

**UNITED BANCORPORATION
OF ALABAMA, INC.
AND SUBSIDIARIES**

CONSOLIDATED FINANCIAL REPORT

DECEMBER 31, 2018

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES**

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INDEPENDENT AUDITOR'S REPORT

**To the Board of Directors
United Bancorporation of Alabama, Inc.
Atmore, Alabama**

We have audited the accompanying consolidated financial statements of **United Bancorporation of Alabama, Inc. and Subsidiaries**, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of earnings, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

A handwritten signature in cursive script that reads "Mauldin & Jenkins, LLC".

Birmingham, Alabama
March 15, 2019

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017**

<u>Assets</u>	<u>2018</u>	<u>2017</u>
Cash and due from banks	\$ 25,499,631	\$ 22,911,048
Interest-bearing deposits in banks	15,880,420	26,049,570
Federal funds sold	4,000,000	4,000,000
Cash and short-term investments	<u>45,380,051</u>	<u>52,960,618</u>
Securities available for sale, at fair value (amortized cost of \$134,269,600 and \$145,634,229 at December 31, 2018 and 2017, respectively)	130,573,099	143,484,897
Securities held to maturity, at amortized cost (fair value of \$17,668,231 and \$20,069,553 at December 31, 2018 and 2017, respectively)	17,790,388	20,003,257
Loans held for sale	110,000	-
Loans held for investment	409,843,750	347,930,552
Less allowance for loan losses	4,390,618	4,290,544
Loans, net	<u>405,453,132</u>	<u>343,640,008</u>
Premises and equipment, net	13,948,726	13,343,230
Interest receivable	3,669,215	3,094,071
Bank owned life insurance	11,381,988	11,048,864
Other real estate owned	1,257,359	1,430,301
Other assets	8,020,425	8,743,006
Total assets	<u><u>\$ 637,584,383</u></u>	<u><u>\$ 597,748,252</u></u>
<u>Liabilities and Stockholders' Equity</u>		
Deposits		
Noninterest-bearing	\$ 258,556,850	\$ 228,403,631
Interest-bearing	314,598,078	309,427,156
Total deposits	<u>573,154,928</u>	<u>537,830,787</u>
Other borrowings	4,661,212	6,243,957
Interest payable	205,896	183,719
Accrued expenses and other liabilities	2,627,714	5,130,600
Note payable to Trust	10,310,000	10,310,000
Total liabilities	<u>590,959,750</u>	<u>559,699,063</u>
Commitments (Note 18)		
Stockholders' equity		
Preferred stock, par value \$.01. Authorized 250,000 shares; no shares issued in 2018 and 2017, respectively	-	-
Class A common stock, par value \$.01. Authorized 5,000,000 shares; 2,438,192 and 2,431,680 shares issued in 2018 and 2017, respectively	24,457	24,317
Class B common stock, par value \$.01. Authorized 250,000 shares; no shares issued or outstanding	-	-
Additional paid-in capital	7,817,131	7,602,094
Retained earnings	41,647,425	32,036,728
Accumulated other comprehensive loss, net of tax	(2,772,374)	(1,611,999)
	<u>46,716,639</u>	<u>38,051,140</u>
Less 239 and 239 treasury shares, at cost, respectively	1,951	1,951
Less unvested restricted stock	90,055	-
Total stockholders' equity	<u>46,624,633</u>	<u>38,049,189</u>
Total liabilities and stockholders' equity	<u><u>\$ 637,584,383</u></u>	<u><u>\$ 597,748,252</u></u>

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF EARNINGS
YEARS ENDED DECEMBER 31, 2018 AND 2017**

	2018	2017
Interest income		
Interest and fees on loans	\$ 20,152,906	\$ 17,168,608
Interest on investment securities:		
Taxable securities	2,293,915	2,434,867
Nontaxable securities	879,121	879,588
Total investment income	3,173,036	3,314,455
Other interest income	631,328	307,139
Total interest income	23,957,270	20,790,202
Interest expense		
Interest on deposits	1,902,612	1,504,770
Interest on other borrowings	644,464	535,115
Total interest expense	2,547,076	2,039,885
Net interest income	21,410,194	18,750,317
Provision for loan losses	1,128,431	382,725
Net interest income after provision for loan losses	20,281,763	18,367,592
Noninterest income:		
Service charges and fees	4,359,282	4,003,709
CDFI magnet fund grant	4,234,061	-
New market tax credit sub-allocation and placement fees	2,001,191	-
Investment securities gains (losses), net	(81,719)	55,503
Mortgage loan and related fees	833,318	953,840
Other	1,440,039	1,582,064
Total noninterest income	12,786,172	6,595,116
Noninterest expense:		
Salaries and benefits	11,687,096	10,272,960
Net occupancy expense	1,802,795	1,793,874
Other	6,672,689	6,517,862
Total noninterest expense	20,162,580	18,584,696
Net earnings before income tax expense	12,905,355	6,378,012
Income tax expense	2,917,131	2,882,700
Net earnings	9,988,224	3,495,312
Net earnings available to common shareholders	\$ 9,988,224	\$ 3,495,312
Basic earnings per share	\$ 4.09	\$ 1.44
Basic weighted-average shares outstanding	2,440,195	2,421,994
Diluted earnings per share	\$ 4.09	\$ 1.44
Diluted weighted-average shares outstanding	2,440,592	2,421,994

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
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**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2018 AND 2017**

	2018	2017
Net earnings	\$ 9,988,224	\$ 3,495,312
Other comprehensive income (loss):		
Unrealized holding (losses) gains on securities available for sale arising during the period, net of tax (benefit) expense of \$(366,362) and \$451,036, respectively	(1,099,087)	676,554
Reclassification adjustment for gains on securities available for sale realized in net earnings from sales, net of taxes of \$20,430 and \$22,201, respectively	(61,288)	(33,302)
Unrealized gains on cash flow hedges arising during period, net of tax expense of \$0 and \$(2,740), respectively	-	4,109
Total other comprehensive income (loss)	(1,160,375)	647,361
Comprehensive income	\$ 8,827,849	\$ 4,142,673

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2018 AND 2017**

	Preferred Stock	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Unvested Restricted Stock	Total
		Shares	Par Value						
Balance, December 31, 2016	\$ -	2,412,468	\$ 24,125	\$ 7,345,204	\$ 28,546,743	\$ (1,936,968)	\$ (1,951)	\$ -	\$ 33,977,153
Net earnings	-	-	-	-	3,495,312	-	-	-	3,495,312
Impact of 2017 Tax Cuts and Jobs Act	-	-	-	-	322,392	(322,392)	-	-	-
Other comprehensive income	-	-	-	-	-	647,361	-	-	647,361
Cash dividend declared (\$.135 per share)	-	-	-	-	(327,719)	-	-	-	(327,719)
Shares issued in accordance with dividend reinvestment plan	-	3,699	37	53,950	-	-	-	-	53,987
Shares issued to KSOP	-	15,513	155	202,940	-	-	-	-	203,095
Balance, December 31, 2017	-	2,431,680	24,317	7,602,094	32,036,728	(1,611,999)	(1,951)	-	38,049,189
Net earnings	-	-	-	-	9,988,224	-	-	-	9,988,224
Other comprehensive loss	-	-	-	-	-	(1,160,375)	-	-	(1,160,375)
Cash dividend declared (\$.155 per share)	-	-	-	-	(377,527)	-	-	-	(377,527)
Restricted stock grants	-	10,635	106	155,846	-	-	-	(90,055)	65,897
Shares issued in accordance with dividend reinvestment plan	-	3,387	34	59,191	-	-	-	-	59,225
Balance, December 31, 2018	\$ -	2,445,702	\$ 24,457	\$ 7,817,131	\$ 41,647,425	\$ (2,772,374)	\$ (1,951)	\$ (90,055)	\$ 46,624,633

See accompanying notes to consolidated financial statement:

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2018 AND 2017**

	2018	2017
OPERATING ACTIVITIES		
Net earnings	\$ 9,988,224	\$ 3,495,312
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Provision for loan losses	1,128,431	382,725
Depreciation of premises and equipment	773,701	771,364
Net amortization of premium on investment securities available for sale	944,474	859,754
Net amortization of premium on investment securities held to maturity	157,281	149,654
Gain (loss) on sales of investment securities available for sale, net	74,650	(55,503)
Gain on sales of investment securities held to maturity, net	7,069	-
Stock based compensation	65,897	-
Loss on sales of other real estate owned	28,188	121,843
Gain on sales of loans held for sale	(571,693)	(665,883)
Originations of loans held for sale	(18,111,606)	(24,543,197)
Proceeds from sales of loans held for sale	18,573,299	25,725,067
Earnings on bank owned life insurance	(333,124)	(294,252)
Gain on sale of premises and equipment	(739)	(2,534)
Change in deferred income taxes	(109,196)	1,522,149
Provision for other real estate owned losses	215,000	398,449
Increase in interest receivable	(575,144)	(346,046)
Increase in prepaids	(70,918)	(1,006,744)
Increase in other assets	(353,513)	(678,674)
Increase in interest payable	22,177	35,944
Increase (decrease) in accrued expenses and other liabilities	(884,722)	575,480
Net cash provided by operating activities	10,967,736	6,444,908
INVESTING ACTIVITIES		
Proceeds from maturities, calls, and principal repayments of investment securities available for sale	17,552,395	21,515,539
Proceeds from maturities, calls, and principal repayments of investment securities held to maturity	1,000,000	227,250
Proceeds from sales of investment securities available for sale	5,714,245	21,588,455
Proceeds from sales of investment securities held to maturity	1,048,520	-
Purchases of investment securities available for sale	(12,921,134)	(25,417,432)
Purchase of bank owned life insurance	-	(1,650,000)
Net increase in loans	(64,660,589)	(47,247,905)
Purchases of premises and equipment, net	(1,387,540)	(698,690)
Proceeds from sale of premises and equipment	9,082	3,888
Proceeds from sale of other real estate owned	598,788	198,057
Net cash used in investing activities	(53,046,233)	(31,480,838)
FINANCING ACTIVITIES		
Net increase in deposits	35,324,141	31,942,385
Cash dividends paid - common stock	(352,691)	(314,088)
Proceeds from sale of common stock	59,225	257,082
Advances from other borrowings	-	1,050,000
Repayment of other borrowings	(532,745)	(150,342)
Net cash provided by financing activities	34,497,930	32,785,037
Net increase (decrease) in cash and short-term investments	(7,580,567)	7,749,107
Cash and short-term investments at beginning of year	52,960,618	45,211,511
Cash and short-term investments at end of year	\$ 45,380,051	\$ 52,960,618
SUPPLEMENTAL DISCLOSURE		
Cash paid during the year for:		
Interest	\$ 2,524,899	\$ 2,003,941
Income taxes	\$ 2,698,000	\$ 2,118,855
OTHER NONCASH TRANSACTIONS		
Transfer of loans to other real estate through foreclosure	\$ 683,765	\$ 115,692
Internally financed sales of other real estate owned	\$ 14,731	\$ 1,766,086

See accompanying notes to consolidated financial statements

**UNITED BANCORPORATION OF ALABAMA, INC.
AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

United Bancorporation of Alabama, Inc. (the “Corporation”) is a financial holding company whose principal activity is the ownership and management of its wholly-owned subsidiaries, United Bank (the “Bank”) and UB Community Development, LLC (UBCD). United Bank is a commercial bank with headquarters in Atmore, Alabama. The Bank provides a full range of banking services in its primary market areas of Baldwin, Escambia, and Monroe Counties, Alabama, and Santa Rosa County, Florida. UBCD is an entity established to manage allocations of New Market Tax Credits under U.S. Treasury Department programs. UBCD has opened an office in Birmingham, Alabama to extend its presence in other areas of the state.

