%	40	0.40%
Nontaxable income	(376)	(2.30)%	(375)	(3.19)%	(398)	(3.99)%
Provisional deferred tax adjustment related to reduction in U.S. federal statutory income tax rate	2,740	16.74%	—	0.00%	—	0.00%
Other	(286)	(1.75)%	(36)	(0.31)%	(48)	(0.48)%
	$9,157	55.95%	$4,416	37.59%	$3,633	36.42%

Income tax expense for 2017 was impacted by the adjustment of our deferred tax assets and liabilities related to the reduction in the U.S. federal statutory income tax rate to 21% under the Tax Cuts and Jobs Act, which was enacted on December 22, 2017. As a result of the new law, we recognized a provisional net tax expense of $2.7 million.

The net deferred tax assets in the accompanying balance sheets include the following components:

	2017	2016
Deferred tax assets		
Allowance for loan losses	$2,893	$3,890
Deferred compensation	2,142	2,520
OREO valuation allowance & expenses	337	413
Unrealized loss on investment securities	452	605
Depreciation	29	
Other	142	509
	5,995	7,937
Deferred tax liabilities		
FHLB stock dividends	109	156
Depreciation	—	15
	109	171
	$5,886	$7,766

The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations, however, such changes do not currently impact the Company.

As stated above, as a result of the enactment of the Tax Cuts and Jobs Act on December 22, 2017, we calculated deferred tax assets and liabilities based upon the newly enacted U.S. statutory federal income tax

NOTE 12 — INCOME TAXES – (continued)

rate of 21%, which is the tax rate at which these assets and liabilities are expected to reverse in the future. We will continue to analyze certain aspects of the new law and refine our calculations based on this analysis and future tax positions taken, which could affect the measurement of these assets and liabilities or give rise to new deferred tax amounts. We recognized a provisional net tax expense related to the calculation of our deferred tax assets and liabilities totaling $2.7 million.

The FASB issued ASU 2018-02, ''Income Statement — Reporting Comprehensive Income,'' which allows companies to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act from AOCI to retained earnings. The Company early adopted this standard for the quarter ended December 31, 2017. See Notes 1 and 2 for further information.

On Friday, December 22, 2017, the SEC issued Staff Accounting Bulletin No. 118 (SAB 118). SAB 118 indicated that a reporting entity must record a reasonable estimate in the first period in which it is possible to determine a reasonable estimate. Under SAB 118, reasonable estimates are considered ''provisional amounts'' that have to be updated when additional information becomes available and the evaluation and computation of the additional information is complete. A reporting entity must act in good faith and update provisional amounts as soon as more information becomes available, evaluated and prepared, during a measurement period that cannot exceed one year from the enactment date. Initial reasonable estimates and subsequent changes to provisional amounts should be reported in income tax expense or benefit from continuing operations in the period in which they are determined.

Retained earnings at December 31, 2017 and 2016 included approximately $1.2 million of bad debt deductions allowed for federal income tax purposes (the ''base year tax reserve'') for which no deferred income tax has been recognized. If, in the future, this portion of retained earnings is used for any purpose other than to absorb bad debt losses, it would create income for tax purposes only and income taxes would be imposed at the then prevailing rates. The unrecorded income tax liability on the above amount was approximately $330,000 and 463,000 at December 31, 2017 and 2016.

The Company does not have uncertain tax positions that are deemed material and did not recognize any adjustments for unrecognized tax benefits. The Company's policy is to recognize interest and penalties on income taxes as a component of tax expense. The Company is no longer subject to U.S. Federal tax examinations by tax authorities for years before 2014.

NOTE 13 — COMMITMENTS AND CONTINGENCIES

The Bank is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments are commitments to extend credit. These instruments may, but do not necessarily, involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized on the balance sheets. The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments as it does for on-balance-sheet loans receivable.

As of December 31, 2017 and 2016, the Bank had outstanding loan commitments of approximately $65.6 million and $67.0 million, respectively. Standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These guarantees are issued primarily to support construction borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds cash or a secured interest in real estate as collateral to support those commitments for which collateral is deemed necessary. Standby letters of credit outstanding amounted to $17.9 million and $17.7 million at December 31, 2017 and 2016, respectively. In addition to the commitments noted above, customers had approximately $162.2 million and $135.3 million available under lines of credit at December 31, 2017 and 2016, respectively.

NOTE 14 — STOCK-BASED COMPENSATION

The Company has stock-based incentive arrangements to attract and retain key personnel. In May 2015, the 2015 Equity Compensation Plan (the ''2015 plan'') was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. Compensation expense for service-based awards is recognized over the vesting period. Performance-based awards are recognized based on a vesting schedule and the probability of achieving goals specified at the time of the grant. The 2015 plan replaced the 2005 Equity Compensation Plan.

Stock-based compensation expense totaled $515,000, $489,000 and $319,000 for the years ended December 31, 2017, 2016 and 2015, respectively, which consisted of grants of restricted stock and restricted stock units.

The Company has not granted any stock options since 2007 and all outstanding options expired on July 17, 2017. The fair value of the Company's outstanding employee stock options were estimated on the date of grant using the Black-Scholes option pricing model. The Company estimated expected market price volatility and expected term of the options based on historical data and other factors. The exercise price for options granted is set at the discretion of the committee administering the Plan, but is not less than the market value of the shares as of the date of grant. An option's maximum term is 10 years and the options vest at the discretion of the committee.

The following tables below summarize option activity and outstanding and exercisable options at and for the years ended December 31, 2017 and 2016. respectively.

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2017	15,081	$27.70	$ —	
Exercised	(14,231)	27.70	134	
Expired	(350)	27.70	—	
Forfeited	(500)	27.70	—	
Outstanding at December 31, 2017	—	$ —	$ —	—
Exercisable at December 31, 2017	—	$ —	$ —	—

(dollars in thousands, except per share amounts)	Shares	Weighted Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Contractual Life Remaining In Years
Outstanding at January 1, 2016	21,211	$27.70	$—	
Forfeited	(6,130)	27.70		
Outstanding at December 31, 2016	15,081	$27.70	$20	0.5
Exercisable at December 31, 2016	15,081	$27.70	$20	0.5

The aggregate intrinsic value of outstanding stock options and exercisable stock options was $20,000 at December 31, 2016. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the period, which was $29.00 per share at December 31, 2016 and the exercise price multiplied by the number of options outstanding.

NOTE 14 — STOCK-BASED COMPENSATION – (continued)

The Company has outstanding restricted stock in accordance with the Plan. As of December 31, 2017 and 2016, unrecognized stock compensation expense was $521,000 and $810,000, respectively. The following tables summarize the unvested restricted stock awards outstanding at December 31, 2017 and 2016, respectively.

