Section 1: 10-K (FORM 10-K)

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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, 2018

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

For the transition period from ______ to ______

Commission file number 333-158525

HomeTown Bankshares Corporation
(Exact name of registrant as specified in its charter)

Virginia **(State or other jurisdiction of incorporation or organization)**	**26-4549960** **(I.R.S. Employer Identification No.)**
202 South Jefferson Street **Roanoke, Virginia** **(Address of principal executive offices)**	**24011** **(Zip Code)**

Registrant's telephone number, including area code (540) 345-6000

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

Title of each class	**Name of each exchange on which registered**
Common Stock, $5.00 par value per share	**The NASDAQ Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $5.00 par value per share

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

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

Indicate by check mark 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, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☐	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 ☒

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2018. $73,767,163, based on $14.0628 per share.

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date 5,815,623 shares outstanding as of March 14, 2019.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the American National Bankshares Inc. and HomeTown Bankshares Corporation joint proxy statement to be delivered to shareholders in connection with the Special Meeting of Shareholders to be held March 19, 2019 are incorporated by reference in Part III.

HOMETOWN BANKSHARES CORPORATION

FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2018

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PART I

ITEM 1. BUSINESS.

Overview and History

General

HomeTown Bankshares Corporation (the “Company”, “HomeTown Bankshares”) was incorporated in the Commonwealth of Virginia on December 8, 2008. On September 4, 2009, the Company acquired all of the outstanding shares of HomeTown Bank in a one for one exchange of stock.

The Company is authorized as a bank holding company. The holding company structure provides greater flexibility than a bank standing alone because it allows expansion and diversification of business activities through subsidiaries or through acquisitions. HomeTown Bankshares Corporation’s business is conducted through its wholly-owned subsidiary, HomeTown Bank.

On October 1, 2018, the Company and American National Bankshares, Inc. (“American National”) announced a definitive agreement to combine in a strategic merger (the “Merger Agreement”) pursuant to which the Company will merge with and into American National (the “Merger”). As a result of the Merger, the holders of shares of the Company's common stock will receive 0.4150 shares of American National common stock for each share of the Company's common stock held immediately prior to the effective date of the Merger. The transaction is expected to be completed in the second quarter of 2019, subject to approval of both companies' shareholders, regulatory approvals and other customary closing conditions.

HomeTown Bank

HomeTown Bank (the “Bank”) is a Virginia banking corporation headquartered in Roanoke, Virginia. The Bank was incorporated under the laws of the Commonwealth of Virginia as a state chartered bank in 2004 and began banking operations in November 2005. The Bank was organized to engage in general retail and commercial banking business.

The Bank opened for business on November 14, 2005 and was capitalized by more than 2,000 shareholders who wanted a new local bank dedicated to customer service. These investors provided the initial customer base and are integral to the success of the Bank. Management believes that the key to the Bank’s success lies in providing Bank customers with personalized service from experienced banking professionals while providing innovative, highly competitive and convenient products and services that meet their banking needs. In 2013 the Bank began operating a mortgage joint venture with another entity. The Bank’s ownership interest in HomeTown Residential Mortgage, LLC is 49%. Due to the marketing support and direction provided by HomeTown Bank to HomeTown Residential Mortgage LLC, along with guarantees of warehouse lines of credit used in its operation, the Company is deemed to exercise control of this entity. The ownership interest in HomeTown Residential Mortgage LLC not owned by the Company is reported as a Non-Controlling Interest in a Consolidated Subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

The Bank is a community-oriented financial institution that provides varied banking services to individuals, small and medium-sized businesses, and larger companies. The Bank provides a full range of services to meet the financial needs of its customers and strives to provide its customers with innovative products while maintaining the prompt response and the high level of service of a community bank. Management believes this operating strategy has particular appeal in the Bank’s market area. Management believes that the combination of local ownership and size allows the Bank to offer services and products specifically tailored to the needs of the community. The Bank’s Principal Office is located at 202 S. Jefferson Street, Roanoke, Virginia. The Bank maintains its primary website at www.hometownbank.com.

Principal Products of the Bank

The Bank offers a full range of banking services to small and medium-size businesses, real estate investors and developers, private investors, professionals and individuals. In addition to its main office, the Company has full-service offices in Franklin County, Virginia at Westlake, in the town of Christiansburg, Virginia at 2950 Market Street, in Roanoke County, Virginia at the intersection of Colonial Avenue and Virginia Route 419, in the City of Roanoke, Virginia at 3521 Franklin Road, and in the City of Salem, at 852 West Main Street.

Deposit Services. The Bank offers a full range of deposit services that are typically available in most banks, savings banks and credit unions including checking accounts, savings accounts and other time deposits of various types, ranging from daily money market accounts to longer-term certificates of deposit. From the beginning, the Bank has focused on convenience, innovation, and value. The transaction accounts and time certificates are tailored to the Bank’s market area at rates competitive to those offered in the area. In addition, the Bank offers its customers Individual Retirement Accounts (IRAs). All deposit accounts are insured by the Federal Deposit Insurance Corporation (the “FDIC”) up to the maximum amount allowed by law (generally, $250,000 per depositor, subject to aggregation rules). The Bank solicits such accounts from individuals, businesses, and associations and organizations.

The Bank also participates in the Certificate of Deposit Account Registry Service ("CDARS") and Insured Cash Sweep ("ICS"). CDARS and ICS enable the Bank to offer our deposit customers access to FDIC insurance in amounts exceeding the existing FDIC limit. This permits our institution to better attract and retain large deposits from businesses, nonprofit organizations, individuals and other customers that require an assurance of safety.

Lending Services. The Bank also offers a full range of short-to-medium term commercial and personal loans. Commercial loans include both secured and unsecured loans for working capital (including inventory and receivables), business expansion (including acquisition of real estate and improvements), and purchase of equipment and machinery. Consumer loans and lines of credit include secured and unsecured loans for financing automobiles, home improvements, education and personal investments. Additionally, the Bank originates fixed and floating-rate mortgage loans and real estate construction and acquisition loans.

Consumer Residential Mortgage Origination. The Bank has expanded their residential mortgage origination operations over the last few years. Initially, the Bank originated loans as a representative for mortgage companies. Then, in February, 2012, the Bank opened a dedicated mortgage office, on Colonial Avenue, next to the existing branch office. In 2013 HomeTown Bank entered into a joint venture agreement with a mortgage company as 49% owner of HomeTown Residential Mortgage, LLC. The new entity began operations at the end of 2013, absorbing the Bank's mortgage office employees and continued working from the Colonial Avenue office. The mortgage office operates under the name HomeTown Mortgage and coordinates the Bank's existing mortgage services and offers mortgages, refinancing, and other services. In 2016, an additional mortgage banker was hired and is based at the Christiansburg branch in order to better serve the New River Valley market. Loans originated are conforming home mortgages in its market area, as defined below. As part of the Bank's overall risk management strategy, loans originated and closed by the mortgage office are pre-sold to major national mortgage banking or financial institutions. In addition to creating customer relationships and the opportunity to sell other products and services, the bank receives fee income for this service.

Investment Services. HomeTown Investment Services, Inc., opened in April 2013, provides diverse investment products and financial advisory services to existing and prospective customers. These products and services provide another source of revenue for the Company. Investment and insurance products and services are offered through an unaffiliated entity LPL Financial, Member FINRA/SIPC. HomeTown Investment Services, Inc. is a subsidiary of the Bank. Products and services made available through LPL Financial are not insured by the FDIC or any other agency of the United States and are not deposits or obligations of nor guaranteed or insured by any bank or bank affiliate. These products are subject to investment risk, including the possible loss of value. Revenue from investment services is comprised mostly of fees based upon the market value of the accounts under administration as well as commissions on investment transactions.

Private Banking. At the end of 2015, the Bank began offering personalized banking solutions to work with customers to clarify financial goals and bring together professionals to satisfy their investment, credit and other financial needs. Revenue from private banking management activities is comprised mostly of interest income earned on loans and service charges and fees from deposit products.

Merchant Card Services. The Bank offers comprehensive payment processing solutions giving businesses the ability to accept all major credit cards, either at a terminal, online, via a mobile device or tablet, or over the phone.

Other Services. Other services offered by the Bank include safe deposit boxes, traveler's checks, and direct deposit of payroll, and social security checks, automatic drafts for various accounts, overdraft protection, check cards, and credit cards. The Bank also has become associated with a shared network of automated teller machines (ATMs) that may be used by Bank customers throughout the world. The Bank intends to introduce new products and services as permitted by the regulatory authorities or desired by the public. The Bank remains committed to meeting the challenges that require technology. The Bank provides its customers with access to the latest technological products, such as internet banking, including on-line bill pay and mobile banking. The services allow customers to handle routine transactions using the internet at the Bank's website www.hometownbank.com or on their mobile phones.

Market Area

The Bank's market area primarily consists of the City of Roanoke, Roanoke County, and the City of Salem, Virginia and contiguous counties, including Botetourt, Bedford, Franklin and Montgomery. Total population in the market area is approximately 450,000. The area is serviced by one daily newspaper, at least 6 weekly, multi-weekly or bi-weekly newspapers and a number of radio and television stations providing diverse media outlets. The City of Roanoke and Roanoke County, the location of three of the Bank's offices, has the largest population base, with approximately 190,000 persons. The Roanoke market area is diversified by industry groups with services, retail trade, manufacturing, construction, transportation, utilities, finance, insurance and real estate. Roanoke is a regional center for banking, medicine and the legal and business professional community. Carilion Clinic, Veterans Affairs, Kroger, and HCA Virginia Health System are among Roanoke's largest private employers. Other major employers are the local school boards, municipal governments, and universities including Virginia Tech, Roanoke College, and Hollins University.

Employees

As of December 31, 2018, the Company had 97 employees, including 97 full-time equivalent employees. None of its employees are represented by any collective bargaining agreements, and relations with employees are considered positive.

Governmental Monetary Policies

The earnings and growth of the Company are affected not only by general economic conditions, but also by the monetary policies of various governmental regulatory authorities, particularly the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Federal Reserve Board implements national monetary policy by its open market operations in United States government securities, control of the discount rate and establishment of reserve requirements against both member and nonmember financial institutions' deposits. These actions have a significant effect on the overall growth and distribution of loans, investments and deposits, as well as the rates earned on loans, or paid on deposits. Management of the Company is unable to predict the effect of possible significant changes in monetary policies upon the future operating results of the Company.

Competition

The Company competes as a financial intermediary with other commercial banks, savings banks, credit unions, mortgage banking firms, consumer finance companies, securities brokerage firms, insurance companies, money market mutual funds and other financial institutions operating in the Roanoke market area and elsewhere. Many of the Company's nonbank competitors are not subject to the same extensive federal regulations that govern federally insured banks and state regulations governing state chartered banks. As a result, such nonbank competitors may have certain advantages over the Company in providing certain services.

Increased competition has come from out-of-state banks through their acquisition of Virginia-based banks and interstate branching, and expansion of community and regional banks into our service areas. Consequently, the Company's market area is a highly competitive, highly branched banking market. Competition, for loans to individuals, small businesses, and professional concerns, is keen in the Company's target market, and pricing is important. Most of the Company's competitors have substantially greater resources and lending limits than the Company and offer certain services, such as extensive and established branch networks and trust services that the Company is not currently providing. Moreover, larger institutions operating in the Roanoke market area have access to borrowed funds at a lower cost than are presently available to the Company. Deposit competition is strong and comes from institutions in the market, U.S. Government securities, private issuers of debt obligations, and suppliers of other investment alternatives for depositors, among other sources.

Cyber Security

In the ordinary course of business, the Company collects and stores sensitive data, including proprietary business information and personally identifiable information of its customers and employees in systems and on networks. The secure processing, maintenance and use of this information is critical to operations and the Company's business strategy. The Company has invested in accepted technologies, and continually reviews processes and practices that are designed to protect its networks, computers and data from damage or unauthorized access. Despite these security measures, the Company's computer systems and infrastructure may be vulnerable to attacks by hackers or breached due to employee error, malfeasance or other disruptions. A breach of any kind could compromise systems and the information stored there could be accessed, damaged or disclosed. A breach in security could result in legal claims, regulatory penalties, disruption in operations, and damage to the Company's reputation, which could adversely affect our business.

Supervision and Regulation

HomeTown Bankshares Corporation

HomeTown Bankshares is a bank holding company organized under the Federal Bank Holding Company Act of 1956 ("BHCA"), which is administered by the Federal Reserve Board. HomeTown Bankshares is required to file an annual report with the Federal Reserve Board and may be required to furnish additional information pursuant to the BHCA. The Federal Reserve Board is authorized to examine HomeTown Bankshares and its subsidiary.

The Bank Holding Company Act. Under the BHCA, a bank holding company is generally prohibited from engaging in nonbanking activities unless the Federal Reserve Board has found those activities to be incidental to banking. Bank holding companies also may not acquire more than 5% of the voting shares of any company engaged in nonbanking activities. With some limited exceptions, the BHCA requires a bank holding company to obtain prior approval from the Federal Reserve Board before acquiring or merging with a bank or before acquiring more than 5% of the voting shares of a bank unless it already controls a majority of shares.

Virginia State Corporation Commission. All Virginia bank holding companies are required to register with the Virginia State Corporation Commission (the "Commission"). HomeTown Bankshares is required to report to the Commission with respect to financial condition, operations and management. The Commission may also make examinations of any bank holding company and its subsidiaries.

The Gramm-Leach-Bliley Act. The Gramm-Leach-Bliley Act of 1999 ("GLBA") permits significant combinations among different sectors of the financial services industry, allows for expansion of financial service activities by bank holding companies and offers financial privacy protections to consumers. GLBA preempts most state laws that prohibit financial holding companies from engaging in insurance activities. GLBA permits affiliations between banks and securities firms in the same holding company structure, and it permits financial holding companies to directly engage in a broad range of securities and merchant banking activities. HomeTown Bankshares is not a financial holding company.

The Sarbanes-Oxley Act. The Sarbanes-Oxley Act of 2002 ("SOX") enacted sweeping reforms of the federal securities laws intended to protect investors by improving the accuracy and reliability of corporate disclosures. It impacts all companies with securities registered under the Securities Exchange Act of 1934, including HomeTown Bankshares. SOX creates increased responsibilities for chief executive officers and chief financial officers with respect to the content of filings with the Securities and Exchange Commission. Section 404 of SOX and related Securities and Exchange Commission rules focused increased scrutiny by internal and external auditors on HomeTown Bankshares' systems of internal controls over financial reporting, which is designed to insure that those internal controls are effective in both design and operation. SOX sets out enhanced requirements for audit committees, including independence and expertise, and it includes stronger requirements for auditor independence and limits the types of non-audit services that auditors can provide. Finally, SOX contains additional and increased civil and criminal penalties for violations of securities laws.

Capital Requirements. The Federal Reserve Board adopted risk-based capital guidelines that are applicable to HomeTown Bankshares. The guidelines provide that the Company must maintain a minimum ratio of 8% of qualified total capital to risk-weighted assets (including certain off-balance sheet items, such as standby letters of credit). At least half of total capital must be comprised of Tier 1 capital, for a minimum ratio of Tier 1 capital to risk-weighted assets of 4%. In addition, the Federal Reserve Board has established minimum leverage ratio guidelines of 4% for banks that meet certain specified criteria. The leverage ratio is the ratio of Tier 1 capital to total average assets, less intangibles. HomeTown Bankshares is expected to be a source of capital strength for its subsidiary bank, and regulators can undertake a number of enforcement actions against HomeTown Bankshares if its subsidiary bank becomes undercapitalized. HomeTown Bankshares' bank subsidiary is well capitalized and fully in compliance with capital guidelines. However, regulatory capital requirements relate to earnings and asset quality, among other factors. Bank regulators could choose to raise capital requirements for banking organizations beyond current levels.

On July 2, 2013, the Federal Reserve Board of Governors approved the final Basel III risk-based capital rule. This rule aims to improve the quality and quantity of capital for all banking organizations and provides a new regulatory framework for U.S. banking organizations which is consistent with international standards. Community banking organizations first became subject to the final Basel III rule on January 1, 2015. Thereafter begins a phase-in period through January 1, 2019. The new rule implements higher minimum capital requirements and emphasizes the use of common equity through the introduction of a new capital ratio: common equity tier 1 (CET1). In addition, the new rule establishes stricter eligibility for capital instruments included in CET1, and additional tier 1 capital or tier 2 capital. The rule introduces the requirement of a new 2.5% capital conservation buffer, to be phased in beginning on January 1, 2016, and ending on January 1, 2019. Banking organizations without other supervisory issues that wish to distribute capital freely, such as in the payment of dividends for example, must maintain the new capital conservation buffer.

The new rule emphasizes common equity as the preferred capital instrument and limits the inclusion of intangible assets, including mortgage servicing assets and deferred tax assets in the capital of financial institutions. The new capital rule addresses the Dodd-Frank Act prohibition on reliance on external credit ratings specified in the regulations of the federal banking agencies. Consequently, the new capital rule replaces the previous credit-rating-based risk-weighting approach of certain assets with a simplified supervisory formula approach.

The Dodd-Frank Act The financial regulatory reform legislation "Dodd-Frank Wall Street Reform and Consumer Protection Act" (the Dodd-Frank Act) was signed into law on July 21, 2010. The Dodd-Frank Act implements financial regulatory reform across the entire financial landscape and has far-reaching provisions including among other things:

- Creates a new agency, the Consumer Financial Protection Bureau, responsible for implementing, examining and enforcing compliance with federal consumer financial laws for institutions with more than $10 billion of assets and, to a lesser extent, smaller institutions. As a smaller institution, most consumer protection aspects of the Dodd-Frank Act will continue to be applied to the Company by the Federal Reserve Board and to the Bank by the FDIC.

- Applies the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies.

- Changes the assessment base for federal deposit insurance from the amount of insured deposits to consolidated assets less tangible capital, eliminates the ceiling on the size of the Deposit Insurance Fund and increases the floor of the size of the Deposit Insurance Fund.

- Requires loan originators to retain 5 percent of any loan sold or securitized, unless it is a “qualified residential mortgage”, which must still be defined by the regulators. Federal Housing Administration, Veterans Affairs and Rural Housing Service loans are specifically exempted from the risk retention requirements.

- Implements corporate governance revisions, including with regard to executive compensation and proxy access by shareholders that apply to all public companies not just financial institutions.

- Makes permanent the $250,000 limit for federal deposit insurance and increases the cash limit of Securities Investor Protection Corporation protection from $100,000 to $250,000.

- Repeals the federal prohibitions on the payment of interest on demand deposits, thereby permitting depository institutions to pay interest on business transaction and other accounts.

- Amends the Electronic Fund Transfer Act (EFTA) to, among other things, give the Federal Reserve the authority to establish rules regarding interchange fees charged for electronic debit transactions by payment card issuers having assets over $10 billion and to enforce a new statutory requirement that such fees be reasonable and proportional to the actual cost of a transaction to the issuer. While the Company is not directly subject to these rules for as long as the Company’s assets do not exceed $10 billion, the Company’s activities as a debit card issuer may be indirectly impacted, potentially requiring the Company to match new lower fee structures implemented by larger financial institutions in order to remain competitive.

The Dodd-Frank Act is the largest piece of financial legislation ever passed, exceeding 2,000 pages in length. Many provisions of the Act are subject to rulemaking and will take effect over several years, making it difficult to anticipate the overall financial impact on the Company, its customers, or the financial industry as a whole. Provisions in the legislation that affect the payment of interest on demand deposits and interchange fees are likely to increase the costs associated with deposits as well as place limitations on certain revenues those deposits may generate.

HomeTown Bank

The Bank is under the supervision of, and subject to regulation and examination by, the Federal Reserve Board and the Bureau of Financial Institutions of the Virginia State Corporation Commission. The Bank is also covered by deposit insurance through the FDIC and is subject to their regulations. As such, the Bank is subject to various statutes and regulations administered by these agencies that govern, among other things, required reserves, investments, loans, lending limits, acquisitions of fixed assets, interest rates payable on deposits, transactions among affiliates and the Bank, the payment of dividends, mergers and consolidations, and establishment of branch offices.

Deposit Insurance. HomeTown Bank has deposits that are insured by the FDIC. The FDIC maintains a Deposit Insurance Fund (“DIF”) that is funded by risk-based insurance premium assessments on insured depository institutions. Assessments are determined based upon several factors, including the level of regulatory capital and the results of regulatory examinations. The FDIC may adjust assessments if the insured institution’s risk profile changes or if the size of the DIF declines in relation to the total amount of insured deposits. It is anticipated that assessments will increase in the future due to the anticipated growth of the Bank.

