

FIRST BANK OF KENTUCKY CORPORATION
Maysville, Kentucky

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
First Bank of Kentucky Corporation
Maysville, Kentucky

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of First Bank of Kentucky Corporation, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and 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.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of First Bank of Kentucky Corporation as of December 31, 2016 and 2015, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe Horwath LLP

Crowe Horwath LLP

Louisville, Kentucky
February 21, 2017

FIRST BANK OF KENTUCKY CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
ASSETS		
Cash and due from banks	\$ 10,599,184	\$ 7,974,377
Securities available for sale	41,832,576	40,250,953
Loans, net	65,483,306	68,044,121
Federal Home Loan Bank stock, at cost	580,300	580,300
Premises and equipment, net	2,388,703	2,446,755
Interest receivable	433,950	436,653
Other real estate	275,000	275,000
Goodwill	2,521,498	2,521,498
Other assets	<u>151,409</u>	<u>96,182</u>
Total assets	<u>\$ 124,265,926</u>	<u>\$ 122,625,839</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest bearing	\$ 16,066,810	\$ 16,939,369
Interest bearing	<u>84,334,012</u>	<u>81,474,813</u>
Total deposits	100,400,822	98,414,182
Dividends payable	213,098	213,110
Interest payable	12,180	12,578
Other liabilities	<u>1,041,799</u>	<u>1,386,572</u>
Total liabilities	101,667,899	100,026,442
Stockholders' equity		
Common stock, \$5 par value, 500,000 shares authorized 85,239 (2016) and 85,244 (2015) shares issued and outstanding	426,195	426,220
Retained earnings	22,730,646	22,085,473
Accumulated other comprehensive income (loss)	<u>(558,814)</u>	<u>87,704</u>
Total stockholders' equity	<u>22,598,027</u>	<u>22,599,397</u>
Total liabilities and stockholders' equity	<u>\$ 124,265,926</u>	<u>\$ 122,625,839</u>

See accompanying notes to consolidated financial statements.

FIRST BANK OF KENTUCKY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Interest income		
Loans, including fees	\$ 3,100,710	\$ 3,097,824
Securities		
Obligations of U. S. government agencies	314,159	296,064
Obligations of states and political subdivisions	418,369	403,080
Other	<u>23,414</u>	<u>23,219</u>
	3,856,652	3,820,187
Interest expense		
Deposits	<u>170,046</u>	<u>191,637</u>
Net interest income	3,686,606	3,628,550
Provision for loan losses	<u>70,000</u>	<u>25,000</u>
Net interest income after provision for loan losses	3,616,606	3,603,550
Noninterest income		
Service charges and fees	405,058	332,146
Trust department income	72,059	87,254
Net gains on sales of securities	54,794	43,741
Other	<u>278,786</u>	<u>269,406</u>
	810,697	732,547
Noninterest expenses		
Salaries and employee benefits	1,637,500	1,583,237
Occupancy and equipment expenses	234,542	244,756
Data processing	387,699	371,264
Taxes, other than income and payroll	245,401	241,289
Advertising	17,579	16,711
FDIC insurance	41,967	49,449
Other	<u>550,448</u>	<u>523,777</u>
	3,115,136	3,030,483
Income before income taxes	1,312,167	1,305,614
Provision for income taxes	<u>302,794</u>	<u>307,012</u>
Net income	<u>\$ 1,009,373</u>	<u>\$ 998,602</u>

See accompanying notes to consolidated financial statements.

FIRST BANK OF KENTUCKY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Net income	\$ 1,009,373	\$ 998,602
Other comprehensive income:		
Unrealized gains (losses) on securities:		
Unrealized holding gains (losses) arising during the period	(924,777)	205,019
Reclassification adjustment for net losses realized in income	<u>(54,794)</u>	<u>(43,741)</u>
Subtotal	(979,571)	161,278
Tax effect	<u>333,053</u>	<u>(54,834)</u>
Total other comprehensive income (loss)	<u>(646,518)</u>	<u>106,444</u>
Comprehensive income	<u>\$ 362,855</u>	<u>\$ 1,105,046</u>

See accompanying notes to consolidated financial statements.