	Restricted Stock	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2017	47,881	$20.41
Granted	6,752	30.20
Vested	(21,738)	20.13
Cancelled	(86)	20.75
Nonvested at December 31, 2017	32,809	$22.61

	Restricted Stock	
	Number of Shares	Weighted Average Grant Date Fair Value
Nonvested at January 1, 2016	37,048	$19.83
Granted	27,403	21.00
Vested	(15,912)	20.09
Cancelled	(658)	20.31
Nonvested at December 31, 2016	47,881	$20.41

NOTE 15 — EMPLOYEE BENEFIT PLANS

The Company has an Employee Stock Ownership Plan (''ESOP'') that covers substantially all its employees. Employees qualify to participate after one year of service and vest in allocated shares after three years of service. The ESOP acquires stock of The Community Financial Corporation by purchasing shares. Dividends on ESOP shares are recorded as a reduction of retained earnings. Contributions are made at the discretion of the Board of Directors. ESOP contributions recognized for the years ended 2017, 2016 and 2015 totaled $242,000, $99,000 and $129,000, respectively. As of December 31, 2017 and 2016, the ESOP held 223,344 and 221,106 allocated shares and 22,908 and 9,562 unallocated shares. The approximate market values of the shares were $9.4 million and $6.7 million, respectively as of December 31, 2017 and 2016. The estimated value was determined using the Company's closing stock price of $38.30 and $29.00 per share as of December 31, 2017 and 2016, respectively. In addition, salary and employee benefit expense for the year ended December 31, 2017 included $110,000 for the excess of fair market value of leveraged ESOP shares released (allocated).

The ESOP has promissory notes with the Company for the purchase of TCFC common stock for the benefit of the participants in the Plan. The ESOP has promissory notes with the Company of $755,000 and $169,000 at December 31, 2017 and 2016, respectively. The promissory notes were originated for the purchase of TCFC common stock for the benefit of the participants in the Plan. Loan terms are at prime rate plus one-percentage point and amortize over seven (7) years. As principal is repaid, common shares are allocated to participants based on the participant account allocation rules described in the Plan. The Bank is a guarantor of the ESOP debt with the Company. During the year ended December 31, 2017, $237,000 or 10,157 ESOP shares were allocated with the payment of promissory notes. This was offset by the purchase of 23,503 shares of the Company's common shares for $823,000 with promissory notes by the ESOP during the third quarter of 2017.

The Company also has a 401(k) plan. The Company matches a portion of the employee contributions. This ratio is determined annually by the Board of Directors. In 2017, 2016 and 2015, the Company matched one-half of the first 8% of the employee's contribution. Employees who have completed six months of service

NOTE 15 — EMPLOYEE BENEFIT PLANS – (continued)

are covered under this defined contribution plan. Employee's vest in the Company's matching contributions after three years of service. Contributions are determined at the discretion of the Board of Directors. For the years ended December 31, 2017, 2016 and 2015, the expense recorded for this plan totaled $298,000, $346,000 and $332,000, respectively.

The Company has a separate nonqualified retirement plan for non-employee directors. Directors are eligible for a maximum benefit of $3,500 a year for ten years following retirement from the Board of Community Bank of the Chesapeake. The maximum benefit is earned at 15 years of service as a non-employee director. Full vesting occurs after two years of service. Expense recorded for this plan was $29,000, $20,000 and $22,000 for the years ended December 31, 2017, 2016 and 2015, respectively.

In addition, the Company has established individual supplemental retirement plans and life insurance benefits for certain key executives and officers of the Bank. The retirement plans provide retirement income payments for 15 years from the date of the employee's expected retirement at age 65. The retirement benefit amount for each agreement is set at the discretion of the Board of Directors and vests from the date of the agreement until the expected retirement date. Expense recorded for the plans totaled $637,000, $525,000 and $519,000 for 2017, 2016 and 2015, respectively.

NOTE 16 — GUARANTEED PREFERRED BENEFICIAL INTEREST IN JUNIOR SUBORDINATED DEBENTURES ("TRUPs")

On June 15, 2005, Tri-County Capital Trust II ("Capital Trust II"), a Delaware business trust formed, funded and wholly owned by the Company, issued $5.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 1.70%. The Trust used the proceeds from this issuance, along with the $155,000 for Capital Trust II's common securities, to purchase $5.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These capital securities qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust II and the junior subordinated debentures are scheduled to mature on June 15, 2035, unless called by the Company.

On July 22, 2004, Tri-County Capital Trust I ("Capital Trust I"), a Delaware business trust formed, funded and wholly owned by the Company, issued $7.0 million of variable-rate capital securities in a private pooled transaction. The variable rate is based on the 90-day LIBOR rate plus 2.60%. The Trust used the proceeds from this issuance, along with the Company's $217,000 capital contribution for Capital Trust I's common securities, to purchase $7.2 million of the Company's junior subordinated debentures. The interest rate on the debentures and the trust preferred securities is variable and adjusts quarterly. These debentures qualify as Tier I capital and are presented in the Consolidated Balance Sheets as "Guaranteed Preferred Beneficial Interests in Junior Subordinated Debentures." Both the capital securities of Capital Trust I and the junior subordinated debentures are scheduled to mature on July 22, 2034, unless called by the Company.

NOTE 17 — SUBORDINATED NOTES

On February 6, 2015 the Company issued $23.0 million of unsecured 6.25% fixed to floating rate subordinated notes due February 15, 2025 ("subordinated notes"). On February 13, 2015, the Company used proceeds of the offering to redeem all $20 million of the Company's outstanding preferred stock issued under the Small Business Lending Fund ("SBLF") program. The subordinated notes qualify as Tier 2 regulatory capital and replaced SBLF Tier 1 capital. The subordinated notes are not listed on any securities exchange or included in any automated dealer quotation system and there is no market for the notes. The notes are unsecured obligations and are subordinated in right of payment to all existing and future senior debt, whether secured or unsecured. The notes are not guaranteed obligations of any of the Company's subsidiaries.

Interest will accrue at a fixed per annum rate of 6.25% from and including the issue date to but excluding February 15, 2020. From and including February 15, 2020 to but excluding the maturity date interest will accrue at a floating rate equal to the three-month LIBOR plus 479 basis points. Interest is payable on the

NOTE 17 — SUBORDINATED NOTES – (continued)

notes on February 15 and August 15 of each year, commencing August 15, 2015, through February 15, 2020, and thereafter February 15, May 15, August 15 and November 15 of each year through the maturity date or earlier redemption date.