On April 1, 2011, the deposit insurance assessment base changed from total deposits to average total assets minus average tangible equity, pursuant to a rule issued by the FDIC as required by the Dodd-Frank Act, which also requires the FDIC to increase the reserve ratio of the DIF from 1.15% to 1.35% of insured deposits by 2020 and eliminates the requirement that the FDIC pay dividends to insured depositary institutions when the reserve ratio exceeds certain thresholds.

The Dodd-Frank Act permanently increased the maximum deposit insurance amounts for banks, savings institutions and credit unions to $250,000 per depositor.

Capital Requirements. The same capital requirements that are discussed above with relation to HomeTown Bankshares are applied to HomeTown Bank by the Federal Reserve Board. Federal Reserve Board guidelines provide that banks experiencing internal growth or making acquisitions are expected to maintain strong capital positions well above minimum levels, without reliance on intangible assets. Also, capital requirements can be increased based on earnings and asset quality concerns as well as other issues.

Mergers and Acquisitions. With some limited exceptions, the BHCA requires a bank holding company to obtain prior approval from the Federal Reserve Board before acquiring or merging with a bank or before acquiring more than 5% of the voting shares of a bank unless it already controls a majority of shares. The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 authorizes the Federal Reserve Board to permit adequately capitalized and adequately managed bank holding companies to acquire all or substantially all of the assets of an out-of-state bank or bank holding company, subject to certain conditions, including nationwide and state concentration limits. Banks also are able to branch across state lines, provided certain conditions are met, including that applicable state law must expressly permit such interstate branching. Virginia law permits branching across state lines, provided there is reciprocity with the state in which the out-of-state bank is based.

Community Reinvestment Act ("CRA"). The Company is also subject to the requirements of the CRA. The CRA imposes on financial institutions an affirmative and ongoing obligation to meet the credit needs of their local communities, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of those institutions. Each financial institution's efforts in meeting community credit needs currently are evaluated as part of the examination process pursuant to a number of assessment factors. These factors also are considered in evaluating mergers, acquisitions and applications to open branches.

Volcker Rule. The Dodd-Frank Act prohibits insured depository institutions and their holding companies from engaging in proprietary trading except in limited circumstances, and prohibits them from owning equity interests over certain thresholds in private equity and hedge funds. Final rules implementing the Volcker Rule were adopted on December 10, 2013. The final rules require entities to establish internal compliance programs which may include making regular reports about those activities to regulators. The final rules were effective April 1, 2015, with full compliance being phased in over a period which ended on July 21, 2016. The Volcker Rule has been subject to much commentary from the banking industry and the Company continues to evaluate the impact the Rule will have on the industry and the Company in particular.

Safety and Soundness. The federal banking agencies have broad powers under current federal law to take prompt corrective action to resolve problems of insured depository institutions. The extent of these powers depends upon whether the institutions in question are "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," all such terms are defined under uniform regulations defining such capital levels issued by each of the federal banking agencies.

Activities and Investments of Insured State-Chartered Banks. The activities and equity investments of FDIC insured, state-chartered banks are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank is not prohibited from, among other things, (i) acquiring or retaining a majority interest in a subsidiary, (ii) investing as a limited partner in a limited partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (iii) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions, and (iv) acquiring or retaining the voting shares of a depository institution if certain requirements are met. In addition, an insured state-chartered bank may not, directly, or indirectly through a subsidiary, engage as "principal" in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with applicable regulatory capital requirements. Any insured state-chartered bank directly or indirectly engaged in any activity that is not permitted for a national bank must cease the impermissible activity.

Regulatory Enforcement Authority. Applicable banking laws include substantial enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against banking organizations and institution-affiliated parties. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions, including the filing of misleading or untimely reports with regulatory authorities, may provide the basis for enforcement action.

USA Patriot Act. The USA Patriot Act became effective on October 26, 2001**,** and provides for the facilitation of information sharing among governmental entities and financial institutions for the purpose of combating terrorism and money laundering. Among other provisions, the USA Patriot Act permits financial institutions, upon providing notice to the United States Treasury, to share information with one another in order to better identify and report to the federal government concerning activities that may involve money laundering or terrorists' activities. Interim rules implementing the USA Patriot Act were issued effective March 4, 2002. The USA Patriot Act is considered a significant banking law in terms of information disclosure regarding certain customer transactions.

Consumer Laws and Regulations. There are a number of laws and regulations that regulate banks' consumer loan and deposit transactions. Among these are the Truth in Lending Act, the Truth in Savings Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Fair Credit Reporting Act, and the Fair Debt Collections Practices Act. HomeTown Bank is required to comply with these laws and regulations in its dealing with customers.

ACCESS TO FILINGS

The Company files annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other filings with the SEC. The public may read and copy any documents the Company files at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The Company's SEC filings can also be obtained on the SEC's website on the internet at http://www.sec.gov. Also, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K are posted on the Company's website at http://www.hometownbank.com as soon as reasonably practical after filing electronically with the SEC.

Executive Officers of the Registrant

The following table shows the Company's executive officers as of March 30, 2019 and their areas of responsibility. The executive officer biographies follow the table.

Name	Age	Position
Susan K. Still	65	President & CEO
Vance W. Adkins	38	Executive Vice President & CFO

Susan K. Still has served as President and Chief Executive Officer of the Company since May 2008. Ms. Still is also a member of the Company's board of directors and served as the Bank's Chief Lending Officer from November 2005 to May 2008.

Vance W. Adkins has served as Executive Vice President and Chief Financial Officer of the Company since August 2016. Mr. Adkins served as the Company's Senior Risk Officer from October 2010 to August 2016.

ITEM 1A. RISK FACTORS.

Not Required.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

Not Required.

ITEM 2. PROPERTIES.

As of March 29, 2019, the Company through its wholly owned subsidiary HomeTown Bank (the "Bank"), conducted its business from the following six locations: i) 202 S. Jefferson Street Roanoke, Virginia (the "Downtown Office"), which also serves as the Bank's main office and operations processing center; ii) a branch office located at 13400 Booker T. Washington Highway, Moneta, Virginia (the "Smith Mountain Lake Office"); iii) a branch office at 4225 Colonial Avenue, Roanoke, Virginia (the "Colonial Avenue at 419 Office"); iv) a branch office at 3521 Franklin Road, Roanoke, Virginia (the "South Roanoke Office"); v) a branch office at 2950 Market Street, Christiansburg, Virginia (the "Christiansburg Office"); vi) a branch office at 852 West Main Street, Salem, Virginia (the "Salem Office").

The Downtown Office. The Bank leases certain space located at 202 S. Jefferson Street, Roanoke, Virginia. The original lease expired on December 31, 2016, which provided an option to extend the lease for two additional five-year periods. The lease was renewed for one additional term of ten years and it provides an option to extend the lease for one additional ten-year term at expiration. The Downtown Branch opened on November 14, 2005.

The Smith Mountain Lake Office. The Bank purchased the Smith Mountain Lake branch on February 14, 2006 and received regulatory approval and opened the office on May 8, 2006.

The Colonial Avenue at 419 Office. The Bank purchased the property for the Colonial Avenue at 419 office on August 31, 2006 and received regulatory approval and opened the Colonial Avenue at 419 Branch on March 22, 2007. In February, 2012, the Bank opened a dedicated mortgage office, on Colonial Avenue, next to the existing branch office.

The South Roanoke Office. The Bank leases real property and improvements thereto located at 3521 Franklin Road, Roanoke, Virginia. The Bank received regulatory approval and opened a branch at this location on July 9, 2007. The initial lease was for a period of ten years from August 1, 2006. Upon expiration on July 31, 2016 the lease was extended for two additional five-year periods.

The Christiansburg Office. The Bank purchased property at 2950 Market Street, Christiansburg on May 26, 2010. The Bank broke ground in December 2012 on a new 9,000 square foot branch. At the end of 2013 the Bank relocated their New River Valley branch operations and mortgage and administrative operations to the new building. The larger facility enables the Bank to meet the growing needs of its customers in the New River Valley and to attract new business. The Bank began operations in the New River Valley market in 2008. The leases for the previous locations, at 1540 Roanoke Street and 1655 Roanoke Street, Christiansburg, expired in 2013.

Salem Office. The Bank purchased property at 852 West Main Street, Salem on September 2, 2011. A stand-alone fully operational ATM was completed and put into service April 15, 2013, and on July 28, 2015, a full service branch office opened at this location.

Market Square ATM. The Bank leases space at 1 Market Square, Roanoke for a cash dispensing ATM. The ATM was put into operation May 10, 2013, and is located at the newly renovated Center in the Square building, a cultural hub in downtown Roanoke.

Operations Center. Due to limited available space at the downtown office and continued growth of the Company, management recognized the need for an Operations Center that would provide ample space for expansion. The Bank owned an office building, initially acquired through foreclosure, at 4633 Brambleton Avenue in Roanoke that could be converted to a secure Operations Center. The two story 12,000 square foot building was built in 2007. At a board meeting held on December 18, 2014, the Board of Directors approved the Bank's use of the property, and it was reclassed from other real estate owned to property and equipment.

ITEM 3. LEGAL PROCEEDINGS.

The Bank is not involved in any material pending legal proceedings at this time, other than routine litigation incidental to its business, and the Company does not expect that such litigation will be material in respect to the amount in controversy.

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 Information and Holders

Shares of the Company's common stock, $5.00 par value per share, were listed and began trading on NASDAQ on October 12, 2016 under the symbol "HMTA." The NASDAQ listing increases visibility to those outside of the Company's core operating markets and enables current and future shareholders greater liquidity to trade shares. Prior to listing on NASDAQ, shares were not listed on any stock exchange, however were quoted on the Over the Counter Bulletin Board under the same stock symbol "HTMA". Based on available information, the Company believes that from January 1, 2018 to December 31, 2018, the selling price of shares of its common stock ranged from $10.95 to $16.50, and that approximately 1,759 thousand shares were traded. There may, however, have been other transactions at other prices not known to the Company.

As of March 14, 2019, there were 5,815,623 shares of the Company's common stock outstanding, which shares were held by 2,265 shareholders of record.

ITEM 6. SELECTED FINANCIAL DATA.

Not Required.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Forward-Looking Statements

Certain information contained in this discussion may include "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21 E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are generally identified by phrases such as "we expect," "we believe" or words of similar import. Such forward-looking statements involve known and unknown risks including, but not limited to, the following factors:

- the ability to successfully manage the Company's growth or implement its growth strategies if it is unable to identify attractive markets, locations or opportunities to expand in the future;
- reliance on the Company's management team, including its ability to attract and retain key personnel;
- interest rate fluctuations;
- maintaining capital levels adequate to support the Company's growth;
- risk inherent in making loans such as repayment risks and fluctuating collateral values;
- the ability to attract low cost core deposits to fund asset growth;
- changes in laws and regulations applicable to us;
- changes in general economic and business conditions;
- competition within and from outside the banking industry;
- problems with our technology;
- changing trends in customer profiles and behavior; and
- new products and services in the banking industry.

On October 1, 2018, HomeTown Bankshares Corporation ("HomeTown" and American National Bankshares Inc. ("American National") entered into an Agreement and Plan of Reorganization ("the Merger Agreement") pursuant to which HomeTown will merge with and into American National (the "Merger"). American National will be the surviving corporation in the Merger. In addition to the factors described above, the Company's operations, performance, business strategy and results may be affected by the following factors:

- the costs associated with the completion of the merger and the realization of the benefits expected to be obtained in connection with the merger, including management's time and energy and potential opportunity cost;
- the potential risks of diverting management attention and resources from the operation of HomeTown's business and toward the completion of the merger;
- the restrictions on the conduct of HomeTown's business during the period between the execution of the merger agreement and the completion of the merger;
- the possibility that the merger and the related integration process could result in the loss of key employees, in the disruption of HomeTown's on-going business and in the loss of customers;
- the challenges in absorbing the effect of any failure to complete the merger, including potential payment of a termination fee and market reactions;
- the possibility of litigation challenging the merger, and its belief that any such litigation would be without merit.

Although the Company's management believes that its expectations with respect to the forward-looking statements are based upon reliable assumptions within the bounds of management's knowledge of the Company's business and operations, there can be no assurance that actual results, performance or achievements of the Company will not differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements.

Critical Accounting Policies

The financial condition and results of operations presented in the consolidated financial statements, accompanying notes to the consolidated financial statements and management's discussion and analysis are, to a large degree, dependent upon the Company's accounting policies. The selection and application of these accounting policies involves judgments, estimates, and uncertainties that are susceptible to change.

Presented below is discussion of those accounting policies that management believes are the most important accounting policies to the portrayal and understanding of the Company's financial condition and results of operations. These critical accounting policies require management's most difficult, subjective and complex judgments about matters that are inherently uncertain. In the event that different assumptions or conditions were to prevail, and depending upon the severity of such changes, the possibility of materially different financial condition or results of operations is a reasonable likelihood. See also Note 1 of the Notes to Consolidated Financial Statements.

Allowance for Loan Losses
Management monitors and maintains an allowance for loan losses to absorb an estimate of probable losses inherent in the loan portfolio. Management maintains policies and procedures that address the systems of controls over the following areas of maintenance of the allowance: the systematic methodology used to determine the appropriate level of the allowance to provide assurance they are maintained in accordance with accounting principles generally accepted in the United States of America; the accounting policies for loan charge-offs and recoveries; the assessment and measurement of impairment in the loan portfolio; and the loan grading system.

The bank maintains an internal risk grading system by which it grades loans based on guidelines for assessing the risk of each loan, and monitoring trends in portfolio quality. Those loans deemed to have a higher-than-average risk of loss are rated pass watch, special mention, substandard, doubtful, or loss, depending upon the severity of risk. Credits with these ratings are made part of the bank's internal watch list and are closely monitored for changes in condition.

Credits rated special mention, substandard, or doubtful, are individually analyzed quarterly by Credit Administration by preparing a detailed Criticized Asset Reporting and Action Plan. An Accounting Standards Codification (ASC) 310 Reserve for Individually Evaluated Credit analysis is performed on loans with relationships in excess of $100,000 identified as impaired using the Fair Value of Collateral Method to determine if the value of the liquidated collateral will satisfy the outstanding loan balance. The evaluations are based upon discounted expected cash flows or collateral valuations. If the evaluation shows that a loan is individually impaired, then a specific reserve is established for the amount of impairment.

For loans without individual measures of impairment, we make estimates of losses for groups of loans based primarily on historical losses grouped by similar characteristics, including the type of loan, the assigned loan classification and the general collateral type. A loss rate reflecting the expected loss inherent in a group of loans is derived based upon estimates of default rates for a given loan grade, the predominant collateral type for the group and the terms of the loan. The resulting estimate of losses for groups of loans is adjusted for relevant environmental factors and other conditions of the portfolio of loans, including: borrower and industry concentrations; levels and trends in delinquencies, charge-offs and recoveries; changes in underwriting standards and risk selection; level of experience, ability and depth of lending management; and national and local economic conditions.

The amount of estimated impairment for individually evaluated loans and groups of loans is added together for a total estimate of loan losses. This estimate of losses is compared to our allowance for loan losses as of the evaluation date and, if the estimate of losses is greater than the allowance, an additional provision to the allowance would be made. If the estimate of losses is less than the allowance, the degree to which the allowance exceeds the estimate is evaluated to determine whether the allowance falls outside a range of estimates. If the estimate of losses is below the range of reasonable estimates, the allowance would be reduced by way of a credit to the provision for loan losses. Management recognizes the inherent imprecision in estimates of losses due to various uncertainties and variability related to the factors used, and therefore a reasonable range around the estimate of losses is derived and used to ascertain whether the allowance is too high. If different assumptions or conditions were to prevail and it is determined that the allowance is not adequate to absorb the new estimate of probable losses, an additional provision for loan losses would be made, which amount may be material to the Consolidated Financial Statements.

Other Real Estate Owned
Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure. Subsequent to foreclosure, management periodically performs valuations of the foreclosed assets based on updated appraisals, general market conditions, recent sales of similar properties, length of time the properties have been held, and our ability and intention with regard to continued ownership of the properties. The Company may incur additional writedowns of foreclosed assets to fair value less costs to sell if valuations indicate a further deterioration in market conditions.

Deferred Tax Assets and Liabilities
The realization of deferred income tax assets is assessed and a valuation allowance is recorded if it is "more likely than not" that all or a portion of the deferred tax asset will not be realized. "More likely than not" is defined as greater than a 50% chance. Management considers all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed.

General

Management's discussion and analysis is intended to assist the reader in evaluating and understanding the financial condition and results of operations of the Company and the Bank as of and for the years ending December 31, 2018 and 2017. This discussion should be read in connection with the Company's Consolidated Financial Statements and the accompanying Notes thereto included in this Form 10-K.

The Company initiated its banking operations through the Bank, on November 14, 2005 with the opening of its main office at 202 S. Jefferson Street, Roanoke, Virginia. The Bank has experienced consistent growth over the last ten years.

The Business

HomeTown Bank provides a full complement of consumer and commercial banking services to its primary service area which includes the City of Roanoke, Roanoke County, and the City of Salem, Virginia and contiguous counties, including Bedford, Franklin and Montgomery, Virginia. We place an emphasis on personal service and offer a broad range of commercial and retail banking products and services including checking, savings and time deposits, individual retirement accounts, residential and commercial mortgages, home equity loans, consumer installment loans, commercial loans, lines and letters of credit.

The Bank currently operates six full service branches, seven 24-hour ATM's, and one mortgage office. In addition to its main office, the Bank has branch offices in Franklin County, Virginia at Westlake; in Roanoke County at the intersection of Colonial Avenue and Virginia Route 419; in Roanoke City on Franklin Road in South Roanoke, in Salem on West Main Street. The Bank operated under the name NewRiver Bank, a branch of HomeTown Bank in the New River Valley market, on Market Street in Christiansburg until the end of the first quarter of 2016. In a step to provide better brand recognition, the Bank began using the name HomeTown Bank throughout all its branch locations.

On October 1, 2018, HomeTown Bankshares entered into a Merger Agreement with American National. The Merger of HomeTown with and into American National is expected to be completed in the second quarter of 2019.

The Company operates in a highly competitive market for commercial banking and financial services as the Roanoke Valley is a banking and financial services hub for much of southwest Virginia.

Discussion of Results of Operations

Overview of Results of Operations

Net income attributable to HomeTown Bankshares Corporation for 2018 totaled $4.0 million and was $1.5 million higher than the prior year. Total assets were up year-over-year due to continued solid loan growth supported by strong growth in core deposits. Earnings per share on a fully diluted basis were $0.68 per share for the 2018 fiscal year, up from $0.43 per share, for fiscal year 2017. The growth in profitability as well as loans and core deposits was achieved in spite of $788 thousand of merger related expenses following the announced plan on October 1, 2018 to merge with American National Bank in the second quarter of 2019. An improved net interest margin, a lower provision for loan losses, and higher noninterest income due to the income from life insurance benefit all contributed to a 58%. increase in net income in 2018 over the prior year.

The following table is a schedule of the return on average assets and return on average equity for the dates indicated:

	For the years ended		
	2018	**2017**	**2016**
Return on average assets	0.71%	0.46%	0.50%
Return on average equity	7.60%	5.02%	5.31%
Average equity to average assets	9.30%	9.21%	9.46%

Summary of Financial Condition

Total assets of the Company were $565 million at December 31, 2018, compared to $550 million at the previous year end. The net loan portfolio increased $27.0 million or 6.1% from the end of 2017 to December 31, 2018, and contributed to a $15 million or 2.7% increase in total assets during the period. Residential real estate accounted for 79.7% of the total $27.3 million increase in gross loans. Total deposits increased 3.3% year over year and fell short of the dollar increase in loans. From December 31, 2017 to December 31, 2018, cash increased $1.1 million or 4.9%.

Securities available for sale were $45.0 million and $55.3 million at the end of 2018 and 2017, respectively. The yields on securities available for purchase continued to be relatively low, and the Company continued to channel cash flow from lower rate investments in bonds to higher rate loans.

Bank owned life insurance (BOLI) decreased $0.5 million during the year ended December 31, 2018 to $8.2 million at the end of the year due to the payout of a death benefit. BOLI is the funding mechanism for the Supplemental Executive Retirement Plan (SERP) provided to executive management. The liability for the SERP is included in other liabilities. The SERP is discussed in greater detail in Note 14 Salary Continuation Plan.

Total liabilities at December 31, 2018 were $511 million, compared to $499 million at the end of 2017, an increase of $11.9 million or 2.4%. Total deposits rose $15.9 million, while FHLB borrowings declined $3.1 million. Core deposits increased $19.6 million resulting in a decrease in reliance on wholesale funding.