Principles of Consolidation

The accompanying consolidated financial statements include the financial statements of United Bancorporation of Alabama, Inc., United Bank and UBCD, collectively referred to as the Corporation. Significant inter-company balances and transactions have been eliminated in consolidation.

Market Concentrations

The Corporation operates primarily in one business segment, commercial banking, in Southwest Alabama and Northwest Florida.

Basis of Presentation and Accounting Estimates

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

Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned and deferred taxes, the valuation of other than temporary impairment for investment securities, and the fair value of financial instruments.

The Corporation has evaluated all transactions, events, and circumstances for consideration or disclosure through March 15, 2019, the date these financial statements were available to be issued and has reflected or disclosed those items within the consolidated financial statements and related footnotes as deemed appropriate.

Fair Valuation of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Cash and Short-Term Investments

The Corporation considers cash and due from banks, interest-bearing deposits in banks, and federal funds sold to be cash and short-term investments. Federal funds are generally sold for one-day periods.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment Securities

Investment securities are classified in one of three portfolios: (i) trading account securities, (ii) securities available for sale, or (iii) securities held to maturity. Trading account securities are stated at fair value. Investment securities available for sale are stated at fair value with any unrealized gains and losses reported in a separate component of stockholders' equity, net of tax effect, until realized. Once realized, gains and losses on investment securities available for sale are reflected in current period earnings. Investment securities held to maturity are stated at amortized cost adjusted for amortization of premiums and accretion of discounts.

Net gains and losses on the sale of investment securities available for sale are recorded at trade date. The net gains and losses are computed using the specific identification method and are shown separately in noninterest income in the consolidated statements of earnings. Accretion of discounts and amortization of premiums are calculated on the effective interest method over the anticipated life of the security.

In December 2018, ASU No. 2017-12 Derivatives and Hedging, provided a one-time opportunity to reclassify held to maturity bonds to available for sale, without tainting the remaining held to maturity portfolio. The held to maturity bonds had to qualify as a prepayable fixed rate asset, but did not need to be a part of a hedging strategy to qualify. Net gains and losses on the sale of investment securities held to maturity are recorded at trade date. The net gains and losses are computed using the specific identification method and are shown separately in noninterest income in the consolidated statements of cash flows.

A decline in the fair value of any security below amortized cost that is deemed other than temporary is charged to earnings resulting in the establishment of a new cost basis for the security.

Other Securities

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

Loans Held For Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value (LOCOM). For loans carried at LOCOM, gains and losses on loan sales (sales proceeds minus carrying value) are recorded in noninterest income upon sale of the loan. The estimated fair value of loans held for sale is based on independent third party quoted prices.

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 balances less the allowance for loan losses. Interest income is accrued on the outstanding principal balance. Loan origination fees, net of certain direct origination costs, are recognized at the time the loan is placed on the books.

The accrual of interest on loans is discontinued when there is a clear indication that the borrower may not be able to meet payments as they become due, which is generally when a loan is 90 days past due. When a loan is placed on non-accrual status, all previously accrued and unpaid interest is reversed. Interest income is subsequently recognized on a cash basis as long as the remaining book balance of the asset is deemed to be collectible. If collectability is questionable, then cash payments are applied to principal. A loan is placed back on accrual status when both principal and interest are current and it is probable that the Corporation will be able to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allowance for Loan Losses

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

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For such loans that are classified as impaired, an allowance is established when the collateral value, present value of expected future cash flows or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical loss experience adjusted for qualitative factors. The qualitative factors considered by management include, among other factors, (1) changes in local and national economic conditions; (2) changes in asset quality; (3) changes in loan portfolio volume; (4) the composition and concentrations of credit; (5) the trends associated with the composition of the loan portfolio; (6) the trends related to classified assets and (7) effectiveness of the Corporation’s loan policies, procedures and internal controls.

Management considers a loan to be impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered impaired, the amount of impairment is measured based on the present value of expected future cash flows discounted at the loan’s effective interest rate. If the loan is collateral-dependent, the fair value of the collateral is used to determine the amount of impairment. Impairment losses are included in the allowance for loan losses through a charge to the provision for loan losses. Impaired loans are charged off against the allowance when such loans are deemed to be uncollectible. Subsequent recoveries are added to the allowance.

When a loan is considered impaired, payments are recognized as scheduled interest and principal reductions as long as the loan is not in default under the terms of the loan agreement. Otherwise, if in default, cash receipts are applied first to principal and once the recorded principal balance has been reduced to zero, future cash receipts are recognized as interest income, to the extent that any interest has not been recognized. Any further cash receipts are recorded as recoveries of any amount previously charged off.

The ultimate ability to collect a substantial portion of the Corporation’s loan portfolio is susceptible to changes in economic and market conditions in the geographic area served by the Corporation and various other factors.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled Debt Restructurings

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

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

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

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets.

Other Real Estate Owned

Other real estate owned represents property acquired through foreclosure or deeded to the Corporation in lieu of foreclosure on real estate mortgage loans on which borrowers have defaulted. Other real estate owned is carried at the lower of cost or fair value, adjusted for estimated selling costs. Reductions in the balance of other real estate owned at the date of foreclosure are charged to the allowance for loan losses. Subsequent valuation decreases in the carrying value of other real estate owned as well as costs to carry other real estate owned are recognized as charges to noninterest expense.

Income Taxes

The Corporation accounts for income taxes in accordance with income tax accounting guidance (FASB ASC 740, *Income Taxes*). The Corporation applies the accounting guidance related to accounting for uncertainty in income taxes, which sets out a consistent framework to determine the appropriate level of tax reserves to maintain for uncertain tax positions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes (Continued)

Income tax accounting results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Corporation determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

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

The Tax Cuts and Jobs Act of 2017 was signed into law on December 22, 2017. The law includes significant changes to the U.S. corporate income tax system, including a federal corporate rate reduction from 34% to 21%. In accordance with the income tax accounting guidance described above, the Corporation recorded additional income tax expense of \$1,052,327 as a result of the re-measurement of deferred tax assets and liabilities as of December 31, 2017.

Stock Based Compensation

At December 31, 2018, the Corporation had stock options and other equity awards outstanding as defined by a stock-based employee compensation plan, which is described more fully in Note 12. The Corporation accounts for its stock based compensation plan under stock compensation accounting guidance (FASB ASC 718, *Compensation – Stock compensation*). This guidance requires that the compensation cost relating to share-based payment transactions be recognized in the financial statements. That cost will be measured based on the grant date fair value of the equity or liability instruments issued. The stock compensation accounting guidance covers a wide range of share-based compensation arrangements including stock options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

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

Earnings per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS reflects the potential dilution that could occur if dilutive stock options were exercised and resulted in the issuance of common stock. Earnings per share was calculated under the treasury stock method for the years ended December 31, 2018 and 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Derivative Financial Instruments

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

All derivatives are recognized on the balance sheet at their fair value. Derivative instruments that are used as part of the Corporation's interest-rate risk management strategy include interest rate caps. An interest rate cap will convert the variable interest rate on the Corporation's variable rate note payable to trust to fixed interest rates should interest rates rise above a specified level. On the date the interest rate cap contract is entered into, the Corporation designates the derivative as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability "cash flow" hedge. Changes in the fair value of a derivative that is highly effective as - and that is designated and qualifies as - a cash-flow hedge are recorded in other comprehensive income, until earnings are affected by the variability of cash flows (e.g., when periodic settlements on a variable-rate asset or liability are recorded in earnings).

Comprehensive Income

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

Fair Value of Financial Instruments

Fair values of financial instruments are estimates using relevant market information and other assumptions, as more fully disclosed in Note 15. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Recent Accounting Pronouncements

ASU 2018-02, "Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." Issued in February 2018, ASU 2018-02 seeks to help entities reclassify certain stranded income tax effects in accumulated other comprehensive income resulting from the Tax Cuts and Jobs Act of 2017, enacted on December 22, 2017. ASU 2018-02 was issued in response to concerns regarding current guidance in GAAP that requires deferred tax liabilities and assets to be adjusted for the effect of a change in tax laws or rates with the effect included in income from continuing operations in the reporting period that includes the enactment date, even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income (loss), rather than net income, and as a result the stranded tax effects would not reflect the appropriate tax rate. The amendments of ASU 2018-02 allow an entity to make a reclassification from accumulated other comprehensive income (loss) to retained earnings for the stranded tax effects, which is the difference between the historical corporate income tax rate of 34% and the newly enacted corporate income tax rate of 21%. ASU 2018-02 is effective for fiscal years beginning after December 31, 2018; however, entities are allowed to early adopt the amendments of ASU 2018-02. As a result of the re-measurement of the Corporation's deferred tax assets following the enactment of the Tax Reform Act, accumulated other comprehensive loss included \$322,392 of stranded tax effects at December 31, 2017. The Corporation early adopted the amendments of 2018-02 as of December 31, 2017 and made the election to reclassify the stranded tax effects from accumulated other comprehensive loss to retained earnings at December 31, 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 2. CASH AND DUE FROM BANKS

The Bank may be required by the Federal Reserve Bank to maintain daily cash balances. The Bank is required to maintain reserve balances in cash or on deposit with the Federal Reserve Bank based on a percentage of deposits. The total of those reserve balances was \$16,374,000 and \$0 at December 31, 2018 and 2017, respectively.