The subordinated notes may be redeemed in whole or in part on February 15, 2020 or on any scheduled interest payment date thereafter and upon the occurrence of certain special events. The redemption price is equal to 100% of the principal amount of the subordinated notes to be redeemed plus accrued and unpaid interest to the date of redemption. Any partial redemption will be made pro rata among all holders of the subordinated notes. The subordinated notes are not subject to repayment at the option of the holders. The subordinated notes may be redeemed at any time, if (1) a change or prospective change in law occurs that could prevent the Company from deducting interest payable on the notes for U.S. federal income tax purposes, (2) a subsequent event occurs that precludes the notes from being recognized as Tier 2 Capital for regulatory capital purposes, or (3) the Company is required to register as an investment company under the Investment Company Act of 1940, as amended.

NOTE 18 — REGULATORY CAPITAL

As of December 31, 2015, the Bank was a member of the Federal Reserve System and its primary federal regulator was the Federal Reserve Board. On April 18, 2016, Community Bank of the Chesapeake, cancelled its stock in the Federal Reserve Bank of Richmond. This terminated its status as a member of the Federal Reserve System. As of that date, the Bank's primary regulator became the Federal Deposit Insurance Corporation (''FDIC'') and is subject to regulation, supervision and regular examination by the Maryland Commissioner of Financial Regulation (the ''Commissioner'') and the FDIC.

The Company continues to be subject to regulation, examination and supervision by the Federal Reserve Board under the Bank Holding Company Act of 1956, as amended (the ''BHCA''), and the regulations of the Federal Reserve Board.

On January 1, 2015, the Company and Bank became subject to the new Basel III Capital Rules with full compliance with all of the final rule's requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. In July 2013, the final rules were published (the ''Basel III Capital Rules'') establishing a new comprehensive capital framework for U.S. banking organizations. The rules implement the Basel Committee's December 2010 framework known as ''Basel III'' for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act. The Basel III Capital Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions compared to the previous U.S. risk-based capital rules. The Basel III Capital Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel III Capital Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach with a more risk-sensitive approach. The Basel III Capital Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0%, require a minimum ratio (''Min. Ratio'') of Total Capital to risk-weighted assets of 8.0%, and require a minimum Tier 1 leverage ratio of 4.0%. A new capital conservation buffer (''CCB'') is also established above the regulatory minimum capital requirements. This capital conservation buffer began its phase-in period beginning January 1, 2016 at 0.625% of risk-weighted assets and will increase each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets.

NOTE 18 — REGULATORY CAPITAL – (continued)

As of December 31, 2017 and 2016, the Company and Bank were well-capitalized under the regulatory framework for prompt corrective action under the new Basel III Capital Rules. Management believes, as of December 31, 2017 and 2016, that the Company and the Bank met all capital adequacy requirements to which they were subject.

The Company's and the Bank's actual regulatory capital amounts and ratios are presented in the following table.

Regulatory Capital and Ratios (dollars in thousands)		The Company		The Bank	
		December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
Common Equity		$ 109,957	$ 104,426	$ 139,046	$ 136,109
AOCI Losses		1,191	928	1,191	928
Common Equity Tier 1 Capital		**111,148**	**105,354**	**140,237**	**137,037**
TRUPs		12,000	12,000	—	—
Tier 1 Capital		**123,148**	**117,354**	**140,237**	**137,037**
Allowable Reserve for Credit Losses and Other Tier 2 Adjustments		10,545	9,860	10,545	9,860
Subordinated Notes		23,000	23,000	—	—
Tier 2 Capital		**$ 156,693**	**$ 150,214**	**$ 150,782**	**$ 146,897**
Risk-Weighted Assets ("RWA")		**$1,169,341**	**$1,104,505**	**$1,164,478**	**$1,102,116**
Average Assets ("AA")		**$1,401,741**	**$1,300,445**	**$1,398,001**	**$1,298,145**
	2019 Regulatory Min. Ratio + CCB[(1)]				
Common Tier 1 Capital to RWA	***7.00%***	9.51%	9.54%	12.04%	12.43%
Tier 1 Capital to RWA	***8.50***	10.53	10.62	12.04	12.43
Tier 2 Capital to RWA	***10.50***	13.40	13.60	12.95	13.33
Tier 1 Capital to AA (Leverage)[(2)]	***n/a***	8.79	9.02	10.03	10.56

(1) These are the fully phased-in ratios as of January 1, 2019 that include the minimum capital ratio ("Min. Ratio") + the capital conservation buffer ("CCB"). The phase-in period is more fully described in the footnote above.

(2) Tier 1 Capital to AA (Leverage) has no capital conservation buffer defined. PCA well capitalized is defined as 5.00%.

NOTE 19 — FAIR VALUE MEASUREMENTS

The Company adopted FASB ASC Topic 820, *"Fair Value Measurements"* and FASB ASC Topic 825, *"The Fair Value Option for Financial Assets and Financial Liabilities"*, which provides a framework for measuring and disclosing fair value under generally accepted accounting principles. FASB ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available for sale investment securities) or on a nonrecurring basis (for example, impaired loans).

FASB ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Securities available for sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis such as loans held for investment and certain other assets. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

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

Level 1 inputs — Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

Level 2 inputs — Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3 inputs — Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstances that caused the transfer, which generally coincides with the Company's quarterly valuation process. Transfers in and out of level 3 during a quarter are disclosed. There was one transfer from Level 2 to Level 3 in the fair value hierarchy during the first quarter of 2017 for premises and equipment held for sale. This asset was sold during the three months ended June 30, 2017. There were no transfers between Level 1, 2 or 3 in the fair value hierarchy for the remaining six months of 2017 and for the year ended December 31, 2016. The Company changed its presentation during the year ended December 31, 2016, for loans and OREO from Level 2 to Level 3. No changes were made to the Company's valuation methodologies as a result of these changes.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value:

Securities Available for Sale

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

Loans Receivable

The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2017 and 2016, substantially all impaired loans were evaluated based upon the fair value of the collateral.

NOTE 19 — FAIR VALUE MEASUREMENTS – (continued)

In accordance with FASB ASC 820, impaired loans where an allowance is established based on the fair value of collateral (loans with impairment) require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the loan as nonrecurring Level 2. When the fair value of the impaired loan is derived from an appraisal, the Company records the loan as nonrecurring Level 3. Fair value is re-assessed at least quarterly or more frequently when circumstances occur that indicate a change in the fair value. The fair values of impaired loans that are not measured based on collateral values are measured using discounted cash flows and considered to be Level 3 inputs.

Premises and Equipment Held For Sale

Premises and equipment are adjusted to fair value upon transfer of the assets to premises and equipment held for sale. Subsequently, premises and equipment held for sale are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the asset as nonrecurring Level 2. When the fair value of premises and equipment is derived from an appraisal or a cash flow analysis, the Company records the asset at nonrecurring Level 3.

As of December 31, 2016, the Company had a small office condo under contract held for sale with a fair value of $345,000 that was recorded as a non-recurring Level 2 asset at December 31, 2016. The contract on the property was cancelled during the three months ended March 31, 2017, and the asset was transferred and recorded as a non-recurring Level 3 asset. During the three months ended June 30, 2017, the property was sold for net proceeds of $392,000 with a gain on the sale of $47,000.