Stockholders' equity was $53.7 million at December 31, 2018, $2.8 million or 5.5% above the $50.9 million at the end of the previous year. Net income available to common stockholders of $4.0 million raised the level of retained earnings to $7.0 million at December 31, 2018, compared to $3.8 million at December 31, 2017 and enabled the Company to begin paying cash dividends in 2018 which totaled $697 thousand for the year. Management believes the Company has sufficient capital to fund its operations while the Company strives to generate profits on a consistent basis, but there can be no assurance that this will be the case.

Non-performing Assets

Non-performing assets consist of nonaccrual loans, restructured loans, and repossessed and foreclosed assets. Following is a breakdown of non-performing assets:

	December 31,				
(Dollars in thousands)	**2018**	**2017**	**2016**	**2015**	**2014**
Real Estate:					
Construction and land development	$ 125	$ 274	$ —	$ 11	$ —
Residential 1-4 families	532	173	577	—	475
Commercial real estate	463	209	336	368	758
Commercial loans	162	403	11	47	—
Equity lines	400	49	—	—	—
Loans to individuals	1	36	—	—	21
Total nonperforming loans	1,683	1,144	924	426	1,254
Other real estate owned	1,893	3,249	3,794	5,237	6,986
Total nonperforming assets, excluding performing restructured loans	3,576	4,393	4,718	5,663	8,240
Performing restructured loans	3,765	3,889	6,160	6,398	6,052
Total nonperforming assets, including restructured loans	$ 7,341	$ 8,282	$ 10,878	$ 12,061	$ 14,292

The five-year trend of non-performing assets reflects continued improvement in the economy. Nonperforming assets, including restructured loans were 1.30% of total assets at the end of 2018, compared to 1.51% at the end of 2017 and 2.10% at the end of 2016.

Interest is accrued on outstanding loan principal balances, unless the Company considers collection to be doubtful. Commercial and consumer loans are designated as non-accrual when payment is delinquent 90 days or at the point which the Company considers collection doubtful, if earlier. When loans are placed in non-accrual status, interest previously accrued and unpaid interest is reversed against interest income in the current period and interest is subsequently recognized only to the extent cash is received and if principal repayment is probable. Interest accruals are resumed on such loans only when in the judgment of management, the loans are estimated to be fully collectible as to both principal and interest. Most non-accrual loans are classified as impaired. Impaired loans are evaluated periodically on an individual basis, and if appropriate, losses are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Total nonperforming assets, including restructured loans, declined $941 thousand from December 31, 2017 to December 31, 2018. The level of nonperforming loans at December 31, 2018 was $539 thousand higher than the level at December 31, 2017, while other real estate owned declined $1.4 million. Write-downs of other real estate owned totaled $158 thousand during the year 2018 compared to $588 thousand in 2017. Performing restructured loans decreased $124 thousand year over year

Real estate properties acquired through, or in lieu of, loan foreclosure are initially recorded at fair value less anticipated selling cost. Valuations are periodically performed by management, and the real estate is carried at the lower of carrying amount or fair value less cost to sell.

See also Note 5 of the Notes to Consolidated Financial Statements for information on changes in other real estate owned and for the major classifications of other real estate owned for 2018 compared to 2017.

Net Interest Income and Net Interest Margin

The primary source of the Company's revenue is net interest income, which represents the difference between interest income on earning assets and interest expense on liabilities used to fund those assets. Earning assets include loans, securities, interest bearing bank accounts and certificates of deposit, and federal funds sold. Interest bearing liabilities include deposits and borrowings. The amount of net interest income is primarily dependent upon the volume and mix of these earning assets and interest-bearing liabilities. Interest rate changes can also impact the amount of net interest income. Management develops pricing and marketing strategies to maximize net interest income while maintaining related assets and liabilities accounts within guideline policies as established by the Company's Board of Directors.

The net interest margin represents net interest income divided by average earning assets. It reflects the average effective rate that the Company earned on its earning assets. The net interest margin is affected by changes in both interest rates and average volumes of interest earning assets and interest-bearing liabilities.

For the year 2018, net interest income totaled $18.8 million; an increase of $1.2 million or 6.6% over the $17.6 million earned in the previous year. The expansion of earning assets, primarily loans, continued to be the driving force underlying increases in net interest income. For the year ended December 31, 2018, average earning assets totaled $524 million and were $17.4 million or 3.4% higher than the average of $506 million for 2017. The increased volume of loans provided $1.3 million additional interest income in 2018 while higher yields contributed $501 thousand. The average volume of the investment portfolio declined slightly but was offset by a higher tax equivalent yield. Decreases in balances on deposits in banks were partially offset by increases in yields.

The net interest margin was 3.55% for the year 2018 compared to 3.47% for the previous year. This was primarily a result of an increase in loan yields. Loan yields rose 13 basis points to 4.46% during 2018. Increases in the federal funds rate led to higher loan interest rates, partially offset by increased liquidity in the markets, which fostered competition among commercial banks and other financial services industries to satisfy growing loan demand. Total average deposits increased $14.7 million in 2018 compared to 2017. Higher interest rates driven by federal funds rate increases contributed to the 15 basis point increase in the cost of funds, partially negating higher loan yields. Management expects rates paid on deposits products will rise in 2019. The more volatile non-interest bearing deposits averaged $8.6 million more than last year.

The Federal Reserve develops monetary policy to attain its objectives of maximum employment and price stability. The Federal Open Market Committee (FOMC) raised the target range for the federal funds rate 25 basis points four times in 2018 - March 21, June 13, September 26 and December 19 to a target range of 2.25 to 2.50%. The Company expects the Federal Reserve to continue to raise rates in 2019.

The following table illustrates average balances of total interest-earning assets and total interest bearing liabilities for 2018, 2017 and 2016, showing the average distribution of assets, liabilities, shareholders' equity and related income, expense and corresponding weighted-average yields and rates. The average balances used in these tables and other statistical data were calculated using daily average balances.

Average Balances, Interest Income and Expense, Yields and Rates

	2018			2017			2016		
(Dollars in thousands)	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**	**Average Balance**	**Interest Income/ Expense**	**Yield/ Rate**
Assets:									
Federal funds sold	$ 205	$ 3	1.62%	$ 92	$ 1	1.00%	$ 998	$ 3	0.37%
Deposits in banks	10,188	185	1.82	19,579	224	1.14	14,125	104	0.74
Securities, taxable	41,299	1,102	2.67	39,518	1,031	2.61	38,501	837	2.18
Securities, nontaxable (1)	8,011	229	3.61	11,535	308	4.05	14,574	388	4.03
Restricted equity securities	2,557	151	5.89	2,372	132	5.56	2,401	131	5.46
Loans held for sale	512	24	4.64	658	26	4.00	512	19	3.74
Loans (1)	460,736	20,796	4.46	432,337	18,947	4.33	390,672	17,692	4.53
Total earnings assets	523,508	22,490	4.26%	506,091	20,669	4.07%	461,783	19,174	4.20%
Less: Allowance for loan losses	(3,898)			(3,705)			(3,433)		
Total non-earning assets	40,135			37,469			43,329		
Total Assets	$ 559,745			$ 539,855			$ 501,679		
Liabilities and shareholders' equity									
Interest bearing deposits:									
Checking	$ 105,043	$ 283	0.27%	$ 97,172	$ 196	0.20%	$ 80,128	$ 127	0.16%
Money market savings	80,517	432	0.54	72,765	181	0.25	70,877	172	0.24
Regular savings	51,093	217	0.43	50,803	185	0.36	41,931	152	0.36
Time Deposits	130,022	1,909	1.47	139,792	1,720	1.23	149,969	1,765	1.18
Total interest-bearing deposits	366,675	2,841	0.77	360,532	2,282	0.63	342,905	2,216	0.65
FHLB borrowings	14,605	299	2.02	11,755	197	1.65	14,176	237	1.65
Subordinated notes	7,268	536	7.38	7,238	537	7.41	7,208	536	7.44
Other borrowings	515	24	4.52	1,079	30	2.74	1,546	29	1.83
Total interest-bearing liabilities	389,063	3,700	0.95	380,604	3,046	0.80	365,835	3,018	0.82
Non-interest-bearing liabilities:									
Demand deposits	115,623			107,072			85,846		
Other liabilities	2,576			1,981			2,135		
Total liabilities	507,262	3,700		489,657	3,046		453,816	3,018	
Total HomeTown Bankshares Corporation stockholders' equity	52,056	—		49,732	—		47,467	—	
Noncontrolling interest in consolidated subsidiary	427			466			396		
Total Stockholders' equity	52,483	—		50,198	—		47,863	—	
Total Liabilities and Stockholders' Equity	$ 559,745	3,700		$ 539,855	3,046		$ 501,679	3,018	
Net interest income		$ 18,790			$ 17,623			$ 16,156	
Interest rate spread			3.31			3.27			3.38
Interest expense to average earning assets			0.71			0.60			0.65
Net interest margin			3.55%			3.47%			3.55%

(1) Yields are reported on a tax equivalent basis assuming a federal income tax rate of 21 percent in 2018 and 34 percent in 2017 and 2016.

Rate and Volume Analysis

(Dollars in thousands)	2018 Compared to 2017 Increase (Decrease)	2018 Compared to 2017 Change Due To: Rate	2018 Compared to 2017 Change Due To: Volume	2017 Compared to 2016 Increase (Decrease)	2017 Compared to 2016 Change Due To: Rate	2017 Compared to 2016 Change Due To: Volume
Interest income:						
Federal funds sold	$ 2	$ 1	$ 1	$ (2)	$ 7	$ (9)
Deposits in banks	(39)	132	(171)	120	58	62
Securities, taxable	71	(2)	73	194	84	110
Securities, nontaxable	(79)	21	(100)	(80)	1	(81)
Restricted equity securities	19	8	11	1	3	(2)
Loans held for sale	(2)	4	(6)	7	1	6
Loans	1,849	501	1,348	1,255	(538)	1,793
Total interest income	1,821	665	1,156	1,495	(384)	1,879
Interest expense:						
Interest bearing liabilities:						
Checking	87	66	21	69	35	34
Money market savings	251	209	42	9	5	4
Regular savings	32	31	1	33	1	32
Time Deposits	189	308	(119)	(45)	69	(114)
FHLB borrowings	102	44	58	(40)	—	(40)
Subordinated notes	(1)	(2)	1	1	(2)	3
Other borrowings	(6)	5	(11)	1	2	(1)
Total interest expense	654	661	(7)	28	110	(82)
Net interest income	$ 1,167	$ 4	$ 1,163	$ 1,467	$ (494)	$ 1,961

Noninterest Income

Noninterest income includes service charges on deposit accounts, ATM and interchange income, brokerage fees on non-portfolio mortgage loans, and net gains on securities sales. Noninterest income increased $415 thousand or 12.6% for the year 2018 compared to the prior year. Excluding gains on sales of investment securities and income from life insurance death benefit, core noninterest revenue for 2018 was $218 lower than the prior year. ATM and interchange income for 2018 was $218 thousand or 26.0% more than the year 2017 due to the expansion of the customer base. Revenue from mortgage banking was $247 thousand or 25.8% lower than the prior year and correlated with rising interest rates that impacted home sales levels. A one-time bankruptcy settlement of $172 thousand was included in 2017 other income and contributed to the decrease when compared to 2018.

Noninterest Income

(Dollars in thousands)	Period Ended December 31, 2018	Period Ended December 31, 2017	$ Change	% Change
Service charges on deposit accounts	$ 578	$ 544	$ 34	6.3%
ATM and interchange income	1,055	837	218	26.0
Mortgage banking income	712	959	(247)	(25.8)
Net gains on sales of investment securities	60	69	(9)	(13.0)
Income from life insurance death benefit	642	-	642	N/A
Investment brokerage income	102	162	(60)	(37.0)
Increase in cash surrender value of bank owned life insurance	202	200	2	1.0
Merchant processing income	167	137	30	21.9
Other income	180	375	(195)	(50.6)
Total noninterest income	$ 3,698	$ 3,283	$ 415	12.6%

Noninterest Expense

Non-interest expense includes, among other things, salaries and benefits, occupancy costs, data processing, advertising and marketing, and professional fees. Total noninterest expense increased $1.1 million or 7.0%, to $17.1 million for 2018. The Company's management and staff monitor and control operating expenses to provide adequate operational support and enable growth opportunities.

Salaries and employee benefits for 2018 were $8.6 million compared to $8.1 million for the prior year. The $550 thousand or 6.8% increase includes the wages for the position of Chief Risk Officer that was vacant for approximately nine months in 2017. In 2017 much of the Company's internal audit work was outsourced and the cost included in professional fees. A higher performance based bonus accrual reflected the increase in net income for 2018 over 2017. Other factors contributing to higher personnel expense were annual merit raises, and the acceleration of the vesting of all remaining restricted stock related to the death of a former executive.

Occupancy and equipment expense totaled $1.7 million for the year ended December 31, 2018, unchanged from the prior year, while discretionary spending on advertising and marketing increased by $69 thousand or 11.9% from the prior year.

Professional fees decreased by $167 thousand or 28.4% in 2018 compared to 2017. In 2017 much of the Company's internal audit work was outsourced and the cost included in professional fees. Data processing expense for 2018 was $184 thousand or 14.0% higher than 2017. The increase reflected additional processing costs incurred from the expansion of the core deposit customer base.

Bank Franchise Tax was $20 thousand or 5.0% higher for 2018 than for 2017. The increase in the Bank’s equity from retained earnings, and the reduction in real estate taxes paid on foreclosed properties, which are deducted from capital on the Bank Franchise return, were factors contributing to the increase in the Bank Franchise Tax in 2018.

Losses on sales and write-downs of other real estate were $247 thousand lower in 2018 than 2017. During 2017, a property acquired in 2011 for $1.2 million, and carried at $599 thousand at December 31, 2016, was written down an additional $380 thousand and sold for a $7 thousand gain before year end December 31, 2017. The year 2017 included additional writedowns totaling $208 thousand.

Merger-related expense totaled $788 thousand in 2018 and included an investment banker's opinion, legal fees related to the merger agreement and executive compensation. Also included was the cost associated with the acceleration of restricted stock awards and stock options vested and exchanged for cash payments for certain executives as part of the merger agreement.

Other expenses were $1.5 million in 2018 compared to $1.7 million in 2017. Other expense includes compliance costs, office supplies and printing costs, and a number of other fees and expenses. The majority of the $158 thousand decrease was due to one-time costs incurred directly related to the core system conversion in 2017.

Non-Interest Expense

(Dollars in thousands)	Period Ended December 31, 2018	2017	$ Change	% Change
Salaries and employee benefits	$ 8,648	$ 8,098	$ 550	6.8%
Occupancy and equipment expense	1,676	1,650	26	12.8
Advertising and marketing expense	606	537	69	11.9
Professional fees	421	588	(167)	(28.4)
Data processing expense	1,498	1,314	184	14.0
Bank franchise taxes	419	399	20	5.0
FDIC insurance expense	235	248	(13)	(5.2)
Losses on sales and writedowns of other real estate	334	581	(247)	(42.5)
Other real estate owned expense	280	106	174	164.2
Directors’ fees	392	410	(18)	(4.4)
Communications expense	191	176	15	8.5
ATM maintenance expense	91	197	(106)	(53.8)
Merger-related expense	788	-	788	N/A
Other expense	1,505	1,663	(158)	(9.5)
Total non-interest expense	$ 17,084	$ 15,967	$ 1,117	7.0%

Income Tax Expense

Income tax expense was $845 thousand million and $1.2 million for the years ended December 31, 2018 and 2017, respectively. The decrease was due to the impact of The Tax Cuts and Jobs Act, which was signed into law on December 22, 2017. The Act reduced the corporate tax rate to which the Company is subject. See Note 16 Income Taxes for a breakdown of current and deferred taxes and detail of the net deferred taxes at the end of both years.

Loans

Our primary source of income is our lending activities. The following table presents the composition of the Company's loan portfolio at the dates indicated:

Loan Portfolio

(Dollars In Thousands)	**December 31, 2018**	**2017**	**2016**	**2015**	**2014**
Construction:					
Residential	$ 17,232	$ 15,221	$ 10,204	$ 11,779	$ 10,019
Land acquisition, development & commercial	28,903	35,601	27,480	27,440	23,686
Real Estate:					
Residential	143,385	121,649	111,626	100,268	86,269
Commercial	184,989	173,999	172,248	140,952	135,070
Commercial, industrial & agricultural	60,265	61,197	59,809	53,012	44,807
Equity lines	28,969	28,835	29,956	26,376	24,330
Consumer	7,719	7,693	7,668	7,531	7,498
Total loans	$ 471,462	$ 444,195	$ 418,991	$ 367,358	$ 331,679

As with most community banks, the loan portfolio is concentrated in commercial real estate loans, and comprised 39.2% of the total loan portfolio at both December 31, 2018 and 2017. At December 31, 2018, there were no industry concentrations with outstanding balances representing 10% or more of total loans.

Maturities of Loans at December 31, 2018 are as follows:

(Dollars in Thousands)	**Fixed Rate**	**Adjustable Rate**	**Total**
Construction loans Maturing:			
Within one year	$ 9,036	$ 12,290	$ 21,326
One to five years	13,423	7,766	21,189
After five years	1,579	2,041	3,620
Total	$ 24,038	$ 22,097	$ 46,135

(Dollars in Thousands)	**Fixed Rate**	**Adjustable Rate**	**Total**
Commercial loans Maturing:			
Within one year	$ 7,341	$ 16,722	$ 24,063
One to five years	19,828	12,969	32,797
After five years	1,885	1,520	3,405
Total	$ 29,054	$ 31,211	$ 60,265

Provision and Allowance for Loan Losses

The provision for loan losses is based upon management's estimate of the amount needed to maintain the allowance for loan losses at an adequate level to cover known and inherent risk of loss in the loan portfolio. Lower net charge offs during 2018 resulted in a provision for loan losses for the year of $561 thousand compared to $1.1 million in the previous year.

Net charge offs for 2017 totaled $327 thousand, compared to $1.0 million in 2017. Charge offs in 2017 included a partial charge off of $150 thousand for one loan. The loan had been current at the end of the quarter prior to the charge off. The remaining balance of $180 thousand was included in nonaccrual loans at December 31, 2017 and was in the process of foreclosure.

The allowance consists of three components: specific, general, and unallocated reserves. Their adequacy is evaluated separately. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. The allowance for loan losses is increased by charges to income and decreased by charge-offs, net of recoveries.

Specific reserves are determined on a loan by loan basis and relate to loans classified as impaired. Management classifies loans as impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Potentially impaired loans may include current "watch list" credits that are rated special mention, substandard, or doubtful with a total combined credit relationship in excess of $100 thousand. Management individually reviews these potentially impaired loans based on generally accepted accounting standards related to receivables and makes a determination if the loan is in fact impaired. Management does not consider a loan impaired during a period of delay in payment if management expects the ultimate collection of all amounts due. If a loan is found to be impaired, an allowance is established when the collateral value less estimated cost to sell, discounted cash flows, or observable market price of the impaired loan is lower than the carrying value of that loan. The factors considered in recognizing a loan as impaired are detailed in Note 1 Significant Accounting Policies. Impaired loans totaled $5.1 million on December 31, 2018, a decrease of $0.2 million from the same period in 2017. Three loan relationships totaling $730 thousand were added to impaired loans in 2018. The property securing one relationship totaling $366 thousand was foreclosed and moved to other real estate owned during 2018. The remaining change in the balance year over year was due to payments. The were no specific reserves related to impaired loans at year end 2018 or 2017.

The credit quality of the remaining portfolio remained strong, and was evaluated collectively to ensure the adequacy of the general reserves for loan losses. The general component of the reserve covers non-classified loans and is based on historical loss experience adjusted for qualitative factors. The adequacy of general reserves is determined by dividing the remaining loan portfolio into 30 homogenous pools, each with its unique degree of inherent risk and applying a loss factor to each pool of loans. In determining the loss factor for each pool of homogenous loans the following factors are considered: net charge-offs, underlying collateral, lending policies and underwriting practices, economic conditions, management experience, quality of loan review and oversight, effects of external competition and regulation, loan pool concentrations, loan pool volume, past due and non-accrual loans and classified loans. From December 31, 2017 to December 31, 2018, the general component, including the unallocated component, increased $234 thousand. For the same period of time, the loans collectively evaluated rose $28 million to $466 million at the end of 2018.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. It also reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. On a quarterly basis, management performs a detailed analysis of the allowance for loan losses to verify the adequacy and appropriateness of the allowance in meeting probable losses in the loan portfolio. The unallocated component was $79 thousand and $9 thousand at December 31, 2018 and 2017, respectively. See Note 4 for a more detailed breakdown of the allowance for loan losses.