NOTE 3. INVESTMENT SECURITIES

The amortized cost and fair value of investment securities available for sale at December 31, 2018 and 2017 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Available for Sale				
December 31, 2018:				
U.S. Treasury securities	\$ 1,980,480	\$ -	\$ (23,917)	\$ 1,956,563
U.S. government sponsored agencies	66,594,232	17,250	(1,863,168)	64,748,314
State and political subdivisions	35,854,649	27,068	(911,754)	34,969,963
Mortgage-backed securities	29,840,239	7,162	(949,142)	28,898,259
	<u>\$ 134,269,600</u>	<u>\$ 51,480</u>	<u>\$ (3,747,981)</u>	<u>\$ 130,573,099</u>
December 31, 2017:				
U.S. Treasury securities	\$ 1,975,271	\$ -	\$ (271)	\$ 1,975,000
U.S. government sponsored agencies	79,715,048	69,318	(1,199,359)	78,585,007
State and political subdivisions	33,878,961	123,528	(491,713)	33,510,776
Mortgage-backed securities	30,064,949	20,485	(671,320)	29,414,114
	<u>\$ 145,634,229</u>	<u>\$ 213,331</u>	<u>\$ (2,362,663)</u>	<u>\$ 143,484,897</u>

The amortized cost and fair value of investment securities held to maturity at December 31, 2018 and 2017 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Securities Held to Maturity				
December 31, 2018:				
U.S. government sponsored agencies	\$ 5,988,003	\$ -	\$ (74,146)	\$ 5,913,857
State and political subdivisions	11,802,385	11,596	(59,607)	11,754,374
	<u>\$ 17,790,388</u>	<u>\$ 11,596</u>	<u>\$ (133,753)</u>	<u>\$ 17,668,231</u>
December 31, 2017:				
U.S. government sponsored agencies	\$ 5,986,176	\$ 7,793	\$ (17,614)	\$ 5,976,355
State and political subdivisions	12,998,304	92,703	(24,929)	13,066,078
Mortgage-backed securities	1,018,777	8,343	-	1,027,120
	<u>\$ 20,003,257</u>	<u>\$ 108,839</u>	<u>\$ (42,543)</u>	<u>\$ 20,069,553</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. INVESTMENT SECURITIES (Continued)

Those investment securities classified as available for sale and held to maturity which have an unrealized loss position at December 31, 2018 and 2017 are detailed below:

	Less Than Twelve Months		Over Twelve Months		Total	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
December 31, 2018:						
U.S. Treasury securities	\$ -	\$ -	\$ (23,917)	\$ 1,956,563	\$ (23,917)	\$ 1,956,563
U.S. government sponsored agencies	(127,993)	11,407,020	(1,809,321)	53,601,966	(1,937,314)	65,008,986
State and political subdivisions	(8,156)	3,805,729	(963,205)	30,686,257	(971,361)	34,491,986
Mortgage-backed securities	-	-	(949,142)	26,379,384	(949,142)	26,379,384
Total securities	<u>\$ (136,149)</u>	<u>\$ 15,212,749</u>	<u>\$ (3,745,585)</u>	<u>\$ 112,624,170</u>	<u>\$ (3,881,734)</u>	<u>\$ 127,836,919</u>
December 31, 2017:						
U.S. Treasury securities	\$ (271)	\$ 1,975,000	\$ -	\$ -	\$ (271)	\$ 1,975,000
U.S. government sponsored agencies	(240,508)	30,029,498	(976,465)	37,095,582	(1,216,973)	67,125,080
State and political subdivisions	(92,980)	10,593,882	(423,662)	16,267,513	(516,642)	26,861,395
Mortgage-backed securities	(93,402)	9,398,894	(577,918)	17,157,955	(671,320)	26,556,849
Total securities	<u>\$ (427,161)</u>	<u>\$ 51,997,274</u>	<u>\$ (1,978,045)</u>	<u>\$ 70,521,050</u>	<u>\$ (2,405,206)</u>	<u>\$ 122,518,324</u>

The unrealized losses in investment securities available for sale at December 31, 2018 and 2017 were attributable to changes in market interest rates since the securities were purchased. The Corporation systematically evaluates investment securities for other-than-temporary declines in fair value on a quarterly basis. This analysis requires management to consider various factors, which include (1) duration and magnitude of the decline in value, (2) the financial condition of the issuer or issuers, (3) structure of the security and (4) the Corporation's intent to sell the security or whether it is more likely than not that the Corporation would be required to sell the security before its anticipated recovery in market value. Because the Corporation does not currently intend to sell the investment securities and it is not more likely than not that the Corporation will be required to sell the investment securities before recovery of their amortized cost bases, which may be maturity, the Corporation does not consider these investment securities to be other-than-temporarily impaired at December 31, 2018.

The amortized cost and fair value of investment securities as of December 31, 2018 categorized by contractual maturity are shown below.

	Securities Available for Sale		Securities Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$ 1,410,140	\$ 1,409,842	\$ -	\$ -
Due after one year through five years	27,556,723	26,884,171	8,359,371	8,281,382
Due after five years through ten years	57,039,751	55,237,509	6,437,291	6,402,766
Due after ten years	48,262,986	47,041,577	2,993,726	2,984,083
	<u>\$ 134,269,600</u>	<u>\$ 130,573,099</u>	<u>\$ 17,790,388</u>	<u>\$ 17,668,231</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. INVESTMENT SECURITIES (Continued)

The gross gains and gross losses realized by the Corporation from sales of investment securities available for sale and held to maturity for the years ended December 31, 2018 and 2017 were as follows:

	Years Ended December 31,	
	2018	2017
Gross gains	\$ 24	\$ 110,956
Gross losses	(81,743)	(55,453)
Net realized gains (losses)	\$ (81,719)	\$ 55,503

Investment securities with carrying values of \$31,870,013 and \$41,040,799 at December 31, 2018 and 2017, respectively, were pledged to secure federal funds lines, Federal Home Loan Bank advances, and public and trust deposits as required by law and for other purposes.

Other securities (included in other assets in the consolidated balance sheets) consist of the following as of December 31, 2018 and 2017:

	December 31,	
	2018	2017
Federal Home Loan Bank of Atlanta	\$ 581,100	\$ 546,000
First National Banker's Bankshares, Inc.	777,000	777,000
Central Alabama Title Center, LLC	30,000	30,000
United Bancorp Capital Trust II	310,000	310,000
Sub-CDE Investments	5,650	3,000
First Community, LP	2,500	2,500
Federal Agricultural Mortgage Corporation	10,153	10,153
	\$ 1,716,403	\$ 1,678,653

NOTE 4. LOANS AND ALLOWANCE FOR LOAN LOSSES

Portfolio Segments and Classes

At December 31, 2018 and 2017, the composition of the loan portfolio was as follows:

	December 31,	
	2018	2017
Real estate:		
Construction and land loans	\$ 23,586,240	\$ 22,224,504
Farmland	39,279,178	35,947,753
1-4 family residential mortgages	82,130,310	78,545,012
Multifamily	6,064,097	3,148,951
Commercial	86,112,328	83,953,376
Agricultural	34,263,997	28,391,442
Commercial	103,976,70	59,989,652
Consumer	19,914,709	17,138,091
States and political subdivisions	11,255,647	15,324,052
Other loans	3,260,537	3,267,719
Total	\$ 409,843,75	\$ 347,930,55

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Portfolio Segments and Classes (Continued)

For purposes of the disclosures required pursuant to ASC 310, the loan portfolio was disaggregated into segments and then further disaggregated into classes for certain disclosures. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for loan losses. There are six primary loan portfolio segments that include real estate, agriculture, commercial, consumer, state and political subdivisions and other loans. A class is generally determined based on the initial measurement attribute, risk characteristic of the loan, and an entity's method for monitoring and assessing credit risk. Classes within the real estate portfolio segment include construction and land loans, farmland, 1-4 family residential mortgages, multifamily, and commercial. The portfolio segments of all other non-real estate loans have not been further segregated by class.

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

Real Estate - As discussed below, the Corporation offers various types of real estate loan products. All loans within this portfolio segment are particularly sensitive to the valuation of real estate:

- Construction and land loans are repaid through cash flow related to the operation, sale or refinance of the underlying property. This portfolio class includes extensions of credit to real estate developers or investors where repayment is dependent on the sale of the real estate or income generated from the real estate collateral.
- 1-4 family residential mortgages and farmland loans are repaid by various means such as a borrower's income, sale of the property, or rental income derived from the property.
- Commercial loans include owner-occupied commercial real estate loans and loans secured by income producing properties. Owner-occupied commercial real estate loans to operating businesses are long-term financing of land and buildings. These loans are viewed primarily as cash flow loans and the repayment of these loans is largely dependent on the successful operation of the business. Real estate loans for income-producing multifamily properties such as apartment buildings, office and industrial buildings, and retail shopping centers are repaid from rent income derived from the properties.

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

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

State and Political Subdivisions - The state and political subdivision loan portfolio segment includes loans to local municipalities to support municipal operations and projects. Loans are repaid generally from tax revenues collected in those municipalities.

Other Loans - The other loans portfolio segment includes loans to non-related bank holding company to invest in subordinated-debt. Loans are interest only fixed rate, interest payable semi-annually.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Credit Risk Management

The Corporation assigns a risk rating to each loan when approved. The rating categories are based on information about the ability of borrowers to service the debt. Such information includes, among other things, current financial information, payment history, credit documentation and current economic conditions. Loan Officers are expected and required to initiate recommendations for changes in assigned risk ratings according to changes in the overall levels of risk in each loan in their portfolio no less than monthly. The current risk rating will be reviewed from time to time by the Chief Credit Officer and the Special Assets Officer for concurrence. The Corporation uses the following guidelines in determining the appropriate risk rating:

Grade 1: Investment Grade – There is an absence of credit risk. Loans in this category are fully secured by United Bank certificates of deposit or savings accounts (demand deposit accounts are not eligible as collateral). The certificate should be sufficient in amount to cover principal and interest.

Grade 2: Minimal Credit Risk – The overall financial condition is very strong. Businesses should have high liquidity, a history of stable and predictable earnings, a strong management team and the primary source of repayment is clear and subject to little risk. Customers should have a substantial net worth in liquid assets with a well-defined source of repayment.