Other Real Estate Owned ("OREO")

OREO is adjusted for fair value upon transfer of the loans to foreclosed assets. Subsequently, OREO is carried at the lower of carrying value and fair value. Fair value is based upon independent market prices, appraised value of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price (e.g., contracted sales price), the Company records the foreclosed asset as nonrecurring Level 2. When the fair value is derived from an appraisal, the Company records the foreclosed asset at nonrecurring Level 3.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The tables below present the recorded amount of assets as of December 31, 2017 and December 31, 2016 measured at fair value on a recurring basis.

(dollars in thousands)	**December 31, 2017**			
Description of Asset	**Fair Value**	**Level 1**	**Level 2**	**Level 3**
Available for sale securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$44,137	$—	$44,137	$—
MBS	7,087	—	7,087	—
U.S. Agency	12,517	—	12,517	—
Corporate equity securities	37	—	37	—
Bond mutual funds	4,507	—	4,507	—
Total available for sale securities	$68,285	$—	$68,285	$—

(dollars in thousands) Description of Asset	December 31, 2016 Fair Value	Level 1	Level 2	Level 3
Available for sale securities				
Asset-backed securities issued by GSEs and U.S. Agencies				
CMOs	$34,228	$—	$34,228	$—
MBS	4,183	—	4,183	—
U.S. Agency	10,172	—	10,172	—
Corporate equity securities	37	—	37	—
Bond mutual funds	4,413	—	4,413	—
Total available for sale securities	$53,033	$—	$53,033	$—

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required from time to time to measure certain assets at fair value on a nonrecurring basis in accordance with U.S. GAAP. These include assets that are measured at the lower of cost or market that were recognized at fair value below cost at the end of the period. Assets measured at fair value on a nonrecurring basis as of December 31, 2017 and 2016 are included in the tables below.

(dollars in thousands) Description of Asset	December 31, 2017 Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$1,638	$—	$—	$1,638
Residential first mortgages	457	—	—	457
Residential rentals	377	—	—	377
Construction and land development	566	—	—	566
Commercial equipment	164	—	—	164
Total loans with impairment	$3,202	$—	$—	$3,202
Other real estate owned	$9,341	$—	$—	$9,341

(dollars in thousands) Description of Asset	December 31, 2016 Fair Value	Level 1	Level 2	Level 3
Loans with impairment				
Commercial real estate	$6,275	$—	$ —	$6,275
Residential first mortgages	468	—	—	468
Residential rentals	142	—	—	142
Construction and land development	673	—	—	673
Commercial loans	77	—	—	77
Total loans with impairment	$7,635	$—	$ —	$7,635
Premises and equipment held for sale	$ 345	$—	$345	$ —
Other real estate owned	$7,763	$—	$ —	$7,763

Loans with impairment have unpaid principal balances of $4.2 million and $8.9 million at December 31, 2017 and 2016, respectively, and include impaired loans with a specific allowance.

NOTE 19 — FAIR VALUE MEASUREMENTS – (continued)

The following tables provide information describing the unobservable inputs used in Level 3 fair value measurements.

December 31, 2017

(dollars in thousands)

Description of Asset	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Loans with impairment	$3,202	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0% – 50% (24)%
Other real estate owned	$9,341	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0% – 50% (12)%

December 31, 2016

(dollars in thousands)

Description of Asset	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Loans with impairment	$7,635	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0% – 50% (14)%
Other real estate owned	$7,763	Third party appraisals and in-house real estate evaluations of fair value	Management discount for property type and current market conditions	0% – 50% (12)%

NOTE 20 — FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgment is required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts. Therefore, any aggregate unrealized gains or losses should not be interpreted as a forecast of future earnings or cash flows. Furthermore, the fair values disclosed should not be interpreted as the aggregate current value of the Company.

Valuation Methodology

Investment securities — Fair values are based on quoted market prices or dealer quotes. If a quoted market price is not available, fair value is estimated using quoted market prices for similar securities.

FHLB stock — Fair values are at cost, which is the carrying value of the securities.

Investment in bank owned life insurance ("BOLI") — Fair values are at cash surrender value.

Loans receivable — The fair values for non-impaired loans are estimated using discounted cash flow analyses, applying interest rates currently being offered for loans with similar terms and credit quality. Internal prepayment risk models are used to adjust contractual cash flows.

Management estimates the fair value of impaired loans using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. After evaluating the underlying collateral, the fair value is determined by allocating specific reserves from the allowance for loan losses to the impaired loans.

Loans held for sale — Fair values are derived from secondary market quotations for similar instruments. There were no loans held for sale at December 31, 2017 and 2016.

Deposits — The fair value of checking accounts, saving accounts and money market accounts were the amount payable on demand at the reporting date.

Time certificates — The fair value was determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

Long-term debt and short-term borrowings — These were valued using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar borrowings.

Guaranteed preferred beneficial interest in junior subordinated securities (TRUPs) — These were valued using discounted cash flows. The discount rate was equal to the rate currently offered on similar borrowings.

Subordinated notes — These were valued using discounted cash flows. The discount rate was equal to the rate currently offered on similar borrowings.

Off-balance sheet instruments — The Company charges fees for commitments to extend credit. Interest rates on loans for which these commitments are extended are normally committed for periods of less than one month. Fees charged on standby letters of credit and other financial guarantees are deemed to be immaterial and these guarantees are expected to be settled at face amount or expire unused. It is impractical to assign any fair value to these commitments.

The Company's estimated fair values of financial instruments are presented in the following tables.

December 31, 2017 Description of Asset (dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements Level 1	Level 2	Level 3
Assets					
Investment securities – AFS	$ 68,285	$ 68,285	$ —	$ 68,285	$ —
Investment securities – HTM	99,246	98,007	1,000	97,007	—
FHLB Stock	7,276	7,276	—	7,276	—
Loans Receivable	1,140,615	1,097,592	—	—	1,097,592
Investment in BOLI	29,398	29,398	—	29,398	—
Liabilities					
Savings, NOW and money market accounts	$ 654,632	$ 654,632	$ —	$654,632	$ —
Time deposits	451,605	453,644	—	453,644	—
Long-term debt	55,498	57,421	—	57,421	—
Short term borrowings	87,500	87,208	—	87,208	—
TRUPs	12,000	9,400	—	9,400	—
Subordinated notes	23,000	22,400	—	22,400	—