The Company's total reserves amounted to $4.0 million or 0.85% of total loans at December 31, 2018, compared to $3.8 million or 0.85% of total loans at December 31, 2017 and reflects the credit quality of the underlying loan portfolio. Net charge-offs for 2018 were down significantly from the prior year. Despite an increase in nonperforming loans, the level of total non-performing assets steadily declined as the economy improved. The "Loans by Credit Quality Indicators" tables in Note 4 Allowance for Loan Losses reveal a $868 thousand decrease in "Substandard Accruing" loans to $1.1 million at December 31, 2018, and a $9.9 million decrease in "Special Mention" loans to $3.1 million at year end 2018. Pass loans as a percent of total loans increased from 96.4% at December 31, 2017 to 98.9% at December 31, 2018. Past due and accruing loans decreased from 0.93% of total loans at December 31, 2017 to 0.58% at December 31, 2018.

Management considers economic information in determining the adequacy of the allowance for loan losses. According to the February 2019 FRB Snapshot report for Virginia, reports on the economy were somewhat mixed. Payroll employment fell slightly; however, the unemployment rate remained low and house prices rose on a year-over-year basis. Virginia issued 2,415 new residential permits in October 2018, down 27.0% from the prior month and down 18.1% from October 2017. The Richmond MSA issued the most permits in October 2018 (486 permits) followed by Virginia Beach-Norfolk (436 permits). Meanwhile, housing starts in Virginia totaled 26,300 in October 2018, down 30.0% from the prior month and 22.1% on a year-over-year basis. Accordingly to CoreLogic Information Soloutions, Virginia home values depreciated 0.3% in November 2018 but appreciated 2.7% on a year-over year basis. House prices decreased in the majority of Virginia MSAs in the month, but rose in every MSA except Danville on a year-over-year basis. Should the economy change, the Bank will look to adjust the factors in future quarter analysis.

The following table presents an analysis of the changes in the allowance for loan losses for the periods indicated.

Allowance for Loan Losses

(Dollars In Thousands)	2018	2017	2016	2015	2014
Balance, beginning	$ 3,758	$ 3,636	$ 3,298	$ 3,332	$ 3,721
Provision charged to operating expense	561	1,142	1,082	–	–
Recoveries of amounts charged off	90	58	104	46	75
Loans charged off	(417)	(1,078)	(848)	(80)	(464)
Balance, ending	$ 3,992	$ 3,758	$ 3,636	$ 3,298	$ 3,332
Ratio of net charge-offs to average loans	0.07%	0.24%	0.19%	0.01%	0.12%

The following table presents the allocation of the Allowance for Loan Losses for the periods indicated. The Allowance for Loan Losses is allocated in the manner prescribed by ASU 2010-20 (Refer to Note 1 of Consolidated Financial Statements). Some unallocated reserves are desirable given the degree of estimation involved in the nature of the analysis of the adequacy of the allowance for loan losses.

December 31, (Dollars in thousands)	2018		2017		2016		2015		2014	
	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans	Amount	% of Loans in Each Category to Total Loans
Construction:										
Residential	$ 111	3.7%	$ 94	3.4%	$ 63	3.2%	$ 83	3.0%	$ 43	2.3%
Land acquisition, development & commercial	239	6.1	311	8.0	173	7.4	187	7.2	453	7.0
Real Estate:										
Residential	1,082	30.4	955	27.4	866	27.3	1,047	26.0	833	24.5
Commercial	1,631	39.2	1,603	39.2	1,516	38.4	1,001	40.7	1,012	42.3
Commercial, industrial & agricultural	456	12.8	441	13.8	461	14.4	531	13.5	319	14.2
Equity lines	252	6.1	237	6.5	338	7.2	277	7.3	423	6.8
Consumer	142	1.7	108	1.7	97	2.1	85	2.3	65	2.9
Unallocated	79	—	9	—	122	—	87	—	184	—
Total allowance for loan losses	$ 3,992	100.0%	$ 3,758	100.0%	$ 3,636	100.0%	$ 3,298	100.0%	$ 3,332	100.0%

Investment Portfolio

At December 31, 2018, 2017 and 2016 all of the Company's securities were classified as available-for-sale. The composition of the investment portfolio for the years ending December 31, 2018 and 2017 appear in Note 2 of this report. The following table presents the composition of the investment portfolio as of December 31, 2016.

(Dollars In Thousands)	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government agency securities	$ 12,422	$ 118	$ (96)	$ 12,444
Mortgage-backed securities and CMO's	19,979	54	(265)	19,768
Corporate securities	5,000	66	-	5,066
Municipal securities	15,659	266	(228)	15,697
	$ 53,060	$ 504	$ (589)	$ 52,975

The Company began recording income tax expense in 2012, based on an assessment of the Company's profitable operations over the preceding quarters and projections of future taxable income. Able to now realize the associated tax benefit from investing in non-taxable municipal securities, the Company has restructured the portfolio to take advantage of this favorable income tax treatment.

Securities Available for Sale, Maturity Distribution and Average Yields

(Dollars in thousands)	December 31, 2018 Amortized Cost	Fair Value	Weighted Average Yield
U.S. government agency securities:			
Maturing within 1 year	$ –	$ –	–%
Maturing after 1 year and within 5 years	1,936	1,910	3.38
Maturing after 5 years and within 10 years	2,619	2,599	3.33
Maturing after 10 years	6,183	6,073	4.23
Mortgage backed securities and CMO's:			
Maturing within 1 year	–	–	–
Maturing after 1 year and within 5 years	376	369	4.50
Maturing after 5 years and within 10 years	2,230	2,177	3.01
Maturing after 10 years	16,919	16,383	3.16
Corporate securities:			
Maturing within 1 year	–	–	–
Maturing after 1 year and within 5 years	–	–	–
Maturing after 5 years and within 10 years	6,641	6,439	4.63
Maturing after 10 years	–	–	–
Taxable municipal securities:			
Maturing within 1 year	456	453	1.92
Maturing after 1 year and within 5 years	–	–	–
Maturing after 5 years and within 10 years	774	806	5.71
Maturing after 10 years	–	–	–
Nontaxable municipal securities:			
Maturing within 1 year	–	–	–
Maturing after 1 year and within 5 years	–	–	–
Maturing after 5 years and within 10 years	1,456	1,458	3.22
Maturing after 10 years	6,413	6,309	4.25
Total Maturities	$ 46,003	$ 44,976	3.73%

The weighted average yield for nontaxable municipal securities is reported on a tax equivalent basis.

Deposits

The Company's primary source of funds is deposit accounts. The Company's deposit base is comprised of demand deposits, savings and money market accounts, and time deposits. The Company's deposits are provided primarily by individuals and businesses located in the Company's market area. The Company is a member of the Promontory Financial Network and uses its CDARS and ICS programs to provide FDIC deposit insurance coverage for certificates of deposit or demand deposits in excess of $250 thousand, when requested by customers.

Total deposits increased by $16 million or 3.3% from $477.3 million at December 31, 2017 to $493.2 million at December 31, 2018. The Company's ability to attract and retain deposits, and our cost of funds, has been, and will continue to be significantly affected by market conditions. Core deposits increased by $20 million or 4.3% from $458 million at December 31, 2017 to $477 million at December 31, 2018. The regulators changed the definition of brokered deposits in 2018 to exclude customer reciprocal CDARs and ICS deposits. Core deposits at December 31, 2017 was restated to include these deposits.

The following table is a schedule of average balances and average rates paid for each deposit category for the periods presented:

Average Deposits and Rates Paid
December 31,

	2018		2017		2016	
(Dollars in thousands)	Amount	Rate	Amount	Rate	Amount	Rate
Non-interest bearing deposits	$ 115,623	–%	$ 107,072	–%	$ 85,846	–%
Interest bearing accounts:						
Checking	105,043	0.27	97,172	0.20	80,128	0.16
Money market savings	80,517	0.54	72,765	0.25	70,877	0.24
Regular savings	51,093	0.43	50,803	0.36	41,931	0.36
Time Deposits	130,022	1.47	139,792	1.23	149,969	1.18
Total Interest Bearing	366,675	0.77%	360,532	0.63%	342,905	0.65%
Total	$ 482,298		$ 467,604		$ 428,751	

The following table is a schedule of maturities for time deposits of $100,000 or more at the dates indicated:

Maturities of Certificates of Deposits with Balances of $100,000 or More

(Dollars in thousands)	Within 3 months	3 to 6 months	6 to 12 months	Over 1 year	Total	Percent of Total Deposits
At December 31, 2018	$ 11,222	$ 7,263	$ 25,789	$ 30,835	$ 75,109	15.23%

Liquidity and Interest Rate Sensitivity

Liquidity is identified as the ability to generate or acquire sufficient amounts of cash when needed and at a reasonable cost to accommodate withdrawals, payments of debt, and increased loan demand. Liquid assets include cash, federal funds sold, securities classified as available for sale as well as loans and securities maturing within one year. As a result of the Company’s management of liquid assets and the ability to generate liquidity through liability funding, management believes the Company maintains overall liquidity sufficient to satisfy its depositors’ requirements and meet its customers’ credit needs.

The Company’s management, under the direction of the Asset/Liability Committee of the Board of Directors, reviews the mix of monetary assets and liabilities to ensure the Company maintains an adequate level of liquidity at all times. This ensures that the Company’s sources of funds, primarily net fluctuations in customer deposits, investments, securities and correspondent banking relationships, must be balanced with the Company’s obligations, commitments, and operational requirements, to maintain overall liquidity in conjunction with the maximization of interest rate spreads.

The Company’s asset-based liquidity position, cash and due from bank balances, federal funds sold, loans held for sale, securities available for sale, net of securities pledged and cash balance requirements totaled $57.9 million at December 31, 2018, compared to $65.2 million at December 31, 2017. Liquidity trended downward during 2018 as the securities available for sale paydowns were not reinvested due to unfavorable market conditions. The strategy of not reinvesting investment paydowns was further exacerbated by the impending merger. These funds were invested to satisfy loan demand.

The Company’s primary source of funding is its retail deposit base. The Company aggressively markets in its trade area and seeks demand deposits through service-related tactics and savings deposits through competitive pricing. If deposits are not an attractive source for funding, either for reasons of maturity or pricing, alternative sources include FHLB advances, brokered deposits, fed funds purchased and lines of credit. The Company is approved to borrow 20% of our total assets from the FHLB subject to providing qualifying collateral. At December 31, 2018, the Company had borrowed $7.9 million of the $20.9 million of lendable collateral value, leaving $12.9 million of unused credit immediately available. The Company also had $26.0 million of fed funds lines of credit available at the end of 2018. In addition, the Company had access to a $10.0 million credit line through Promontory’s Insured Cash Sweep (ICS) one way buy program at a rate of the one-month LIBOR plus 11 basis points but not less than 20 basis points. At December 31, 2018, $5.0 million of the $10.0 million ICS credit line was drawn down; there were no advances on the fed funds lines.

A financial institution can be exposed to several market risks that may impact its value or future earnings capacity. These risks include interest rate risk, foreign currency exchange risk, commodity price risk and equity market price risk. The Company’s primary market risk is interest rate risk. Interest rate risk is inherent, because as a financial institution, a significant amount of operating revenue is derived from customer deposits and possible borrowings at various terms and rates. These funds are then invested into earning assets (loans and investments) at various terms and rates.

Interest rate risk is the exposure to fluctuations in future earnings (earnings at risk) and value (value at risk) resulting from changes in interest rates. This exposure results from differences between the amounts of interest earning assets and interest-bearing liabilities that reprice within a specific time period as a result of scheduled maturities and repayment and contractual interest rate changes.

Interest rate sensitivity at December 31, 2018 is summarized in the table below

	Interest Rate Sensitivity	
Rate Shock	**Net Interest Income (NII)**	**NII Change from Level**
+400	$ 20,960	4.86%
+300	20,740	3.76%
+200	20,501	2.56%
+100	20,232	1.22%
Level	19,988	- %
-100	19,525	-2.32%
-200	19,276	-3.56%
-300	19,248	-3.71%

The shifts in net interest income due to rate shocks are all within our policy limits. Recent growth in the loan portfolio has been in fixed rate products decreasing the impact of interest rate shocks on net interest income. Growth in a Prime based money market product has also decreased the asset sensitivity of the balance sheet. Net interest income continues to increase with increases in interest rates.

The primary objective of our asset/liability management process is to maximize current and future net interest income within acceptable levels of interest rate risk while satisfying liquidity and capital requirements. Management recognizes that a certain amount of interest rate risk is inherent and appropriate. The goal is to maintain a balance between risk and reward such that net interest income is maximized while risk is maintained at an acceptable level.

Management strives to control the exposure to interest rate volatility and operates under policies and guidelines established by the Board of Directors, who set the level of acceptable risk, by understanding, reviewing and making decisions based on the Company's risk position. In addition, pricing, promotion and product development activities are assessed in an effort to emphasize the loan and deposit term or repricing characteristics that best meet current interest risk objectives. A variety of analytical systems and balance sheet tools are used to manage interest rate risk.

Interest Rate Sensitivity

(Dollars in thousands)	0 - 3 Months	3 - 12 Months	1 - 5 Years	Over 5 Years	Total
Interest Earning Assets					
Securities	$ 9,165	$ 4,594	$ 15,374	$ 19,111	$ 48,244
Interest-bearing deposits in other banks	7,439	—	—	—	7,439
Loans	132,503	56,759	228,476	53,724	471,462
Loans held for sale	85	—	—	—	85
Federal funds sold	194	—	—	—	194
Total	$ **149,386**	$ 61,353	$ 243,850	$ 72,835	$ 527,424
Cumulative totals	$ **149,386**	$ 210,739	$ 454,589	$ 527,424	
Interest Bearing Liabilities					
Interest checking	$ 107,003	$ —	$ —	$ —	$ 107,003
Savings	45,543	—	—	—	45,543
Money market	99,104	—	—	—	99,104
Time deposits	18,500	52,889	52,243	347	123,979
FHLB borrowings	6,583	1,000	361	—	7,944
Subordinated notes	—	—	7,285	—	7,285
Other borrowings	201	—	—	—	201
Total	276,934	53,889	59,889	347	391,059
Cumulative totals	276,934	330,823	390,712	391,059	
Interest sensitivity gap	$ (127,548)	$ 7,464	$ 183,961	$ 72,488	$ 136,365
Cumulative interest sensitivity gap	$ (127,548)	$ (120,084)	$ 63,877	$ 136,365	
Cumulative interest sensitivity gap to total interest earning assets	(24.18%)	(22.77%)	12.11%	25.85%	

Capital Resources

To enable future growth of the Company, there must be an adequate level of capital. Management reviews the Company's capital to ensure that the amount, composition and quality of the Company's assets and liabilities satisfy regulatory requirements, meet or exceed industry standards, and support projected Company growth. The Company's stock is traded on the NASDAQ Capital Market under the symbol "HMTA."

At December 31, 2018 and December 31, 2017, the Company had stockholders' equity of $53.7 million and $50.9 million, respectively, an increase of $2.8 million or 5.5%.

The ability to pay dividends to common stockholders is limited by regulatory restrictions and the need to maintain sufficient capital in the Company and in our subsidiaries. No cash dividends were paid to common stockholders prior to 2018. The Company declared and paid its first cash dividends to common shareholders in 2018. Dividends of $0.04 per common share were paid in each of the latter three quarters of 2018. On February 20, 2019 the Company declared a dividend of $0.04 per common share to be paid in the first quarter of 2019. The Company must consider different factors to ensure that any future dividends to common stockholders would be prudent relative to the organization's financial position and is not based on overly optimistic earnings scenarios. The Company had $7.0 million in retained earnings at the end of 2018.

The Basel III capital framework represented the most comprehensive overhaul of the U.S. banking capital framework in over two decades. This new capital framework and related changes to the standardized calculations of risk-weighted assets were complex and created additional compliance burdens. Basel III rules became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule. The Basel III Capital Rules have required significantly more capital and adopted more demanding regulatory capital risk weightings and calculations. As a result of the Basel III Capital Rules, many community banks may be forced to limit banking operations and activities, and growth of loan portfolios, in order to focus on retention of earnings to improve capital levels. The Company believes that it maintains sufficient levels of Tier 1 and Common Equity Tier 1 capital to comply with the Basel III Final Rules. However, increased capital requirements imposed by the Basel III Capital Rules may require the Company to limit its banking operations, retain net income to improve regulatory capital levels, which could negatively affect our business, financial condition and results of operations. See Note 18 for additional discussion of capital requirements.

The Company met the eligibility criteria of a small bank holding company in accordance with the Federal Reserve's Small Bank Holding Company Policy statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. The table presents the Bank's capital amounts and ratios calculated using the Basel III rules in effect at December 31, 2018, and December 31, 2017.

Risk Based Capital Analysis

Capital Analysis

HomeTown Bank (Dollars in thousands)	**December 31, 2018**	**2017**
Common Equity Tier 1 Capital:		
Common Stock	$ 14,697	$ 14,697
Surplus	32,427	32,226
Retained Earnings	14,179	10,551
Common Equity Tier 1 Capital	61,303	57,474
Tier 1 Capital:		
Tier 1 Minority Interest	2	25
Tier 1 Capital	61,305	57,499
Total Capital:		
Allowance for Loan Losses (allowable portion)	3,992	3,758
Total Capital	$ 65,297	$ 61,257
Capital Ratios:		
Total Capital to Risk-Weighted Assets	12.49%	12.48%
Tier 1 Common Equity to Risk-Weighted Assets	11.72%	11.71%
Tier 1 Capital to Risk-Weighted Assets	11.72%	11.72%
Tier 1 Capital to Average Assets	10.79%	10.39%

Financial Instruments with off Balance Sheet Risk and Contractual Obligations and Other Commitments

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve elements of credit risk and interest rate risk in excess of the amount recognized in the balance sheets. The contractual amounts of these instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instruments for commitments to extend credit and letters of credit written is represented by the contractual amount of these instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Note 17 provides additional detail regarding commitments at the end of 2018 and 2017. There are no commitments to extend credit on impaired loans.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments may expire without being completely drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Not Required.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following financial statements are filed as a part of this report:

Financial Statements

Consolidated Balance Sheets, December 31, 2018 and 2017

Consolidated Statements of Income, Years Ended December 31, 2018 and 2017

Consolidated Statements of Comprehensive Income, Years Ended December 31, 2018 and 2017

Consolidated Statements of Changes in Stockholders' Equity, Years Ended December 31, 2018 and 2017

Consolidated Statements of Cash Flows, Years Ended December 31, 2018 and 2017

Notes to Consolidated Financial Statements

Report of Independent Registered Public Accounting Firm

HomeTown Bankshares Corporation
Consolidated Balance Sheets
December 31, 2018 and 2017

Dollars in Thousands, Except Share and Per Share Data	**December 31, 2018**	**December 31, 2017**
Assets		
Cash and due from banks	$ 22,771	$ 21,714
Federal funds sold	194	180
Securities available for sale, at fair value	44,976	55,344
Restricted equity securities, at cost	2,241	2,371
Loans held for sale	85	1,587
Loans, net of allowance for loan losses of $3,992 in 2018 and $3,758 in 2017	467,470	440,437
Property and equipment, net	12,943	12,937
Other real estate owned, net of valuation allowance of $328 in 2018 and $797 in 2017	1,893	3,249
Bank owned life insurance	8,197	8,669
Accrued income	2,299	2,681
Other assets	1,909	1,084
Total assets	$ 564,978	$ 550,253
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing	$ 117,544	$ 106,956
Interest-bearing	375,629	370,364
Total deposits	493,173	477,320
Federal Home Loan Bank borrowings	7,944	11,028
Subordinated notes	7,285	7,254
Other borrowings	83	1,558
Accrued interest payable	403	368
Other liabilities	2,391	1,833
Total liabilities	511,279	499,361
Commitments and contingencies		
Stockholders' equity:		
Common stock, $5 par value; authorized 10,000,000 shares, issued and outstanding 5,810,023 (includes 28,147 restricted shares) at December 31, 2018 and 5,775,597 (includes 32,087 restricted shares) at December 31, 2017	28,909	28,777
Surplus	18,228	17,980
Retained earnings	7,024	3,767
Accumulated other comprehensive loss	(811)	(141)
Total HomeTown Bankshares Corporation stockholders' equity	53,350	50,383
Noncontrolling interest in consolidated subsidiary	349	509
Total stockholders' equity	53,699	50,892
Total liabilities and stockholders' equity	$ 564,978	$ 550,253

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Income
For the years ended December 31, 2018 and 2017

