



*2017 Annual
Financial Report*

PIONEER BANKSHARES, INC. AND SUBSIDIARY

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PIONEER BANKSHARES, INC. AND SUBSIDIARY

Market Data

The Common Stock of the Company trades on the OTC Bulletin Board under the symbol "PNBI" and transactions generally involve a small number of shares. The Company's transfer agent is Computershare, Inc. located at 480 Washington Boulevard, 29th Floor, in Jersey City, New Jersey, 07013. The following table shows actual trade prices during the year. Other transactions may have occurred which were not included in the table.

COMMON STOCK TRADE PRICES

<u>2017</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 24.00	\$ 22.87
Second Quarter	26.50	23.28
Third Quarter	29.00	25.61
Fourth Quarter	28.75	25.90
<u>2016</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 24.00	\$ 22.10
Second Quarter	24.20	22.75
Third Quarter	24.20	23.00
Fourth Quarter	24.00	21.75

The Company has declared dividends on its Common Stock as follows:

<u>Declared Date</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Per Share Amount</u>
3/09/17	3/23/17	3/31/17	\$.20
6/08/17	6/22/17	6/30/17	.20
8/10/17	9/14/17	9/29/17	.20
11/09/17	12/14/17	12/29/17	.20
Total for 2017			<u>\$.80</u>
2/11/16	3/21/16	3/31/16	\$.19
6/09/16	6/20/16	6/30/16	.19
8/11/16	9/19/16	9/30/16	.19
12/08/16	12/19/16	12/31/16	.19
Total for 2016			<u>\$.76</u>

The Company's ability to pay dividends is subject to certain restrictions imposed by the Federal Reserve and capital requirements of Federal and Virginia banking statutes and regulations. Additionally, the Company intends to follow a policy of retaining sufficient earnings in order to maintain the net worth and reserves of the Bank at adequate levels and to provide for the Company's growth and ability to compete in its market area.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

FINANCIAL HIGHLIGHTS (In thousands, except for per share information)

	<u>2017</u>	<u>2016</u>
Results of Operations		
Interest and dividend income	\$ 9,625	\$ 9,297
Interest expense	834	740
Net interest income	<u>8,791</u>	<u>8,557</u>
Provision for loan losses	384	538
Net interest income after provision for loan losses	<u>8,407</u>	<u>8,019</u>
Noninterest income	1,749	1,136
Noninterest expense	7,121	7,108
Income before income taxes	<u>3,035</u>	<u>2,047</u>
Income tax expense	994	424
Net Income	<u>\$ 2,041</u>	<u>\$ 1,623</u>
Financial Condition, At Year End		
Assets	\$ 203,452	\$ 194,909
Deposits	166,933	158,882
Loans, net of allowance	160,959	158,736
Stockholders' Equity	27,414	26,019
Per Share Data		
Net income per share, basic and diluted	\$ 2.10	\$ 1.68
Dividends per share	.80	.76
Book value per share	28.13	26.83
Performance Ratios		
Return on average assets ¹	1.02%	0.84%
Return on average equity ¹	7.58%	6.36%
Dividend payout ratio	38.10%	45.33%
Average equity to average assets ¹	13.40%	13.25%

¹Ratios are based primarily on daily average balances

PIONEER BANKSHARES, INC. AND SUBSIDIARY

General Business Description

Pioneer Bankshares, Inc. (the “Company”), a Virginia one bank holding company headquartered in Stanley, Virginia, was incorporated under the laws of the Commonwealth of Virginia on November 4, 1983. The Company’s wholly-owned subsidiary, Pioneer Bank, Inc. (the “Bank”) was established as a national bank in 1909. The Bank converted from a national bank to a state chartered bank, effective April 1994, and changed its name to Pioneer Bank, effective April 1999.

Pioneer Bank’s main branch and corporate office are located in Stanley, Virginia, with other branch locations in Shenandoah, Luray, Harrisonburg, Stanardsville, Ruckersville, and Charlottesville, Virginia. The Bank also operates a small finance company known as Valley Finance Services, a Division of Pioneer Bank, which specializes in consumer and auto lending.

Pioneer Bank also owns and operates two subsidiaries, one of which is Pioneer Financial Services, LLC. Income received from insurance services and non-banking investment services is handled through Pioneer Financial Services, LLC. The second subsidiary owned by Pioneer Bank is Pioneer Special Assets, LLC, which is generally used in conjunction with foreclosed properties, as a means of minimizing the risk of liability to the Bank.

The assets of the Company consist primarily of all of the stock of the Bank, real estate holdings leased to the Bank, a portfolio of equity investment securities, and minimal cash accounts.

The Bank is engaged in the general commercial banking business, primarily serving the counties of Page, Greene, Rockingham, and Albemarle, Virginia. In addition, the close proximity and mobile nature of individuals and businesses in adjoining Virginia counties and nearby cities places these markets within the Bank’s targeted trade area. The Bank also anticipates serving some individuals and businesses from other areas, including, but not limited to, the counties surrounding Page County.

The Bank offers a full range of banking and related financial services focused primarily towards serving individual consumers, small to medium size commercial businesses, and the professional community. The Bank strives to serve the banking needs of its customers while developing personal, hometown relationships. The Bank’s Board of Directors and management believe that the marketing of customized banking services will enable the Bank to continue its position in the financial services marketplace.

The Bank provides individual consumers, professionals and small and medium size commercial businesses in its market area with responsive and technologically advanced banking services. These services include competitively priced loans that are based on deposit relationships, easy access to the Bank’s decision-makers, and quick and innovative action necessary to meet a customer’s banking needs. The Bank’s capitalization and lending limit enables it to satisfy the credit needs of a large portion of the targeted market segment. In the event there are customers whose loan requirements exceed the Bank’s lending limit, the Bank will seek to arrange such loans on a participation basis with other financial institutions or private investors. The Board of Directors and management believe the Bank’s present capitalization will support substantial growth in deposits and loans.



Independent Auditor's Report

To the Board of Directors and Stockholders
Pioneer Bancshares, Inc. and Subsidiary
Stanley, Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Pioneer Bankshares, Inc. and its Subsidiary, which comprise the consolidated balance sheets as of December 31, 2017 and 2016, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Pioneer Bankshares, Inc. and its Subsidiary as of December 31, 2017 and 2016, 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.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 29, 2018

PIONEER BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS DECEMBER 31, 2017 AND 2016

(In Thousands, except share and per share data)

	<u>2017</u>	<u>2016</u>
ASSETS		
Cash and due from banks	\$ 3,630	\$ 6,888
Interest-bearing deposits in other banks	8,634	6,630
Federal funds sold	2,876	1,810
Securities available for sale, at fair value	16,296	8,278
Restricted securities, at cost	705	694
Loans receivable, net of allowance of \$2,005 in 2017 and \$2,022 in 2016	160,959	158,736
Bank premises and equipment, net	4,631	4,756
Accrued interest receivable	1,076	925
Other real estate owned, net of valuation allowance	335	1,419
Other assets	4,310	4,773
Total Assets	<u>\$ 203,452</u>	<u>\$ 194,909</u>
LIABILITIES		
Deposits		
Noninterest bearing:	\$ 51,443	\$ 49,696
Interest bearing:		
Demand	45,321	36,526
Savings	25,483	25,863
Time deposits	44,686	46,797
Total Deposits	166,933	158,882
Accrued expenses and other liabilities	1,580	1,733
Borrowings	7,525	8,275
Total Liabilities	<u>176,038</u>	<u>168,890</u>
STOCKHOLDERS' EQUITY		
Common stock; \$.50 par value, authorized 5,000,000 shares; outstanding – 974,563 and 969,911 shares in 2017 and 2016, respectively	487	485
Retained earnings	26,812	25,451
Accumulated other comprehensive income	115	83
Total Stockholders' Equity	<u>27,414</u>	<u>26,019</u>
Total Liabilities and Stockholders' Equity	<u>\$ 203,452</u>	<u>\$ 194,909</u>

See Notes to Consolidated Financial Statements.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME YEARS ENDED DECEMBER 31, 2017 AND 2016

(In Thousands, except per share data)

	<u>2017</u>	<u>2016</u>
INTEREST AND DIVIDEND INCOME:		
Loans including fees	\$ 9,207	\$ 9,013
Interest on securities – taxable	141	82
Interest on securities – nontaxable	36	50
Deposits and federal funds sold	109	47
Dividends	132	105
Total Interest and Dividend Income	<u>9,625</u>	<u>9,297</u>
INTEREST EXPENSE:		
Deposits	723	596
Borrowings	111	144
Total Interest Expense	<u>834</u>	<u>740</u>
NET INTEREST INCOME	8,791	8,557
PROVISION FOR LOAN LOSSES	384	538
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	<u>8,407</u>	<u>8,019</u>
NONINTEREST INCOME:		
Service charges on deposit accounts	1,141	1,130
Commission income	83	89
Other income	85	85
Gains (Losses) on securities transactions, net	440	(168)
Total Noninterest Income	<u>1,749</u>	<u>1,136</u>
NONINTEREST EXPENSES:		
Salaries and employee benefits	3,140	3,218
Occupancy expenses	487	517
Equipment expenses	304	294
ATM expenses	298	268
Contributions	154	29
FDIC assessment	55	150
Sales and franchise tax	117	134
Supplies and printing	100	114
Director compensation and fees	137	148
Loss on sales of and valuation adjustments to other real estate owned	156	8
Legal fees	58	103
Professional and audit fees	404	430
Data processing fees	484	462
Telephone	193	205
Amortization expenses	210	210
Other expenses	824	818
Total Noninterest Expenses	<u>7,121</u>	<u>7,108</u>
INCOME BEFORE INCOME TAXES	3,035	2,047
INCOME TAX EXPENSE	994	424
NET INCOME	<u>\$ 2,041</u>	<u>\$ 1,623</u>
PER SHARE DATA:		
Net income, basic and diluted	<u>\$ 2.10</u>	<u>\$ 1.68</u>
Dividends	<u>\$ 0.80</u>	<u>\$ 0.76</u>

See Notes to Consolidated Financial Statements.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME YEARS ENDED DECEMBER 31, 2017 AND 2016

(In Thousands of Dollars)