Grade 3: Attractive Credit Risk – The overall financial condition is good. Financial statements are current and show satisfactory income, profits, cash flow, and debt service coverage, debt to worth ratio and credit history. Loans in this category are properly structured and documented and require only minimal supervision.

Grade 4: Average Risk – The overall financial condition is average. Credit history has been satisfactory. Refinancing could be obtained with normal effort. Financial statements are current and show some volatility in income, profits, cash flow, debt service coverage or credit history. The volatility is easily identifiable and has been addressed and does not constitute an unwarranted level of risk.

Grade 5: Acceptable Risk – The overall financial condition of the business or individual is acceptable. There is more than average credit risk and the credit should be more closely watched but there is little chance of loss. While acceptable, loans in this category may warrant close monitoring for any number of reasons including inconsistent earnings, leveraged balance sheet, economic conditions, collateral requiring close supervision, financial information that is stale or incomplete or irregular payment record.

Grade 6: Monitor – This asset has potential weakness and deserves management attention. If left uncorrected the potential weakness may result in deterioration of the overall financial condition. There is no room for debt expansion and they are fully leveraged. If liquidation were to take place there could be a minimal loss and thus an analysis should be made to determine if a specific reserve is needed.

Grade 7: Substandard – This asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Loans in this category involve more than a normal risk. There is limited opportunity to refinance. If liquidation were to take place there could be some recognized loss exposure. If the loan is determined to be impaired, an analysis will be performed to determine the amount of reserve, if any, to be recognized.

Grade 8: Doubtful – A loss is highly likely and there probably will be a default. There is no ability to refinance. At this point collection effort should be in full process. Loans in this category will be reserved at a specific amount in line with the impairment analysis performed if the loan is determined to be impaired.

These risk ratings are summarized into categories as follows: Pass includes loans with Grades 1-5, Special Mention includes loans with a Grade of 6, and Substandard/Doubtful include loans with Grades 7 and 8.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Credit Risk Management (Continued)

The following tables summarize the credit risk profile of our loan portfolio by internally assigned grades as of December 31, 2018 and 2017.

	Pass	Special Mention	Substandard	Total
	<i>(Dollars in Thousands)</i>			
December 31, 2018:				
Real estate:				
Construction and land loans	\$ 21,593	\$ 1,221	\$ 772	\$ 23,586
Farmland	31,675	3,233	4,371	39,279
1-4 family residential mortgages	79,834	1,967	329	82,130
Multifamily	6,064	-	-	6,064
Commercial	80,758	1,664	3,690	86,112
Agricultural	32,885	726	653	34,264
Commercial	102,796	503	678	103,977
Consumer	19,817	76	22	19,915
States and political subdivisions	11,256	-	-	11,256
Other loans	3,261	-	-	3,261
Total	\$ 389,939	\$ 9,390	\$ 10,515	\$ 409,844

There were no loans considered doubtful as of December 31, 2018.

	Pass	Special Mention	Substandard	Total
	<i>(Dollars in Thousands)</i>			
December 31, 2017:				
Real estate:				
Construction and land loans	\$ 20,179	\$ 362	\$ 1,684	\$ 22,225
Farmland	30,016	1,783	4,149	35,948
1-4 family residential mortgages	75,588	1,993	964	78,545
Multifamily	3,149	-	-	3,149
Commercial	76,994	2,103	4,856	83,953
Agricultural	24,279	3,288	824	28,391
Commercial	59,031	619	340	59,990
Consumer	17,061	27	50	17,138
States and political subdivisions	15,324	-	-	15,324
Other loans	3,268	-	-	3,268
Total	\$ 324,889	\$ 10,175	\$ 12,867	\$ 347,931

There were no loans considered doubtful as of December 31, 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Allowance for Loan Losses

The following tables detail the change in the allowance for loan losses for the years ended December 31, 2018 and 2017. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

	Beginning Balance	Charge-offs	Recoveries	Provision Allocation	Ending Balance
<i>(Dollars in Thousands)</i>					
December 31, 2018:					
Real estate:					
Construction and land loans	\$ 345	\$ -	\$ 25	\$ (226)	\$ 144
Farmland	213	-	-	83	296
1-4 family residential mortgages	933	(131)	2	37	841
Multifamily	6	-	-	37	43
Commercial	1,700	(670)	5	115	1,150
Agriculture	51	-	-	179	230
Commercial	742	(159)	-	691	1,274
Consumer	262	(112)	11	147	308
States and political subdivisions	29	-	-	52	81
Other loans	10	-	1	13	24
Total:	<u>\$ 4,291</u>	<u>\$ (1,072)</u>	<u>\$ 44</u>	<u>\$ 1,129</u>	<u>\$ 4,391</u>
December 31, 2017:					
Real estate:					
Construction and land loans	\$ 327	\$ -	\$ 6	\$ 12	\$ 345
Farmland	153	-	-	60	213
1-4 family residential mortgages	825	(25)	35	98	933
Multifamily	7	-	-	(1)	6
Commercial	1,925	-	25	(250)	1,700
Agriculture	46	-	-	5	51
Commercial	399	-	20	323	742
Consumer	214	(99)	35	112	262
States and political subdivisions	7	-	-	22	29
Other loans	9	(1)	-	2	10
Total:	<u>\$ 3,912</u>	<u>\$ (125)</u>	<u>\$ 121</u>	<u>\$ 383</u>	<u>\$ 4,291</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Allowance for Loan Losses (Continued)

	Loan Balances			Allowance for Loan Loss		
	Total Loans	Loans Individually Evaluated for Impairment	Loans Collectively Evaluated for Impairment	Specific Reserves	General Reserves	Total Reserves
December 31, 2018:						
Real estate:						
Construction and land loans	\$ 23,586	\$ 1,513	\$ 22,073	\$ -	\$ 144	\$ 144
Farmland	39,279	4,402	34,877	10	286	296
1-4 family residential mortgages	82,130	385	81,745	144	697	841
Multifamily	6,064	-	6,064	-	43	43
Commercial	86,112	4,356	81,756	225	925	1,150
Agriculture	34,264	1,045	33,219	-	230	230
Commercial	103,977	643	103,334	240	1,034	1,274
Consumer	19,915	214	19,701	12	296	308
States and political subdivisions	11,256	-	11,256	-	81	81
Other loans	3,261	-	3,261	-	24	24
Total:	\$ 409,844	\$ 12,558	\$ 397,286	\$ 631	\$ 3,760	\$ 4,391
December 31, 2017:						
Real estate:						
Construction and land loans	\$ 22,225	\$ 1,575	\$ 20,650	\$ 100	\$ 245	\$ 345
Farmland	35,948	4,486	31,462	49	164	213
1-4 family residential mortgages	78,545	667	77,878	384	549	933
Multifamily	3,149	-	3,149	-	6	6
Commercial	83,953	5,379	78,574	673	1,027	1,700
Agriculture	28,391	1,065	27,326	-	51	51
Commercial	59,990	678	59,312	251	491	742
Consumer	17,138	160	16,978	18	244	262
States and political subdivisions	15,324	-	15,324	-	29	29
Other loans	3,268	-	3,268	-	10	10
Total:	\$ 347,931	\$ 14,010	\$ 333,921	\$ 1,475	\$ 2,816	\$ 4,291

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due (both principal and interest) according to the terms of the loan agreement.

The following tables detail the Corporation's impaired loans, by portfolio class, as of December 31, 2018 and 2017.

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2018:	<i>(Dollars in Thousands)</i>				
With no related allowance recorded:					
Real estate:					
Construction and land loans	\$ 1,513	\$ 1,513	\$ -	\$ 1,180	\$ 52
Farmland	4,006	4,006	-	4,035	35
1-4 family residential mortgages	178	178	-	181	8
Multifamily	-	-	-	-	-
Commercial	2,434	3,056	-	3,181	56
Agriculture	1,045	1,045	-	1,050	34
Commercial	-	-	-	-	-
Consumer	96	96	-	78	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	<u>9,272</u>	<u>9,894</u>	<u>-</u>	<u>9,705</u>	<u>185</u>
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	-	-	-	364	-
Farmland	396	396	10	424	20
1-4 family residential mortgages	207	207	144	279	7
Multifamily	-	-	-	-	-
Commercial	1,922	1,922	225	1,363	2
Agriculture	-	-	-	-	-
Commercial	643	643	240	734	19
Consumer	118	118	12	129	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	<u>3,286</u>	<u>3,286</u>	<u>631</u>	<u>3,293</u>	<u>48</u>
Total impaired loans:	<u>\$ 12,558</u>	<u>\$ 13,180</u>	<u>\$ 631</u>	<u>\$ 12,998</u>	<u>\$ 233</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Impaired Loans (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2017:					
(Dollars in Thousands)					
With no related allowance recorded:					
Real estate:					
Construction and land loans	\$ 662	\$ 853	\$ -	\$ 534	\$ 32
Farmland	4,042	4,042	-	1,975	137
1-4 family residential mortgages	232	232	-	211	14
Multifamily	-	-	-	-	-
Commercial	3,784	3,784	-	2,116	180
Agriculture	1,065	1,065	-	1,098	55
Commercial	-	-	-	-	-
Consumer	-	-	-	-	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with no related allowance recorded	<u>9,785</u>	<u>9,976</u>	<u>-</u>	<u>5,934</u>	<u>418</u>
With an allowance recorded:					
Real estate mortgages:					
Construction and land loans	913	913	100	916	50
Farmland	444	546	49	423	20
1-4 family residential mortgages	435	510	384	454	5
Multifamily	-	-	-	-	-
Commercial	1,595	1,595	673	2,257	49
Agriculture	-	-	-	-	-
Commercial	678	1,049	251	623	21
Consumer	160	160	18	189	-
States and political subdivisions	-	-	-	-	-
Other loans	-	-	-	-	-
Total with an allowance recorded	<u>4,225</u>	<u>4,773</u>	<u>1,475</u>	<u>4,862</u>	<u>145</u>
Total impaired loans:	<u>\$ 14,010</u>	<u>\$ 14,749</u>	<u>\$ 1,475</u>	<u>\$ 10,796</u>	<u>\$ 563</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Past Due Loans

The table below provides an age analysis of past due loans as of December 31, 2018 and 2017:

	Current	Past Due Status (Accruing Loans)				Non-accrual	Total
		30-59 Days	30-89 Days	90+ Days	Total Past Due		
<i>(Dollars in Thousands)</i>							
December 31, 2018:							
Real estate:							
Construction and land loans	\$ 23,391	\$ 38	\$ -	\$ -	\$ 38	\$ 157	\$ 23,586
Farmland	37,693	-	665	379	1,044	542	39,279
1-4 family residential mortgages	80,715	912	231	165	1,308	107	82,130
Multifamily	6,064	-	-	-	-	-	6,064
Commercial	82,211	1,810	-	-	1,810	2,091	86,112
Agriculture	34,249	-	-	-	-	15	34,264
Commercial	103,181	127	-	-	127	669	103,977
Consumer	19,706	36	58	34	128	81	19,915
States and political subdivisions	11,256	-	-	-	-	-	11,256
Other loans	3,261	-	-	-	-	-	3,261
Total:	<u>\$ 401,727</u>	<u>\$ 2,923</u>	<u>\$ 954</u>	<u>\$ 578</u>	<u>\$ 4,455</u>	<u>\$ 3,662</u>	<u>\$ 409,844</u>
December 31, 2017:							
Real estate:							
Construction and land loans	\$ 22,041	\$ 51	\$ -	\$ 24	\$ 75	\$ 109	\$ 22,225
Farmland	35,450	82	-	-	82	416	35,948
1-4 family residential mortgages	76,198	1,069	290	493	1,852	495	78,545
Multifamily	3,149	-	-	-	-	-	3,149
Commercial	80,282	-	253	2,108	2,361	1,310	83,953
Agriculture	28,391	-	-	-	-	-	28,391
Commercial	59,619	-	27	28	55	316	59,990
Consumer	17,070	11	4	14	29	39	17,138
States and political subdivisions	15,324	-	-	-	-	-	15,324
Other loans	3,268	-	-	-	-	-	3,268
Total:	<u>\$ 340,792</u>	<u>\$ 1,213</u>	<u>\$ 574</u>	<u>\$ 2,667</u>	<u>\$ 4,454</u>	<u>\$ 2,685</u>	<u>\$ 347,931</u>

Related Party Transactions

Certain executive officers and directors of the Corporation, including their immediate families and companies with which they are associated, are loan customers of the Bank. Total loans outstanding and available lines of credit to these related parties at December 31, 2018 and 2017, totaled \$4,196,152 and \$8,520,209, respectively. Such loans are made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements, and do not represent more than a normal credit risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Troubled Debt Restructurings

Restructured loans are loans on which, because of a borrower's financial difficulties, the Corporation has granted a concession that would not otherwise be considered. Modifications of terms that could potentially qualify as a restructuring include reduction of contractual interest rate, extension of the maturity date at a contractual interest rate lower than the current market rate for new debt with similar risk, or a reduction of the face amount of debt, or either forgiveness of either principal or accrued interest. The following table summarizes, as of December 31, 2018 and 2017, loans that have been restructured:

	Troubled-Debt Restructurings			Effect on the Allowance for Loan Losses
	Number of Loans	Recorded Investment Prior to Modification	Recorded Investment After Modification	
<i>(Dollars in Thousands)</i>				
December 31, 2018:				
Real estate:				
Construction and land loans	-	\$ -	\$ -	\$ -
Farmland	1	511	396	(10)
1-4 family residential mortgages	1	93	83	-
Multifamily	-	-	-	-
Commercial	1	90	91	(25)
Agricultural	-	-	-	-
Commercial	1	547	460	(57)
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total:	4	\$ 1,241	\$ 1,030	\$ (92)
December 31, 2017:				
Real estate:				
Construction and land loans	-	\$ -	\$ -	\$ -
Farmland	2	635	407	(10)
1-4 family residential mortgages	2	157	131	-
Multifamily	-	-	-	-
Commercial	3	657	542	(72)
Agricultural	2	1,340	1,065	-
Commercial	1	547	467	(12)
Consumer	-	-	-	-
States and political subdivisions	-	-	-	-
Other loans	-	-	-	-
Total:	10	\$ 3,336	\$ 2,612	\$ (94)

The Corporation has not forgiven any principal on the above loans. At December 31, 2018 and 2017, \$0 and \$1,604, respectively, of the above restructured loans were held as non-accrual.

As of December 31, 2018 and 2017, there were no loans restructured within the last 12 months that had subsequently defaulted.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5. OTHER REAL ESTATE OWNED

The table below presents a summary of the activity related to other real estate owned for the years ending December 31, 2018 and 2017, respectively.

	Years Ended December 31,	
	2018	2017
Balance, beginning of year	\$ 1,430,301	\$ 3,799,044
Additions	683,764	115,692
Sales proceeds	(598,788)	(198,057)
Internally financed sales	(14,731)	(1,766,086)
Loss on sales of other real estate owned	(28,187)	(121,843)
Provision for other real estate owned losses	(215,000)	(398,449)
Balance, end of year	<u>\$ 1,257,359</u>	<u>\$ 1,430,301</u>

Other real estate owned by type is as follows:

	December 31,	
	2018	2017
Construction and land development real estate	\$ 1,041,600	\$ 1,041,601
Residential real estate	60,859	18,800
Commercial real estate	369,900	369,900
ORE Valuation Allowance	(215,000)	-
	<u>\$ 1,257,359</u>	<u>\$ 1,430,301</u>

Expenses related to other real estate owned for the year ended December 31, 2018 and 2017 are as follows:

	Years Ended December 31,	
	2018	2017
Net loss on sales of other real estate owned	\$ 28,187	\$ 121,843
Provision for other real estate owned losses	215,000	398,449
Operating expenses, net of lease income	97,991	118,449
	<u>\$ 341,178</u>	<u>\$ 638,741</u>

NOTE 6. PREMISES AND EQUIPMENT

At December 31, 2018 and 2017, premises and equipment were as follows:

	December 31,	
	2018	2017
Land	\$ 5,253,129	\$ 5,253,129
Buildings and leasehold improvements (depreciated over 5 to 50 years)	16,479,263	16,360,180
Furniture, fixtures, and equipment (depreciated over 3 to 10 years)	11,517,001	10,313,910
Automobiles (depreciated over 3 years)	182,187	129,336
	<u>33,431,580</u>	<u>32,056,555</u>
Accumulated depreciation	(19,482,854)	(18,713,325)
	<u>\$ 13,948,726</u>	<u>\$ 13,343,230</u>

Depreciation expense for the years ended December 31, 2018 and 2017 was \$773,701 and \$771,364, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7. DEPOSITS

At December 31, 2018 and 2017, deposits were as follows:

	December 31,	
	2018	2017
Noninterest-bearing accounts	\$ 258,556,850	\$ 228,403,631
NOW accounts	88,735,154	91,148,730
Money market investment accounts	46,889,645	39,411,068
Savings accounts	60,545,611	57,656,589
Time deposits:		
Time deposits less than \$250,000	104,468,415	108,259,747
Time deposits equal to or greater than \$250,000	13,959,253	12,951,022
Total deposits	\$ 573,154,928	\$ 537,830,787

At December 31, 2018 and 2017 interest expense on deposits was as follows:

	Years Ended December 31,	
	2018	2017
NOW accounts	\$ 180,998	\$ 179,409
Money market investment accounts	334,763	131,981
Savings accounts	86,447	82,330
Time deposits:		
Time deposits less than \$250,000	1,156,581	955,503
Time deposits equal to or greater than \$250,000	143,823	155,547
Total deposits	\$ 1,902,612	\$ 1,504,770

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

2019	\$ 60,000,719
2020	24,252,650
2021	14,502,465
2022	7,397,408
2023	12,274,426
	\$ 118,427,668

At December 31, 2018 and 2017, overdraft demand and savings deposits reclassified to loans totaled \$770,521 and \$89,541, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8. PARTICIPATION IN U.S. TREASURY PROGRAMS

New Market Tax Credits

On November 17, 2016, the Corporation was awarded a \$65,000,000 allocation of New Market Tax Credits from the Community Development Financial Institution (CDFI) Fund administered by the U.S. Department of Treasury for the 2015/2016 award year. The Corporation will allocate these tax credits into qualified projects in Alabama, Florida and Mississippi. As of December 31, 2018, the Corporation has \$7,500,000 in remaining tax credit allocations available to deploy from the 2016 allocation. On February 13, 2018, the Corporation was awarded a \$55,000,000 allocation of New Market Tax Credits from the Community Development Financial Institution (CDFI) Fund administered by the U.S. Department of Treasury for the 2017 award year. The Corporation will allocate these tax credits into qualified projects in Alabama and Florida. As of December 31, 2018, the Corporation has \$47,000,000 in remaining tax credit allocations available to deploy from the 2017 allocation.

In aggregate as of December 31, 2018, the Corporation has \$54,400,000 of New Market Tax Credits remaining to deploy. As of the audit issue date, for the 2016 allocation, \$7,500,000 has been allocated leading to the full deployment of the 2016 New Market Tax Credit award. As of the audit issue date, for the 2017 allocation, in addition to the \$8,000,000 already deployed in 2018, \$29,000,000 has been fully committed to projects, all of which are expected to close no later than June 30, 2019. The remaining \$18,000,000 have been earmarked for projects that are in the Corporation's pipeline. There is \$102,000,000 in project demands to allocate the remaining \$18,000,000 of New Market Tax Credits of the Corporation.

Community Development Financial Institutions Income

On May 7, 2018, the Corporation received an award of \$4,000,000 from the U.S. Department of Treasury's Capital Magnet Fund (CMF) program administered by the Department of Treasury's Community Development Financial Institutions (CDFI) Fund. The award will be used to develop projects aimed at providing better housing options for low-income families and creating new economic opportunities throughout Alabama and Florida. The Corporation was one of the only 40 entities nationwide to receive a Capital Magnet Fund award, and its \$4 million was one of the largest awards granted to a single entity.

On June 27, 2018, the Corporation received an award of \$233,387 from the Bank Enterprise Award Program (BEA Program) 2017 round administered by the CDFI Fund. The BEA Program is a performance-based grant program that provides monetary awards to FDIC-insured depository institutions that successfully demonstrate an increase in their investments in mission-driven lenders known as CDFIs, or in their own lending, investing, or service activities in highly distressed communities. The BEA Program awards help offset some of the risks and/or costs associated with investing in these highly distressed communities and provide an incentive to increase their investments.