Dollars in Thousands, Except Share and Per Share Data	2018	2017
Interest and dividend income:		
Loans and fees on loans	$ 20,820	$ 18,973
Taxable investment securities	1,102	1,031
Nontaxable investment securities	229	308
Dividends on restricted stock	151	132
Other interest income	188	225
Total interest and dividend income	22,490	20,669
Interest expense:		
Deposits	2,841	2,282
Subordinated notes	536	537
Other borrowed funds	323	227
Total interest expense	3,700	3,046
Net interest income	18,790	17,623
Provision for loan losses	561	1,142
Net interest income after provision for loan losses	18,229	16,481
Noninterest income:		
Service charges on deposit accounts	578	544
ATM and interchange income	1,055	837
Mortgage banking	712	959
Gains on sales of investment securities, net	60	69
Income from life insurance death benefit	642	–
Other income	651	874
Total noninterest income	3,698	3,283
Noninterest expense:		
Salaries and employee benefits	8,648	8,098
Occupancy and equipment expense	1,676	1,650
Data processing expense	1,498	1,314
ATM maintenance expense	90	197
Advertising and marketing expense	606	537
Professional fees	421	588
Bank franchise taxes	419	399
FDIC insurance expense	235	248
Losses on sales and write-downs of other real estate owned, net	334	581
Other real estate owned expense	280	106
Directors' fees	392	410
Merger-related expense	788	–
Other expense	1,697	1,839
Total noninterest expense	17,084	15,967
Net income before income taxes	4,843	3,797
Income tax expense	845	1,228
Net income	3,998	2,569
Less net income attributable to non-controlling interest	44	73
Net income attributable to HomeTown Bankshares Corporation	$ 3,954	$ 2,496
Basic earnings per common share	$ 0.68	$ 0.43
Diluted earnings per common share	$ 0.68	$ 0.43
Weighted average common shares outstanding	5,805,654	5,769,752
Diluted weighted average common shares outstanding	5,853,277	5,804,382

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Comprehensive Income
For the years ended December 31, 2018 and 2017

Dollars in Thousands	2018	2017
Net income	$ 3,998	$ 2,569
Other comprehensive loss:		
Net unrealized holding losses on securities available for sale during the period	(788)	(25)
Deferred income tax benefit on unrealized holding losses on securities available for sale	165	9
Reclassification adjustment for gains on sales of investment securities included in net income	(60)	(69)
Tax expense related to realized gains on securities sold	13	24
Total other comprehensive loss	(670)	(61)
Comprehensive income	3,328	2,508
Less: comprehensive income attributable to the non-controlling interest	44	73
Comprehensive income attributable to HomeTown Bankshares Corporation	$ 3,284	$ 2,435

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Changes in Stockholders' Equity
For the years ended December 31, 2018 and 2017

Dollars in Thousands, Except Share and Per Share Data

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance, December 31, 2016	$ 28,765	$ 17,833	$ 1,247	$ (56)	$ 436	$ 48,225
Net income			2,496		73	2,569
Other comprehensive loss, net of tax				(61)		(61)
Net settlement of restricted stock vesting (9,821 shares, net)	(10)	(10)				(20)
Exercise of stock options (4,500 shares)	22	9				31
Reclassification of stranded tax effects from change in tax rate			24	(24)		–
Stock based compensation		148				148
Balance, December 31, 2017	28,777	17,980	3,767	(141)	509	50,892
Net income			3,954		44	3,998
Capital distribution					(204)	(204)
Other comprehensive loss, net of tax				(670)		(670)
Net settlement of restricted stock vesting (14,348 shares, net)	65	(85)				(20)
Exercise of stock options (13,471 shares, net)	67	18				85
Common stock cash dividend declared $0.12 per share			(697)			(697)
Stock based compensation		315				315
Balance, December 31, 2018	$ 28,909	$ 18,228	$ 7,024	$ (811)	$ 349	$ 53,699

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Consolidated Statements of Cash Flows
For the years ended December 31, 2018 and 2017

Dollars in Thousands	2018	2017
Cash flows from operating activities:		
Net income	$ 3,998	$ 2,569
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	678	726
Provision for loan losses	561	1,142
Amortization of premium on securities, net	409	465
Amortization of discount on subordinated notes	31	30
Losses on sales and write-downs of other real estate, net	334	581
Gains on sales of investment securities	(60)	(69)
Increase in value of life insurance contracts	(202)	(200)
Income from life insurance death benefit	(642)	–
Stock compensation expense	315	148
Originations of loans held for sale	(25,394)	(33,611)
Proceeds from sales of loans held for sale	27,405	33,392
Gains on sales of loans held for sale	(509)	(690)
Changes in assets and liabilities:		
Accrued income	382	(392)
Other assets	(439)	(53)
Deferred taxes, net	(208)	(123)
Accrued interest payable	35	(18)
Other liabilities	558	343
Net cash flows provided by operating activities	7,252	4,240
Cash flows from investing activities:		
Net increase in federal funds sold	(14)	(138)
Purchases of available for sale securities	(900)	(23,403)
Sales, maturities, and calls of available for sale securities	10,071	20,544
Redemptions (purchase) of restricted equity securities, net	130	(158)
Net increase in loans	(28,291)	(27,248)
Proceeds from sales of other real estate	1,719	988
Purchases of bank owned life insurance	–	(1,000)
Death benefit from bank owned life insurance	1,316	–
Purchases of property and equipment	(684)	(292)
Net cash flows used in investing activities	(16,653)	(30,707)
Cash flows from financing activities:		
Net increase in noninterest-bearing deposits	10,588	15,602
Net increase in interest-bearing deposits	5,265	10,870
Net increase (decrease) in FHLB borrowings	(3,084)	3,028
Net increase (decrease) in other borrowings	(1,475)	441
Distribution of equity of non-controlling interest	(204)	–
Common stock cash dividends paid	(697)	–
Exercise of stock options	85	31
Net settlement of restricted stock and cash in lieu of fractional shares	(20)	(20)
Net cash flows provided by financing activities	10,458	29,952
Net increase in cash and cash equivalents	1,057	3,485
Cash and cash equivalents, beginning	21,714	18,229
Cash and cash equivalents, ending	$ 22,771	$ 21,714
Supplemental disclosure of cash flow information:		
Cash payments for interest	$ 3,665	$ 3,064
Cash payments for income taxes	$ 1,245	$ 1,461
Supplemental disclosure of noncash investing and financing activities:		
Transfer from loans to other real estate owned	$ 697	$ 1,024
Change in unrealized gains and losses on available for sale securities	$ (848)	$ (94)

See Notes to Consolidated Financial Statements

HomeTown Bankshares Corporation
Notes to Consolidated Financial Statements

Note 1. Organization and Summary of Significant Accounting Policies

Organization

On September 4, 2009, HomeTown Bankshares Corporation (the "Company") acquired all outstanding stock of HomeTown Bank (the "Bank") in an exchange for shares of the Company on a one-for-one basis to become a single-bank holding company with the Bank becoming a wholly-owned subsidiary. The Bank was organized and incorporated under the laws of the State of Virginia on November 9, 2004 and commenced operations on November 14, 2005. The Bank currently serves Roanoke City, Virginia; the County of Roanoke, Virginia; the City of Salem, Virginia; Christiansburg, Virginia; and surrounding areas. As a state chartered bank, which is a member of the Federal Reserve System, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions, the Federal Deposit Insurance Corporation and the Federal Reserve Board.

In 2013 the Bank formed a joint venture with another entity and now has a 49% ownership interest in HomeTown Residential Mortgage, LLC. The consolidated financial statements of HomeTown Bankshares Corporation include the accounts of its wholly-owned subsidiary HomeTown Bank and the accounts of its subsidiary, HomeTown Residential Mortgage LLC. HomeTown Residential Mortgage LLC originates and sells mortgages secured by personal residences. Due to the marketing support and direction provided by HomeTown Bank to HomeTown Residential Mortgage LLC, along with guarantees of warehouse lines of credit used in its operation, the Company is deemed to exercise control of this entity. The ownership interest in HomeTown Residential Mortgage LLC not owned by the Company is reported as a Non-Controlling Interest in a Consolidated Subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

On October 1, 2018, the Company and American National Bankshares, Inc. ("American National") announced a definitive agreement to combine in a strategic merger (the "Merger Agreement") pursuant to which the Company will merge with and into American National (the "Merger"). As a result of the Merger, the holders of shares of the Company's common stock will receive 0.4150 shares of American National common stock for each share of the Company's common stock held immediately prior to the effective date of the Merger. The transaction is expected to be completed in the second quarter of 2019, subject to approval of both companies' shareholders, regulatory approvals and other customary closing conditions.

Summary of Significant Accounting Policies

The following is a description of the significant accounting and reporting policies the Company follows in preparing and presenting its consolidated financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of HomeTown Bankshares Corporation and its wholly-owned subsidiary HomeTown Bank. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

In preparing 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 consolidated 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, the valuation of other real estate owned, and the valuation of deferred tax assets. Substantially all of the Company's loan portfolio consists of loans in its market area. Accordingly, the ultimate collectability of a substantial portion of the Company's loan portfolio and the recovery of a substantial portion of the carrying amount of foreclosed real estate (as applicable) is susceptible to changes in local market conditions.

Cash and Cash Equivalents

Cash and cash equivalents include cash on hand and amounts due from correspondent banks. For the purpose of presentation in the consolidated statements of cash flows, cash and cash equivalents are defined as those amounts included in the consolidated balance sheet caption "cash and due from banks."

Securities

Investments in debt securities with readily determinable fair values are classified as either held to maturity, available for sale, or trading, based on management's intent. Currently, all of the Company's investment securities are classified as available for sale. Available for sale securities are carried at estimated fair value with the corresponding unrealized gains and losses excluded from earnings and reported in other comprehensive income. Gains or losses are recognized in earnings on the trade date using the amortized cost of the specific security sold. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) the Company intends to sell the security or (ii) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If, however, the Company does not intend to sell the security and it is not likely that it will be required to sell the security before recovery, the Company must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. The Company regularly reviews each investment security for other-than-temporary impairment based on criteria that include the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, the best estimate of the present value of cash flows expected to be collected from debt securities, the Company's intention with regard to holding the security to maturity and the likelihood that the Company would be required to sell the security before recovery.

Restricted Equity Securities

As members of the Federal Reserve Bank (FRB) and the Federal Home Loan Bank (FHLB), the Bank is required to maintain certain minimum investments in the capital stock of the FRB and FHLB. The Company's investment in these securities is recorded at cost, based on the redemption provisions of the FRB and FHLB.

Loans Held for Sale

Secondary market mortgage loans are designated as held for sale at the time of their origination. These loans are pre-sold with servicing released and the Company does not retain any interest after the loans are sold. These loans consist primarily of fixed-rate, single-family residential mortgage loans which meet the underwriting characteristics of certain government sponsored enterprises (conforming loans). In addition, the Company requires a firm purchase commitment from a permanent investor before a loan can be committed, thus limiting interest rate risk. Loans held for sale are carried at fair value. Gains and losses on sales of loans are recognized at the loan closing date and are included in noninterest income.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding principal amount adjusted for any charge-offs, allowance for loan losses and deferred fees or costs on originated loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment of the yield of the related loan.

Interest is accrued and credited to income based on the principal amount outstanding. The accrual of interest on impaired loans for all classes is discontinued when, in management's opinion, the borrower may be unable to meet payments as they become due. When interest accrual is discontinued, all unpaid accrued interest for the current year is reversed. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Interest income is subsequently recognized only to the extent cash payments are received. When facts and circumstances indicate the borrower has regained the ability to meet the required payments, the loan is returned to accrual status. Past-due status of loans is determined based on contractual terms. The loan portfolio is comprised of the following classes.

- Residential real estate construction loans carry risks that the home will not be finished according to schedule, will not be finished according to the budget and the value of the collateral, at any point in time, may be less than the principal amount of the loan. Construction loans also bear the risk that the general contractor may be unable to finish the construction project as planned because of financial pressure unrelated to the project.

- Land acquisition and development loans and commercial construction loans carry risks that the project will not be finished according to schedule, will not be finished according to budget and the value of the collateral, at any point in time, may be less than the principal amount of the loan. Land acquisition and development loans and commercial construction loans also bear the risk that the developer, in the case of land acquisition and development loans, or the general contractor, in the case of commercial construction loans, may be unable to finish the development or construction project as planned because of financial pressure unrelated to the project.

- Residential real estate loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

- Commercial real estate loans carry risks associated with the successful operation of a business or a real estate project, in addition to other risks associated with the ownership of real estate, because the repayment of these loans may be dependent upon the profitability and cash flows of the business or project.

- Commercial, industrial and agricultural loans carry risks associated with the successful operation of a business. Typically repayment is dependent on the cash flow of the business, and is secured by business assets, such as accounts receivable, equipment, and inventory. There is risk associated with the value of the collateral which may depreciate over time and cannot be appraised with as much precision.

- Equity lines of credit carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.

- Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral (e.g., rapidly depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s obtainable market price, or the fair value of the collateral, less cost to sell, if the loan is collateral dependent.

TDRs (Troubled Debt Restructurings) occur when the Company agrees to significantly modify the original terms of a loan due to the deterioration in the financial condition of the borrower. TDRs are considered impaired loans. Upon designation as a TDR, the Company evaluates the borrower’s payment history, past-due status and ability to make payments based on the revised terms of the loan. If a loan was accruing prior to being modified as a TDR and if the Company concludes that the borrower is able to make such payments, and there are no other factors or circumstances that would cause it to conclude otherwise, the loan will remain on an accruing status. If a loan was on nonaccrual status at the time of the TDR, the loan will remain on nonaccrual status following the modification and may be returned to accrual status based on a record of making payments as scheduled for a period of six consecutive months.

Allowance for Loan Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Consumer loans are charged off when they become 120 days past due. Non-consumer loans are charged off when the loan becomes 180 days past due unless the loan is well secured and in the process of collection. Borrowers that are in bankruptcy are charged off unless the debt has been reaffirmed and is well secured and recovery is probable. 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 in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower’s ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired, and is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. For collateral dependent loans, an updated appraisal will be ordered if a current one is not on file. Appraisals are performed by independent third-party appraisers with relevant industry experience. Adjustments to the appraised value may be made based on recent sales of like properties or general market conditions when appropriate. The general component covers non-classified, or performing, loans and those loans classified as substandard or special mention that are not impaired. The general component is based on historical loss experience adjusted for qualitative factors, such as current economic conditions, including current home sales and foreclosures, unemployment rates and retail sales. The characteristics of the loan ratings are as follows:

- Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. The borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. When necessary, acceptable personal guarantors support the loan.

- Special mention loans have a specific defined weakness in the borrower's operations and the borrower's ability to generate positive cash flow on a sustained basis. The borrower's recent payment history may be characterized by late payments. The Company's risk exposure is mitigated by collateral supporting the loan. The collateral is considered to be well-margined, well maintained, accessible and readily marketable.

- Substandard loans are considered to have specific and well-defined weaknesses that jeopardize the viability of the Company's credit extension. The payment history for the loan may have been inconsistent, and the expected or projected primary repayment source may be inadequate to service the loan. The estimated net liquidation value of the collateral pledged and/or ability of the personal guarantor(s) to pay the loan may not adequately protect the Company. There is a distinct possibility that the Company will sustain some loss if the deficiencies associated with the loan are not corrected in the near term. A substandard loan would not automatically meet our definition of impaired unless the loan is significantly past due and the borrower's performance and financial condition provide evidence that it is probable that the Company will be unable to collect all amounts due.

- Substandard nonaccrual loans have the same characteristics as substandard loans; however, they have a non-accrual classification and are considered impaired.

- Doubtful rated loans have all the weaknesses inherent in a loan that is classified substandard but with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is extremely high.

- Loss rated loans are not considered collectible under normal circumstances, and there is no realistic expectation for any future payment on the loan. Loss rated loans are fully charged off.

Loan Fees and Costs

Loan origination and commitment fees and certain direct loan origination costs charged by the Bank are deferred and the net amount amortized as an adjustment of the related loan's yield. The Bank is amortizing these net amounts over the contractual life of the related loans or, in the case of demand loans, over the estimated life. Net fees related to standby letters of credit are recognized over the commitment period.

Property and Equipment

Land is carried at cost. Buildings, equipment, and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Depreciation is provided over the estimated useful lives of the respective assets on the straight-line basis. Estimated useful lives range from ten to forty years for buildings and leasehold improvements, and from three to ten years for equipment, furniture, and fixtures. Leasehold improvements are amortized over a term which includes the remaining lease term and probable renewal periods on a straight-line basis. Maintenance and repairs are charged to expense as incurred and major improvements are capitalized.

Other Real Estate Owned

Real estate properties acquired through, or in lieu of, loan foreclosure are to be sold and are initially recorded at fair value less anticipated cost to sell at the date of foreclosure establishing a new cost basis. After foreclosure, valuations are periodically performed by management, and the real estate is carried at the lower of carrying amount or fair value less cost to sell. Changes in the valuation allowance are included in the income statement in the line "Losses on sales and write-downs of other real estate owned, net."

Bank Owned Life Insurance

The Company purchased life insurance policies on certain key executives. These policies are recorded at their cash surrender value. Increases in the cash surrender value of the life insurance contracts are included in noninterest income in the consolidated income statement caption "other 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, or the ability to unilaterally cause the transferee to return specific assets.

Advertising Expense

The Company expenses advertising and marketing costs as they are incurred.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability 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 basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the consolidated financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the consolidated statement of income. There are no unrecognized tax benefits as of December 31, 2018 and 2017.

Earnings per Common Share

Basic earnings per common share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period, after giving retroactive effect to stock splits and dividends. Nonvested restricted shares are included in basic earnings per share because of dividend participation rights. Diluted earnings per common share is similar to the computation of basic earnings per common share except that the denominator is increased to include the number of additional common shares that would have been outstanding if dilutive potential common shares had been issued. The numerator is adjusted for any changes in income or loss that would result from the assumed conversion of those potential common shares. Potential common shares that may be issued by the Company relate to the outstanding stock options. The potential dilutive effect of the outstanding stock options is determined using the treasury stock method.

Comprehensive Income

Comprehensive income reflects the change in the Company’s equity during the year arising from transactions and events other than investment by and distributions to stockholders. It consists of net income plus certain other changes in assets and liabilities that are reported as separate components of stockholders’ equity rather than as income or expense. These changes for the Company relate solely to unrealized gains and losses on securities available for sale.

In February 2018, the FASB issued ASU 2018-02, “Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (“AOCI”).” The Company early adopted this new standard in 2017. ASU 2018-02 requires reclassification from AOCI to retained earnings for stranded tax effects resulting from the impact of the newly enacted federal income tax rate on items included in AOCI. The amount of this reclassification in 2017 was $24 thousand.

Fair Value Measurements

During the first quarter of 2018, the Company adopted ASU 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." The amendments in ASU 2016-01, among other things: (1) requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; (2) requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; (3) requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables); and (4) eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The adoption of ASU No. 2016-01 on January 1, 2018 did not have a material impact on the Company’s Consolidated Financial Statements. In accordance with (2) above, the Company measured the fair value of its loan and deposit portfolios and subordinated debt as of December 31, 2018 using an exit price notion (see Note 11 Fair Value Measurement). The disclosure included for the period ended December 31, 2017 continues to be presented utilizing entry price assumptions.

Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2016-10 “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing” and all subsequent ASUs that modified Topic 606. This standard is on the recognition of revenue from contracts with customers with the core principle being for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also results in enhanced disclosures about revenue, provides guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. The Company’s revenue is comprised of net interest income on financial assets and liabilities, which is explicitly excluded from the scope of the new guidance, and noninterest income. The contracts that are in scope of the guidance are primarily related to service charges on deposit accounts, cardholder and merchant income, other service charges and fees, sales of other real estate and miscellaneous fees. We have performed an analysis of contracts for customer service charges, ATM fees and miscellaneous income. The adoption of ASU 2016-10 did not have a material impact on our consolidated financial statements. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2018 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. In addition, certain noninterest income streams such as fees associated with mortgage servicing rights, financial guarantees, derivatives, and certain credit card fees are also not in scope of the new guidance. Topic 606 is applicable to noninterest revenue streams such as trust and asset management income, deposit related fees, interchange fees, merchant income, and annuity and insurance commissions. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts
Service charges on deposit accounts consist of account analysis fees (i.e., net fees earned on analyzed business and public checking accounts), monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for account analysis fees and monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided. Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or in the following month through a direct charge to customers’ accounts.

Fees, Exchange, and Other Service Charges
Fees, exchange, and other service charges are primarily comprised of debit and credit card income, ATM fees, merchant services income, and other service charges. Debit and credit card income is primarily comprised of interchange fees earned whenever the Company’s debit and credit cards are processed through card payment networks such as Visa. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM or a non-Company cardholder uses a Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit and credit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, bill pay service, cashier’s checks, and other services. The Company’s performance obligation for fees, exchange, and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month.