	<u>2017</u>	<u>2016</u>
Net Income	\$2,041	\$1,623
Other comprehensive income, net of tax		
Unrealized gains on securities:		
Unrealized holding gains arising during period, (net of tax \$156 and \$65 for 2017 and 2016, respectively)	303	124
Reclassification adjustment for losses (gains) included in net income (net of tax \$150 and \$57 for 2017 and 2016, respectively)	<u>(290)</u>	<u>111</u>
Other comprehensive income	<u>13</u>	<u>235</u>
Comprehensive income	<u>\$ 2,054</u>	<u>\$ 1,858</u>

See Notes to Consolidated Financial Statements.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 2017 AND 2016

(In Thousands of Dollars)

	<u>Common Stock</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total</u>
BALANCE DECEMBER 31, 2015	\$ 483	\$ 24,468	\$ (152)	\$ 24,799
Net Income		1,623		1,623
Other Comprehensive Income			235	235
Cash Dividends		(736)		(736)
Stock issued for compensation	<u>2</u>	<u>96</u>	<u> </u>	<u>98</u>
BALANCE DECEMBER 31, 2016	\$ 485	\$ 25,451	\$ 83	\$ 26,019
Net Income		2,041		2,041
Other Comprehensive Income			13	13
Cash Dividends		(778)		(778)
Stock issued for compensation	2	117		119
Reclassification of stranded tax effects from change in tax rate	<u> </u>	<u>(19)</u>	<u>19</u>	<u>---</u>
BALANCE DECEMBER 31, 2017	\$ <u>487</u>	\$ <u>26,812</u>	\$ <u>115</u>	\$ <u>27,414</u>

See Notes to Consolidated Financial Statements.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, 2017 AND 2016

	<u>2017</u>	<u>2016</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,041	\$ 1,623
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	384	538
(Gain) Loss on securities transactions, net	(440)	168
Net amortization on securities	20	21
Deferred income tax expense (benefit)	262	(95)
Depreciation	327	325
Amortization	210	210
Stock based compensation	102	80
Loss on sales of and valuation adjustments to other real estate owned	156	8
Gain on sales and disposals equipment, net	(14)	---
Loss on charitable contribution of other real estate owned	13	---
Net change in:		
Accrued interest receivable	(151)	(30)
Other assets	(15)	(677)
Accrued expenses and other liabilities	(153)	47
	<u>2,742</u>	<u>2,218</u>
Net Cash Provided by Operating Activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Net change in interest-bearing deposits in other banks	(2,004)	(1,467)
Net change in federal funds sold	(1,066)	696
Net change in restricted securities	(11)	(96)
Proceeds from calls, maturities, sales, and principal payments of securities available for sale	9,403	12,675
Purchase of securities available for sale	(16,982)	(7,722)
Net (increase) in loans	(3,101)	(12,795)
Proceeds on sale of other real estate	1,409	17
Purchase of bank premises and equipment	(209)	(253)
Proceeds from sales of equipment	21	---
	<u>(12,540)</u>	<u>(8,945)</u>
Net Cash (Used in) Investing Activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net change in:		
Demand and savings deposits	10,162	7,537
Time deposits	(2,111)	2,615
Proceeds from borrowings	3,000	7,500
Curtailements of borrowings	(3,750)	(6,525)
Exercise of stock options	17	18
Dividends paid	(778)	(736)
	<u>6,540</u>	<u>10,409</u>
Net Cash Provided by Financing Activities		
CASH AND CASH EQUIVALENTS		
Net (decrease) increase in cash and cash equivalents	(3,258)	3,682
Cash and cash equivalents, beginning of year	6,888	3,206
	<u>3,630</u>	<u>6,888</u>
Cash and cash equivalents, end of year	\$	\$
Supplemental Disclosure of Cash Paid During the Year for:		
Interest	\$ 809	\$ 725
Income taxes	830	520
Supplemental Disclosure of non-cash activity:		
Unrealized gain on securities available for sale	19	357
Other real estate acquired in settlement of loans	494	1,092

See Notes to Consolidated Financial Statements.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting and reporting policies of Pioneer Bankshares, Inc. ("Company"), and its subsidiary Pioneer Bank ("Bank"), conform to accounting principles generally accepted in the United States of America and to accepted practice within the banking industry. A summary of significant accounting policies is as follows:

Consolidation Policy - The consolidated financial statements of the Company include the Bank and Pioneer Financial Services, LLC, and Pioneer Special Assets, LLC which are wholly-owned subsidiaries of the Bank. All significant inter-company balances and transactions have been eliminated.

Use of Estimates - In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of foreclosed real estate, and other-than-temporary impairment of securities.

Reclassifications - Certain reclassifications have been made to prior period balances to conform to the current year presentation. None were of a material nature.

Subsequent Events - In preparing these financial statements, the Company has evaluated events and transactions for potential recognition or disclosure through March 29, 2018, which is the date the financial statements were available to be issued. In the opinion of management, all subsequent events requiring recognition or disclosure have been included in the consolidated financial statements.

Securities - Investment securities which the Company intends to hold until maturity or until called are classified as held to maturity. These investment securities are carried at cost. Restricted securities include the Bank's investments in Federal Reserve Bank stock and FHLB stock and are carried at cost. Securities which the Company intends to hold for indefinite periods of time, including securities used as part of the Company's asset/liability management strategy, are classified as available for sale. These securities are carried at fair value. Net unrealized gains and losses, net of deferred income taxes, are excluded from earnings and reported as a separate component of stockholders' equity until realized. At December 31, 2017 and 2016, the Company classified all securities as available for sale.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage backed securities where prepayments are anticipated. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the Company intends to sell the security or (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. If, however, the Company does not intend to sell the security and it is not more-than-likely that the Company will be required to sell the security before recovery, management must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income. For equity securities, impairment is considered to be other-than-temporary based on the institution's ability and intent to hold the investment until a recovery of fair value. Other-than-temporary impairment of an equity security results in a write-down that must be included in income. The Company regularly reviews each security for other-than-temporary impairment based on criteria that include the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, a best estimate of the present value of cash flows expected to be collected from debt securities, the institution's intention with regard to holding the security and the likelihood that the Company would be required to sell the security before recovery.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Loans Receivable - Loans receivable are intended to be held until maturity and are reported at their outstanding principal balance less any adjustments for charge-offs, net of unearned interest, the allowance for loan losses, and deferred loan fees and costs. Interest is computed by methods which generally result in level rates of return on principal. Interest income is generally not recognized on nonaccrual loans and payments received on such loans are applied as a reduction of the loan principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

The Company classifies all loans past due when the payment of principal and interest based upon contractual terms is greater than 30 days delinquent.

The accrual of interest on loans is generally discontinued at the time the loan is 90 days delinquent unless the credit is well-secured and in process of collection for all loan classes. Commercial non-real estate classes are placed on nonaccrual status when it is probable that principal or interest is not fully collectible, or generally when principal or interest becomes 90 days past due, whichever occurs first. Real estate loans, which includes the residential, commercial, construction and land categories, are generally placed on nonaccrual status when principal and interest becomes 90 days past due. Consumer non-real estate loans, including personal automobile loans and all other individual loans are placed on nonaccrual status at varying intervals, based on the type of product, generally when principal and interest becomes between 90 days and 120 days past due. Revolving consumer credit card loans are not placed on nonaccrual but are generally charged-off if they reach 120 days past due, with unpaid fees and finance charges reversed against interest income. Consumer non-real estate loans are typically charged off between 90 and 120 days past due unless the loan is well secured and in the process of collection and are subject to mandatory charge-off at a specified delinquency date consistent with regulatory guidelines. In most cases, loans are placed on non-accrual or charged off at an earlier date if collection of principal or interest is considered doubtful. All other loan classes are generally charged off within the range of 90 to 180 days, unless there are specific or extenuating circumstances that warrant further collection or legal actions.

Interest accrued but not collected for loans that are placed on nonaccrual or charged off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Payments received on nonaccrual loans are applied as a reduction to the remaining principal balance as long as concern exists as to the ultimate collection of the principal. Loans are generally removed from nonaccrual status when the concern no longer exists as to the collectability of principal and interest and the borrower has been able to demonstrate a specific period of payment performance.

Allowance for Loan Losses – The provision for loan losses charged to operations is an amount sufficient to bring the allowance for loan losses to an estimated balance that management considers adequate to absorb potential losses in the portfolio. This evaluation process is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available. The allowance evaluation process also gives consideration to risk characteristics associated with each segment of the loan portfolio, which are further defined in Note 6 of this report.

Loans are generally charged against the allowance when management believes the collectability of the principal is unlikely. Recoveries of amounts previously charged-off are credited to the allowance. Management's determination of the adequacy of the allowance is based on the evaluation of the composition of the loan portfolio, the value and adequacy of collateral, current economic conditions, historical loan loss experience, concentrations of credit within the portfolio, loan growth trends, levels of adversely classified loans, past due trends, as well as other factors related to the knowledge and experience of lending personnel and legal, regulatory, or compliance issues related to lending practices. While management uses available information to recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions, particularly those affecting real estate values. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses. Such agencies may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

The allowance consists of specific and various general components. The specific component relates to loans that are classified as either substandard or doubtful. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired.

Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impairment is measured on a loan by loan basis for commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent. Large commercial real estate loans and construction land loans are reviewed and evaluated on an annual basis or as they become delinquent so as to determine any possible impairment. Residential real estate loans are specifically evaluated for possible impairment on a case by case basis as they become delinquent or are identified as a potential problem credit. Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Company does not generally separately identify individual consumer loans for impairment disclosures.

Troubled Debt Restructurings - In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructure (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

Transfers of Financial Assets - Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Bank – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Other Real Estate Owned- Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in net expenses from other real estate owned. At December 31, 2017, the balance of other real estate owned consisted of commercial real estate properties with approximate values of \$335,000. These were recorded as a result of obtaining physical possession of the property. At December 31, 2017, there were no formal foreclosure proceedings in process. At December 31, 2016, the balance of other real estate owned included commercial real estate properties with approximate values of \$823,000 and commercial business real estate loans which were secured by residential real estate properties with approximate values of \$596,000. These were recorded as a result of obtaining physical possession of the property. At December 31, 2016, there were no formal foreclosure proceedings in process.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Bank Premises and Equipment – Land values are carried at cost. Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is charged to income over estimated useful lives ranging from 3 to 40 years, on a straight-line method.

Income Taxes – Amounts provided for income tax expense are based on income reported for financial statement purposes rather than amounts currently payable under income tax laws. Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions.

Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. There were no such liabilities recorded as of December 31, 2017 or December 31, 2016.

Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the Company's consolidated statements of income.