NOTE 9. OTHER BORROWINGS

Other borrowings consist of the following:

	December 31,	
	2018	2017
Federal Home Loan Bank advances	\$ 116,791	\$ 193,957
Term Note	4,544,421	5,000,000
Loan-related borrowing	-	1,050,000
Total other borrowings	<u>\$ 4,661,212</u>	<u>\$ 6,243,957</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 9. OTHER BORROWINGS (Continued)

Federal Home Loan Bank Advances

The Corporation's advances from the Federal Home Loan Bank of Atlanta bear interest at fixed rates, ranging from 4.62% to 7.54% at December 31, 2018. These advances are due at various dates through 2020. The weighted average interest rate as of December 31, 2018 and 2017 was 5.11% and 5.11%, respectively.

At December 31, 2018 and 2017, Federal Home Loan Bank advances were collateralized by investment securities with carrying values of \$416,237 and \$520,458, respectively.

Term Note

On November 7, 2016, the Corporation entered into a revolving line of credit with a commercial bank in the amount of \$5,000,000. The outstanding balance of the line of credit was \$4,544,421 and \$5,000,000 at December 31, 2018 and 2017, respectively. The interest rate is the prime rate less .25% (5.25% at December 31, 2018) and interest is payable quarterly for one year then converting to a term note with quarterly principal and interest payments due through maturity on November 7, 2026. The note is secured by 100% of the outstanding stock of the Bank.

Loan-Related Borrowing

The Corporation has a loan participation agreement with a financial institution whereby it sold to them a participating interest in a commercial loan. However, the participation agreement contains a "put option" clause that gives the participant financial institution the right and option to require the Corporation to repurchase its participating interest. This type of clause precludes sales treatment and the participating interest amount must be recorded as a borrowing rather than as a reduction of the loan balance. On September 24, 2018, the participating financial institution exercised the "put option", thus qualifying the participation as a sale.

USDA Re-Lending Program

During 2016, the Corporation entered in to a \$40,000,000 promissory note with the United States Department of Agriculture's Community Facilities Direct Loan program which will allow it to re-lend funds to eligible borrowers in rural areas in Alabama and Florida on a fixed rate structure. There were no amounts outstanding under this note agreement as of December 31, 2018 and 2017.

At December 31, 2018, other borrowings are due as follows:

2019	\$	-
2020		116,791
2021		-
2022		-
2023		-
Thereafter		4,544,421
	\$	<u>4,661,212</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10. NOTE PAYABLE TO TRUST

United Bancorp Capital Trust II

In 2007, the Corporation formed a wholly-owned grantor trust to issue cumulative trust preferred securities. The grantor trust has invested the proceeds of the trust preferred securities in junior subordinated debentures of the Corporation. The junior subordinated debentures can be redeemed prior to maturity at the option of the Corporation on or after September 30, 2011. The sole assets of the guarantor trust are the Junior Subordinated Deferrable Interest Debentures of the Corporation (the Debentures) held by the grantor trust. The debentures have the same interest rate (three month LIBOR plus 1.68%, floating) as the trust preferred securities. The interest rate in effect as of December 31, 2018 was 4.483%. The Corporation has the right to defer interest payments on the Debentures at any time or from time to time for a period not exceeding 20 consecutive quarters provided that no extension period may extend beyond the stated maturity of the related Debentures. During any such extension period, distributions on the trust preferred certificates would also be deferred.

Payment of periodic cash distributions and payment upon liquidation or redemption with respect to the trust preferred securities are guaranteed by the Corporation to the extent of funds held by the grantor trust (the Preferred Securities Guarantee). The Preferred Securities Guarantee, when taken together with the Corporation's other obligations under the Debentures, constitute a full and unconditional guarantee, on a subordinated basis, by the Corporation of payments due on the trust preferred securities.

The trust preferred securities and the related debentures were issued on September 27, 2007. Distributions on the trust preferred securities are paid quarterly on March 30, June 30, September 30 and December 30 of each year. Interest on the Debentures is paid on the corresponding dates. The aggregate principal amount of Debentures outstanding at December 31, 2018 and 2017 was \$10,310,000.

NOTE 11. INCOME TAXES

The Tax Cuts and Jobs Act (the "Act"), which was enacted on December 22, 2017, made key changes to the U.S. tax law, including the reduction of the U.S. federal corporate tax rate from 34% to 21%. As ASC 740, *Income Taxes*, requires the effects of changes in tax rates and laws on deferred tax balances to be recognized in the period in which the legislation is enacted, the Corporation remeasured its deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is 21%. The deferred tax expense recorded related to the remeasurement of net deferred tax assets was \$729,935. Additionally, the deferred tax effects on the unrealized holding losses for available for sale securities was also remeasured as a component of deferred income tax expense in the amount of \$322,392.

The components of income tax expense are as follows:

	Years Ended December 31,	
	2018	2017
Current:		
Federal	\$ 2,409,572	\$ 1,113,182
State	616,755	247,369
Total	3,026,327	1,360,551
Deferred:		
Federal	(84,160)	1,593,405
State	(25,036)	(71,256)
Total	(109,196)	1,522,149
Income tax expense	\$ 2,917,131	\$ 2,882,700

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 11. INCOME TAXES (Continued)

Total income tax expense differed from the amount computed by applying the statutory federal income tax rate of 21% and 34%, respectively, to pretax income is as follows:

	Years Ended December 31,	
	2018	2017
Income tax expense at federal statutory rate	\$ 2,723,648	\$ 2,168,524
Increase (decrease) resulting from:		
Tax exempt interest	(315,862)	(503,321)
Interest disallowance	76,411	9,026
State income tax, net of federal benefit	6,948	116,235
Premium amortization on tax exempt investment securities	(69,956)	130,098
Cash surrender value of life insurance	467,458	(100,046)
Impact of federal income tax rate change	272	1,052,327
Other, net	28,212	9,857
Total income tax expense	\$ 2,917,131	\$ 2,882,700

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

	December 31,	
	2018	2017
Deferred tax assets:		
Loans, principally due to the allowance for loan losses	\$ 1,102,607	\$ 779,460
Other real estate, principally due to difference in carrying value	110,929	56,936
Intangible assets	10,153	25,509
Premises and equipment, principally due to difference in depreciation	21,717	289,278
Deferred compensation	325,679	317,922
Accrued expenses	89,228	70,517
Interest rate hedge	-	-
Investment securities available for sale	966,080	537,333
Alternative minimum tax credit	-	-
Other	3,674	14,889
	2,630,067	2,091,844
Deferred income tax liabilities:		
Discount accretion	2,391	2,111
Net deferred income tax assets	\$ 2,627,676	\$ 2,089,733

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies. Based upon the level of historical taxable income and projection for future taxable income over the periods which the temporary differences resulting in the deferred tax assets are deductible, management believes it is more likely than not that the Corporation will realize the benefits of these deductible differences.

The federal and state income tax returns of the Corporation for 2015, 2016, and 2017 are subject to examination, generally for three years after they were filed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12. STOCK BASED COMPENSATION

Stock Options

2018 Equity Incentive Plan

The United Bancorporation of Alabama, Inc. 2018 Equity Incentive Plan (formerly the 2007 Equity Incentive Plan) provides for the grant of stock options, stock appreciation rights, restricted stock awards, performance units, or any combination thereof to officers, directors, and employees of the Corporation to purchase up to an aggregate of 308,000 shares of Class A Stock. As of December 31, 2018, 287,532 shares of stock could be granted in the future. The changes in outstanding options are as follows:

	Shares Under Option	Weighted- Average Exercise Price Per Share
Balance at December 31, 2016	2,000	\$ 14.85
Granted	-	-
Surrendered	-	-
Exercised	-	-
Balance at December 31, 2017	2,000	\$ 14.85
Granted	-	-
Surrendered	-	-
Exercised	-	-
Balance at December 31, 2018	2,000	\$ 14.85
Exercisable at December 31, 2018	2,000	\$ 14.85

Grant-date fair value is measured on the date of grant using an option-pricing model with market assumptions. The grant-date fair values are amortized into expense on a straight-line basis over the vesting period. The company applies the Black-Scholes-Merton option-pricing model which requires the use of highly subjective assumptions, including but not limited to, expected stock price volatility, term, dividend rates, forfeiture rates, and risk-free interest rates, which if changed can materially affect fair value estimates.

Restricted Stock

As of December 31, 2018, the Corporation has awarded stock grants in two formats to two distinct classes. Directors have been awarded grants that 100% vest as of the grant date. The second type of grant has been awarded to senior officers of the Corporation. These grants have three year terms with one-third of the award shares vesting on each grant date anniversary. The expense of these awards is recorded on a straight-line bases over the 36 month term.

	Shares Under Option	Weighted- Average Exercise Price Per Share
Balance at December 31, 2017	-	\$ -
Granted	10,635	17.14
Surrendered	-	-
Vested	(3,125)	21.09
Balance at December 31, 2018	7,510	\$ 15.50

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13. DIVIDEND REINVESTMENT AND SHARE PURCHASE PLAN

The Corporation sponsors a dividend reinvestment and share purchase plan. Under the plan, all holders of record of common stock are eligible to participate in the plan. Participants in the plan may direct the plan administrator to invest cash dividends declared with respect to all or any portion of their common stock. Participants may also make optional cash payments that will be invested through the plan. All cash dividends paid to the plan administrator are invested within 30 days of cash dividend payment date. Cash dividends and optional cash payments will be used to purchase common stock of the Corporation in the open market, from newly-issued shares, from shares held in treasury, in negotiated transactions, or in any combination of the foregoing. The purchase price of the shares of common stock is based on the average market price. All administrative costs are borne by the Corporation.

For the year ended December 31, 2018, 3,387 shares were purchased under the Plan. Regular cash dividends of \$0.080 per share were declared on December 11, 2018 and paid on January 15, 2019. Regular cash dividends of \$0.075 per share were declared on June 12, 2018 and paid on July 17, 2018. For the year ended December 31, 2017, 3,699 shares were purchased under the Plan. Regular cash dividends of \$0.07 per share were declared on December 13, 2017 and paid on January 16, 2018. Regular cash dividends of \$0.065 per share were declared on June 13, 2017 and paid on July 17, 2017.

NOTE 14. EMPLOYEE BENEFIT PLANS

401(k) Employee Stock Ownership Plan

During 2017, the Corporation amended its 401(k) Savings Plan and adopted a 401(k) Employee Stock Ownership Plan (the KSOP), which covers substantially all employees over 21 years of age with at least one year of service. Employees may defer up to 5.5 percent of their compensation monthly. The Bank makes annual discretionary matching contributions of 5.5 percent of the employee's contributions, not to exceed 5.5% of the participating employees' compensation. The Bank may also make additional discretionary contributions to the KSOP which is unrelated to any employer matching contributions. For the years ended December 31, 2018 and 2017, the Bank expensed \$352,472 and \$321,183, respectively, for matching discretionary contributions to this Plan. Shares of Corporation common stock owned by the KSOP plan total 28,013 and 15,513 as of December 31, 2018 and 2017 with a fair value of \$569,224 and \$255,965, respectively. All KSOP shares have been fully allocated to the participants.