FIRST BANK OF KENTUCKY CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 2016 and 2015

	<u>Common Stock Shares</u>	<u>Stock Amount</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income (Loss)</u>	<u>Total Stockholders' Equity</u>
Balances, January 1, 2015	85,677	\$ 428,385	\$ 21,610,159	\$ (18,740)	\$ 22,019,804
Net income	-	-	998,602	-	998,602
Dividends (\$4.10 per share)	-	-	(350,193)	-	(350,193)
Other comprehensive income	-	-	-	106,444	106,444
Purchase of shares	<u>(433)</u>	<u>(2,165)</u>	<u>(173,095)</u>	<u>-</u>	<u>(175,260)</u>
Balances, December 31, 2015	85,244	426,220	22,085,473	87,704	22,599,397
Net income	-	-	1,009,373	-	1,009,373
Dividends (\$4.25 per share)	-	-	(362,275)	-	(362,275)
Other comprehensive loss	-	-	-	(646,518)	(646,518)
Purchase of shares	<u>(5)</u>	<u>(25)</u>	<u>(1,925)</u>	<u>-</u>	<u>(1,950)</u>
Balances, December 31, 2016	<u>85,239</u>	<u>\$ 426,195</u>	<u>\$ 22,730,646</u>	<u>\$ (558,814)</u>	<u>\$ 22,598,027</u>

See accompanying notes to consolidated financial statements.

FIRST BANK OF KENTUCKY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities		
Net income	\$ 1,009,373	\$ 998,602
Adjustments to reconcile net income to net cash from operating activities		
Depreciation and amortization	104,979	108,013
Provision for loan losses	70,000	25,000
Net gains on sales of securities	(54,794)	(43,741)
Net loss on disposal of fixed assets	-	2,258
Net loss on sale of other real estate	10,711	13,560
Net amortization and accretion of securities	37,023	29,508
Changes in		
Interest receivable	2,703	1,810
Other assets	(55,227)	(27,214)
Interest payable	(398)	(3,873)
Other liabilities	(11,719)	(2,475)
Net cash from operating activities	1,112,651	1,101,448
Cash flows from investing activities		
Proceeds from maturities of, principal payments, and calls on securities available for sale	15,470,000	9,870,000
Proceeds from sales of securities available for sale	3,725,096	1,228,871
Purchase of securities available for sale	(21,738,520)	(15,261,650)
Net change in loans	2,380,315	(3,255,760)
Proceeds from sale of other real estate	99,789	171,440
Purchase of premises and equipment	(46,927)	(10,110)
Net cash from investing activities	(110,247)	(7,257,209)
Cash flows from financing activities		
Net change in deposits	1,986,640	5,970,403
Payments to purchase common stock	(1,950)	(175,260)
Dividends paid	(362,287)	(351,276)
Net cash from financing activities	1,622,403	5,443,867
Net change in cash and cash equivalents	2,624,807	(711,894)
Cash and cash equivalents at beginning of year	7,974,377	8,686,271
Cash and cash equivalents at end of year	\$ 10,599,184	\$ 7,974,377
Supplemental cash flow information		
Interest paid	\$ 170,444	\$ 195,510
Income taxes paid	375,000	315,000
Supplemental noncash disclosures		
Real estate acquired through foreclosure	\$ 110,500	\$ 185,000

See accompanying notes to consolidated financial statements.

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Principles of Consolidation: The consolidated financial statements include the accounts of First Bank of Kentucky Corporation (the Company) and its wholly-owned subsidiary, Bank of Maysville (the Bank). All material intercompany transactions and balances have been eliminated.

The Bank operates under a state bank charter, and provides full banking services, including trust services. As a state bank, the Bank is subject to regulation by the Kentucky Department of Financial Institutions and the Federal Deposit Insurance Corporation. The Company is a bank holding company regulated by the Federal Reserve.

Subsequent Event: The Company has evaluated subsequent events for recognition and disclosure through February 21, 2017, which is the date the financial statements were available to be issued.

Use of Estimates: To prepare financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ.

Cash and Cash Equivalents: Cash and cash equivalents include cash, deposits in other financial institutions under 90 days, and federal funds sold. Net cash flows are reported for loan, deposit, and other borrowed funds transactions.

Securities: Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income, net of tax.

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.

Management evaluates securities for other-than-temporary impairment (“OTTI”) on at least a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. For securities in an unrealized loss position, management considers the extent and duration of the unrealized loss, and the financial condition and near-term prospects of the issuer. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis. If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings.