Financial Instruments - In the ordinary course of business, the Bank has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, commitments under credit-card arrangements, commercial letters of credit, and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded.

The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank uses the same credit policies in making commitments as it does for other loans. Commitments to extend credit are generally made for a period of one year or less and interest rates are determined when funds are disbursed. Collateral and other security for the loans are determined on a case-by-case basis. Since some of the commitments are expected to expire without being drawn upon, the contract or notional amounts do not necessarily represent future cash requirements.

Cash and Cash Equivalents – For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks.

Advertising Costs - The Company follows the policy of charging the production costs of advertising to expense as incurred. Advertising expense amounted to \$31,000 and \$37,000, for the years ended December 31, 2017 and 2016, respectively.

Earnings Per Share – Basic earnings per share represents income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Stock Compensation – Accounting guidance requires that costs resulting from all share-based plans be expensed and recognized in the financial statements over the vesting period of each specific stock option granted. Additional information related to the Company’s stock option plan can be found in Note 15 of this financial report. On an annual basis, the company pays two-thirds of its board of director fees and retainer fees in the form of stock compensation. Additionally, a portion of certain officers’ bonuses are periodically paid with stock compensation. The fair market value of the Company’s stock at the time of the stock issuance is used as the pricing factor to arrive at the appropriate number of shares issued.

Comprehensive Income – Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes unrealized gains and losses on securities available for sale.

Recent Accounting Pronouncements – In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers: Topic 606.” This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The original guidance has been amended through subsequent accounting standard updates that resulted in technical corrections, improvements, and a one-year deferral of the effective date to January 1, 2018. The guidance, as amended, is applicable to all entities and, once effective, will replace significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on investment securities, derivatives, and sales of financial instruments are similarly excluded from the scope. Entities can elect to adopt the guidance either on a full or modified retrospective basis. Full retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the earliest comparative period presented. Modified retrospective adoption will require a cumulative effect adjustment to retained earnings as of the beginning of the reporting period in which the entity first applies the new guidance. The Company has completed its assessment of the adoption of this ASU, noting the standard will result in expanded disclosures related to noninterest income and enhance the qualitative disclosures on the revenues within the scope of the new guidance. The Company has concluded the adoption of ASU 2014-09 will not have a material impact on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments in ASU 2016-01, among other things: 1) Requires equity investments (except those accounted for under the equity method of accounting, or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. 2) Requires public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. 3) Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables). 4) Eliminates the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases (Topic 842).” Among other things, in the amendments in ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted upon issuance. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently assessing the impact that ASU 2016-02 will have on its consolidated financial statements and has assigned members of the accounting team to develop an implementation plan.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public companies that are not SEC filers, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements and has begun the data gathering and collection phase relating to its loan portfolio and credit losses. Additionally, a committee has been established to evaluate the methodologies and to further analyze the requirements of this standard.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments”, to address diversity in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The amendments are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. The amendments should be applied using a retrospective transition method to each period presented. If retrospective application is impractical for some of the issues addressed by the update, the amendments for those issues would be applied prospectively as of the earliest date practicable. Early adoption is permitted, including adoption in an interim period. The Company does not expect the adoption of ASU 2016-15 to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment”. The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit’s goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

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

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

In February 2018, the FASB issued ASU 2018-02, "Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income." The amendments provide financial statement preparers with an option to reclassify stranded tax effects within accumulated other comprehensive income to retained earnings in each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The amendments are effective for all organizations for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. Organizations should apply the proposed amendments either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company has elected to reclassify the stranded income tax effects from the Tax Cuts and Jobs Act in the consolidated financial statements for the period ending December 31, 2017. The amount of this reclassification in 2017 was \$19,000.

NOTE 2 NATURE OF OPERATIONS:

The Company operates under a charter issued by the Commonwealth of Virginia and provides commercial banking services to its customers through its subsidiary bank. As a state chartered member bank, the Bank is subject to regulation by the Virginia Bureau of Financial Institutions and the Board of Governors of the Federal Reserve Banking System. As of December 31, 2017, the Bank had seven physical locations available to customers with 3 branches being located in Page County, 2 in Greene County, 1 in Rockingham County, and 1 in Albemarle County. The Bank also operates two separate subsidiaries, one being known as Pioneer Financial Services, LLC, which offers a variety of consumer investment and insurance services. The second subsidiary owned by Pioneer Bank is Pioneer Special Assets, LLC, which is generally used in conjunction with certain foreclosed properties. The Bank also operates a small consumer loan finance company known as Valley Finance Services, a Division of Pioneer Bank, which specializes in consumer and auto lending.

NOTE 3 CASH AND DUE FROM BANKS:

The Bank is required to maintain average reserve balances based on a percentage of deposits. The average balance of cash, which the Federal Reserve Bank required to be on reserve, was \$2.0 million and \$1.8 million at December 31, 2017 and December 31, 2016, respectively. These reserve requirements were satisfied by available vault cash and/or funds on deposit with the Federal Reserve Bank at December 31, 2017 and 2016.

NOTE 4 DEPOSITS IN AND FEDERAL FUNDS SOLD TO BANKS:

The Bank had cash deposited in and federal funds sold to other banks, most of which exceed federally insured limits, totaling approximately \$4.7 million and \$6.3 million at December 31, 2017 and 2016, respectively. Management has established acceptable risk tolerances relating to uninsured deposits in other banks and diversifies these funds in accordance with policy guidelines.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 INVESTMENT SECURITIES:

The amortized cost and fair value of investment securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)				
<u>December 31, 2017</u>				
Available for Sale				
U.S. treasury securities	\$ 4,073	\$ ---	\$ (43)	\$ 4,030
Mortgage-backed securities	1,481	1	(22)	1,460
Agency securities	3,523	2	(25)	3,500
State and municipals	2,331	7	(16)	2,322
Equity securities	4,742	245	(3)	4,984
	<u>\$ 16,150</u>	<u>\$ 255</u>	<u>\$ (109)</u>	<u>\$ 16,296</u>

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
(In Thousands)				
<u>December 31, 2016</u>				
Available for Sale				
U.S. government and agency securities	\$ 2,500	\$ ---	\$ ---	\$ 2,500
Mortgage-backed securities	1,808	2	(33)	1,777
State and municipals	2,745	19	(14)	2,750
Equity securities	1,098	156	(3)	1,251
	<u>\$ 8,151</u>	<u>\$ 177</u>	<u>\$ (50)</u>	<u>\$ 8,278</u>

Realized gains and losses on available for sale securities are summarized below:

	<u>2017</u>	<u>2016</u>
(In Thousands)		
Gains	\$ 444	\$ 136
Losses	<u>(4)</u>	<u>(304)</u>
Net Gains (Losses)	<u>\$ 440</u>	<u>\$ (168)</u>

Proceeds on the sale of investment securities during 2017 and 2016 totaled \$6.2 million and \$3.5 million, respectively. The net securities gain of \$440,000 for the year ended December 31, 2017 and the net securities loss of \$168,000 for the year ended December 31, 2016, were reclassified from accumulated other comprehensive income to income during the periods and are included in the "gains (losses) on securities transactions, net" line item on the consolidated statements of income. The income tax related to these reclassifications resulted in a \$150,000 tax expense for the year ended December 31, 2017 and a \$57,000 tax benefit for the year ended December 31, 2016. The income tax expense or benefit related to reclassification adjustments are included in the "income tax expense" line item on the consolidated statements of income.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 INVESTMENT SECURITIES: (continued)

The amortized cost and fair value of investment securities at December 31, 2017, by contractual maturity, are shown in the following schedule. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Securities Available for Sale</u>	
	<u>Amortized</u>	<u>Fair</u>
	<u>Cost</u>	<u>Value</u>
	(In Thousands)	
Due within one year	\$ 1,177	\$ 1,176
Due after one year through five years	6,998	6,954
Due five years through ten years	2,161	2,128
Due after ten years	<u>1,072</u>	<u>1,054</u>
	11,408	11,312
Equity securities	<u>4,742</u>	<u>4,984</u>
	<u>\$ 16,150</u>	<u>\$ 16,296</u>

Investment securities with an amortized cost of \$74,000 and \$110,000 and fair value of \$74,000 and \$111,000 at December 31, 2017 and 2016, respectfully, were pledged to secure public deposits and for other purposes required by law.

Management recognizes that current economic conditions and market trends may result in other than temporary impairment classifications for certain securities or equity investments. Management's evaluation of the individual stocks and securities within the investment portfolios is performed on a quarterly basis and assesses the unrealized loss positions that exist to determine whether there is potential other than temporary impairment. The key factors considered during this evaluation process are the amount of unrealized loss, percentage decline in value, length of time in loss position, near-term prospects of the issuer, current market trading activity, financial strength ratings from industry reports, credit quality, credit ratings, continued dividend payments of the issuer, diversification or multiple holdings within particular funds, as well as management's intent and ability to hold securities until such time that they can recover in value and further assessment and determination that the institution will not be required to sell such investments to meet operational cash flow needs in the near future. In analyzing an issuer's financial condition, management also considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As of December 31, 2017 and 2016, the Company's evaluation concluded that there were no other-than-temporary impairments within the investment portfolios to be recorded.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 INVESTMENT SECURITIES: (Continued):

As of December 31, 2017, there were 22 securities in the portfolio that have unrealized losses, which are considered to be temporary. The schedule of unrealized losses on these securities is as follows (in thousands):

		<u>Mortgaged Backed Securities</u>	<u>Agency Securities</u>	<u>State and Municipal Securities</u>	<u>US Treasury Securities</u>	<u>Equity Securities</u>	<u>Total</u>
Less than 12 Months	Fair Value	\$ 887	\$ 3,008	\$ 1,797	\$ 3,947	\$ 819	\$10,458
	Unrealized Losses	(4)	(25)	(16)	(27)	(3)	(75)
More than 12 Months	Fair Value	548	---	---	83	---	631
	Unrealized Losses	(18)	---	---	(16)	---	(34)
Total	Fair Value	1,435	3,008	1,797	4,030	819	11,089
	Unrealized Losses	(22)	(25)	(16)	(43)	(3)	(109)

As of December 31, 2016, there were 13 securities in the portfolio that have unrealized losses, which are considered to be temporary. The schedule of unrealized losses on these securities is as follows (in thousands):

		<u>Mortgaged Backed Securities</u>	<u>State and Municipal Securities</u>	<u>Equity Securities</u>	<u>Total</u>
Less than 12 Months	Fair Value	\$ 1,713	\$ 1,810	\$ 117	\$ 3,640
	Unrealized Losses	(33)	(14)	(1)	(48)
More than 12 Months	Fair Value	---	---	7	7
	Unrealized Losses	---	---	(2)	(2)
Total	Fair Value	1,713	1,810	124	3,647
	Unrealized Losses	(33)	(14)	(3)	(50)

The Bank also holds additional investments in Federal Home Loan Bank of Atlanta (“FHLB”) in the form of FHLB stock, which is a membership requirement. Loan advances from FHLB are subject to additional stock purchase requirements, which are generally redeemed as outstanding loan balances are repaid, subject to FHLB’s quarterly excess capital evaluation process. FHLB evaluates the excess capital stock of its members on a quarterly basis to determine stock repurchase activities. Additionally, FHLB generally pays quarterly dividends on the outstanding stock investment of each of its members.