Annuity and Insurance Commissions
Annuity and insurance income primarily consists of commissions received on annuity product sales. The Company acts as an intermediary between the Company’s customer and the insurance carrier. The Company’s performance obligation is generally satisfied upon the issuance of the annuity policy. Shortly after the policy is issued, the carrier remits the commission payment to the Company, and the Company recognizes the revenue. The Company does not earn a significant amount of trailer fees on annuity sales. The majority of the trailer fees relates to variable annuity products and are calculated based on a percentage of market value at period end. Revenue is not recognized until the annuity’s market value can be determined.

Other
Other noninterest income consists of other recurring revenue streams such as commissions from sales of mutual funds and other investments, investment advisor fees from wealth management products, safety deposit box rental fees, and other miscellaneous revenue streams. Commissions from the sale of mutual funds and other investments are recognized on trade date, which is when the Company has satisfied its performance obligation. The Company also receives periodic service fees (i.e., trailers) from mutual fund companies typically based on a percentage of net asset value. Trailer revenue is recorded over time, usually monthly or quarterly, as net asset value is determined. Investment advisor fees from wealth management products are earned over time and based on an annual percentage rate of the net asset value. The investment advisor fees are charged to the customer’s account in advance on the first month of the quarter, and the revenue is recognized over the following three-month period. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment. The Company determined that since rentals and renewals occur fairly consistently over time, revenue is recognized on a basis consistent with the duration of the performance obligation.

Credit Related Financial Instruments

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

Stock-Based Compensation Plan

The 2005 Stock Option Plan was approved by stockholders on April 20, 2006, which authorized 550,000 shares of common stock to be used in the granting of incentive options to employees and directors. This plan expired in 2016. Under the plan, the option price could not be less than the fair market value of the stock on the date granted. An option's maximum term was ten years from the date of grant. Options granted under the plan were subject to a vesting schedule.

The Company accounts for the stock option plan in accordance with applicable accounting guidance. Under the fair value recognition provisions of this guidance, stock-based compensation cost was measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

In 2009, the Board of Directors authorized 137,280 (adjusted for 4% stock dividend in 2016) shares of common stock for issuance under the Restricted Stock Plan. The plan provides for restricted stock awards to key employees. Restricted shares awarded to employees generally vest over a five-year period and compensation expense is charged to income ratably over the vesting period. Compensation is accounted for using the fair market value of the Company's common stock on the date the restricted shares are awarded.

Recent Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees will be required to 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. 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. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. 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 FASB made subsequent amendments to Topic 842 in July 2018 through ASU 2018-10 ("Codification Improvements to Topic 842, Leases.") and ASU 2018-11 ("Leases (Topic 842): Targeted Improvements.") Among these amendments is the provision in ASU 2018-11 that provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). The adoption of this standard on January 1, 2019 did not have a material effect on the Company's consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The amendments in this ASU are effective for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The Bank has formed a committee to address the compliance requirements, data gathering, archiving and analysis efforts. The Bank began tracking data during the 2nd quarter of 2018 and began reassessing its position during the 4th quarter of 2018.

In March 2017, the FASB issued ASU 2017-08, "Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20), Premium Amortization on Purchased Callable Debt Securities." The amendments in this ASU shorten the amortization period for certain callable debt securities purchased at a premium. Upon adoption of the standard, premiums on these qualifying callable debt securities will be amortized to the earliest call date. Discounts on purchased debt securities will continue to be accreted to maturity. The amendments are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. Upon transition, entities should apply the guidance on a modified retrospective basis, with a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption and provide the disclosures required for a change in accounting principle. The Company is currently assessing the impact that ASU 2017-08 will have on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

Note 2. Investment Securities

Amortized cost and fair value of securities available for sale are as follows:

(Dollars in Thousands)	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government agency securities	$ 10,738	$ 33	$ (189)	$ 10,582
Mortgage-backed securities and CMO's	19,525	-	(596)	18,929
Corporate securities	6,641	37	(239)	6,439
Municipal securities	9,099	67	(140)	9,026
	$ 46,003	$ 137	$ (1,164)	$ 44,976

(Dollars in Thousands)	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Government agency securities	$ 13,475	$ 61	$ (101)	$ 13,435
Mortgage-backed securities and CMO's	24,344	12	(375)	23,981
Corporate securities	6,991	118	(42)	7,067
Municipal securities	10,713	213	(65)	10,861
	$ 55,523	$ 404	$ (583)	$ 55,344

The primary purpose of the investment portfolio is to generate income, diversify earning assets, and meet liquidity needs of the Company through readily saleable financial instruments. The portfolio is made up primarily of fixed rate bonds, whose prices move inversely with rates. At the end of any accounting period, the investment portfolio has unrealized gains and losses. The Company monitors the portfolio, which is subject to liquidity needs, market rate changes, and credit risk changes, to see if adjustments are needed. The primary concern in a loss situation is the credit quality of the business or entity behind the instrument. The primary cause of unrealized losses is the increase in market interest rates over the yields available at the time the securities were purchased.

At December 31, 2018, the Company does not consider any security in an unrealized loss position to be other-than-temporarily impaired.

U.S. Government agency securities. The unrealized losses on twenty-eight of the Company's investments in obligations of the U.S. government were caused by increases in market interest rates over the yields available at the time the securities were purchased. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. The Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Mortgage-backed securities and CMO's. The unrealized losses on thirty-six of the Company's investments in government-sponsored entity mortgage-backed securities were caused by increases in market interest rates over the yields available at the time the securities were purchased. Because the decline in market value is attributable to changes in interest rates and not credit quality, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Corporate securities. The unrealized losses on five of the Company's investments in corporate securities were caused by increases in market interest rates over the yield available at the time the security was purchased. Because the decline in market value is attributable to changes in interest rates and not credit quality, the Company does not consider this investment to be other-than-temporarily impaired at December 31, 2018.

Municipal securities. The unrealized losses on eight of the Company's investments in obligations of municipal securities were caused by increases in market interest rates over the yields available at the time the securities were purchased. All municipal securities are investment grade. Because the decline in market value is attributable to changes in interest rates and credit spreads, and not credit quality, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

The following tables demonstrate the unrealized loss position of securities available for sale at December 31, 2018 and 2017.

	December 31, 2018					
	Less than 12 months		12 months or more		Total	
(Dollars in Thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agency securities	$ 668	$ (3)	$ 8,129	$ (186)	$ 8,797	$ (189)
Mortgage-backed securities and CMO's	90	(1)	18,782	(595)	18,872	(596)
Corporate securities	1,953	(56)	1,299	(183)	3,252	(239)
Municipal securities	435	(1)	3,466	(139)	3,901	(140)
	$ 3,146	$ (61)	$ 31,676	$ (1,103)	$ 34,822	$ (1,164)

	December 31, 2017					
	Less than 12 months		12 months or more		Total	
(Dollars in Thousands)	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Government agency securities	$ 6,859	$ (44)	$ 2,995	$ (57)	$ 9,854	$ (101)
Mortgage-backed securities and CMO's	15,624	(192)	7,386	(183)	23,010	(375)
Corporate securities	1,438	(42)	-	-	1,438	(42)
Municipal securities	453	(3)	2,332	(62)	2,785	(65)
	$ 24,374	$ (281)	$ 12,713	$ (302)	$ 37,087	$ (583)

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

(Dollars In Thousands)	Amortized Cost	Fair Value
Less than one year	$ 456	$ 453
Over one through five years	2,312	2,279
Over five through ten years	13,720	13,479
Greater than 10 years	29,515	28,765
	$ 46,003	$ 44,976

Proceeds from the sales, maturities and calls of securities available for sale in 2018 and 2017 were $10.1 million and $20.5 million, respectively. The Company realized $60 thousand in net gains on sales of thirteen available for sale securities in 2018, compared to $69 thousand from the sales of forty-five securities in the prior year. The net gain in 2018 included gross gains of $68 thousand net of gross losses of $8 thousand. The prior year included gross gains of $170 thousand and gross losses of $101 thousand. Total pledged securities had a fair market value of $3.2 million at December 31, 2018 and $4.0 million at December 31, 2017. At December 31, 2018, securities having a fair market value of $1.7 million were pledged to secure public deposits, securities pledged to secure Federal Home Loan Bank borrowings totaled $74 thousand, and $1.4 million in securities were pledged for other purposes.

Note 3. Loans Receivable

The major classifications of loans in the consolidated balance sheets at December 31, 2018 and 2017 were as follows:

(Dollars in Thousands)	December 31, 2018	December 31, 2017
Construction:		
Residential	$ 17,232	$ 15,221
Land acquisition, development & commercial	28,903	35,601
Real Estate:		
Residential	143,385	121,649
Commercial	184,989	173,999
Commercial, industrial & agricultural	60,183	61,129
Equity lines	28,969	28,835
Consumer	7,719	7,693
Overdrafts	82	68
Total loans	471,462	444,195
Less allowance for loan losses	(3,992)	(3,758)
Loans, net	$ 467,470	$ 440,437

The past-due and nonaccrual status of loans as of December 31, 2018 was as follows:

(Dollars in Thousands)	30-59 Days Past-Due	60-89 Days Past-Due	90 Days or More Past-Due	Total Past-Due	Current	Total Loans	Nonaccrual Loans
Construction:							
Residential	$ 507	$ –	$ –	$ 507	$ 16,725	$ 17,232	$ –
Land acquisition, development & commercial	243	–	–	243	28,660	28,903	125
Real Estate:							
Residential	513	–	–	513	142,872	143,385	532
Commercial	856	–	–	856	184,133	184,989	463
Commercial, industrial & agricultural	206	–	–	206	60,059	60,265	162
Equity lines	398	–	–	398	28,571	28,969	400
Consumer	21	3	–	24	7,695	7,719	1
Total	$ 2,744	$ 3	$ –	$ 2,747	$ 468,715	$ 471,462	$ 1,683

The past-due and nonaccrual status of loans as of December 31, 2017 was as follows:

(Dollars in Thousands)	30-59 Days Past-Due	60-89 Days Past-Due	90 Days or More Past-Due	Total Past-Due	Current	Total Loans	Nonaccrual Loans
Construction:							
Residential	$ –	$ –	$ –	$ –	$ 15,221	$ 15,221	$ –
Land acquisition, development & commercial	43	–	274	317	35,284	35,601	274
Real Estate:							
Residential	589	870	546	2,005	119,644	121,649	173
Commercial	278	19	209	506	173,493	173,999	209
Commercial, industrial & agricultural	130	143	392	665	60,532	61,197	403
Equity lines	544	49	–	593	28,242	28,835	49
Consumer	17	2	36	55	7,638	7,693	36
Total	$ 1,601	$ 1,083	$ 1,457	$ 4,141	$ 440,054	$ 444,195	$ 1,144

There were no residential real estate loans that were past due ninety days or more and still accruing interest at December 31, 2018.

There was one residential real estate loan, totaling $373 thousand that was past due ninety days or more and still accruing interest at December 31, 2017.

Impaired loans, which include TDRs of $4.0 million, and the related allowance at December 31, 2018, were as follows:

With no related allowance: *(Dollars in Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	43	43	–	43	–
Real Estate:					
Residential	538	538	–	557	12
Commercial	4,228	4,228	–	4,350	155
Commercial, industrial & agricultural	63	63	–	66	–
Equity lines	210	298	–	299	–
Consumer	–	–	–	–	–
Total loans with no allowance	$ 5,082	$ 5,170	$ –	$ 5,315	$ 167

With an allowance recorded: *(Dollars in Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	–	–	–	–	–
Real Estate:					
Residential	–	–	–	–	–
Commercial	–	–	–	–	–
Commercial, industrial & agricultural	–	–	–	–	–
Equity lines	–	–	–	–	–
Consumer	–	–	–	–	–
Total loans with an allowance	$ –	$ –	$ –	$ –	$ –

Impaired loans, which include TDRs of $4.1 million, and the related allowance at December 31, 2017, were as follows:

With no related allowance: *(Dollars in Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	181	331	–	331	10
Real Estate:					
Residential	360	640	–	638	30
Commercial	4,098	4,273	–	4,166	161
Commercial, industrial & agricultural	379	379	–	379	15
Equity lines	299	299	–	300	14
Consumer	–	–	–	–	–
Total loans with no allowance	$ 5,317	$ 5,922	$ –	$ 5,814	$ 230

With an allowance recorded: *(Dollars in Thousands)*	Recorded Investment in Loans	Unpaid Principal Balance	Related Allowance	Average Balance Total Loans	Interest Income Recognized
Construction:					
Residential	$ –	$ –	$ –	$ –	$ –
Land acquisition, development & commercial	–	–	–	–	–
Real Estate:					
Residential	–	–	–	–	–
Commercial	–	–	–	–	–
Commercial, industrial & agricultural	–	–	–	–	–
Equity lines	–	–	–	–	–
Consumer	–	–	–	–	–
Total loans with an allowance	$ –	$ –	$ –	$ –	$ –

Troubled Debt Restructurings

At December 31, 2018, four loans totaling $4.0 million were classified as troubled debt restructurings (“TDRs”). Two of the four loans totaling $3.8 million were performing in accordance with their restructured terms and were not on nonaccrual status at year end 2018. The other two loans from one borrower totaled $195 thousand and were on nonaccrual status at year end 2018. All four TDRs were current with their restructured terms at December 31, 2018.

At December 31, 2017, four loans totaling $4.1 million were classified as troubled debt restructurings (“TDRs”). Two of the four loans totaling $3.9 million were performing in accordance with their restructured terms and were not on nonaccrual status at year end 2017. The other two loans from one borrower totaled $219 thousand and were on nonaccrual status at year end 2017. All four TDRs were current with their restructured terms at December 31, 2017.

There was no valuation allowance related to total TDRs at December 31, 2018 or December 31, 2017. No loans were modified in a TDR during the years ended December 31, 2018 or December 31, 2017.

Management considers troubled debt restructurings and subsequent defaults in restructured loans in the determination of the adequacy of the Company’s allowance for loan losses. When identified as a TDR, a loan is evaluated for potential loss based on the present value of expected future cash flows discounted at the loan’s effective interest rate, the loan’s observable market price, or the estimated fair value of the collateral, less any selling costs if the loan is collateral dependent. Loans identified as TDRs frequently are on non-accrual status at the time of the restructuring and, in some cases, partial charge-offs may have already been taken against the loan and a specific allowance may have already been established for the loan. As a result of any modification as a TDR, the specific reserve associated with the loan may be increased. Additionally, loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future defaults. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. As a result, any specific allowance may be increased, adjustments may be made in the allocation of the total allowance balance, or partial charge-offs may be taken to further write-down the carrying value of the loan. Management exercises significant judgment in developing estimates for potential losses associated with TDRs.

Note 4. Allowance for Loan Losses

The following table presents, as of December 31, 2018, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), the total loans and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

December 31, 2018	**Allowance for loan losses**							**Loans**		
Class of Loan *(Dollars in Thousands)*	Beginning balance	Charge-offs	Recoveries	Provisions	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment
Construction loans:										
Residential	$ 94	$ –	$ –	$ 17	$ 111	$ –	$ 111	$ 17,232	$ –	$ 17,232
Land acquisition, development & commercial	311	–	10	(82)	239	–	239	28,903	43	28,860
Real estate:										
Residential	955	(122)	30	219	1,082	–	1,082	143,385	538	142,847
Commercial	1,603	–	1	27	1,631	–	1,631	184,989	4,228	180,761
Commercial, industrial & agricultural	441	(37)	27	25	456	–	456	60,265	63	60,202
Equity lines	237	(87)	–	102	252	–	252	28,969	210	28,759
Consumer	108	(171)	22	183	142	–	142	7,719	–	7,719
Unallocated	9	–	–	70	79	–	79	–	–	–
Total	$ 3,758	$ (417)	$ 90	$ 561	$ 3,992	$ –	$ 3,992	$ 471,462	$ 5,082	$ 466,380

The following table presents, as of December 31, 2017, the total allowance for loan losses, the allowance by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment), the total loans and loans by impairment methodology (individually evaluated for impairment or collectively evaluated for impairment).

December 31, 2017	**Allowance for loan losses**							**Loans**		
Class of Loan *(Dollars in Thousands)*	Beginning balance	Charge-offs	Recoveries	Provisions	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment	Ending balance	Ending balance: individually evaluated for impairment	Ending balance: collectively evaluated for impairment
Construction loans:										
Residential	$ 63	$ –	$ –	$ 31	$ 94	$ –	$ 94	$ 15,221	$ –	$ 15,221
Land acquisition, development & commercial	173	(150)	–	288	311	–	311	35,601	181	35,420
Real estate:										
Residential	866	(293)	–	382	955	–	955	121,649	360	121,289
Commercial	1,516	(454)	43	498	1,603	–	1,603	173,999	4,098	169,901
Commercial, industrial & agricultural	461	(80)	–	60	441	–	441	61,197	379	60,818
Equity lines	338	–	–	(101)	237	–	237	28,835	299	28,536
Consumer	97	(101)	15	97	108	–	108	7,693	–	7,693
Unallocated	122	–	–	(113)	9	–	9	–	–	–
Total	$ 3,636	$ (1,078)	$ 58	$ 1,142	$ 3,758	$ –	$ 3,758	$ 444,195	$ 5,317	$ 438,878

Loans by credit quality indicators as of December 31, 2018 were as follows:

(Dollars in Thousands)	Pass	Special Mention	Substandard Accruing	Substandard Nonaccrual	Doubtful Nonaccrual	Total
Construction loans:						
Residential	$ 17,232	$ –	$ –	$ –	$ –	$ 17,232
Land acquisition, development & commercial	28,860	–	–	43	–	28,903
Real estate loans:						
Residential	142,473	408	182	235	87	143,385
Commercial	181,842	2,122	562	463	–	184,989
Commercial, industrial, agricultural	59,262	477	393	133	–	60,265
Equity lines	28,712	47	–	210	–	28,969
Consumer	7,719	–	–	–	–	7,719
Total Loans	$ 466,100	$ 3,054	$ 1,137	$ 1,084	$ 87	$ 471,462

At December 31, 2018, the Company does not have any loans classified as Loss.

Loans by credit quality indicators as of December 31, 2017 were as follows:

(Dollars in Thousands)	Pass	Special Mention	Substandard Accruing	Substandard Nonaccrual	Doubtful Nonaccrual	Total
Construction loans:						
Residential	$ 15,221	$ –	$ –	$ –	$ –	$ 15,221
Land acquisition, development & commercial	31,433	3,987	–	181	–	35,601
Real estate loans:						
Residential	120,575	342	559	–	173	121,649
Commercial	165,760	7,386	644	209	–	173,999
Commercial, industrial, agricultural	59,042	1,249	503	379	24	61,197
Equity lines	28,536	–	299	–	–	28,835
Consumer	7,658	–	–	35	–	7,693
Total Loans	$ 428,225	$ 12,964	$ 2,005	$ 804	$ 197	$ 444,195

At December 31, 2017, the Company does not have any loans classified as Loss.

Note 5. Other Real Estate Owned

Changes in other real estate owned for 2018 were as follows:

(Dollars in Thousands)	Other Real Estate Owned	Valuation Allowance	Net
Balance at the beginning of the year	$ 4,046	$ (797)	$ 3,249
Additions	697	—	697
Write-downs	—	(158)	(158)
Sales	(2,522)	627	(1,895)
Balance at the end of the year	$ 2,221	$ (328)	$ 1,893

Changes in other real estate owned for 2017 were as follows:

(Dollars in Thousands)	Other Real Estate Owned	Valuation Allowance	Net
Balance at the beginning of the year	$ 4,619	$ (825)	$ 3,794
Additions	1,024	—	1,024
Write-downs	—	(588)	(588)
Sales	(1,597)	616	(981)
Balance at the end of the year	$ 4,046	$ (797)	$ 3,249

The major classifications of other real estate owned in the consolidated balance sheets at December 31, 2018 and December 31, 2017 were as follows:

(Dollars in Thousands)	2018	2017
Residential lots	$ 1,172	$ 1,745
Residential real estate	331	1,024
Commercial lots	-	90
Commercial buildings	390	390
Total Other Real Estate Owned	$ 1,893	$ 3,249

Other real estate owned related expenses in the consolidated statements of income for the years ended December 31, 2018 and December 31, 2017 include:

(Dollars in Thousands)	2018	2017
Net (gain)/loss on sales	$ 176	$ (7)
Provision for unrealized losses	158	588
Operating expenses	280	106
Total Other Real Estate Owned	$ 614	$ 687

Note 6. Property and Equipment

The major components of property and equipment at December 31, 2018 and 2017 were as follows:

(Dollars in Thousands)	2018	2017
Land	$ 4,309	$ 4,309
Buildings and improvements	8,617	8,617
Leasehold improvements	2,154	2,154
Furniture and equipment	2,479	2,314
Software	301	296
Construction in process	456	4
Property and equipment, total	18,316	17,694
Less accumulated depreciation and amortization	5,373	4,757
Property and equipment, net	$ 12,943	$ 12,937

Depreciation and amortization expense totaled $678 thousand and $726 thousand for the years ended December 31, 2018 and 2017, respectively.