Loans: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of the allowance for loan losses. Interest income is accrued on the unpaid principal balance.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Interest income is reported on the interest method. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Consumer loans are typically charged off no later than 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans. A loan is moved to non-accrual status in accordance with the Company's policy, typically after 90 days of non-payment.

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

Allowance for Loan Losses: The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Management estimates the allowance balance required using past loan loss experience, the nature and volume of the portfolio, information about specific borrower situations and estimated collateral values, economic conditions, and other factors. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged-off.

The allowance consists of specific and general components. The specific component relates to loans that are individually classified as impaired. The general component covers non-classified loans and is based on historical loss experience adjusted for current factors.

A loan is impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and classified as impaired.

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 case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral.

Commercial and commercial real estate loans over \$25,000 are individually evaluated for impairment. If a loan is impaired, a portion of the allowance is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Large groups of smaller balance homogeneous loans, such as consumer and residential real estate loans, are collectively evaluated for impairment, and accordingly, they are not separately identified for impairment disclosures.

(Continued)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral. For troubled debt restructurings that subsequently default, the Company determines the amount of reserve in accordance with the accounting policy for the allowance for loan losses.

The general component covers loans collectively evaluated for impairment and is based on historical loss experience adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Company over the most recent three years. This actual loss experience is supplemented with other economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. The following portfolio segments have been identified:

- Commercial loans include commercial and industrial businesses. They are dependent on the strength of the industries of the related borrowers and the success of their businesses. Financial information is obtained from the borrower to evaluate ability to repay the loans.
- Real estate loans include residential properties, commercial properties as well as agricultural properties. These loans are secured by real estate, and appraisals are obtained to support the loan amount.
- Consumer and other loans are generally secured by consumer assets, but also may be unsecured. The Bank evaluates the borrower's repayment ability through a review of credit scores and an evaluation of debt to income ratios.

Other Real Estate: Assets acquired through or instead of foreclosure are initially recorded at fair value less estimated selling costs establishing a new cost basis. These assets are subsequently accounted for at their lower of cost or market. If fair value declines, a valuation allowance is recorded through expense. Costs after acquisition are expensed.

Premises and Equipment: Buildings and equipment are stated at cost less accumulated depreciation computed principally on the straight-line method over the estimated useful lives of the assets.

Federal Home Loan Bank (FHLB) Stock: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors, and may invest in additional amounts. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Income Taxes: Income tax expense is the total of the current year net income tax due or refundable and the change in deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax bases of assets and liabilities, computed using enacted tax rates. A valuation allowance, if needed, reduces deferred tax assets to the amount expected to be realized.

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NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

The Company recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense.

Goodwill and Other Intangible Assets: Goodwill resulting from business combinations prior to January 1, 2009 represents the excess of the purchase price over the fair value of the net assets of businesses acquired. Goodwill resulting from business combinations after January 1, 2009, is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but tested for impairment at least annually. The Company has selected November 30 as the date to perform the annual impairment test. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Goodwill is the only intangible asset with an indefinite life on the balance sheet. There are no other intangible assets with definite useful lives on the balance sheet.

Loan Commitments and Related Financial Instruments: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded.

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 which are also recognized as separate components of equity.

Fair Value of Financial Instruments: Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in a separate note. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Reclassifications: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or stockholders’ equity.

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 2 – SECURITIES AVAILABLE FOR SALE

The following table summarizes the amortized cost and fair value of available for sale securities at December 31, 2016 and 2015 and the corresponding unrealized gains and losses recognized in accumulated other comprehensive income (loss):

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
<u>2016</u>				
U. S. government agencies	\$ 21,992,774	\$ 2,754	\$ (394,070)	\$ 21,601,458
State and political subdivisions	<u>20,686,489</u>	<u>61,568</u>	<u>(516,939)</u>	<u>20,231,118</u>
Total	<u>\$ 42,679,263</u>	<u>\$ 64,322</u>	<u>\$ (911,009)</u>	<u>\$ 41,832,576</u>
<u>2015</u>				
U. S. government agencies	\$ 22,725,921	\$ 4,797	\$ (193,480)	\$ 22,537,238
State and political subdivisions	<u>17,392,148</u>	<u>339,205</u>	<u>(17,638)</u>	<u>17,713,715</u>
Total	<u>\$ 40,118,069</u>	<u>\$ 344,002</u>	<u>\$ (211,118)</u>	<u>\$ 40,250,953</u>

The amortized cost and fair value of debt securities, by contractual maturity. 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.