FHLB stock is generally viewed as a long term investment and is considered to be a restricted security, which is carried at cost, because there is no market for the stock other than FHLB or other member institutions. As of December 31, 2017 the Bank’s investment in FHLB stock totaled approximately \$580,000 and is included in restricted securities on the consolidated balance sheets.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 5 INVESTMENT SECURITIES: (Continued):

Management's evaluation of FHLB stock for possible impairment is based on the ultimate recoverability of par value rather than recognizing temporary declines in value. Management's evaluation of FHLB stock as of December 31, 2017 and 2016 did not consider this investment to be other than temporarily impaired, and therefore, no impairment has been recognized.

NOTE 6 LOANS:

Loans are stated at their face amount, net of deferred loan fees, and are classified as follows:

	December 31, 2017	December 31, 2016
	(In Thousands)	
Real estate loans		
Construction & land loans	\$ 5,459	\$ 4,657
Residential equity lines of credit	1,486	2,443
Residential 1-4 family	64,333	61,991
Residential second mortgages 1 - 4 family	1,575	1,027
Residential multifamily	5,420	5,236
Commercial agricultural loans	4,153	4,031
Commercial municipal loans	160	186
Commercial owner & non-owner occupied	51,389	51,659
Total real estate loans	<u>133,975</u>	<u>131,230</u>
Commercial non real estate loans	9,241	11,587
Consumer non real estate loans		
Personal installments	19,127	17,371
Credit cards	721	731
Total consumer installment loans	<u>19,848</u>	<u>18,102</u>
	<u>163,064</u>	<u>160,919</u>
Gross loans ⁽¹⁾	163,064	160,919
Less unearned discount on loans	(100)	(161)
Loans, less unearned discount	162,964	160,758
Less allowance for loan losses	(2,005)	(2,022)
Net loans receivable	<u>\$ 160,959</u>	<u>\$ 158,736</u>

(1)Gross loans are presented net of deferred loan fees of \$122,000 and \$151,000 respectively for December 31, 2017 and 2016.

The Bank grants commercial, real estate and consumer installment loans to its customers. Collateral requirements for loans are determined on a case by case basis depending upon the purpose of the loan and the financial condition of the borrower. The ultimate collectability of the Bank's loan portfolio and the ability to realize the value of any underlying collateral, if needed, are influenced by the economic conditions of its market service area.

The Bank's loan portfolio is concentrated in real estate loans, including those secured by residential consumer properties and small business commercial properties. The residential real estate loans, including equity lines of credit, residential 1 – 4 family first and second mortgages, and multifamily loans totaled \$72.8 million as of December 31, 2017 as compared to \$70.7 million at December 31, 2016. The small business commercial real estate loans, including commercial construction and land loans, agricultural/farm loans, and other business properties totaled \$60.2 million as of December 31, 2017 as compared to \$58.9 million at December 31, 2016. Management has established specific lending criteria relating to real estate loans as a means of assessing the risk inherent in the portfolio.

Deposit account overdrafts are also classified as loans and totaled \$45,000 and \$43,000 as of December 31, 2017 and 2016, respectively.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table reflects the detailed breakdown of impaired loans with a recorded allowance by loan class for the year ended December 31, 2017 (in thousands):

Impaired Loans with a Recorded Allowance <u>December 31, 2017</u>	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Residential Real Estate 1-4 Family Residences	201	201	38	236	---
Commercial Real Estate Owner Occupied	---	---	---	252	--
Commercial – Non Real Estate Industrial loans	<u>43</u>	<u>43</u>	<u>21</u>	<u>116</u>	---
Totals	<u>\$ 244</u>	<u>\$ 244</u>	<u>\$ 59</u>	<u>\$ 604</u>	<u>\$ ---</u>

Impaired Loans without a Recorded Allowance <u>December 31, 2017</u>	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Construction & Land Loans Commercial	\$ 389	\$ 389	\$ 437	\$ ---
Other – land only	16	16	17	2
Residential Real Estate 1-4 Family Residences	2,134	2,134	2,360	66
Commercial Real Estate Owner Occupied	4,541	4,541	3,959	181
Non-owner Occupied	258	258	262	15
Agricultural Loans	230	230	251	--
Commercial – Non Real Estate Industrial loans	<u>194</u>	<u>194</u>	<u>198</u>	<u>4</u>
Totals	<u>\$ 7,762</u>	<u>\$ 7,762</u>	<u>\$7,484</u>	<u>\$ 268</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table reflects the detailed breakdown of impaired loans with a recorded allowance by loan class for the year ended December 31, 2016 (in thousands):

Impaired Loans with a Recorded Allowance <u>December 31, 2016</u>	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Construction & Land Loans					
Commercial properties	\$ ---	\$---	\$ ---	\$ 261	\$ ---
Other-land only	---	---	---	10	---
Residential Real Estate					
1-4 Family Residences	271	271	46	545	5
Commercial Real Estate					
Owner Occupied	503	503	19	734	--
Agricultural Loans	---	---	---	142	---
Commercial – Non Real Estate					
Industrial loans	<u>189</u>	<u>189</u>	<u>73</u>	<u>187</u>	<u>---</u>
Totals	<u>\$ 963</u>	<u>\$ 963</u>	<u>\$ 138</u>	<u>\$ 1,879</u>	<u>\$ 5</u>
Impaired Loans without a Recorded Allowance <u>December 31, 2016</u>	<u>Recorded Investment</u>	<u>Unpaid Principal</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	
Construction & Land Loans					
Commercial	\$ 485	\$ 485	\$ 243	\$ --	
Residential Real Estate					
1-4 Family Residences	2,603	2,603	2,417	86	
Commercial Real Estate					
Owner Occupied	3,377	3,377	3,312	254	
Non-owner Occupied	265	265	269	15	
Agricultural Loans	272	272	136	--	
Commercial – Non Real Estate					
Industrial loans	<u>202</u>	<u>202</u>	<u>282</u>	<u>15</u>	
Totals	<u>\$ 7,204</u>	<u>\$ 7,204</u>	<u>\$6,659</u>	<u>\$ 370</u>	

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table reflects the amounts of outstanding delinquencies by loan class as of December 31, 2017 (in thousands):

<u>Past Due Loans by Class</u>	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>90 Days or More</u>	<u>Total Past Due</u>	<u>Total Current</u>	<u>Total Loans</u>
Construction & Land Loans						
Residential	\$ ---	\$ ---	\$ ---	\$ ---	\$ 926	\$ 926
Commercial	---	---	---	---	1,154	1,154
Other – Land only	55	---	---	55	3,324	3,379
Residential Real Estate						
Equity Lines of Credit	---	40	---	40	1,446	1,486
1-4 Family Residences	2,895	909	198	4,002	61,906	65,908
Multifamily Dwellings	---	---	---	---	5,420	5,420
Commercial Real Estate						
Owner occupied	40	---	---	40	36,373	36,413
Non-owner occupied	---	---	---	---	14,976	14,976
Agricultural / Farm loans	---	---	---	---	4,153	4,153
Municipals	---	---	---	---	160	160
Commercial – Non Real Estate						
Agricultural	---	---	---	---	169	169
Industrial	85	21	6	112	8,884	8,996
Municipals	---	---	---	---	76	76
Consumer – Non Real Estate						
Credit Cards	12	5	13	30	691	721
Automobile loans	647	132	140	919	12,561	13,480
Other personal loans	<u>119</u>	<u>18</u>	<u>16</u>	<u>153</u>	<u>5,494</u>	<u>5,647</u>
Totals Gross Loans	<u>\$ 3,853</u>	<u>\$ 1,125</u>	<u>\$ 373</u>	<u>\$ 5,351</u>	<u>\$ 157,713</u>	<u>\$ 163,064</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table reflects the amounts of outstanding delinquencies by loan class as of December 31, 2016 (in thousands):

<u>Past Due Loans by Class</u>	<u>30-59 Days</u>	<u>60-89 Days</u>	<u>90 Days or More</u>	<u>Total Past Due</u>	<u>Total Current</u>	<u>Total Loans</u>
Construction & Land Loans						
Residential	\$ ---	\$ ---	\$ ---	\$ ---	\$ 1,653	\$ 1,653
Commercial	---	75	---	75	1,275	1,350
Other – Land only	54	---	---	54	1,600	1,654
Residential Real Estate						
Equity Lines of Credit	94	---	---	94	2,349	2,443
1-4 Family Residences	2,415	920	208	3,543	59,475	63,018
Multifamily Dwellings	---	---	---	---	5,236	5,236
Commercial Real Estate						
Owner occupied	947	---	703	1,650	36,308	37,958
Non-owner occupied	---	---	---	---	13,701	13,701
Agricultural / Farm loans	---	---	272	272	3,759	4,031
Municipals	---	---	---	---	186	186
Commercial – Non Real Estate						
Agricultural	14	---	5	19	187	206
Industrial	22	---	27	49	11,294	11,343
Municipals	---	---	---	---	38	38
Consumer – Non Real Estate						
Credit Cards	13	---	2	15	716	731
Automobile loans	578	136	45	759	10,661	11,420
Other personal loans	<u>99</u>	<u>59</u>	<u>32</u>	<u>190</u>	<u>5,761</u>	<u>5,951</u>
Totals Gross Loans	<u>\$ 4,236</u>	<u>\$ 1,190</u>	<u>\$ 1,294</u>	<u>\$ 6,720</u>	<u>\$ 154,199</u>	<u>\$ 160,919</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table represents loans 90 days delinquent and still accruing interest and loans in a nonaccrual status as of December 31, 2017 by loan class (in thousands):