Profit-Sharing Plan

The Corporation also maintains a profit-sharing plan for eligible employees. Eligibility requirements for this plan are the same as the 401(k) Employee Incentive Savings Plan. Benefits paid under the Plan are subject to approval by the Board of Directors each year. Contributions to the Plan charged to expense during 2018 and 2017 were \$90,000 and \$75,000, respectively.

Salary Continuation Plan

The Corporation provides a salary continuation plan providing for death and retirement benefits for certain executive officers. The present value of the estimated amounts to be paid under the plan is being accrued over the remaining service period of the executives. The expense recognized for the salary continuation plan amounted to \$139,083 and \$96,842 for the years ended December 31, 2018 and 2017, respectively. The balance of the liability for the salary continuation plan included in other liabilities at December 31, 2018 and 2017 totaled \$1,296,865 and \$1,265,975, respectively.

The cost of the salary continuation plan described above is being offset by earnings from bank owned life insurance policies on the executives. The balance of the policy surrender values totaled \$11,381,988 and \$11,048,864 at December 31, 2018 and 2017, respectively. Income recognized from the increase in cash surrender value on these policies totaled \$333,124 and \$294,252 for the years ended December 31, 2018 and 2017, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14. EMPLOYEE BENEFIT PLANS (Continued)

Employee Stock Purchase Plan

The Corporation sponsors an employee stock purchase plan which is available to all employees subject to certain minimum service requirements. The Plan is administered by a Board appointed committee which designates the offering period in which employees may purchase shares and the offering price. All administrative costs are borne by the Corporation. No shares were purchased under the Plan for the years ended December 31, 2018 and 2017, respectively.

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS

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

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

Fair Value Hierarchy

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

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Assets Measured at Fair Value on a Recurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Available for Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds, mortgage products and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities include U.S. agency securities, mortgage-backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where Level 1 or Level 2 inputs are not available, securities would be classified within Level 3 of the hierarchy.

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

		Fair Value Measurements at December 31, 2018 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets Measured at Fair Value December 31, 2018	\$	\$	\$	\$
Available for sale securities	130,573,099	1,956,563	128,616,536	-

		Fair Value Measurements at December 31, 2017 Using		
		Quoted Prices In Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets Measured at Fair Value December 31, 2017	\$	\$	\$	\$
Available for sale securities	143,484,897	1,975,000	141,509,897	-

Assets Measured at Fair Value on a Nonrecurring Basis

Following is a description of the valuation methodologies used for instruments measured at fair value on a non-recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such instruments pursuant to the valuation hierarchy.

Impaired Loans

Loan impairment is reported when full payment under the loan terms is not expected. Impaired loans are carried at the present value of estimated future cash flows using the loan's existing rate, or the fair value of collateral if the loan is collateral dependent. A portion of the allowance for loan losses is allocated to impaired loans if the value of such loans is deemed to be less than the unpaid balance. If these allocations cause the allowance for loan losses to require increase, such increase is reported as a component of the provision for loan losses. Loan losses are charged against the allowance when Management believes the uncollectibility of a loan is confirmed. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the loan impairment 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 appraised value and there is no observable market price, the Corporation records the loan impairment as nonrecurring Level 3.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis (Continued)

Other Real Estate Owned

Other real estate owned is adjusted to fair value upon transfer from the loan portfolio. Subsequently, other real estate assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation records the other real estate 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 appraised value and there is no observable market price, the Corporation records the other real estate as nonrecurring Level 3.

The following tables present the assets carried on the consolidated balance sheets by caption and by level within the (FASB ASC 820) valuation hierarchy (as described above) as of December 31, 2018 and 2017, for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2018 and 2017, respectively.

	Assets Measured at Fair Value 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)		
		Impaired loans	\$ 2,656,009	\$ -	\$ -	\$ 2,656,009
		Other real estate	1,257,359	-	-	1,257,359

	Assets Measured at Fair Value 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)		
		Impaired loans	\$ 1,340,115	\$ -	\$ -	\$ 1,340,115
		Other real estate	1,430,301	-	-	1,430,301

Impaired loans, which are usually measured for impairment using the fair value of collateral, had a carrying amount of \$12,558,339 and \$14,010,738, with a specific valuation allowance of \$630,882 and \$1,474,721 at December 31, 2018 and 2017, respectively. Of the \$12,558,339 and \$14,010,738 impaired loan portfolio, \$3,286,891 and \$2,049,508 were carried at fair value as a result of charge-offs and specific valuation allowances at December 31, 2018 and 2017, respectively. The remaining \$9,271,448 and \$11,961,230 was carried at cost, as the fair value of the collateral on these loans exceeded the book value for each individual loan at December 31, 2018 and 2017, respectively.

The Corporation considers the fair value of other real estate owned to be the liquidation value from the current appraisal. Due to the subjective nature, incorporating both observable and unobservable inputs factored into the appraisal process, including various assumptions and expectations on cash flows, all of the Corporation's other real estate owned carried at fair value are classified within Level 3 of the valuation hierarchy.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Quantitative Disclosures for Level 3 Fair Value Measurements

The Corporation had no Level 3 assets measured at fair value on a recurring basis at December 31, 2018 or 2017.

For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2018, the significant unobservable inputs used in the fair value measurements are presented below.

	Carrying Amount	Valuation Technique	Significant Unobservable Input	Weighted Average of Input
Nonrecurring:				
Impaired loans	\$ 2,656,009	Appraisal	Appraisal discounts (%)	15-20 %
Other real estate owned	1,257,359	Appraisal	Appraisal discounts (%)	10-20 %

For Level 3 assets measured at fair value on a non-recurring basis as of December 31, 2017, the significant unobservable inputs used in the fair value measurements are presented below.

	Carrying Amount	Valuation Technique	Significant Unobservable Input	Weighted Average of Input
Nonrecurring:				
Impaired loans	\$ 1,340,115	Appraisal	Appraisal discounts (%)	15-20 %
Other real estate owned	1,430,301	Appraisal	Appraisal discounts (%)	10-20 %

Fair Value of Financial Instruments

The assumptions used in estimating the fair value of the Corporation's financial instruments are explained below. Where quoted market prices are not available, fair values are based on estimates using discounted cash flow and other valuation techniques. Discounted cash flows can be significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. The following fair value estimates cannot be substantiated by comparison to independent markets and should not be considered representative of the liquidation value of the Corporation's financial instruments, but rather a good-faith estimate of the fair value of financial instruments held by the Corporation. FASB ASC 820 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements.

The following methods and assumptions were used by the Corporation in estimating the fair value of its financial instruments:

Cash and Short-Term Investments: Fair value approximates the carrying value of such assets.

Investment Securities and Other Securities: The fair value of investment securities is based on quoted market prices. The fair value of other securities, which includes Federal Home Loan Bank stock and other correspondent stocks, approximates their carrying value.

Loans: The fair value of loans is calculated using discounted cash flows and excludes lease-financing arrangements. The discount rates used to determine the present value of the loan portfolio are estimated market discount rates that reflect the credit and interest rate risk inherent in the loan portfolio. The estimated maturities are based on the Corporation's historical experience with repayments adjusted to estimate the effect of current market conditions.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 15. FAIR VALUATION OF FINANCIAL INSTRUMENTS (Continued)

Fair Value of Financial Instruments (Continued)

Deposits: The fair value of deposits with no stated maturity, such as non-interest bearing demand deposits, NOW accounts, savings and money market deposit accounts, approximates the carrying value. Certificates of deposit have been valued using discounted cash flows. The discount rates used are based on estimated market rates for deposits of similar remaining maturities.

The fair value estimates in the table below do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Other borrowings and Note payable to Trust: The fair value of the Corporation's note payable to trust and its revolving line of credit approximates the carrying value of such liabilities. The fair value of FHLB advances have been valued using discounted cash flows. The discount rates used are based on estimated market rates for borrowings of similar remaining maturities.

Accrued Interest: The fair value of accrued interest receivable and payable approximates their carrying value.

Commitments to Extend Credit and Standby Letters of Credit: There is no market for the commitment to extend credit and standby letters of credit and they were issued without explicit cost. Therefore, it is not practical to establish their fair value.

The carrying value and estimated fair value of the Corporation's financial instruments at December 31, 2018 and 2017 are as follows:

	December 31,			
	2018		2017	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	<i>(Dollars in Thousands)</i>			
Financial assets:				
Cash and short-term investments	\$ 45,380	\$ 45,380	\$ 52,961	\$ 52,961
Investment securities-available for sale	130,573	130,573	143,485	143,485
Investment securities-held to maturity	17,790	17,668	20,003	20,069
Loans held for sale	110	110	-	-
Loans held for investment, net of the allowance for loan losses	405,453	401,963	343,640	342,148
Bank owned life insurance	11,382	11,382	11,049	11,049
Other securities	1,716	1,716	1,679	1,679
Accrued interest receivable	3,669	3,669	3,094	3,904
Financial liabilities:				
Deposits	573,155	573,345	537,831	539,546
Other borrowings	4,661	4,668	6,244	5,826
Note payable to trust	10,310	10,310	10,310	10,310
Accrued interest payable	206	206	184	184

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16. DIVIDENDS FROM BANK

Dividends paid by the Bank are the primary source of funds available to the Corporation for payment of dividends to its stockholders and for other needs. Applicable federal and state statutes and regulations impose restrictions on the amounts of dividends that may be declared by the subsidiary bank. In addition, the subsidiary bank is also required to maintain minimum amounts of capital to both total “risk-weighted” assets and total average assets, as defined by banking regulators. Capital adequacy considerations could further limit the availability of dividends from the subsidiary bank. The payment of dividends from the Bank is regulated by the Alabama State Banking Department and may be limited based on earnings and credit losses. Future payments of dividends by the Bank to the Corporation will be dependent on earnings, loan losses and compliance with applicable regulations of the Alabama State Banking Department and applicable federal regulators.

NOTE 17. LITIGATION

The Corporation is involved in various legal proceedings arising in connection with their business. In the opinion of management, the ultimate resolution of these proceedings is not expected to have a material adverse effect upon the financial statements of the Corporation.