	December 31, 2016	
	<u>Amortized Cost</u>	<u>Fair Value</u>
Due in one year or less	\$ 861,414	\$ 863,957
Due from one to five years	23,546,541	23,281,164
Due from five to ten years	17,680,279	17,131,255
Due after ten years	<u>591,029</u>	<u>556,200</u>
	<u>\$ 42,679,263</u>	<u>\$ 41,832,576</u>

Securities having a carrying value of \$22,369,673 and \$20,397,627 at December 31, 2016 and 2015 were pledged to secure public deposits and for other purposes as required or permitted by law.

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 2 – SECURITIES AVAILABLE FOR SALE (Continued)

The following table summarizes securities with unrealized losses at December 31, 2016 and 2015, aggregated by major security type and length of time in a continuous unrealized loss position:

Description of Securities	<u>Less than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>	<u>Unrealized Loss</u>
<u>2016</u>						
U.S. government agencies	\$ 18,103,673	\$ (394,070)	\$ -	\$ -	\$ 18,103,673	\$ (394,070)
State and political subdivisions	<u>14,295,758</u>	<u>(507,667)</u>	<u>149,429</u>	<u>(9,272)</u>	<u>14,445,187</u>	<u>(516,939)</u>
Total temporarily impaired	<u>\$ 32,399,431</u>	<u>\$ (901,737)</u>	<u>\$ 149,429</u>	<u>\$ (9,272)</u>	<u>\$ 32,548,860</u>	<u>\$ (911,009)</u>
<u>2015</u>						
U.S. government agencies	\$ 11,915,137	\$ (139,083)	\$ 3,970,602	\$ (54,397)	\$ 15,885,739	\$ (193,480)
State and political subdivisions	<u>2,478,385</u>	<u>(17,638)</u>	<u>-</u>	<u>-</u>	<u>2,478,385</u>	<u>(17,638)</u>
Total temporarily impaired	<u>\$ 14,393,522</u>	<u>\$ (156,721)</u>	<u>\$ 3,970,602</u>	<u>\$ (54,397)</u>	<u>\$ 18,364,124</u>	<u>\$ (211,118)</u>

Unrealized losses on U.S. government and federal agency bonds and obligations of states and political subdivisions have not been recognized into income because the bonds are of high credit quality, management does not intend to sell and it is likely that management will not be required to sell the securities prior to their anticipated recovery, and the decline in fair value is largely due to an increase in market interest rates. The fair value is expected to recover as the bonds approach their maturity date and/or market rates decline.

NOTE 3 – LOANS

Loans at year-end were as follows:

	<u>2016</u>	<u>2015</u>
Commercial	\$ 638,404	\$ 525,202
Real estate:		
Commercial real estate	17,137,743	17,789,719
Residential real estate	40,233,193	41,086,740
Agriculture real estate	6,332,479	7,388,805
Consumer	1,377,445	1,467,042
Other	<u>323,913</u>	<u>330,389</u>
	66,043,177	68,587,897
Allowance for loan losses	<u>(559,871)</u>	<u>(543,776)</u>
Loans, net	<u>\$ 65,483,306</u>	<u>\$ 68,044,121</u>

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 3 – LOANS (Continued)

The following table presents the activity in the allowance for loan losses by portfolio segment for the years ended December 31, 2016 and 2015:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Agricultural Real Estate</u>	<u>Consumer</u>	<u>Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>December 31, 2016</u>								
Allowance for loan losses:								
Beginning balance	\$ 2,637	\$ 163,507	\$ 118,533	\$ 96,912	\$ 11,367	\$ 1,824	\$ 148,996	\$ 543,776
Provision for loan losses	(930)	(35,628)	(17,153)	15,226	18,184	9,682	80,619	70,000
Loans charged-off	-	(17,205)	(10,484)	-	(24,995)	(9,124)	-	(61,808)
Recoveries	-	459	1,290	-	5,300	854	-	7,903
Total ending allowance balance	<u>\$ 1,707</u>	<u>\$ 111,133</u>	<u>\$ 92,186</u>	<u>\$ 112,138</u>	<u>\$ 9,856</u>	<u>\$ 3,236</u>	<u>\$ 229,615</u>	<u>\$ 559,871</u>
<u>December 31, 2015</u>								
Allowance for loan losses:								
Beginning balance	\$ 3,219	\$ 148,631	\$ 195,601	\$ 84,433	\$ 14,920	\$ 2,166	\$ 134,830	\$ 583,800
Provision for loan losses	(582)	14,876	(12,864)	12,479	(4,331)	1,256	14,166	25,000
Loans charged-off	-	-	(64,314)	-	(889)	(2,876)	-	(68,079)
Recoveries	-	-	110	-	1,667	1,278	-	3,055
Total ending allowance balance	<u>\$ 2,637</u>	<u>\$ 163,507</u>	<u>\$ 118,533</u>	<u>\$ 96,912</u>	<u>\$ 11,367</u>	<u>\$ 1,824</u>	<u>\$ 148,996</u>	<u>\$ 543,776</u>