	90 days past due & still accruing interest	Nonaccrual Loans
Construction & Land Loans		
Commercial	\$ ---	\$ 389
Other- Land Only	---	18
Residential Real Estate		
1-4 Family Residences	198	1,254
Commercial Real Estate		
Owner occupied	---	644
Agricultural / Farm loans	---	230
Commercial Non-Real Estate		
Industrial	6	134
Consumer – Non Real Estate		
Automobile loans	140	---
Other personal loans	<u>16</u>	<u>---</u>
Totals Gross Loans	<u>\$ 360</u>	<u>\$ 2,669</u>

The following table represents loans 90 days delinquent and still accruing interest and loans in a nonaccrual status as of December 31, 2016 by loan class (in thousands):

	90 days past due & still accruing interest	Nonaccrual Loans
Construction & Land Loans		
Commercial	\$ ---	\$ 485
Other- Land Only	---	25
Residential Real Estate		
1-4 Family Residences	92	1,234
Commercial Real Estate		
Owner occupied	274	1,095
Agricultural / Farm loans	---	272
Commercial Non-Real Estate		
Agricultural	5	---
Industrial	27	172
Consumer – Non Real Estate		
Automobile loans	45	3
Other personal loans	<u>23</u>	<u>9</u>
Totals Gross Loans	<u>\$ 466</u>	<u>\$ 3,295</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

Loans past due greater than 90 days and still accruing interest at December 31, 2017 and 2016 totaled \$360,000 and \$466,000, respectively. Management continually monitors past due accounts and places these accounts in nonaccrual status if the payment plans are not adhered to. Nonaccrual loans excluded from impaired loan disclosure amounted to \$241,000 and \$159,000, at December 31, 2017 and 2016, respectively. The nonaccrual loans excluded from impaired loan disclosure at December 31, 2017 and 2016 consisted of several consumer loans which were in the process of collection.

The loan portfolio is comprised of various categories or segments, each of which have certain risk characteristics that are evaluated at the time of loan origination and periodically thereafter. Construction loans carry risks associated with whether or not the project will be completed according to schedule and within its original budget, as well as valuation risk associated with the overall value of the collateral upon completion. Residential real estate loans carry risks associated with continued credit-worthiness and financial stability of the borrower, as well as potential valuation changes relating to collateral. Commercial real estate loans carry risks associated with the continued operations of the business, as well as sufficient cash flow and profitability to service the debt. Additionally, commercial real estate loans are subject to risks associated with potential collateral valuation changes.

Commercial non-real estate loans, including those in the industrial and agricultural categories, carry similar risks to the commercial real estate loans, as they are dependent upon the continued successful business operations and cash flow. Commercial non-real estate loans also carry a risk associated with collateral being more difficult to assess. Consumer loans carry risks associated with the continued credit-worthiness and financial stability of the borrower, as well as potential for rapid depreciation or reduced value of the collateral, especially in automobile lending.

Management has developed an internal loan risk rating system as part of its credit analysis process. Loans are assigned an appropriate risk grade at the time of origination based on specific assessment factors relating to the borrower's ability to meet contractual obligations under the loan agreement. This process includes reviewing borrowers' financial information, historical payment experience, credit documentation, public information, and other information specific to each borrower. Commercial loan grade assessments also include consideration of business cash flow and debt obligations. Risk grades are generally reviewed on an annual basis for credit relationships with total credit exposure of \$500,000 or more, or at any point management becomes aware of information affecting the borrower's ability to fulfill their obligations. Management utilizes both internal and external loan review processes as a means of monitoring the appropriateness of risk ratings across the loan portfolio.

The specific loan risk rating categories included in the Bank's internal rating system include pass credits, pass-watch, special mention, substandard, doubtful, and loss. Pass credits generally consist of loans secured by cash or cash equivalents and loans to borrowers with a strong cash flow ratio, stable financial net worth and above average sources of liquidity to meet financial obligations. Pass-watch credits generally consist of loans to borrowers that may have minor, yet manageable, weaknesses related to the stability of cash flow and repayment sources and may require periodic monitoring. Special mention credits are loans that have identified weaknesses or adverse trends in the borrower's financial position that could potentially impact the Bank's credit position at some future date if not monitored closely. Substandard credits are those loans that have been identified as having a well-defined, specific, or major weakness in the primary cash flow sources or upon which significant reliance is being placed on secondary sources of repayment due to the borrower's financial difficulties. Potential for losses related to substandard credits is evaluated on a regular basis with specific allocations being made as needed, as well as other corrective actions necessary to protect the institution. Loans categorized as doubtful also have well defined weaknesses with the added characteristic of the likelihood that collection of payment in full is highly questionable or perhaps improbable. Loans classified as loss are considered to be totally uncollectible or of such little value that their continuance on the Bank's books as an asset is not warranted.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table represents a summary of the Bank's loan portfolio by class and internal risk rating as of December 31, 2017 (in thousands):

	<u>Pass</u>	<u>Pass- Watch</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Loss</u>	<u>Total Loans</u>
Construction & Land Loans							
Residential	\$ 926	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---	\$ 926
Commercial	---	765	---	389	---	---	1,154
Other – Land only	807	2,553	19	---	---	---	3,379
Residential Real Estate							
Equity Lines of Credit	1,373	113	---	---	---	---	1,486
1-4 Family Residences	45,776	18,113	1,272	747	---	---	65,908
Multifamily Dwellings	1,688	3,732	---	---	---	---	5,420
Commercial Real Estate							
Owner occupied	4,042	23,988	4,526	3,857	---	---	36,413
Non-owner occupied	297	14,421	---	258	---	---	14,976
Agricultural / Farm loans	53	2,771	1,099	230	---	---	4,153
Municipals	160	---	---	---	---	---	160
Commercial – Non Real Estate							
Agricultural	37	132	---	---	---	---	169
Industrial	408	8,341	75	172	---	---	8,996
Municipals	76	---	---	---	---	---	76
Consumer – Non Real Estate							
Credit Cards	691	17	13	---	---	---	721
Automobile loans	13,480	---	---	---	---	---	13,480
Other personal loans	<u>5,637</u>	<u>3</u>	<u>7</u>	---	---	---	<u>5,647</u>
Totals Gross Loans	<u>\$ 75,451</u>	<u>\$74,949</u>	<u>\$7,011</u>	<u>\$ 5,653</u>	<u>\$ ---</u>	<u>\$ ---</u>	<u>\$ 163,064</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

The following table represents a summary of the Bank's loan portfolio by class and internal risk rating as of December 31, 2016 (in thousands):

	<u>Pass</u>	<u>Pass- Watch</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Loss</u>	<u>Total Loans</u>
Construction & Land Loans							
Residential	\$ 1,653	\$ ---	\$ ---	\$ ---	\$ ---	\$ ---	\$ 1,653
Commercial	92	773	---	485	---	---	1,350
Other – Land only	883	746	25	---	---	---	1,654
Residential Real Estate							
Equity Lines of Credit	2,142	301	---	---	---	---	2,443
1-4 Family Residences	44,975	15,873	1,480	690	---	---	63,018
Multifamily Dwellings	1,752	3,484	---	---	---	---	5,236
Commercial Real Estate							
Owner occupied	4,446	27,079	2,945	3,488	---	---	37,958
Non-owner occupied	280	12,953	203	265	---	---	13,701
Agricultural / Farm loans	340	2,272	1,147	272	---	---	4,031
Municipals	186	---	---	---	---	---	186
Commercial – Non Real Estate							
Agricultural	38	168	---	---	---	---	206
Industrial	896	10,158	22	212	55	---	11,343
Municipals	38	---	---	---	---	---	38
Consumer – Non Real Estate							
Credit Cards	716	13	2	---	---	---	731
Automobile loans	11,420	---	---	---	---	---	11,420
Other personal loans	<u>5,901</u>	<u>15</u>	<u>35</u>	---	---	---	<u>5,951</u>
Totals Gross Loans	<u>\$ 75,758</u>	<u>\$73,835</u>	<u>\$5,859</u>	<u>\$ 5,412</u>	<u>\$ 55</u>	<u>\$ ---</u>	<u>\$ 160,919</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6 LOANS: (continued)

Loans classified as troubled debt restructurings are monitored for payment default on an on-going basis. There were no accounts that had defaulted during the year and were within 12 months of the original modification date, with default being defined as payments 90 days or more past due as of December 31, 2017 and December 31, 2016.

At December 31, 2017, there were a total of \$5.0 million in loans classified as troubled debt restructurings, with approximately \$781,000 being loans that were modified during 2017. There were approximately \$3.0 million in restructured loan balances classified as performing and in compliance with their modified terms at December 31, 2017. Restructured loans classified as nonperforming based on their past due or nonaccrual status at December 31, 2017 totaled \$2.0 million. Loans modified and classified as troubled debt restructurings during the reporting period ending December 31, 2017 are reported in the table below. These loans are also included in the impaired loan disclosures previously presented within this report.

(Dollars in thousands)

	Number of TDR <u>modifications</u>	Pre- modification outstanding recorded <u>investment</u>	Post- modification outstanding recorded <u>investment</u>
Commercial non real estate – industrial	2	\$56	\$56
Commercial real estate – owner occupied	2	\$639	\$726
Total	<u>4</u>	<u>\$ 695</u>	<u>\$782</u>

At December 31, 2016, there were a total of \$6.1 million in loans classified as troubled debt restructurings, with approximately \$109,000 being loans that were modified during 2016. There were approximately \$3.7 million in restructured loan balances classified as performing and in compliance with their modified terms at December 31, 2016. Restructured loans classified as nonperforming based on their past due or nonaccrual status at December 31, 2016 totaled \$2.4 million. Loans modified and classified as troubled debt restructurings during the reporting period ending December 31, 2016 are reported in the table below. These loans are also included in the impaired loan disclosures previously presented within this report.