Leases

The Company currently leases its main office under a non-cancelable lease agreement. The lease has a ten-year term and expires on December 31, 2025. The agreement provides an option to extend the lease for one additional ten-year term at expiration. Terms of the new agreement provide for an annual rental increase, beginning January 1, 2017, based on a published inflation index, not to exceed three percent over the rent for the immediately preceding lease year. The Company currently leases a branch location under a non-cancelable lease agreement. The original lease expired on July 31, 2016. The lease was renewed for one additional term of ten years and it provides an option to extend the lease for two additional, consecutive five-year terms. The newly negotiated lease expires July 31, 2026. The Company currently leases space to operate an automated teller machine under a non-cancelable lease agreement. The term of the eight year lease commenced on April 1, 2013 and expires on April 1, 2021. The lease provides an option to extend the term for two additional five-year periods. Terms of the agreement provide for an annual rental increase of three percent over the rent for the immediately preceding lease year. HomeTown Residential Mortgage, LLC leases space in Roanoke and Christiansburg for its mortgage operations. Both leases are for a term of twelve months and renew under the same terms unless 60 days’ notice is provided by the lessor or the Company. The Roanoke lease expires every May 31 and the Christiansburg lease expires every September 30.

The current minimum annual lease payments under non-cancelable leases in effect at December 31, 2018 were as follows:

(Dollars In Thousands)	2018
2019	$ 288
2020	274
2021	265
2022	265
2023	270
Thereafter	606
Total	$ 1,968

Rent expense for the years ended December 31, 2018 and 2017 was $287 thousand and $304 thousand, respectively, and is included in occupancy and equipment expense on the Company's consolidated statements of income.

Note 7. Deposits

The aggregate amount of time deposits in denominations of over $250,000 at December 31, 2018 and 2017 were $10.0 million and $8.3 million, respectively.

At December 31, 2018, the scheduled maturities of time deposits are as follows:

(Dollars In Thousands)	2018
2019	$ 71,997
2020	34,865
2021	7,004
2022	5,746
2023	4,627
Thereafter	347
Total	$ 124,586

The Company obtains certain deposits through the efforts of third-party deposit brokers. At December 31, 2018 and 2017, brokered deposits totaled $5.9 million and $33.1 million, respectively, and were included in interest-bearing deposits on the consolidated balance sheets. There were no deposit relationships over 5% of total deposits at the end of 2018.

Note 8. Federal Home Loan Bank Borrowings

The Company has outstanding debt with the Federal Home Loan Bank of Atlanta in the amount of $7.9 million and $11.0 million as of December 31, 2018 and 2017, respectively. The Federal Home Loan Bank debt at December 31, 2018 is comprised of six fixed rate advances totaling $7.9 million.

At December 31, 2018 and 2017, borrowings from the Federal Home Loan Bank of Atlanta were as follows:

(Dollars In Thousands)

Advance Date	Maturity Date	Conversion Date	Current Rate	2018	2017
January 14, 2015	January 16, 2018	Quarterly	1.090%	$ -	$ 4,000
August 19, 2016	August 20, 2018	Quarterly	2.535%	-	4,000
January 3, 2017	January 3, 2020	N/A	1.500%	361	695
February 3, 2017	February 3, 2020	N/A	1.490%	389	722
May 3, 2017	May 4, 2010	N/A	1.580%	944	1,611
March 15, 2018	March 15, 2019	N/A	2.650%	1,000	-
October 4, 2018	January 4, 2019	N/A	2.380%	3,150	-
December 31, 2018	January 31, 2019	N/A	2.530%	2,100	-
				$ 7,944	$ 11,028

The Company had collateral pledged on these borrowings at December 31, 2018, including real estate loans totaling $18.0 million, investment securities totaling $2.9 million, and Federal Home Loan Bank stock with a book value of $833 thousand.

Note 9. Subordinated Notes

On December 18, 2015, the Company completed the issuance of $7.5 million in aggregate principal amount of fixed-to-floating rate subordinated notes in a private placement transaction to various institutional accredited investors. The net proceeds of the offering are intended to support growth and be used for other general business purposes. The notes have a maturity date of December 30, 2025 and have an annual fixed interest rate of 6.75% until December 30, 2020. Thereafter, the notes will have a floating interest rate based on LIBOR. Interest will be paid semi-annually, in arrears, on June 30 and December 30 of each year during the time that the notes remain outstanding through the fixed interest rate period or earlier redemption date. Interest will be paid quarterly, in arrears, on March 30, June 30, September 30 and December 30 throughout the floating interest rate period or earlier redemption date.

(Dollars in Thousands)

As of December 31, 2018	Principal	Unamortized Debt Issuance Costs	Net
Subordinated notes	$ 7,500	$ 215	$ 7,285

(Dollars in Thousands)

As of December 31, 2017	Principal	Unamortized Debt Issuance Costs	Net
Subordinated notes	$ 7,500	$ 246	$ 7,254

For the years ended December 31, 2018 and 2017, the average effective interest rate was 7.38% and 7.41%, respectively.

The indebtedness evidenced by the notes, including principal and interest, is unsecured and subordinate and junior in right of the Company's payments to general and secured creditors and depositors of its wholly owned subsidiary, HomeTown Bank. The notes are redeemable, without penalty, on or after December 30, 2020 and, in certain limited circumstances, prior to that date. The notes limit the Company from declaring or paying any dividend, or making any distribution on capital stock or other equity securities of any kind of the Company if the Company is not "well capitalized" for regulatory purposes, immediately prior to the declaration of such dividend or distribution, except for dividends payable solely in shares of common stock of the Company.

Note 10. Other Borrowings

Other borrowings consist of the following at December 31, 2018 and 2017:

(Dollars In Thousands)	2018	2017
Warehouse line of credit	$ 83	$ 1,558
Weighted average interest rate at December 31	5.02%	4.11%

Short-term borrowings may also include federal funds purchased, which are unsecured overnight borrowings from other financial institutions. The warehouse line of credit is a short-term revolving credit facility used to fund mortgage loans originations until the underlying loan is sold. The amount borrowed on the $5.0 million warehouse line of credit was $83 thousand at year end 2018 at a rate of LIBOR plus 2.75%. The Company had $26.0 million of federal funds lines of credit available at year-end 2018. In addition, the Company had access to a $10.0 million credit line through Promontory's Insured Cash Sweep (ICS) one way buy program at a rate of the one month LIBOR plus 11 basis points but not less than 20 basis points. At December 31, 2018 and 2017, there were no advances on the federal funds or credit lines.

Note 11. Fair Value Measurements

The Company uses a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain financial assets and liabilities recorded at fair value on a recurring basis in the consolidated financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

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

(Dollars in Thousands)		Carrying value at December 31, 2018		
Description	Balance as of December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government agency securities	$ 10,582	$ –	$ 10,582	$ –
Mortgage-backed securities and CMO’s	18,929	–	18,929	–
Corporate securities	6,439	–	6,439	–
Municipal securities	9,026	–	9,026	–

(Dollars in Thousands)		Carrying value at December 31, 2017		
Description	Balance as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
U.S. Government agency securities	$ 13,435	$ –	$ 13,435	$ –
Mortgage-backed securities and CMO’s	23,981	–	23,981	–
Corporate securities	7,067	–	7,067	–
Municipal securities	10,861	–	10,861	–

Certain assets are measured at fair value on a nonrecurring basis in accordance with generally accepted accounting principles (GAAP). Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the consolidated financial statements:

Impaired Loans: The Company does not record loans at fair value on a recurring basis. However, from time to time a loan is considered impaired and a specific reserve 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 agreement are considered impaired. Once a loan is identified as individually impaired, management measures the extent of any loss. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value, and discounted cash flow. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investment in such loans. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. If carried at market price based on appraised value less selling costs using observable market data, it is recorded as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraisal value and there is no observable market price, the Company records the impaired loan as nonrecurring Level 3.

Loans held for sale: The carrying value of these loans approximates the fair value. These loans close in the name of the Bank’s consolidated joint venture subsidiary HomeTown Residential Mortgage, LLC, but are generally sold within a two-week period.

Other Real Estate Owned (OREO): The carrying amount of real estate owned by the Company resulting from foreclosures is estimated at the lesser of cost or the fair value of the real estate based on an observable market price or a current appraised value less selling costs. If carried at market price based on appraised value using observable market data, it is recorded as nonrecurring Level 2. When an appraised value is not available or is not current, or management determines the fair value of the real estate is further impaired below the appraised value or there is no observable market price, the Company records the real estate as nonrecurring Level 3.

The following table summarizes the Company’s assets that were measured at fair value on a nonrecurring basis as of December 31, 2018 and 2017.

(Dollars in Thousands)

Description	Balance as of December 31, 2018	Carrying value at December 31, 2018: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans held for sale	$ 85	$ –	$ 85	$ –
Other real estate owned	1,893	–	331	1,562

(Dollars in Thousands)

Description	Balance as of December 31, 2017	Carrying value at December 31, 2017: Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Loans held for sale	$ 1,587	$ –	$ 1,587	$ –
Other real estate owned	3,249	–	–	3,249

At December 31, 2018 and December 31, 2017, the Company did not have any liabilities measured at fair value on a nonrecurring basis.

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2018:

(Dollars in Thousands)

	Quantitative information about Level 3 Fair Value Measurements for December 31, 2018			
Assets	Fair Value	Valuation Technique(s)	Unobservable input	Range (Weighted Average)
Other real estate owned	$ 986	Discounted appraised value	Selling cost	6% - 6% (6%)
			Discount for lack of marketability and age of appraisal	0% - 10% (1%)
	$ 576	Internal evaluations	Internal evaluations	29% - 29% (29%)

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2017:

(Dollars in Thousands)

	Quantitative information about Level 3 Fair Value Measurements for December 31, 2017			
Assets	Fair Value	Valuation Technique(s)	Unobservable input	Range (Weighted Average)
Other real estate owned	$ 2,254	Discounted appraised value	Selling cost	6% - 10% (8%)
			Discount for lack of marketability and age of appraisal	0% - 43% (7%)
	$ 995	Internal evaluations	Internal evaluations	19% - 19% (19%)

The following tables summarize the estimated fair values of the Company’s financial instruments at December 31, 2018 and at December 31, 2017. The Company discloses fair value information about financial instruments, whether or not recognized in the statements of financial condition, for which it is practicable to estimate that value. The following estimated fair value amounts have been determined using available market information and appropriate valuation methodologies. However, management judgment is required to interpret data and develop fair value estimates. Accordingly, the estimates below 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.

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During the first quarter of 2018, the Company adopted ASU 2016-01 Financial Instruments – Overall (Subtopic 825-10): "Recognition and Measurement of Financial Assets and Financial Liabilities", which among other things, requires a public business entity to base their fair value disclosures for financial instruments that are not measured at fair value in the financial statements on the exit price notion. In accordance with this guidance, the Company has adopted the exit price disclosure requirements for the below table on a prospective basis for the period ended December 31, 2018. The disclosure included for the period ended December 31, 2017 continues to be presented utilizing entry price assumptions.

The carrying amounts and approximate fair values of the Company's financial instruments are as follows at December 31, 2018:

(Dollars in Thousands)		Fair value at December 31, 2018			
Description	Carrying value as of December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Values
Financial assets					
Cash and due from banks	$ 22,771	$ 22,771	$ –	$ –	$ 22,771
Federal funds sold	194	194	–	–	194
Securities available for sale	44,976	–	44,976	–	44,976
Restricted equity securities	2,241	–	2,241	–	2,241
Loans held for sale	85	–	85	–	85
Loans, net	467,470	–	–	458,240	458,240
Bank owned life insurance	8,197	–	8,197	–	8,197
Accrued income	2,299	–	2,299	–	2,299
Financial liabilities					
Total deposits	493,173	–	492,753	–	492,753
FHLB borrowings	7,944	–	7,939	–	7,939
Subordinated notes	7,285	–	7,667	–	7,667
Other borrowings	83	–	83	–	83
Accrued interest payable	403	–	403	–	403

The carrying amounts and approximate fair values of the Company's financial instruments are as follows at December 31, 2017:

(Dollars in Thousands)		Fair value at December 31, 2017			
Description	Carrying value as of December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Fair Values
Financial assets					
Cash and due from banks	$ 21,714	$ 21,714	$ –	$ –	$ 21,714
Federal funds sold	180	180	–	–	180
Securities available for sale	55,344	–	55,344	–	55,344
Restricted equity securities	2,371	–	2,371	–	2,371
Loans held for sale	1,587	–	1,587	–	1,587
Loans, net	440,437	–	–	438,449	438,449
Bank owned life insurance	8,669	–	8,669	–	8,669
Accrued income	2,681	–	2,681	–	2,681
Financial liabilities					
Total deposits	477,320	–	477,599	–	477,599
FHLB borrowings	11,028	–	11,150	–	11,150
Subordinated notes	7,254	–	7,890	–	7,890
Other borrowings	1,558	–	1,558	–	1,558
Accrued interest payable	368	–	368	–	368

Note 12. Earnings per Common Share

The following tables show the weighted average number of shares used in computing earnings per common share and the effect on weighted average number of shares of diluted potential common stock.

	For the Years Ended December 31,					
	2018			2017		
Dollars in Thousands, except share and per share data	Weighted Average Common Shares Outstanding	Net Income Available to Common Shareholders	Per Share Amount	Weighted Average Common Shares Outstanding	Net Income Available to Common Shareholders	Per Share Amount
Earnings per common share, basic	5,805,654	$ 3,954	$ 0.68	5,769,752	$ 2,496	$ 0.43
Effect of dilutive securities:						
Dilutive stock options	47,623	–	–	34,630	–	–
Earnings per common share, diluted	5,853,277	$ 3,954	$ 0.68	5,804,382	$ 2,496	$ 0.43

At December 31, 2018, no stock options were considered antidilutive and excluded from the calculation of diluted weighted average shares. At December 31, 2017, the number of stock options considered antidilutive and excluded from the calculation of diluted weighted average shares were 38,500. Non-vested restricted shares were included in weighted average common shares outstanding for computing basic earnings per share, as the holder has voting rights and would share in dividends during the vesting period.

Note 13. Stock Based Compensation

The Company recorded stock-based compensation expense of $315 thousand and $148 thousand for the years ended December 31, 2018 and 2017, respectively.

The 2005 Stock Option Plan (the Plan) pursuant to which the Board of Directors granted stock options to directors, officers and employees expired in 2016, thus there are no options available for future issuance. Under the fair value recognition provisions of relevant accounting guidance, stock-based compensation cost was measured at the grant date based on the fair value of the award and was and continues to be recognized as expense on a straight-line basis over the requisite service period, which is the vesting period.

The Company used the Black-Scholes option pricing model to determine the fair value of stock options. The fair value of the stock-based payment awards was affected by the price of the Company's stock and a number of financial assumptions and variables. These variables included the risk-free interest rate, expected dividend rate, expected stock price volatility and the expected life of the options. Since the Plan expired in 2016, no stock options were available for grant during 2018 or 2017. Compensation expense is charged to income ratably over the vesting period and was $77 thousand in 2018 and $71 thousand in 2017. As of December 31, 2018, there was $54 thousand of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost will be recognized over the next year. At the discretion of the Board of Directors, the stock option plan was not modified for the 4% stock dividend distributed on July 11, 2016

A summary of option activity under the 2005 stock option plan during the year ended December 31, 2018 is as follows:

	Options Outstanding	Weighted Average Exercise Price	Aggregate Intrinsic Value(1)	Weighted Average Contractual Term (years)
Balance at December 31, 2017	187,000	$ 7.78		
Granted	–	–		
Exercised	(23,800)	8.33		
Expired	(31,500)	10.79		
Vested	(15,000)	6.90		
Balance at December 31, 2018	116,700	$ 6.90	$ 576,498	5.97
Exercisable at December 31, 2018	92,100	$ 6.90	$ 454,974	5.97

(1) The aggregate intrinsic value of a stock option in the table above represents the total pre-tax intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) that would have been received by the option holders had all option holders exercised their options on December 31, 2018.

In 2009, the Board of Directors authorized 137,280 shares, restated for the 4% stock dividend distributed July 11, 2016, of common stock for issuance under the Restricted Stock Plan. The plan provides for restricted stock awards to key employees. Restricted shares awarded to employees generally vest over a five-year period and compensation expense is charged to income ratably over the vesting period and was $238 thousand in 2018 and $77 thousand in 2017. Compensation is accounted for using the fair market value of the Company's common stock on the date the restricted shares are awarded. The weighted-average grant date fair value of restricted stock granted in 2018 was $11.32 compared to $10.24 in 2017. The Company granted 22,649 and 13,258 shares of restricted stock under the plan in 2018 and 2017, respectively.

As of December 31, 2018, there was $235 thousand of total unrecognized compensation cost related to restricted stock granted under the Plan. The cost is expected to be recognized through 2023. A summary of the activity for restricted stock awards for the periods indicated is presented below:

	2018		2017	
	Shares	Weighted-Average Grant Date Fair Value	Shares	Weighted-Average Grant Date Fair Value
Nonvested at beginning of year	32,087	$ 8.63	31,546	$ 7.03
Granted	22,649	11.32	13,258	10.24
Vested	(26,589)	8.88	(11,920)	6.18
Forfeited	–	–	(797)	8.37
Nonvested at the end of the period	28,147	$ 10.56	32,087	$ 8.63

Note 14. Salary Continuation Plan

The Company has a Salary Continuation Plan for certain key officers. The plan provides the participating officers with supplemental retirement income. The Supplemental Executive Retirement Plan (the "SERP") provides lifetime payments equal to 20% of a participant's average annual base salary for the five years immediately prior to retirement. There is an incentive formula with an additional benefit of 20% of a participant's average annual base salary for the five years immediately prior to retirement if performance targets set by the Board of Directors are met. The SERP contains provisions for disability and survivor benefits, a benefit vesting schedule based on age attained and automatic full vesting in the event of a change in control of the Company. Accrued deferred compensation expense under the SERP, included in other liabilities, totaled $1.4 million and $1.0 million at the end of 2018 and 2017, respectively. Compensation expense related to the SERP was $351 thousand for 2018 compared to $357 thousand for 2017. Payments made under the SERP totaled $11 thousand for 2018 compared to none in 2017. The funding mechanism for the plan is Bank Owned Life Insurance policies on the lives of the participants.

Note 15. Employee Benefit Plan

The Company adopted a profit sharing plan pursuant to Section 401(k) of the Internal Revenue Code. The plan covers substantially all employees. Participants may contribute a percentage of compensation, subject to a maximum allowed under the Code. The Company makes non-discretionary matching contributions of 100% of the employee's deferral up to 3% of compensation and matches 50% of the employee's next 3% deferral. In addition, the Company may make additional contributions at the discretion of the Board of Directors. The Company's matching contributions were $276 thousand and $263 thousand for the years ended December 31, 2018 and 2017, respectively.

Note 16. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction and the Commonwealth of Virginia. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2015.

The current and deferred components of income tax expense for the periods ended December 31, 2018 and 2017 are as follows:

(Dollars In Thousands)	2018	2017
Current	$ 1,053	$ 1,351
Deferred	(208)	(123)
Income tax expense	$ 845	$ 1,228

Income tax expense for 2017 includes a downward adjustment of net deferred tax assets in the amount of $100 thousand, recorded as a result of the enactment of H.R.1 Tax Cuts and Jobs Act on December 22, 2017. The Act reduced the corporate Federal tax rate from 34% to 21% effective January 1, 2018

Rate Reconciliation

Total income tax expense differed from the "expected" amount computed by applying the U.S. Federal income tax rate of 21 percent for 2018 and 34 percent for 2017 to income before income taxes as a result of the following.