December 31, 2016 Description of Asset (dollars in thousands)	Carrying Amount	Fair Value	Fair Value Measurements Level 1	Level 2	Level 3
Assets					
Investment securities – AFS	$ 53,033	$ 53,033	$ —	$ 53,033	$ —
Investment securities – HTM	109,247	108,034	850	107,184	—
FHLB Stock	7,235	7,235	—	7,235	—
Loans Receivable	1,079,519	1,066,975	—	—	1,066,975
Investment in BOLI	28,625	28,625	—	28,625	—
Liabilities					
Savings, NOW and money market accounts	$ 606,033	$ 606,033	$ —	$606,033	$ —
Time deposits	432,792	433,242	—	433,242	—
Long-term debt	65,559	66,302	—	66,302	—
Short term borrowings	79,000	78,984	—	78,984	—
TRUPs	12,000	8,100	—	8,100	—
Subordinated notes	23,000	23,000	—	23,000	—

NOTE 20 — FAIR VALUE OF FINANCIAL INSTRUMENTS – (continued)

At December 31, 2017 and 2016, the Company had outstanding loan commitments and standby letters of credit of $65.6 million and $67.0 million, respectively, and $17.9 million and $17.7 million respectively. Additionally, at December 31, 2017 and 2016, customers had $162.2 million and $135.3 million, respectively, available and unused on lines of credit, which include lines of credit for commercial customers, home equity loans as well as builder and construction lines. Based on the short-term lives of these instruments, the Company does not believe that the fair value of these instruments differs significantly from their carrying values.

The fair value estimates presented herein are based on pertinent information available to management as of December 31, 2017 and 2016, respectively. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these financial statements since that date and, therefore, current estimates of fair value may differ significantly from the amount presented herein.

NOTE 21 — CONDENSED FINANCIAL STATEMENTS — PARENT COMPANY ONLY

Balance Sheets

(dollars in thousands)	December 31, 2017	December 31, 2016
Assets		
Cash – noninterest bearing	$ 2,812	$ 2,366
Investment in wholly owned subsidiaries	139,418	136,481
Other assets	4,491	2,017
Total Assets	$146,721	$140,864
Liabilities and Stockholders' Equity		
Current liabilities	$ 1,392	$ 1,066
Guaranteed preferred beneficial interest in junior subordinated debentures	12,372	12,372
Subordinated notes – 6.25%	23,000	23,000
Total Liabilities	36,764	36,438
Stockholders' Equity		
Common stock	46	46
Additional paid in capital	48,209	47,377
Retained earnings	63,648	58,100
Accumulated other comprehensive loss	(1,191)	(928)
Unearned ESOP shares	(755)	(169)
Total Stockholders' Equity	109,957	104,426
Total Liabilities and Stockholders' Equity	$146,721	$140,864

Condensed Statements of Income

(dollars in thousands)	Years Ended December 31, 2017	2016	2015
Interest and Dividend Income			
Dividends from subsidiary	$ 7,500	$ 5,500	$ 2,775
Interest income	64	19	51
Interest expense	1,865	1,795	1,599
Net Interest Income	5,699	3,724	1,227
Miscellaneous expenses	(2,968)	(2,110)	(1,421)
Income (loss) before income taxes and equity in undistributed net income of subsidiary	2,731	1,614	(194)
Federal and state income tax benefit	1,583	1,321	1,009
Equity in undistributed net income of subsidiary	2,894	4,396	5,528
Net Income	$ 7,208	$ 7,331	$ 6,343
Preferred stock dividends	—	—	23
Net Income Available to Common Shareholders	$ 7,208	$ 7,331	$ 6,320

Condensed Statements of Cash Flows

(dollars in thousands)	Years Ended December 31, 2017	2016	2015
Cash Flows from Operating Activities			
Net income	$ 7,208	$ 7,331	$ 6,343
Adjustments to reconcile net income to net cash provided by operating activities			
Equity in undistributed earnings of subsidiary	(2,894)	(4,396)	(5,528)
Stock based compensation	515	489	139
(Increase) in other assets	(2,446)	(145)	(284)
(Increase) decrease in deferred income tax benefit	(29)	55	23
Increase (decrease) in current liabilities	327	(157)	459
Net Cash Provided by Operating Activities	2,681	3,177	1,152
Cash Flows from Financing Activities			
Dividends paid	(1,804)	(1,814)	(1,916)
Capital (to) from subsidiary	—	180	(78)
Proceeds from Subordinated Notes	—	—	23,000
Redemption of Small Business Lending Fund Preferred Stock	—	—	(20,000)
Exercise of stock options	155	—	—
Net change in unearned ESOP shares	(586)	147	146
Repurchase of common stock	—	(865)	(1,827)
Net Cash Used in Financing Activities	(2,235)	(2,352)	(675)
Increase in Cash	446	825	477
Cash at Beginning of Year	2,366	1,541	1,064
Cash at End of Year	$ 2,812	$ 2,366	$ 1,541

NOTE 22 — QUARTERLY FINANCIAL COMPARISON (Unaudited)

	2017			
(dollars in thousands)	**Fourth Quarter**	**Third Quarter**	**Second Quarter**	**First Quarter**
Interest and dividend income	$13,573	$13,680	$13,395	$12,922
Interest expense	2,800	2,672	2,462	2,248
Net interest income	10,773	11,008	10,933	10,674
Provision for loan losses	30	224	376	380
Net interest income after provision	10,743	10,784	10,557	10,294
Noninterest income	1,000	1,157	1,052	875
Noninterest expense	7,746	7,442	7,530	7,379
Income before income taxes	3,997	4,499	4,079	3,790
Provision for income taxes	4,456	1,717	1,536	1,448
Net (Loss) Income Available to Common Stockholders	**$ (459)**	**$ 2,782**	**$ 2,543**	**$ 2,342**
Earnings Per Common Share[(1)]				
Basic	$ (0.10)	$ 0.60	$ 0.55	$ 0.51
Diluted	$ (0.10)	$ 0.60	$ 0.55	$ 0.51

	2016			
(dollars in thousands)	**Fourth Quarter**	**Third Quarter**	**Second Quarter**	**First Quarter**
Interest and dividend income	$12,584	$12,223	$11,928	$11,312
Interest expense	2,111	2,079	2,033	1,919
Net interest income	10,473	10,144	9,895	9,393
Provision for loan losses	670	698	564	427
Net interest income after provision	9,803	9,446	9,331	8,966
Noninterest income	891	842	777	850
Noninterest expense	7,316	7,311	7,292	7,240
Income before income taxes	3,378	2,977	2,816	2,576
Provision for income taxes	1,356	1,014	1,078	968
Net Income Available to Common Stockholders	**$ 2,022**	**$ 1,963**	**$ 1,738**	**$ 1,608**
Earnings Per Common Share[(1)]				
Basic	$ 0.44	$ 0.43	$ 0.38	$ 0.35
Diluted	$ 0.44	$ 0.42	$ 0.38	$ 0.35

NOTE 22 — QUARTERLY FINANCIAL COMPARISON (Unaudited) – (continued)