(Dollars in thousands)

	Number of TDR <u>modifications</u>	Pre- modification outstanding recorded <u>investment</u>	Post- modification outstanding recorded <u>investment</u>
Residential real estate loans	2	\$ 103	\$110
Total	<u>2</u>	<u>\$ 103</u>	<u>\$110</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 ALLOWANCE FOR LOAN LOSSES (ALLL):

The summary table below includes the allowance allocations and total loans evaluated both individually and collectively for impairment, as well as a roll-forward representation of the activity that has occurred in the allowance account during the period ending December 31, 2017 (in thousands):

	Construction & Land Loans	Residential Real Estate	Commercial Real Estate	Commercial Non-Real Estate	Consumer Non-Real Estate	Total
ALLL ending balance 12/31/2016	<u>\$ 31</u>	<u>\$ 660</u>	<u>\$ 598</u>	<u>\$ 179</u>	<u>\$ 554</u>	<u>\$ 2,022</u>
Charge-offs	---	(100)	---	(5)	(530)	(635)
Recoveries	---	60	---	18	156	234
Provision	---	<u>80</u>	<u>(9)</u>	<u>(95)</u>	<u>408</u>	<u>384</u>
ALLL ending Balance 12/31/2017	<u>\$ 31</u>	<u>\$ 700</u>	<u>\$ 589</u>	<u>\$ 97</u>	<u>\$ 588</u>	<u>\$ 2,005</u>
Evaluated individually for impairment	--	38	--	21	---	59
Evaluated collectively for impairment	31	662	589	76	588	1,946
Total Gross Loans 12/31/2017	<u>\$ 5,459</u>	<u>\$ 72,814</u>	<u>\$ 55,702</u>	<u>\$ 9,241</u>	<u>\$ 19,848</u>	<u>\$ 163,064</u>
Evaluated individually for impairment	405	2,335	5,029	237	---	8,006
Evaluated collectively for impairment	5,054	70,479	50,673	9,004	19,848	155,058

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 7 ALLOWANCE FOR LOAN LOSSES (ALLL): (continued)

The summary table below includes the allowance allocations and total loans evaluated both individually and collectively for impairment, as well as a roll-forward representation of the activity that has occurred in the allowance account during the period ending December 31, 2016 (in thousands):

	Construction & Land Loans	Residential Real Estate	Commercial Real Estate	Commercial Non-Real Estate	Consumer Non-Real Estate	Total
ALLL ending balance 12/31/2015	<u>\$ 88</u>	<u>\$ 581</u>	<u>\$ 565</u>	<u>\$ 306</u>	<u>\$ 563</u>	<u>\$ 2,103</u>
Charge-offs	---	(87)	(193)	(23)	(603)	(906)
Recoveries	---	8	---	14	265	287
Provision	<u>(57)</u>	<u>158</u>	<u>226</u>	<u>(118)</u>	<u>329</u>	<u>538</u>
ALLL ending Balance 12/31/2016	<u>\$ 31</u>	<u>\$ 660</u>	<u>\$ 598</u>	<u>\$ 179</u>	<u>\$ 554</u>	<u>\$ 2,022</u>
Evaluated individually for impairment	--	46	19	73	---	138
Evaluated collectively for impairment	31	614	579	106	554	1,884
Total Gross Loans 12/31/2016	<u>\$ 4,657</u>	<u>\$ 70,697</u>	<u>\$ 55,876</u>	<u>\$ 11,587</u>	<u>\$ 18,102</u>	<u>\$ 160,919</u>
Evaluated individually for impairment	485	2,874	4,417	391	---	8,167
Evaluated collectively for impairment	4,172	67,823	51,459	11,196	18,102	152,752

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 8 BANK PREMISES and EQUIPMENT:

Bank premises, equipment and computer software included in the financial statements at December 31, 2017 and 2016 are as follows:

	<u>2017</u>	<u>2016</u>
	(In Thousands)	
Land	\$ 1,627	\$ 1,627
Land improvements and buildings	5,856	5,852
Furniture and equipment	5,604	5,666
Computer software	<u>1,667</u>	<u>1,642</u>
	14,754	14,787
Less accumulated depreciation	<u>10,123</u>	<u>10,031</u>
Net	<u>\$ 4,631</u>	<u>\$ 4,756</u>

Depreciation and amortization related to bank premises, equipment and software included in operating expense was \$327,000 and \$325,000 for December 31, 2017 and 2016, respectively.

NOTE 9 LEASE COMMITMENTS:

The Company has a lease commitment relating to its Charlottesville branch location. The lease agreement term for this branch has an expiration date of June 30, 2018. The Company also has a lease commitment relating to the Commercial Lending Office in Charlottesville, which has an expiration date of May 31, 2018 with renewal options for an additional two years. The Company's future minimum rental payments as required under the remaining non-cancelable lease terms as of December 31, 2017, were as follows:

	(In Thousands)
2018	<u>\$ 21</u>
TOTAL:	<u>\$ 21</u>

Subsequent to December 31, 2017, the Company executed a new lease for its Charlottesville office. Total minimum rental payments required under the new lease are as follows:

	(In Thousands)
2018	\$ 38
2019	67
2020	69
2021	70
2022	72
Thru May 2023	<u>30</u>
TOTAL	<u>\$346</u>

Lease expense, included in occupancy expense, was \$44,000 and \$45,000 for the years ending in December 31, 2017 and 2016, respectively.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 10 DEPOSITS:

The Bank's total deposit portfolio consists primarily of demand checking accounts, savings accounts and time deposit accounts. Total deposits were \$166.9 million and \$158.9 million as of December 31, 2017 and 2016, respectively. Brokered deposits included in this total were \$10.2 million and \$11.9 million as of December 31, 2017 and 2016, respectively. Customer time deposit balances that met or exceeded the \$250,000 FDIC insurance limit totaled \$3.9 million and \$4.0 million as of December 31, 2017 and 2016, respectively. At December 31, 2017, time deposit scheduled maturities (in thousands) are as follows:

2018	\$	22,034
2019		7,759
2020		6,262
2021		2,521
2022		5,982
2023 & Thereafter		128
Total	\$	<u>44,686</u>

The Bank has one customer with large deposit balances exceeding 5% of total deposits as of December 31, 2017. The total deposit balances for this customer as of December 31, 2017 were \$17.4 million or 10.43% of total deposits.

NOTE 11 BORROWINGS:

The Bank has a line of credit with the Federal Home Loan Bank of Atlanta upon which credit advances can be made up to 40% of total Bank assets, subject to certain eligibility requirements. This represents a total credit line of approximately \$79.2 million and \$75.9 million as of December 31, 2017 and 2016, respectively. FHLB advances bear interest at a fixed or floating rate depending on the terms and maturity of each advance and numerous renewal options are available. These advances are secured by first lien 1-4 family residential mortgages totaling \$64.3 million at December 31, 2017. On certain fixed rate advances, the FHLB may convert the advance to an indexed floating rate at some set point in time for the remainder of the term. If the advance converts to a floating rate, the Bank may repay all or part of the advance without a prepayment penalty. At December 31, 2017 and December 31, 2016, total outstanding borrowings with FHLB were \$7.5 million and \$7.9 million, respectively. The outstanding borrowings at December 31, 2017 consisted of one fixed rate advance of \$4.9 million and one variable rate advance of \$2.6 million. Scheduled principal payments on the fixed rate advance are due quarterly with a final maturity of January 28, 2021. The variable rate advance has a maturity date of June 29, 2018. The interest rates on these outstanding advances range from 1.36% to 1.59%. The remaining scheduled principal payments on the outstanding FHLB advances for the Bank as of December 31, 2017 are shown below:

(In thousands)	
Due in 2018	\$ 4,150
Due in 2019	1,500
Due in 2020	1,500
Due in 2021	375
Total	\$ <u>7,525</u>

The Bank also has available credit lines with other correspondent banks totaling \$8.5 million, which can be used for short-term liquidity purposes, if necessary. Any funds borrowed on these credit lines are required to be repaid within 7 to 30 consecutive business days. The interest rate on such borrowings is set in accordance with the then current daily market rate. As of December 31, 2017, there were no outstanding borrowings against these credit facilities.

Additionally, the Company had outstanding borrowings with a private individual in the amount of \$400,000 as of December 31, 2016. This loan was executed in July 2012 for the purpose of stock repurchase transactions with a maturity date of July 2017 and a stated interest rate of 4.0%. The interest expense related to this debt for 2017 was approximately \$9,000. The Company had no other debt outstanding as of December 31, 2017.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 12 DIVIDEND LIMITATION ON SUBSIDIARY BANK:

A principal source of funds of the Company is dividend transfers paid by the Bank. The amount of dividends the Bank may pay to the Company is regulated by the Federal Reserve. As of December 31, 2017, the maximum amount of dividends the Bank could pay to the Company was \$2.5 million or 9.1% of the consolidated net assets, without requesting permission from the Federal Reserve Bank. There are additional regulatory guidelines, which establishes further limitations for banks based on quarterly earnings.

NOTE 13 INCOME TAXES:

The Company files income tax returns in the U.S. federal jurisdiction and the state of Virginia. The Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years prior to 2014. The components of income tax expense are as follows:

	<u>2017</u>	<u>2016</u>
	(In Thousands)	
Current income tax expense	\$ 732	\$ 519
Deferred income tax expense (benefit)	40	(95)
Deferred tax asset adjustment for enacted change in tax rate	<u>222</u>	<u>---</u>
Income Tax Expense	<u>\$ 994</u>	<u>\$ 424</u>

The results for the year ended December 31, 2017 include the effect of the Tax Cuts and Jobs Act (the Act), which was signed into law on December 22, 2017. Among other things, the Act permanently lowers the federal corporate income tax rate to 21% from the maximum rate prior to the passage of the Act of 35%, effective January 1, 2018. As a result of the reduction of the federal corporate income tax rate, U.S. GAAP requires companies to re-measure their deferred tax assets and deferred tax liabilities, including those accounted for in accumulated other comprehensive income, as of the date of the Act's enactment and record the corresponding effects in income tax expense in the further quarter of 2017. As a result of the permanent reduction in the corporate income tax rate, the Company recognized a \$222,000 reduction in the value of its net deferred tax asset and recorded a corresponding incremental income tax expense of \$222,000 in the Company's consolidated results of operations for the fourth quarter of 2017. The Company's evaluation of the effect of the Act is subject to refinement for up to one year after enactment.