NOTE 18. COMMITMENTS

The Corporation leases certain property and equipment for use in its business. These leases have lease terms generally not in excess of five years. The Corporation is not committed to any operating leases, which have initial or remaining noncancelable lease terms in excess of one year as of December 31, 2018.

Rental expense for all operating leases charged to earnings aggregated \$68,388 and \$64,051 for the years ended December 31, 2018 and 2017, respectively.

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such instruments involve elements of credit risk in excess of the amounts recognized in the consolidated financial statements.

The Corporation’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 these instruments. The Corporation uses the same credit policies in making conditional obligations as it does for on-balance sheet instruments.

The financial instruments whose contractual amounts represent credit risk as of December 31, 2018 and 2017 are approximately as follows:

	December 31,	
	2018	2017
Commitments to extend credit	\$ 75,501,305	\$ 63,906,461
Standby letters of credit	1,629,013	1,362,660
	<u>\$ 77,130,318</u>	<u>\$ 65,269,121</u>

Standby letters of credit are commitments issued by the Corporation 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. The Corporation holds various assets as collateral supporting those commitments for which collateral is deemed necessary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18. COMMITMENTS (Continued)

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.

NOTE 19. OTHER NONINTEREST EXPENSE

Components of other noninterest expense exceeding 1% of the total of net interest income and noninterest income for the years ended December 31, 2018 or 2017, respectively, include the following:

	Years Ended December 31,	
	2018	2017
Accounting and audit	\$ 279,228	\$ 319,386
Advertising	455,511	375,821
ATM network	176,166	157,947
Card-based expense	1,096,360	1,132,082
Network and communications	451,039	451,398
Internet and mobile banking	231,283	224,231
Core processing	646,579	646,505
Other data processing	307,568	317,097
FDIC deposit insurance	215,588	240,093
Other real estate owned expenses	97,991	118,449
Provision for other real estate owned losses	215,000	398,449
Other	2,500,376	2,136,404
	\$ 6,672,689	\$ 6,517,862

NOTE 20. CONCENTRATIONS OF CREDIT RISK

The Corporation originates primarily commercial, agricultural, residential, and consumer loans to customers in its primary market areas. The ability of the majority of the Corporation's customers to honor their contractual loan obligations is dependent on the economy in these areas. As of December 31, 2018 and 2017, approximately 46% and 49%, respectively, of the Corporation's loans were commercial loans, including those secured by real estate. The Corporation's commercial customers are primarily small to middle market enterprises. The Corporation also specializes in agricultural loans, including loans secured by farmland, which represented approximately 18% and 18% of the Corporation's total loans at December 31, 2018 and 2017, respectively.

Total loans secured by real estate was approximately 58% and 64% of the Corporation's loan portfolio at December 31, 2018 and 2017, respectively, of which a substantial portion is secured by real estate in the Corporation's market areas. At December 31, 2018 and 2017, real estate construction loans accounted for approximately 6% and 6%, respectively, of the total loan portfolio, while 1-4 family residential mortgage loans made up approximately 20% and 23%, respectively, of the loan portfolio. A more complete discussion and analysis of the Corporation's loan types and concentrations and the related credit risk is set forth in Note 4.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21. REGULATORY MATTERS

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

Regulatory capital rules include a capital conservation buffer designed to absorb losses during periods of economic stress. The capital conservation buffer must be composed entirely of Common Equity Tier 1 capital (CET1). When fully phased-in on January 1, 2019, the capital conservation buffer of 2.5% will be added on top of each of the minimum risk-based capital ratios. The implementation of the capital conservation buffer began phasing in on January 1, 2016 at the rate of 0.625% per year and will be phased-in over a three-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019) as presented in the chart below. Banking institutions with risk-based capital ratios above the minimum but below the capital conservation buffer will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

The minimum capital ratios (as established in 2015 under Basel III), including the phase-in of the capital conservation buffer through January 1, 2019, for capital adequacy purposes are as follows:

Year	Total Capital to Risk-Weighted Assets	Tier 1 Capital to Risk-Weighted Assets	CET1 Capital to Risk-Weighted Assets	Tier 1 Capital to Average Total Assets
2015	8.000 %	6.000 %	4.500 %	4.000 %
2016	8.625 %	6.625 %	5.125 %	4.000 %
2017	9.250 %	7.250 %	5.750 %	4.000 %
2018	9.875 %	7.875 %	6.375 %	4.000 %
2019	10.500 %	8.500 %	7.000 %	4.000 %

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total, Tier 1 and CET1 capital to risk-weighted assets, as defined, and of Tier 1 capital to average total assets (leverage ratio), as defined. Management believes, as of December 31, 2018 and 2017, the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2018, the most recent notification from the FDIC categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum Total, Tier 1 and CET1 risk-based capital ratios and Tier 1 leverage capital ratios as set forth in the following table and not be subject to any formal enforcement action. There are no conditions or event since that notification that management believes have changed the Bank's category.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 21. REGULATORY MATTERS (Continued)

The Bank's actual capital amounts and ratios are presented in the following table.

	Actual		For Capital Adequacy Purposes ¹		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<i>(Dollars in Thousands)</i>						
As of December 31, 2018:						
Total Capital to Risk-Weighted Assets	\$ 65,006	14.030%	\$ 45,753	9.875%	\$ 46,332	10.000%
Tier 1 Capital to Risk-Weighted Assets	\$ 60,615	13.083%	\$ 36,487	7.875%	\$ 37,066	8.000%
CET1 Capital to Risk-Weighted Assets	\$ 60,615	13.083%	\$ 29,537	6.375%	\$ 30,116	6.500%
Tier 1 Capital to Average Total Assets	\$ 60,615	9.446%	\$ 25,669	4.000%	\$ 32,086	5.000%
As of December 31, 2017:						
Total Capital to Risk-Weighted Assets	\$ 56,915	14.439%	\$ 36,460	9.250%	\$ 39,417	10.000%
Tier 1 Capital to Risk-Weighted Assets	\$ 52,624	13.351%	\$ 28,577	7.250%	\$ 31,533	8.000%
CET1 Capital to Risk-Weighted Assets	\$ 52,624	13.351%	\$ 22,664	5.750%	\$ 25,621	6.500%
Tier 1 Capital to Average Total Assets	\$ 52,624	8.715%	\$ 24,153	4.000%	\$ 30,191	5.000%

¹ Includes the phase-in percentages of the capital conservation buffer.

NOTE 22. DERIVATIVE FINANCIAL INSTRUMENTS

To hedge the Corporation's exposure to changing interest rates, management entered into an agreement known as an "interest rate cap" on its variable rate note payable to trust during April 2012. Interest rate caps are typically used to mitigate a borrowing's exposure to rising interest rates. Pursuant to the agreement, the Corporation's counterparty agrees to pay the Corporation an amount equal to the difference between the three-month LIBOR and 2.5% multiplied by a \$10,000,000 notional amount should the three-month LIBOR rise above 2.5% during the five-year term of the agreement. The Corporation paid its counterparty a one-time premium equal to \$158,000 which will be amortized over the five-year term. The interest rate cap matured during 2017.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION

The condensed financial information for United Bancorporation of Alabama, Inc. (Parent Corporation Only) follows:

CONDENSED BALANCE SHEETS

	2018	2017
Assets		
Cash	\$ 1,629,651	\$ 1,611,538
Investment in subsidiaries	59,879,559	51,575,546
Other assets	400,900	572,719
Total assets	\$ 61,910,110	\$ 53,759,803
Liabilities and stockholders' equity		
Other liabilities	\$ 431,056	\$ 400,614
Other borrowings	4,544,421	5,000,000
Note payable to trust	10,310,000	10,310,000
Total liabilities	15,285,477	15,710,614
Stockholders' equity		
Preferred stock of \$.01 par value. Authorized 250,000 shares; no shares issued in 2018 and 2017, respectively	-	-
Class A common stock of \$.01 par value. Authorized 5,000,000 shares; issued 2,438,192 and 2,431,680 shares in 2018 and 2017, respectively	24,382	24,317
Class B common stock of \$.01 par value. Authorized 250,000 shares; no shares issued	-	-
Additional paid-in capital	7,727,151	7,602,094
Retained earnings	41,647,425	32,036,728
Accumulated other comprehensive loss, net of tax	(2,772,374)	(1,611,999)
Less: 239 and 239 treasury shares at cost in 2018 and 2017	1,951	1,951
Total stockholders' equity	46,624,633	38,049,189
Total liabilities and stockholders' equity	\$ 61,910,110	\$ 53,759,803

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 23. PARENT CORPORATION FINANCIAL INFORMATION (Continued)

CONDENSED STATEMENTS OF EARNINGS

	2018	2017
Income		
Dividend income from subsidiary	\$ 1,500,000	\$ 1,500,000
Other income	12,355	9,040
Total income	1,512,355	1,509,040
Expense		
Interest on other borrowings and note payable	635,720	498,311
Other operating expense	655,325	639,316
Total expense	1,291,045	1,137,627
Income before equity in undistributed earnings of subsidiary and income taxes	221,310	371,413
Income tax benefit	(304,576)	(439,010)
Income before equity in undistributed earnings of subsidiary	525,886	810,423
Equity in undistributed earnings of subsidiary	9,462,338	2,684,889
Net earnings	\$ 9,988,224	\$ 3,495,312

CONDENSED STATEMENTS OF CASH FLOWS

	2018	2017
OPERATING ACTIVITIES		
Net earnings	\$ 9,988,224	\$ 3,495,312
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Distributions in excess of (equity in undistributed) earnings of subsidiary	(9,462,338)	(2,684,889)
Stock based compensation	65,897	-
Increase in other liabilities	5,606	151,669
(Increase) decrease in other assets	169,770	(414,341)
Net cash provided by operating activities	767,159	547,751
INVESTING ACTIVITIES		
Investment in subsidiaries	-	(53,000)
Net cash used in investing activities	-	(53,000)
FINANCING ACTIVITIES		
Cash dividends - common stock	(352,691)	(314,088)
Proceeds from dividend reinvestment plan	59,224	53,987
Proceeds from sale of common shares to KSOP	-	203,095
Repayment of other borrowings	(455,579)	-
Net cash used in financing activities	(749,046)	(57,006)
Net increase in cash	18,113	437,745
Cash at beginning of year	1,611,538	1,173,793
Cash at end of year	\$ 1,629,651	\$ 1,611,538

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