(dollars in thousands)	2015 Fourth Quarter	Third Quarter	Second Quarter	First Quarter
Interest and dividend income	$11,208	$11,002	$10,935	$10,728
Interest expense	1,860	1,918	1,902	1,665
Net interest income	9,348	9,084	9,033	9,063
Provision for loan losses	362	501	392	178
Net interest income after provision	8,986	8,583	8,641	8,885
Noninterest income	909	466	962	962
Noninterest expense	7,556	7,031	6,888	6,943
Income before income taxes	2,339	2,018	2,715	2,904
Provision for income taxes	811	735	1,004	1,083
Net Income (NI)	**$ 1,528**	**$ 1,283**	**$ 1,711**	**$ 1,821**
Preferred stock dividends	—	—	—	23
NI Available to Common Stockholders	**$ 1,528**	**$ 1,283**	**$ 1,711**	**$ 1,798**
Earnings Per Common Share(1)				
Basic	$ 0.33	$ 0.28	$ 0.37	$ 0.38
Diluted	$ 0.33	$ 0.27	$ 0.37	$ 0.38

(1) Earnings per share are based upon quarterly results and, when added, may not total the annual earnings per share amounts.

NOTE 23 — SUBSEQUENT EVENTS

County First Acquisition

On January 1, 2018, the Company completed its previously announced merger of County First Bank (''County First'') with and into the Bank, with the Bank as the surviving bank (the ''Merger'') pursuant to the Agreement and Plan of Merger, dated as of July 31, 2017, by and among the Company, the Bank and County First. Pursuant to the Merger Agreement, at the effective time of the Merger (the ''Effective Time''), each share of common stock, par value $1.00 per share, of County First issued and outstanding immediately prior to the Effective Time was converted into the right to receive 0.9543 shares of Company common stock and $2.20 in cash (the ''Merger Consideration''). The $2.20 in cash represents the sum of (i) $1.00 in cash consideration (the ''Cash Consideration'') plus (ii) $1.20 in Contingent Cash Consideration that was determined before the completion of the Merger in accordance with the terms of the Merger Agreement. The aggregate merger consideration consisted of approximately 919,000 shares of the Company's common stock and approximately $2.1 million in cash. Based upon the $38.78 per share closing price of the Company's common stock on December 28, 2017, the transaction value was approximately $37.7 million.

The County First Bank acquisition is being accounted for under the acquisition method of accounting with the Company treated as the acquirer. Under the acquisition method of accounting, the assets and liabilities of County First Bank, as of January 1, 2018, will be recorded by the Company at their respective fair values, and the excess of the merger consideration over the fair value of County First Bank's net assets will be allocated to goodwill. At December 31, 2017, County First had total assets of approximately $227 million (Unaudited), total loans of $143 million (Unaudited) and total deposits of $200 million (Unaudited). County First has five branch offices in La Plata, Waldorf, New Market, Prince Frederick and California, Maryland. The Bank intends to keep the La Plata branch open and consolidate the remaining four branches with legacy Community Bank of the Chesapeake branch offices in May of 2018. The calculations to determine fair values were not complete at the time of filing of the 2017 Annual Report on Form 10-K. Until the determination of the fair values is complete, it is impractical to include disclosures related to the fair value of the assets acquired and liabilities assumed as required by the accounting guidance.

Merger related costs, which included mainly professional fees and investment banking costs, for the year ended December 31, 2017 were $829,000.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

The Community Financial Corporation's (the ''Company'') independent registered public accounting firm, Stegman & Company, announced that effective June 1, 2016 substantially all directors and employees of Stegman & Company joined Dixon Hughes Goodman LLP. As a result, effective June 1, 2016 Stegman & Company resigned as the Company's independent registered public accounting firm. The Audit Committee of the Company's Board of Directors engaged Dixon Hughes Goodman to serve as the Company's independent registered public accounting firm effective June 1, 2016.

The reports of Stegman & Company on the audits of the consolidated financial statements of the Company as of and for the years ended December 31, 2015 and 2014, and audit of internal control over financial reporting as of December 31, 2015, did not contain an adverse opinion or a disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company's fiscal years ended December 31, 2015 and 2014 and the subsequent interim period through June 1, 2016, there were (i) no disagreements (as such term is used in Item 304(a)(1)(iv) of Regulation S-K) between the Company and Stegman & Company on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreement(s), if not resolved to the satisfaction of Stegman & Company, would have caused Stegman & Company to make reference to the subject matter of the disagreement(s) in connection with its report on the Company's financial statements and (ii) no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

During the Company's fiscal years ended December 31, 2015 and 2014 and the subsequent interim period through the engagement of Dixon Hughes Goodman on June 1, 2016, the Company did not consult with Dixon Hughes Goodman regarding any of the matters set forth in Items 304(a)(2)(i) and (ii) of Regulation S-K.

Item 9A. Controls and Procedures

(a) Disclosure Controls and Procedures

The Company's management, including the Company's principal executive officer and principal financial officer, have evaluated the effectiveness of the Company's ''disclosure controls and procedures,'' as such term is defined in Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended, (the ''Exchange Act''). Based upon their evaluation, the principal executive officer and principal financial officer concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were effective for the purpose of ensuring that the information required to be disclosed in the reports that the Company files or submits under the Exchange Act with the Securities and Exchange Commission (the ''SEC'') (1) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (2) is accumulated and communicated to the Company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

(b) Internal Controls Over Financial Reporting

Management's annual report on internal control over financial reporting is provided at Item 8 in this 10K.

(c) Changes to Internal Control Over Financial Reporting

Except as indicated herein, there were no changes in the Company's internal control over financial reporting during the three months ended December 31, 2017 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B. Other Information

Not applicable.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

For information concerning the Company's directors, the information contained under the section captioned *"Items to be voted on by Stockholders — Item 1 — Election of Directors"* in the Company's definitive proxy statement for the Company's 2017 Annual Meeting of Stockholders (the "Proxy Statement") is incorporated herein by reference. For information concerning the executive officers of the Company, see *"Item 1 — Business — Executive Officers of the Registrant"* under Part I of this Annual Report on Form 10-K.

For information regarding compliance with Section 16(a) of the Exchange Act, the cover page of this Annual Report on Form 10-K and the information contained under the section captioned *"Other Information Relating to Directors and Executive Officers Section 16(a) Beneficial Ownership Reporting Compliance"* in the Proxy Statement are incorporated herein by reference.

For information concerning the Company's code of ethics, the information contained under the section captioned *"Corporate Governance — Code of Ethics"* in the Proxy Statement is incorporated by reference. A copy of the code of ethics and business conduct is filed as Exhibit 14 hereto and is available to stockholders within the "Investor Relations" section of the Bank's website under the tabs "Investor Resources", "Proxy and Annual Report, Committee Charters and Code of Ethics", and Code of Ethics.