The reasons for the differences between income tax expense and the amount computed by applying the statutory federal income tax rate are as follows:

	<u>2017</u>	<u>2016</u>
	(In Thousands)	
Income taxes computed at the applicable federal income tax rate	\$1,032	\$ 696
Increase (decrease) resulting from:		
Tax-exempt income and dividends	(38)	(33)
Low income housing investments	(267)	(249)
Impact of enacted change in tax rate	222	---
Other	<u>45</u>	<u>10</u>
Income Tax Expense	<u>\$ 994</u>	<u>\$ 424</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 13 INCOME TAXES: (continued)

At December 31, the net deferred tax asset was made up of the following:

	<u>2017</u>	<u>2016</u>
	(In Thousands)	
Deferred Tax Assets:		
Allowance for loan losses	\$ 309	\$ 493
Other real estate owned	60	96
Nonaccrual interest	202	276
Other	<u>29</u>	<u>113</u>
Total	\$ <u>600</u>	\$ <u>978</u>
Deferred Tax Liabilities:		
Depreciation	\$ 91	\$ 122
Cash surrender value of life insurance	42	63
Securities available for sale	30	43
Goodwill	76	122
Other	<u>3</u>	<u>2</u>
Total	\$ <u>242</u>	\$ <u>352</u>
Net Deferred Tax Assets	\$ <u>358</u>	\$ <u>626</u>

NOTE 14 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 financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

New regulatory capital requirements under Basel III became effective January 1, 2015, with full compliance with all of the requirements to be phased in over a multi-year schedule, and fully phased in by January 1, 2019. As part of the new requirements, the Common Equity Tier I Capital ratio is calculated and utilized in the assessment of capital for all institutions. In addition, a capital conservation buffer must be maintained in excess of the minimum capital requirements to allow an institution to avoid restrictions on dividend payments, share repurchase transactions, and discretionary bonus payments. The capital conservation buffer requirement began its phase-in on January 1, 2016, at 0.625% of risk-weighted assets, and will increase by the same percentage in each successive year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is applicable to all ratios with the exception of the leverage ratio, which is noted below as Tier I Capital to Average Assets.

The quantitative measures established by regulation ensure capital adequacy and require the Bank to maintain minimum amounts and ratios as set forth in the table below. Management believes, as of December 31, 2017 and 2016, the Bank met all capital adequacy requirements to which it was subject. As of December 31, 2017, the most recent notification from the Bank's primary federal regulator 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 risk-based, Tier I risk-based, Common Equity Tier I, and Tier I leverage ratios as set forth in the table. The Bank's actual capital amounts and ratios are also presented below:

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 14 REGULATORY MATTERS: (continued)

	<u>Actual</u>		<u>For Capital Adequacy Purposes</u>		<u>Minimum To Be Well Capitalized</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
As of December 31, 2017:						
Total Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 23,427	15.8%	\$ 11,882	≥ 8.0%	\$ 14,853	≥10.0%
Tier I Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 21,569	14.5%	\$ 8,912	≥ 6.0%	\$ 11,882	≥ 8.0%
Common Equity Tier I Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 21,569	14.5%	\$ 6,684	≥ 4.5%	\$ 9,654	≥ 6.5%
Tier I Capital to Average Assets:						
Pioneer Bank	\$ 21,569	10.9%	\$ 7,914	≥ 4.0%	\$ 9,893	≥ 5.0%
As of December 31, 2016:						
Total Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 22,021	15.0%	\$ 11,746	≥ 8.0%	\$ 14,683	≥10.0%
Tier I Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 20,184	13.7%	\$ 8,810	≥ 6.0%	\$ 11,746	≥ 8.0%
Common Equity Tier I Capital to Risk Weighted Assets:						
Pioneer Bank	\$ 20,184	13.7%	\$ 6,607	≥ 4.5%	\$ 9,544	≥ 6.5%
Tier I Capital to Average Assets:						
Pioneer Bank	\$ 20,184	10.7%	\$ 7,545	≥ 4.0%	\$ 9,431	≥ 5.0%

NOTE 15 STOCK OPTION PLAN:

The Company's 1998 Stock Incentive Plan (the "Plan") was adopted by the Board of Directors on June 11, 1998 and approved by the shareholders on June 11, 1999. Generally, the Plan provided for the grants of incentive stock options and non-qualified stock options. The exercise price of an option could not be less than 100% of the fair market value of the common stock (or if greater, the book value) on the date of the grant. The option terms applicable to each grant were determined at the grant date, but no option could be exercisable in any event, after ten years from its grant date. This ten year Plan expired in June of 2008 with respect to the issuance of new option grants. However, grants previously issued under this Plan were still eligible to be exercised within their original terms during 2017.

A summary of the activity in the Company's stock option plan is as follows:

	<u>Shares</u>	<u>Weighted Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Term (In Years)</u>	<u>Intrinsic Value of Unexercised In-the-Money Options (In Thousands)</u>
Options outstanding, 12/31/16	800	\$23.80	.50	
Options Granted	--	--		
Options Exercised	(700)	23.80		
Options Expired	(100)	23.80		
Options outstanding, 12/31/17	---	\$---	---	
Options exercisable, 12/31/17	---	\$---	---	\$ ---

The intrinsic value of stock options exercised in 2017 and 2016 was \$70 and \$440, respectively.

At December 31, 2017, there were no options outstanding as all options outstanding at the end of the prior year were exercised or expired during the year. There was no unrecognized compensation expense relating to outstanding stock options as of December 31, 2016.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 16 EARNINGS PER SHARE:

The following shows the weighted average number of shares used in computing earnings per share and the effect on weighted average number of shares of diluted potential common stock. Potential dilutive common stock had no effect on income available to common shareholders.

	<u>2017</u>		<u>2016</u>	
	Weighted Average Shares	Per Share Amount	Weighted Average Shares	Per Share Amount
Basic earnings per share	971,408	<u>\$2.10</u>	967,326	<u>\$ 1.68</u>
Effect of dilutive securities:				
Stock options	----		----	
Diluted earnings per share	<u>971,408</u>	<u>\$ 2.10</u>	<u>967,326</u>	<u>\$ 1.68</u>

For 2017 and 2016, all average outstanding option shares were excluded from the computation of diluted earnings per share because their effects were anti-dilutive.

NOTE 17 OFF-BALANCE SHEET COMMITMENTS:

The contract or notional amount of financial instruments with off-balance sheet risks are as follows:

	December 31,	
	<u>2017</u>	<u>2016</u>
	(In Thousands)	
Unfunded lines of credit (commercial and personal)	\$ 5,058	\$ 4,802
Loan commitments and letters of credit (commercial and personal)	6,299	5,302
Credit card unused credit limits	1,448	1,464

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the counter-party.

Unfunded commitments under commercial lines of credit, revolving credit lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. These lines of credit generally are un-collateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments for which collateral is deemed necessary.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 18 TRANSACTIONS WITH RELATED PARTIES:

During the year, executive officers and directors (and companies controlled by them) were customers of and had transactions with the Company in the normal course of business. These transactions were made on substantially the same terms as those prevailing for other customers and did not involve any abnormal risk. Deposit account balances of executive officers and directors totaled \$20.8 million as of December 31, 2017 and \$17.0 million for the year ended December 31, 2016. Loan transactions, including all extensions of credit to such related parties are shown in the following schedule:

	<u>2017</u>	<u>2016</u>
	<u>(In Thousands)</u>	
Total loans, beginning of year	\$ 801	\$ 274
New loans	2,012	---
Effect of change in composition of related parties	---	545
Payments	<u>(585)</u>	<u>(18)</u>
Total loans, end of year	<u>\$ 2,228</u>	<u>\$ 801</u>

NOTE 19 FAIR VALUE MEASUREMENTS:

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

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

Fair Value Hierarchy

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

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

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

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

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

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

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

The following table presents the balances of financial assets measured at fair value on a recurring basis as of December 31, 2017 and December 31, 2016:

Description	Balances Outstanding (In Thousands)	Fair Value Measurements Using:		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>As of December 31, 2017</i>				
U.S. treasury securities	\$ 4,030	\$ ---	\$ 4,030	\$ ---
Mortgage-backed Securities	1,460	---	1,460	---
Agency securities	3,500	---	3,500	---
State & Municipals	2,322	---	2,322	---
Equity Securities	<u>4,984</u>	<u>4,984</u>	---	---
Total Available –for-sale securities	\$ <u>16,296</u>	\$ <u>4,984</u>	\$ <u>11,312</u>	\$ <u>---</u>
<i>As of December 31, 2016</i>				
U.S. treasury securities	\$ 2,500	\$ ---	\$ 2,500	\$ ---
Mortgage-backed Securities	1,777	---	1,777	---
State & Municipals	2,750	---	2,750	---
Equity Securities	<u>1,251</u>	<u>1,251</u>	---	---
Total Available –for-sale securities	\$ <u>8,278</u>	\$ <u>1,251</u>	\$ <u>7,027</u>	\$ <u>---</u>

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

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

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

Impaired Loans: The Fair Value Measurement accounting standard also applies to loans measured for impairment including impaired loans measured at an observable market price (if available), or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral.

Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreement will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old, not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business financial statement if not considered significant using observable market data. Internal collateral evaluations relating to commercial loans secured by business assets such as inventory and equipment are generally performed on an annual basis. However, since this is not a formalized or certified valuation, these evaluations are considered to be level 3 for fair value disclosure and reporting purposes. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the Allowance for Loan Losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

For residential and commercial real estate loans considered to be collateral dependent, appraisals or updated collateral evaluations are generally obtained in conjunction with specific allowance allocations and/or anticipated foreclosure proceedings, on a case by case basis, depending upon the strength of additional mitigating arrangements with individual borrowers. The outstanding principal balance of impaired loans considered to be collateral dependent in the level 3 category as of December 31, 2017 totaled approximately \$185,000 compared to \$825,000 at December 31, 2016. These loans primarily consisted of business asset loans and certain real estate properties with appraisal valuations that were in the process of being updated. As a general rule, management utilizes a significant discount factor for outdated appraisals when calculating its allowance allocation estimates and making specific reserves. Local professional realtors are also contacted regarding potential fair market values in an effort to ensure that the discounted values are within reasonable ranges on individual properties. Additionally, updated tax assessed values are also considered in this evaluation process on a case by case basis.

Other Real Estate Owned: Certain assets such as other real estate owned (OREO) are measured at fair market value less selling expenses. Fair value of OREO properties held are generally based on current appraisal values, as previously defined above.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

The following table summarizes the Company's assets that were measured at fair value on a nonrecurring basis during the period.