(Dollars In Thousands)	2018	2017
Tax at statutory federal rate	$ 1,017	$ 1,291
Tax-exempt interest income	(55)	(116)
Earnings on Bank Owned Life Insurance	(177)	(68)
Stock awards	(30)	24
Tax impact from enacted change in tax rate	–	100
Facilitative merger costs	88	–
Other	2	(3)
Income tax expense	$ 845	$ 1,228

Deferred Income Tax Analysis

The significant components of net deferred taxes at December 31, 2018 and 2017 are summarized as follows:

(Dollars In Thousands)	2018	2017
Deferred tax assets		
Pre-opening expenses	$ 18	$ 28
Allowance for loan losses	689	528
Deferred compensation	286	215
Other real estate expenses	88	187
Unrealized loss on securities available for sale	216	38
Nonaccrual loan interest	20	9
Other	17	17
Deferred tax asset	1,334	1,022
Deferred tax liabilities		
Property and equipment	179	230
Deferred loan fees and costs	607	613
Other	–	17
Deferred tax liability	786	860
Net deferred tax asset	$ 548	$ 162

Note 17. Commitments and Contingencies

Litigation

In the normal course of business, the Company becomes involved in litigation arising from the banking, financial and other activities it conducts. Management, after consultation with legal counsel, does not anticipate that the ultimate liability, if any, arising from these matters will have a material effect on the Company's financial condition, operating results or liquidity.

Credit Related Financial Instruments

The Company is party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, credit risk in excess of the amount recognized in the consolidated balance sheet.

The Company's exposure to credit loss, in the event of nonperformance by the other party to the financial instrument, for commitments to extend credit and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

A summary of the Company’s commitments at December 31, 2018 and 2017 is as follows (dollars in thousands):

(Dollars In Thousands)		2018		2017
Commitments to extend credit	$	123,995	$	109,285
Standby letters of credit		7,543		6,711

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

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Collateral held varies as specified above and is required in instances which the Company deems necessary.

The Company is required to maintain certain required reserve balances with the Federal Reserve Bank. At December 31, 2018 and 2017, these reserve balances amounted to $9.7 million and $9.6 million, respectively.

The Company from time to time may have cash and cash equivalents on deposit with financial institutions that exceed federally insured limits. Balances in excess of FDIC insured amounts totaled $10.7 million and $5.9 million at December 31, 2018 and 2017, respectively.

Purchase Obligation

On November 1, 2015, the Company entered into a three-year marketing agreement involving naming, advertising, and sponsorship rights. This agreement was replaced with a new agreement effective July 1, 2016. The new term was for three years, with options for a fourth and fifth year, and expanded the exclusivity of marketing rights and increased signage. In relation to these agreements, the Company expensed $65 thousand and $55 thousand in 2018 and 2017, respectively. The agreement obligates the Company to pay $33 thousand for the first half of 2019 for these rights.

Note 18. Regulatory Restrictions

Dividends

The Company, as a Virginia banking corporation, may pay dividends only out of its retained earnings. However, regulatory authorities may limit payment of dividends by any company when it is determined that such a limitation is in the public interest and is necessary to ensure financial soundness of the Company. At December 31, 2018, there was $7.0 million in retained earnings available from which to pay dividends to common stockholders. On May 15, 2018 at the annual shareholders meeting the Board of Directors declared the Company’s first cash dividend. The cash dividend of $0.04 per common share was paid on June 15, 2018 to shareholders of record on May 31, 2018. The Board declared cash dividends of $0.04 per common share for each of the three subsequent quarters. No cash dividends were paid to common stockholders in 2017. A stock dividend was distributed in 2016 and is discussed in Note 20 Capital Transactions.

Capital Requirements

The Bank is subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgements by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision’s capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in January 1, 2019. As part of the new requirements, the Common Equity Tier 1 Capital is calculated and utilized in the assessment of capital for all institutions. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

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Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year end 2018 and 2017, the most recent regulatory notifications categorized the bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution's category.

The Company meets eligibility criteria of a small bank holding company in accordance with the Federal Reserve Board's Small Bank Holding Company Policy statement issued in February 2015, and is no longer obligated to report consolidated regulatory capital. In July 2013, the Federal Reserve Bank issued revised final rules that make technical changes to its market risk capital rules to align it with the Basel III regulatory capital framework and meet certain requirements of the Dodd-Frank Act.

The new rules introduced the requirement of a new 2.5% capital conservation buffer, to be phased in beginning on January 1, 2016, and ending on January 1, 2019. Banking organizations without other supervisory issues that wish to distribute capital freely, such as in the payment of dividends for example, must maintain the new capital conservation buffer. The final new capital rules required the Bank to comply with the following new minimum capital ratios (including the capital conservation buffer), effective January 1, 2018 and 2017, respectively: (1) a new common equity Tier 1 capital ratio of 6.375% and 5.75% of risk-weighted assets; (2) a Tier 1 capital ratio of 7.875% and 7.25% of risk-weighted assets; (3) a total capital ratio of 9.875% and 9.25% of risk-weighted assets; and (4) a leverage ratio of 4% of total assets.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the table below) of total, Tier I common equity, and Tier I capital to risk-weighted assets, and of Tier I capital to average assets, as all those terms are defined in the applicable regulations. As of December 31, 2018, management believes the Bank met all capital adequacy requirements to which it was subject.

The Bank's actual capital amounts and ratios are also presented in the following tables:

HomeTown Bank December 31, 2018	**Actual**		**Minimum Capital Requirement**		**Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions**	
(in thousands except for percentages)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)	$ 65,297	12.49%	$ 51,626	9.875%	$ 52,280	10.00%
Tier I Common Equity (to Risk-Weighted Assets)	61,303	11.72%	33,346	6.375%	33,999	6.50%
Tier I Capital (to Risk-Weighted Assets)	61,305	11.72%	41,193	7.875%	41,847	8.00%
Tier I Capital (to Average Assets)	61,305	10.79%	22,727	4.00%	28,408	5.00%

HomeTown Bank December 31, 2017	**Actual**		**Minimum Capital Requirement**		**Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions**	
(in thousands except for percentages)	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)	$ 61,257	12.48%	$ 45,403	9.25%	$ 49,084	10.00%
Tier I Common Equity (to Risk-Weighted Assets)	57,474	11.71%	28,222	5.75%	31,903	6.50%
Tier I Capital (to Risk-Weighted Assets)	57,499	11.72%	35,569	7.25%	39,248	8.00%
Tier I Capital (to Average Assets)	57,499	10.39%	22,136	4.00%	27,670	5.00%

Note 19. Transactions with Related Parties

The Company has entered into transactions with its directors, significant shareholders and their affiliates (related parties). Such transactions were made in the ordinary course of business on substantially the same terms and conditions, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other customers, and did not, in the opinion of management, involve more than normal credit risk or present other unfavorable features.

Aggregate loan transactions with related parties were as follows:

(Dollars In Thousands)	2018	2017
Balance, beginning	$ 3,949	$ 8,194
New loans	2,417	392
Repayments	(425)	(4,637)
Balance, ending	$ 5,941	$ 3,949

Aggregate deposit balances with related parties at December 31, 2018 and 2017 were $10.6 million and $12.5 million, respectively.

Note 20. Capital Transactions

The ability to pay cash dividends to common stockholders is limited by regulatory restrictions and the need to maintain sufficient capital in the Company and in our subsidiaries. The Company must consider different factors to ensure that any future cash dividends to common stockholders would be prudent relative to the organization's financial position and not based on overly optimistic earnings scenarios. The Company had $7.0 million of retained earnings at December 31, 2018. On May 15, 2018 at the annual shareholders meeting the Board of Directors declared the Company's first cash dividend. The cash dividend of $0.04 per common share was paid on June 15, 2018 to shareholders of record on May 31, 2018. The Board declared cash dividends of $0.04 per common share for each of the three subsequent quarters.

Note 21. Reclassifications Out of Other Comprehensive Income

Items not reclassified in their entirety to net income for the years ended December 31, 2018 and 2017 are as follows:

Details about Other Comprehensive Components	**Amounts Reclassified from Other Comprehensive Income for the Years Ended December 31,**		**Affected Line Item in the Statement Where Net Income is Presented**
(Dollars In Thousands)	**2018**	**2017**	
Available for sale securities			
Realized gains on sales of securities held for sale during the period	$ 60	$ 69	Gains on sales of investment securities
Tax expense related to realized gains on securities sold	13	24	Income tax expense
	$ 47	$ 45	Net income

Note 22. Condensed Parent Company Financial Information

Financial information pertaining only to HomeTown Bankshares Corporation follows.

CONDENSED BALANCE SHEETS

Dollars In Thousands	**December 31, 2018**	**December 31, 2017**
Assets		
Cash and due from banks	$ 70	$ 313
Investment in bank subsidiary	60,492	57,333
Other assets	98	3
Total assets	$ 60,660	$ 57,649
Liabilities and Stockholders' Equity		
Other liabilities	$ 25	$ 12
Subordinated notes	7,285	7,254
Total liabilities	7,310	7,266
Stockholders' equity:		
Total stockholders' equity	53,350	50,383
Total liabilities and stockholders' equity	$ 60,660	$ 57,649

CONDENSED STATEMENTS OF INCOME

Dollars In Thousands	For the year ended December 31, 2018	For the year ended December 31, 2017
Dividend from Bank subsidiary	$ 1,650	$ 511
Income	1,650	511
Interest expense	536	537
Other expenses	1,064	272
Expenses	1,600	809
Net income (loss) before income taxes	50	(298)
Income tax benefit	276	275
Net income (loss) before equity in undistributed net income of subsidiary	326	(23)
Undistributed net income of subsidiary	3,628	2,519
Net Income	$ 3,954	$ 2,496

CONDENSED STATEMENTS OF CASH FLOWS

Dollars In Thousands	For the year ended December 31, 2018	For the year ended December 31, 2017
Cash flows from operating activities:		
Net income	$ 3,954	$ 2,496
Equity in undistributed net income of subsidiary bank	(3,628)	(2,519)
Amortization expense on subordinated notes	31	30
Equity compensation expense	114	
Increase in other assets	(95)	(3)
Increase in other liabilities	13	—
Net cash flows provided by operating activities	389	4
Cash flows from financing activities:		
Common stock dividend	(697)	—
Exercise of stock options	85	31
Net settlement of vested restricted stock	(20)	(20)
Net cash flows provided by (used in) financing activities	(632)	11
Net increase (decrease) in cash and cash equivalents	(243)	15
Cash and cash equivalents, beginning	313	298
Cash and cash equivalents, ending	$ 70	$ 313
Supplemental disclosure of cash flow information:		
Cash payments for interest	$ 506	$ 506

YHB CPAs & Consultants

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
HomeTown Bankshares Corporation
Roanoke, Virginia

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of HomeTown Bankshares Corporation and subsidiary (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, 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, 2018 and 2017, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

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 Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

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/ Yount, Hyde & Barbour, P.C.

We have served as the Company's auditor since 2005.

Roanoke, Virginia
March 15, 2019

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Based upon an evaluation of the effectiveness of disclosure controls and procedures by the Company's management, including the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), the CEO and CFO have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures, as defined under Exchange Act Rule 13a-15(e) and 15d-15(e), were effective to provide reasonable assurance that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified by the SEC and is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

HomeTown Bankshares Corporation's management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. HomeTown Bankshares Corporation's internal control over financial reporting is 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.

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.

Management assessed the effectiveness of HomeTown Bankshares' internal control over financial reporting as of December 31, 2018. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework in 2013. Based on this assessment, management believes that, as of December 31, 2018, HomeTown Bankshares' internal control over financial reporting was effective.

This annual report does not include an attestation report of HomeTown Bankshares' registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by HomeTown Bankshares' registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit filers to provide only management's report in this annual report.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting that occurred during the year ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE.

The information required by this item relating to the Company's directors and nominees is included under the captions "Item 1: Election of Directors" and "Directors Meetings, Committees and Fees, Leadership Structure, Oversight of Risk and Communications with Directors" in the Company's Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

The information required by this item relating to the Bank's executive officers is included under the caption "Executive Officers of the Registrant" in Part I of this report.

The information required by this item regarding compliance with Section 16(a) of the Securities Act of 1934 is included under the caption “Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

The Company has adopted a Code of Ethics that applies to its directors and executive officers, including its Chief Executive Officer, Chief Financial Officer, principal accounting officer or controller, or persons performing similar functions. The Code of Ethics is posted to the Investor Relations section of the Company’s website at www.hometownbank.com. In addition, a copy of the Code of Ethics may be obtained without charge by written request to the Company’s corporate secretary.

The information required by this item relating to the Company’s Audit Committee is included under the captions “Item 1: Election of Directors,” “Audit Committee Matters” and “—Audit Committee Report” in the Company’s Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION.

The information required to be disclosed in this item 11 is included under the caption “Executive Compensation” of the Company’s Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required to be disclosed in this item 12 is relating to security ownership of certain beneficial owners and management is included under the caption “Common Stock Ownership” in the Company’s Proxy Statement for the 2019 Special Meeting of Shareholders and is incorporated herein by reference.

Equity Compensation Plans

The following table summarizes information concerning the Company’s equity compensation plans as of December 31, 2018.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (1)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
Equity compensation plans approved by security holders	116,700(2)	$ 6.90	N/A(3)
Equity compensation plans not approved by security holders	0	N/A	37,200(4)

(1) Excludes restricted stock awards currently vesting under the Restricted Stock Plan. See Part II, Item 8, Note 12 for a detailed discussion of the Restricted Stock Plan.

(2) Represents options to purchase common stock outstanding under the 2005 Stock Option Plan. See Part II, Item 8, Note 13 for a detailed discussion of the Restricted Stock Plan.

(3) The 2005 Stock Option Plan expired in 2016 and no shares are available for future issuance.

(4) Represents shares available for future issuance under the Restricted Stock Plan.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this item relating to review, approval or ratification of transactions with related persons is included under the caption “Certain Relationships and Related Transactions,” and the information required by this item relating to director independence is included under the caption “Item 1: Election of Directors” and “Directors Meetings, Committees and Fees, Leadership Structure, Oversight of Risk and Communications with Directors” in the Bank’s Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.

The information required to be disclosed in this item 14 is included under the captions “Audit Committee Matters” and “Item III: Ratification of Independent Auditors” in the Company’s Proxy Statement for the 2019 Special Meeting of Stockholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

Financial Statements:

Consolidated Balance Sheets as of December 31, 2018 and 2017
Consolidated Statements of Income for the Years Ended December 31, 2018 and 2017
Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2018 and 2017
Consolidated Statements of Changes in Stockholders' Equity for the Years Ended December 31, 2018 and 2017
Consolidated Statements of Cash Flows for the Years Ended December 31, 2018 and 2017
Report of Independent Registered Public Accounting Firm

Exhibit Number	
3.1	Articles of Incorporation of Registrant as amended incorporated herein by reference to Exhibit 3.1 to Form 10-K for the year ended December 31, 2011.
3.2	By-laws of Registrant included as Appendix B-2 to the proxy statement contained in, and incorporated by reference to the Registrant's registration statement on Form S-4 (No. 333-158525) filed June 26, 2009).
4.1	See Exhibit 3.1.
10.2*	Employment Agreement dated March 1, 2006 between HomeTown Bank and S. K. Still, incorporated herein by reference to Exhibit 10.2 to Form 10QSB for the quarter ended March 31, 2006.
10.3*	Employment Agreement dated March 1, 2006 between HomeTown Bank and W. C. Moses, incorporated herein by reference to Exhibit 10.3 to Form 10QSB for the quarter ended March 31, 2006.
10.4	Real estate purchase contract, incorporated herein by reference to Exhibit 10.5 to Form 10QSB for the quarter ended June 30, 2006.
10.5	Lease agreement, incorporated herein by reference to Exhibit 10.7 to form 10QSB for the quarter ended September 30, 2006.
10.6*	Hometown Bankshares Corporation Restricted Stock Plan, Incorporated herein by reference to Exhibit 10.1 to Form 8-K filed September 16, 2009.
10.7	Letter Agreement, including Schedule A, and Securities Purchase Agreement, dated September 18, 2009, between HomeTown Bankshares Corporation and United States Department of the Treasury, with respect to the issuance and sale of the Series A Preferred Stock and Series B Preferred Stock, incorporated herein by reference to Exhibit 10.1 to Form 8-K filed September 24, 2009.
10.8*	Form of Compensation Modification Agreement and Waiver, executed by Senior Executive Officers of HomeTown Bankshares Corporation, incorporated herein by reference to Exhibit 10.2 to Form 8-K filed September 24, 2009.
10.9*	Supplemental Executive Retirement Plan by and between Hometown Bank and Susan K. Still incorporated herein by reference to Exhibit 10.11 to Form 10-K for the year ended December 31, 2013.
10.10*	Supplemental Executive Retirement Plan by and between Hometown Bank and Vance W. Adkins, incorporated herein by reference to Exhibit 10.10 to Form 10-K for the year ended December 31, 2016.
10.11*	Employment Agreement ("Agreement"), made as of the 5th day of August, 2016, among HomeTown Bank, a Virginia Banking Corporation, HomeTown Bankshares Corporation, a Virginia incorporated registered bank holding company (collectively with HomeTown Bank, the "Employer") and Vance Adkins ("Employee"), incorporated herein by reference to Exhibit 10.11 to Form 10-K for the year ended December 31, 2016.
21	Subsidiaries of the Registrant
31.1	Certification of Chief Executive of Officer (302 Certification).

31.2	Certification of Chief Financial Officer (302 Certification).
32	Certification pursuant to 18 U.S.C. Section 1350 (906 Certification).
101**	Pursuant to Rule 405 of Regulation S-T, the following financial information from the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, is formatted in XBRL interactive data files: (i) Consolidated Balance Sheets at December 31, 2018 and 2017; (ii) Consolidated Statements of Income for the years ended December 31, 2018 and 2017; (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2018 and 2017; (iv) Consolidated Statements of Changes in Stockholders’ Equity for the years ended December 31, 2018 and 2017; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017; and (vi) Notes to Consolidated Financial Statements.

* Denotes management contract or compensatory plan or arrangement.

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

ITEM 16. FORM 10K SUMMARY.

None.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

HOMETOWN BANKSHARES CORPORATION

Date: March 15, 2019

By: /S/ SUSAN K. STILL
Susan K. Still
President
Chief Executive Officer

Pursuant to the requirements 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.

Signature	Title	Date
/S/ SUSAN K. STILL **Susan K. Still**	Director, President, and Chief Executive Officer (principal executive officer)	March 15, 2019
/S/ GEORGE B. CARTLEDGE, JR. **George B. Cartledge, Jr.**	Director	March 15, 2019
/S/ NANCY H. AGEE **Nancy H. Agee**	Director	March 15, 2019
/S/ WARNER N. DALHOUSE **Warner N. Dalhouse**	Director	March 15, 2019
/S/ MARC S. FINK **Marc S. Fink**	Director	March 15, 2019
/S/ DANIEL D. HAMRICK **Daniel D. Hamrick**	Director	March 15, 2019
/S/ WILLIAM R. RAKES **William R. Rakes**	Director	March 15, 2019
/S/ JAMES M. TURNER, JR. **James M. Turner, Jr.**	Director	March 15, 2019
/S/ VANCE W ADKINS **Vance W. Adkins**	Chief Financial Officer *(principal accounting and financial officer)*	March 15, 2019

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Section 2: EX-21 (EXHIBIT 21)

Exhibit 21

Subsidiaries of the Registrant

HomeTown Bank, Roanoke, Virginia

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Section 3: EX-31.1 (EXHIBIT 31.1)

Exhibit 31.1

CERTIFICATION

I, Susan K. Still certify that:

1.I have reviewed this annual report on Form 10-K of HOMETOWN BANKSHARES CORPORATION.

2.Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3.Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4.The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and

d) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2019

/s/ Susan K. Still

Susan K. Still

President and Chief Executive Officer

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Section 4: EX-31.2 (EXHIBIT 31.2)

Exhibit 31.2

CERTIFICATION

I, Vance W. Adkins certify that:

1.I have reviewed this annual report on Form 10-K of HOMETOWN BANKSHARES CORPORATION.

2.Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;

3.Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4.The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, 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;

c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report; and

d) disclosed in this report any changes in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.The registrant's other certifying officer and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 15, 2019 /s/ Vance W. Adkins

Vance W. Adkins

Executive Vice President

Chief Financial Officer

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Section 5: EX-32 (EXHIBIT 32)

Exhibit 32

CERTIFICATION OF FINANCIAL REPORTS PURSUANT TO 18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

The undersigned hereby certifies that, to his or her knowledge, (i) the Form 10-K filed by HOMETOWN BANKSHARES CORPORATION (the "Issuer") for the year ended December 31, 2018, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) the information contained in that report fairly presents, in all material respects, the financial condition and results of operations of the Issuer [on the dates and for the periods presented therein].

HOMETOWN BANKSHARES CORPORATION

Date: March 15, 2019 By: /s/ Susan K. Still

Susan K. Still

President and Chief Executive Officer

Date: March 15, 2019 By: /s/ Vance W. Adkins

Vance W. Adkins

Executive Vice President

Chief Financial Officer

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