For information regarding the audit committee and its composition and the audit committee financial expert, the section captioned *"Corporate Governance — Committees of the Board of Directors — Audit Committee"* in the Proxy Statement is incorporated by reference.

Item 11. Executive Compensation

For information regarding executive compensation, the information contained under the sections captioned *"Executive Compensation", "Directors' Compensation"* and *"Pay Ratio Disclosure"* in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

(a) Security Ownership of Certain Owners

The information required by this item is incorporated herein by reference to the section captioned *"Principal Holders of Voting Securities"* in the Proxy Statement.

(b) Security Ownership of Management

Information required by this item is incorporated herein by reference to the section captioned *"Principal Holders of Voting Securities"* in the Proxy Statement.

(c) Changes in Control

Management of the Company knows of no arrangements, including any pledge by any person of securities of the Company, the operation of which may, at a subsequent date, result in a change in control of the registrant.

(d) Equity Compensation Plan Information

The Company's Tri-County 2005 Equity Compensation Plan was terminated in May 2015 and replaced with the 2015 Equity Compensation Plan (the "2015 Plan"). The 2015 Plan was approved by shareholders, which authorizes the issuance of restricted stock, stock appreciation rights, stock units and stock options to the Board of Directors and key employees. There were no outstanding options issued under any plan as of December 31, 2017.

Item 13. Certain Relationships, Related Transactions and Director Independence

The information regarding certain relationships and related transactions, the section captioned *"Other Information Relating to Directors and Executive Officers — Policies and Procedures for Approval and Related Parties Transactions and Relationships and Transactions with the Company and the Bank"* in the Proxy Statement is incorporated herein by reference.

For information regarding director independence, the section captioned *"Proposal 1 — Election of Directors"* in the Proxy Statement is incorporated by reference.

Item 14. Principal Accountant Fees and Services

The information required by this item is incorporated herein by reference to the section captioned *"Audit Related Matters — Audit Fees"* and *"— an Pre-Approval of Services by the Independent Registered Public Accounting Firm"* in the Proxy Statement.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a) List of Documents Filed as Part of this Report

(1) *Financial Statements.* The following consolidated financial statements and notes related thereto are incorporated by reference from Item 8 hereof:

(2) *Financial Statement Schedules.* All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are omitted because of the absence of conditions under which they are required or because the required information is included in the consolidated financial statements and related notes thereto.

(3) *Exhibits.* The following is a list of exhibits filed as part of this Annual Report on Form 10-K and is also the Exhibit Index.

Exhibit No	Description	Incorporated by Reference to
2.1	Agreement and Plan of Merger dated as of July 31, 2017 by and among The Community Financial Corporation, Community Bank of the Chesapeake and County First Bank	Form 8-K as filed on August 1, 2017
3.1	Articles of Incorporation of as Amended and Restated of The Community Financial Corporation	Form S-4 (Registration No. 333-220455).
3.2	Amended and Restated Bylaws of The Community Financial Corporation	Form 8-K as filed on March 25, 2016.
4.1	Amended and Restated Articles Supplementary establishing Senior Non-cumulative Perpetual Preferred Stock, Series C, of Tri-County Financial Corporation	Form 8-K as filed on September 23, 2011.
4.2	Form of Subordinated Indenture between The Community Financial Corporation and Wilmington Trust, National Association, as Trustee	Form 8-K as filed on February 4, 2015.
4.3	Form of First Supplemental Indenture between The Community Financial Corporation and Wilmington Trust, National Association, as Trustee	Form 8-K as filed on February 4, 2015.
4.4	Form of Global Note to represent the 6.25% Fixed to Floating Rate Subordinated Notes due 2025 (included in Exhibit 4.3)	Form 8-K as filed on February 4, 2015.

Exhibit No	Description	Incorporated by Reference to
10.4*	Community Bank of the Chesapeake Executive Incentive Compensation Plan, as amended and restated	Form 8-K as filed on February 10, 2016.
10.5*	Community Bank of the Chesapeake Retirement Plan for Directors, as amended and restated	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.6*	Split Dollar Agreement with Michael L. Middleton	Form 10-K for the year ended December 31, 2000 as filed on March 30, 2001.
10.7*	Split Dollar Agreement with William J. Pasenelli dated April 12, 2001	Form 10-K for the year ended December 31, 2001 as filed on April 1, 2002.
10.8*	Salary Continuation Agreement with Michael L. Middleton, dated September 6, 2003	Form 10-K for the year ended December 31, 2003 as filed on March 26, 2004.
10.9*	First Amendment to the Salary Continuation Agreement, dated September 6, 2003, with Michael L. Middleton	Form 10-K for the year ended December 31, 2008 as filed on March 9, 2009.
10.10*	Tri-County Financial Corporation 2005 Equity Compensation Plan	Definitive Proxy Statement as filed on April 11, 2005.
10.11*	Amendment No. 1 to the Tri-County Financial Corporation 2005 Equity Compensation Plan	Form 10-Q for the quarter ended September 30, 2007 as filed on November 13, 2007.
10.12*	Community Bank of the Chesapeake Executive Deferred Compensation Plan, as amended and restated	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.13*	Amended and Restated Employment Agreement by and among Community Bank of Tri-County, William J. Pasenelli and Tri-County Financial Corporation, as guarantor	Form 10-Q for the quarter ended March 31, 2007 as filed on May 11, 2007.
10.14*	First Amendment to the Employment Agreement, dated April 20, 2007, with William J. Pasenelli	Form 10-Q for the quarter ended June 30, 2013 as filed on August 14, 2013.
10.15*	Supplemental Executive Retirement Plan Agreement, dated January 1, 2011 and First Amendment to the Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with William J. Pasenelli	Form 10-Q for the quarter ended June 30, 2013 as filed on August 14, 2013.
10.16*	Amended and Restated Employment Agreement by and among Community Bank of Tri-County, Gregory C. Cockerham and Tri-County Financial Corporation, as guarantor	Form 10-Q for the quarter ended March 31, 2007 as filed on May 11, 2007.
10.17*	Supplemental Executive Retirement Plan Agreement, dated January 1, 2011 and First Amendment to the Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with Gregory C. Cockerham	Form 10-Q for the quarter ended June 30, 2013 as filed on August 14, 2013.
10.18*	Salary Continuation Agreement with Gregory C. Cockerham, dated August 21, 2006	Form 10-Q for the quarter ended September 30, 2006 as filed on November 14, 2006.