Description of Assets:	Balances Outstanding (In Thousands)	Carrying values		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
As of December 31, 2017				
Impaired Loans, net of allowance	\$ 185	\$---	\$ ---	\$ 185
Other Real Estate Owned	\$ 335	\$---	\$ ----	\$ 335
As of December 31, 2016				
Impaired Loans, net of allowance	\$ 825	\$---	\$ ---	\$ 825
Other Real Estate Owned	\$ 1,419	\$---	\$ ---	\$ 1,419

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2017 (dollars in thousands):

Assets	Quantitative information about Level 3 Fair Value Measurements			
	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 185	Discounted appraised value or recent tax assessment values	Selling cost	0% - 10% (7%)
OREO properties	\$ 335			
			Discount for lack of marketability, Age of appraisal, or Condition of property	10% - 30% (20%)

The following table displays quantitative information about Level 3 Fair Value Measurements for December 31, 2016 (dollars in thousands):

Assets	Quantitative information about Level 3 Fair Value Measurements			
	Fair Value	Valuation Technique(s)	Unobservable Input	Range (Weighted Average)
Impaired loans	\$ 825	Discounted appraised value or recent tax assessment values	Selling cost	0% - 10% (7%)
OREO properties	\$ 1,419			
			Discount for lack of marketability, Age of appraisal, or Condition of property	10% - 30% (20%)

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

Accounting guidance defines the fair value of a financial instrument as the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale. As the majority of the Company's financial instruments lack an available trading market; significant estimates, assumptions and present value calculations are required to determine estimated fair value. The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

Cash and Due From Banks and Federal Funds Sold - For those short-term instruments, the carrying amount is a reasonable estimate of fair value.

Interest Bearing Deposits in Other Banks - Fair values are based on quoted reinvestment market rates available for similar deposit accounts as of the date of this report.

Securities - Fair values, excluding restricted stock, are based on items previously described within this footnote.

Loans Receivable - For certain homogeneous categories of loans, such as some residential mortgages, and other consumer loans, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics. The fair value of other types of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Bank Owned Life Insurance - The carrying amount of bank owned life insurance approximates fair value.

Deposits and Borrowings - The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value of all other deposits and borrowings is determined using the discounted cash flow method. The discount rate was equal to the rate currently offered on similar products.

Accrued Interest - The carrying amounts of accrued interest approximates fair value.

Off-Balance-Sheet Financial Instruments - The fair value of commitments to extend credit is estimated using the fees currently charged to enter similar agreements, taking into account the remaining terms of the agreements and the present credit worthiness of the counter party. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of stand-by letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counter parties at the reporting date.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

At December 31, 2017 and December 31, 2016, the fair value of loan commitments and stand-by letters of credit was immaterial. Therefore, they have not been included in the following tables. The carrying values and estimated fair values of the Company's financial instruments as of December 31, 2017 are as follows:

	Carrying Value	Fair Value Measurements at December 31, 2017 using			Total Fair Value Balance
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets					
<i>(In thousands)</i>					
Cash and cash equivalents	\$3,630	\$ 3,630	\$ ---	\$ ---	\$3,630
Interest bearing deposits in other banks	8,634	8,284	339	---	8,623
Federal funds sold	2,876	2,876	---	---	2,876
Securities available for sale	16,296	4,984	11,312	---	16,296
Loans, net	160,959	---	---	164,867	164,867
Bank owned life insurance	388	---	388	---	388
Accrued interest receivable	1,076	---	1,076	---	1,076
Liabilities					
Non-interest bearing deposits	51,443	---	51,443	---	51,443
Interest bearing deposits	45,321	---	45,321	---	45,321
Savings deposits	25,483	---	25,483	---	25,483
Time deposits	44,686	---	45,082	---	45,082
Borrowings	7,525	---	7,599	---	7,599
Accrued interest payable	109	---	109	---	109

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 19 FAIR VALUE MEASUREMENTS (continued):

Estimated fair value and the carrying value of financial instruments as of December 31, 2016 are as follows:

	Carrying Value	Fair Value Measurements at December 31, 2016 using			Total Fair Value Balance
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Assets					
<u>(In thousands)</u>					
Cash and cash equivalents	\$6,888	\$ 6,888	\$ ---	\$ ---	\$ 6,888
Interest bearing deposits in other banks	6,630	6,280	341	---	6,621
Federal funds sold	1,810	1,810	---	---	1,810
Securities available for sale	8,278	1,251	7,027	---	8,278
Loans, net	158,736	---	---	161,999	161,999
Bank owned life insurance	371	---	371	---	371
Accrued interest receivable	925	---	925	---	925
Liabilities					
Non-interest bearing deposits	49,696	---	49,696	---	49,696
Interest bearing deposits	36,526	---	36,526	---	36,526
Savings deposits	25,863	---	25,863	---	25,863
Time deposits	46,797	---	47,018	---	47,018
Borrowings	8,275	---	8,380	---	8,380
Accrued interest payable	84	---	84	---	84

The Company, through its bank subsidiary, assumes interest rate risk (the risk that general interest rate levels will change) as a result of its normal operations. As a result, the fair value of their financial instruments will change when interest rate levels change and that change may be either favorable or unfavorable. Management attempts to match maturities of assets and liabilities to the extent believed necessary to minimize interest rate risk. However, borrowers with fixed rate obligations are less likely to repay in a rising rate environment and more likely to repay in a falling rate environment. Management monitors rates and maturities of assets and liabilities and attempts to minimize interest rate risk by adjusting terms of new loans and deposits and by investing in securities with terms that mitigate the Company's overall interest rate risk.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 20 BENEFIT PLANS:

The Bank has a 401(k) Profit Sharing Plan covering employees who have completed six months of service and are at least 21 years of age. Employees may contribute compensation subject to certain limits based on federal tax laws. The Bank makes matching contributions up to 3 percent of an employee's eligible annual compensation contributed to the Profit Sharing Plan. Additional amounts may be contributed, at the option of the Bank's Board of Directors. Employer contributions vest to the employee at 100% after six years of service. A year of vesting service is a plan year during which an employee is credited with at least 1,000 hours of service. For the years ended December 31, 2017 and 2016, total expense attributable to this 401(k) plan amounted to approximately \$55,000 and \$63,000, respectively.

The Bank also provides a cafeteria insurance plan including medical, life, and long-term disability coverage for eligible employees. The net expense attributable to this insurance plan was approximately \$289,000 and \$297,000, for the years ending December 31, 2017 and 2016, respectively.

NOTE 21 LOW INCOME HOUSING TAX CREDIT INVESTMENTS:

The Bank has invested in seven separate housing equity funds at December 31, 2017. The general purpose of these funds is to encourage and assist participants in investing in low-income residential rental properties located in the Commonwealth of Virginia, develop and implement strategies to maintain projects as low-income housing, deliver Federal Low Income Housing Credits to investors, allocate tax losses and other possible tax benefits to investors, and to preserve and protect project assets. The investments in these funds were recorded as other assets on the consolidated balance sheets and were \$2.5 million and \$2.7 million at December 31, 2017 and 2016, respectively. The expected terms of these investments and the related tax benefits run through 2033. Tax credits and other tax benefits recognized as a component of income tax expense during the years ended December 31, 2017 and 2016 were \$267,000 and \$249,000 respectively, related to these investments. Additional capital calls expected for the funds totaled \$1.0 million and \$1.4 million at December 31, 2017 and 2016, respectively, and are included in other liabilities on the consolidated balance sheets.

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 PARENT CORPORATION ONLY FINANCIAL STATEMENTS:

BALANCE SHEETS

	December 31,	
	2017	2016
	(In Thousands)	
ASSETS		
Cash and cash equivalents	\$ 240	\$ 4,045
Investment in subsidiary	21,865	20,527
Securities available for sale	4,984	1,251
Bank premises and equipment, net	441	468
Other assets	2	132
Total Assets	<u>\$ 27,532</u>	<u>\$ 26,423</u>
LIABILITIES		
Accrued expenses and other liabilities	\$ 118	\$ 4
Borrowings	---	400
Total Liabilities	<u>118</u>	<u>404</u>
STOCKHOLDERS' EQUITY		
Common stock	487	485
Retained earnings	26,812	25,451
Accumulated other comprehensive income	115	83
Total Stockholders' Equity	<u>27,414</u>	<u>26,019</u>
Total Liabilities and Stockholders' Equity	<u>\$ 27,532</u>	<u>\$ 26,423</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 PARENT CORPORATION ONLY FINANCIAL STATEMENTS: (continued)

STATEMENTS OF INCOME

	December 31,	
	2017	2016
	(In Thousands)	
INCOME		
Dividends from subsidiary	\$ 325	\$ 1,225
Interest income	1	1
Dividend income	100	71
Gains (Losses) on securities transactions, net	440	(168)
Rent income	82	92
Other income	1	6
Total Income	<u>949</u>	<u>1,227</u>
EXPENSES		
Interest expense on borrowings	9	26
Compensation expense	60	60
Occupancy expenses	43	54
Other operating expenses	63	98
Total Expenses	<u>175</u>	<u>238</u>
Net income before income tax expense (benefit) and undistributed income of subsidiary	774	989
INCOME TAX EXPENSE (BENEFIT)	<u>118</u>	<u>(96)</u>
Net income before undistributed income of subsidiary	656	1,085
Undistributed income of subsidiary	<u>1,385</u>	<u>538</u>
NET INCOME	<u>\$ 2,041</u>	<u>\$ 1,623</u>

PIONEER BANKSHARES, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 22 PARENT CORPORATION ONLY FINANCIAL STATEMENTS: (continued)

STATEMENTS OF CASH FLOWS

	December 31,	
	<u>2017</u>	<u>2016</u>
	(In Thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,041	\$ 1,623
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed subsidiary income	(1,385)	(538)
(Gain) Loss on securities transactions, net	(440)	168
Depreciation	27	27
Stock based compensation	102	80
Net change in:		
Other assets	130	32
Accrued expenses and other liabilities	85	(15)
Net Cash Provided by Operating Activities	<u>560</u>	<u>1,377</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of premises and equipment	---	(5)
Proceeds from sales and maturities of securities available for sale	6,180	3,502
Purchase of securities available for sale	(9,384)	(223)
Net Cash (Used In) Provided by Investing Activities	<u>(3,204)</u>	<u>3,274</u>
CASH FLOWS FROM FINANCING ACTIVITIES:		
Curtailments of borrowings	(400)	(400)
Exercise of Stock Options	17	18
Dividends paid	(778)	(736)
Net Cash Used in Financing Activities	<u>(1,161)</u>	<u>(1,118)</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(3,805)	3,533
Cash and Cash Equivalents, Beginning of Year	4,045	512
Cash and Cash Equivalents, End of Year	<u>\$ 240</u>	<u>\$ 4,045</u>
Supplemental Disclosure of non-cash activity:		
Unrealized gain on securities available for sale	89	416