Exhibit No	Description	Incorporated by Reference to
10.19*	First Amendment to the Salary Continuation Agreement, dated August 21, 2006, with Gregory C. Cockerham	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.20*	Second Amendment to the Salary Continuation Agreement, dated August 21, 2006, with Gregory C. Cockerham	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.21*	Salary Continuation Agreement with William J. Pasenelli, dated August 21, 2006	Form 10-Q for the quarter ended September 30, 2006 as filed on November 14, 2006.
10.22*	First Amendment to the Salary Continuation Agreement, dated August 21, 2006, with William J. Pasenelli	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.23*	Second Amendment to the Salary Continuation Agreement, dated August 21, 2006, with William J. Pasenelli	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.26*	Form of Letter Agreement between Tri-County Financial Corporation and each of Michael L. Middleton, Gregory C. Cockerham and William J. Pasenelli	Form 8-K as filed on September 23, 2011.
10.27*	Salary Continuation Agreement between Gregory C. Cockerham and Community Bank of Tri-County, dated September 6, 2003, as amended on December 22, 2008	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.28*	Salary Continuation Agreement between William J. Pasenelli and Community Bank of Tri-County, dated September 6, 2003, as amended on June 11, 2004 and December 22, 2008	Form 10-K/A for the year ended December 31, 2008 as filed on April 20, 2009.
10.29*	Employment Agreement with Michael L. Middleton dated July 1, 2014	Form 10-K/A for the year ended December 31, 2014 as filed on March 17, 2015.
10.30*	Supplemental Executive Retirement Plan agreement, dated November 1, 2014 with William J. Pasenelli	Form 10-K/A for the year ended December 31, 2014 as filed on March 17, 2015.
10.31*	Supplemental Executive Retirement Plan Agreement, dated November 1, 2014 with Gregory C. Cockerham	Form 10-K/A for the year ended December 31, 2014 as filed on March 17, 2015.
10.32*	The Community Financial Corporation 2015 Equity Compensation Plan	Definitive Proxy Statement as filed on March 25, 2015.
10.33*	Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, with Todd L. Capitani, as amended	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.34*	Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, with James Burke, as amended	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.35*	Supplemental Executive Retirement Plan Agreement, dated November 1, 2014, with Todd L. Capitani	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.

Exhibit No	Description	Incorporated by Reference to
10.36*	Supplemental Executive Retirement Plan Agreement, dated November 1, 2014, with James Burke	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.37*	Split Dollar Agreement with Todd L. Capitani dated March 3, 2011	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.38*	Split Dollar Agreement with James Burke dated March 15, 2011	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.39*	Employment Agreement with Todd L. Capitani dated April 23, 2013	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.40*	Employment Agreement James Burke dated April 20, 2007, as amended on November 24, 2008 and April 23, 2013	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.41*	Salary Continuation Agreement between James M. Burke and Community Bank of Tri-County, dated August 21, 2006, as amended on April 13, 2007 and December 30, 2007	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.42*	Supplemental Executive Retirement Plan agreement, dated January 1, 2011, with Michael L. Middleton	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.43*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and Michael L. Middleton dated January 12, 2004	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.44*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and William J. Pasenelli dated January 12, 2004	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.45*	Split Dollar Agreement with William J. Pasenelli dated March 15, 2011	Form 10-K for the year ended December 31, 2015 as filed on March 10, 2016.
10.46*	Consulting Agreement, effective July 1, 2016, by and between Community Bank of the Chesapeake and Michael L. Middleton	Form 8-K as filed on July 5, 2016.
10.47	Agreement dated March 25, 2016, by and between Community Financial Corporation and Basswood Capital Management, LLC	Form 8-K as filed on March 25, 2016.
10.48*	Split Dollar Agreement with Gregory C. Cockerham dated April 5, 2011	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
10.49*	Supplemental Life Insurance Agreement between Community Bank of Tri-County and Gregory C. Cockerham dated January 12, 2004	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
10.50*	Employment Agreement with James F. Di Misa dated April 20, 2007, as amended on November 24, 2008 and April 23, 2013	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
10.51*	Salary Continuation Agreement between James F. Di Misa and Community Bank of Tri-County, dated August 21, 2006, as amended on April 16, 2007 and December 30, 2007	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.

Exhibit No	Description	Incorporated by Reference to
10.52*	Supplemental Executive Retirement Plan Agreement, dated January 1, 2011, with James F. Di Misa, as amended	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
10.53*	Supplemental Executive Retirement Plan Agreement, dated November 1, 2014, with James F. Di Misa	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
10.54*	Split Dollar Agreement with James F. Di Misa dated March 15, 2011	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
14.0	Code of Ethics	Form 10-K for the year ended December 31, 2016 as filed on March 13, 2017.
21.0	List of Subsidiaries	
23.1	Consent of Dixon Hughes Goodman LLP	
23.2	Consent of Stegman & Company	
31.1	Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer	
31.2	Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer	
32.0	Section 1350 Certification of Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer	
101.0	The following materials from the Company's Annual Report on Form 10-K for the year ended December 31, 2017, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Income and Comprehensive Income, (iii) the Consolidated Statements of Changes In Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows and (v) the Notes in the Consolidated Financial Statements.	

(*) Management contract or compensating arrangement.

(b) Exhibits. The exhibits required by Item 601 of Regulation S-K are either filed as part of this Annual Report on Form 10-K or incorporated by reference herein.

(c) Financial Statements and Schedules Excluded From Annual Report. There are no other financial statements and financial statement schedules which were excluded from this Annual Report pursuant to Rule 14a-3(b)(1) which are required to be included herein.

Item 16. Form 10-K Summary

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

THE COMMUNITY FINANCIAL CORPORATION

Date: March 12, 2018

By: /s/ William J. Pasenelli
William J. Pasenelli
President and Chief Executive Officer
(Duly Authorized Representative)

Pursuant to the requirement of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Michael L. Middleton
Michael L. Middleton
Director, Chairman of the Board
Date: March 12, 2018

By: /s/ William J. Pasenelli
William J. Pasenelli
Director, Vice-Chairman of the Board
President and Chief Executive Officer
(Principal Executive Officer)
Date: March 12, 2018

By: /s/ Todd L. Capitani
Todd L. Capitani
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)
Date: March 12, 2018

By: /s/ Austin J. Slater, Jr.
Austin J. Slater, Jr.
Director
Date: March 12, 2018

By: /s/ Louis P. Jenkins, Jr
Louis P. Jenkins, Jr.
Director
Date: March 12, 2018

By: /s/ Kathryn M. Zabriskie
Kathryn M. Zabriskie
Director
Date: March 12, 2018

By: /s/ John K. Parlett, Jr
John K. Parlett, Jr
Director
Date: March 12, 2018

By: /s/ Joseph V. Stone, Jr.
Joseph V. Stone, Jr.
Director
Date: March 12, 2018

By: /s/ Mary Todd Peterson
Mary Todd Peterson
Director
Date: March 12, 2018

By: /s/ M. Arshed Javaid
M. Arshed Javaid
Director
Date: March 12, 2018

By: /s/ Edward Lawrence Sanders, III
Edward Lawrence Sanders, III
Director
Date: March 12, 2018

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