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 3 – LOANS (Continued)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method as of December 31, 2016 and 2015:

	<u>Commercial</u>	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Agricultural Real Estate</u>	<u>Consumer</u>	<u>Other</u>	<u>Unallocated</u>	<u>Total</u>
<u>December 31, 2016</u>								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Collectively evaluated for impairment	<u>1,707</u>	<u>111,133</u>	<u>92,186</u>	<u>112,138</u>	<u>9,856</u>	<u>3,236</u>	<u>229,615</u>	<u>559,871</u>
Total ending allowance balance	<u>\$ 1,707</u>	<u>\$ 111,133</u>	<u>\$ 92,186</u>	<u>\$ 112,138</u>	<u>\$ 9,856</u>	<u>\$ 3,236</u>	<u>\$ 229,615</u>	<u>\$ 559,871</u>
Loans:								
Loans individually evaluated for impairment	\$ -	\$ -	\$ 794,428	\$ -	\$ -	\$ -	\$ -	\$ 794,428
Loans collectively evaluated for impairment	<u>638,404</u>	<u>17,137,743</u>	<u>39,438,765</u>	<u>6,332,479</u>	<u>1,377,445</u>	<u>323,913</u>	<u>-</u>	<u>65,248,749</u>
Total ending loan balance	<u>\$ 638,404</u>	<u>\$ 17,137,743</u>	<u>\$ 40,233,193</u>	<u>\$ 6,332,479</u>	<u>\$ 1,377,445</u>	<u>\$ 323,913</u>	<u>\$ -</u>	<u>\$ 66,043,177</u>
<u>December 31, 2015</u>								
Allowance for loan losses:								
Ending allowance balance attributable to loans:								
Individually evaluated for impairment	\$ -	\$ 10,394	\$ 2,621	\$ -	\$ -	\$ -	\$ -	\$ 13,015
Collectively evaluated for impairment	<u>2,637</u>	<u>153,113</u>	<u>115,912</u>	<u>96,912</u>	<u>11,367</u>	<u>1,824</u>	<u>148,996</u>	<u>530,761</u>
Total ending allowance balance	<u>\$ 2,637</u>	<u>\$ 163,507</u>	<u>\$ 118,533</u>	<u>\$ 96,912</u>	<u>\$ 11,367</u>	<u>\$ 1,824</u>	<u>\$ 148,996</u>	<u>\$ 543,776</u>
Loans:								
Loans individually evaluated for impairment	\$ -	\$ 79,364	\$ 519,572	\$ 201,224	\$ -	\$ -	\$ -	\$ 800,160
Loans collectively evaluated for impairment	<u>525,202</u>	<u>17,710,355</u>	<u>40,567,168</u>	<u>7,187,581</u>	<u>1,467,042</u>	<u>330,389</u>	<u>-</u>	<u>67,787,737</u>
Total ending loan balance	<u>\$ 525,202</u>	<u>\$ 17,789,719</u>	<u>\$ 41,086,740</u>	<u>\$ 7,388,805</u>	<u>\$ 1,467,042</u>	<u>\$ 330,389</u>	<u>\$ -</u>	<u>\$ 68,587,897</u>

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 3 – LOANS (Continued)

The following table presents information related to impaired loans by class of loans as of and for the years ended December 31, 2016 and 2015:

	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Allowance for Loan Losses Allocated</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	<u>Cash Basis Interest Recognized</u>
<u>December 31, 2016</u>						
With no related allowance recorded:						
Residential real estate	<u>794,428</u>	<u>794,428</u>	<u>-</u>	<u>795,104</u>	<u>16,941</u>	<u>15,796</u>
Total	<u>\$ 794,428</u>	<u>\$ 794,428</u>	<u>\$ -</u>	<u>\$ 795,104</u>	<u>\$ 16,941</u>	<u>\$ 15,796</u>
<u>December 31, 2015</u>						
With no related allowance recorded:						
Commercial real estate	\$ 14,220	\$ 14,220	\$ -	\$ 16,568	\$ 674	\$ 696
Residential real estate	284,510	284,510	-	283,091	8,941	8,966
Agricultural real estate	<u>201,224</u>	<u>201,224</u>	<u>-</u>	<u>206,027</u>	<u>11,547</u>	<u>11,547</u>
Subtotal	<u>499,954</u>	<u>499,954</u>	<u>-</u>	<u>505,686</u>	<u>21,162</u>	<u>21,209</u>
With an allowance recorded:						
Commercial real estate	65,144	65,144	10,394	63,448	-	-
Residential real estate	<u>235,062</u>	<u>235,062</u>	<u>2,621</u>	<u>237,853</u>	<u>7,379</u>	<u>7,756</u>
Subtotal	<u>300,206</u>	<u>300,206</u>	<u>13,015</u>	<u>301,301</u>	<u>7,379</u>	<u>7,756</u>
Total	<u>\$ 800,160</u>	<u>\$ 800,160</u>	<u>\$ 13,015</u>	<u>\$ 806,987</u>	<u>\$ 28,541</u>	<u>\$ 28,965</u>

The recorded investment in loans excludes accrued interest receivable due to immateriality.

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 3 – LOANS (Continued)

Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The following table presents the recorded investment in nonaccrual and loans past due 90 days or more still on accrual by class of loans as of December 31, 2016 and 2015:

	Nonaccrual		Loans Past Due 90 Days or More Still Accruing	
	2016	2015	2016	2015
Real estate:				
Commercial real estate	\$ -	\$ 65,144	\$ -	\$ -
Residential real estate	357,106	62,536	-	92,083
Agricultural real estate	-	201,224	-	-
Consumer	-	-	-	795
	\$ 357,106	\$ 328,904	\$ -	\$ 92,878
Total				

The following table presents the aging of the recorded investment in past due loans as of December 31, 2016 and 2015 by class of loans:

	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due	Total
<u>December 31, 2016</u>						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 638,404	\$ 638,404
Real estate:						
Commercial real estate	33,602	-	-	33,602	17,104,141	17,137,743
Residential real estate	257,781	-	357,106	614,887	39,618,306	40,233,193
Agricultural real estate	-	-	-	-	6,332,479	6,332,479
Consumer	14,265	-	-	14,265	1,363,180	1,377,445
Other	-	-	-	-	323,913	323,913
	\$ 305,648	\$ -	\$ 357,106	\$ 662,754	\$ 65,380,423	\$ 66,043,177
<u>December 31, 2015</u>						
Commercial	\$ -	\$ -	\$ -	\$ -	\$ 525,202	\$ 525,202
Real estate:						
Commercial real estate	-	-	65,144	65,144	17,724,575	17,789,719
Residential real estate	213,375	240,326	154,619	608,320	40,478,420	41,086,740
Agricultural real estate	-	-	-	-	7,388,805	7,388,805
Consumer	-	-	795	795	1,466,247	1,467,042
Other	-	-	-	-	330,389	330,389
	\$ 213,375	\$ 240,326	\$ 220,558	\$ 674,259	\$ 67,913,638	\$ 68,587,897

(Continued)

NOTE 3 – LOANS (Continued)

Troubled Debt Restructurings:

The Company has allocated \$0 and \$2,621 in specific reserves to customers whose loan terms have been modified in troubled debt restructurings as of December 31, 2016 and 2015. The Company has not committed to lend additional amounts as of December 31, 2016 and 2015 to customers with outstanding loans that are classified as troubled debt restructurings.

During the years ended December 31, 2016 and 2015, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or capitalization of interest. The modifications involved a reduction of the stated interest rate of the loans and extension of the maturity dates.

There were no troubled debt restructurings in payment default as of December 31, 2016 and 2015.

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

Credit Quality Indicators:

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. The Company uses the following definitions for risk ratings:

Watch. Loans classified as watch have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

Substandard. Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2016 and 2015

NOTE 3 – LOANS (Continued)

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered to be pass rated loans.

Based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	<u>Pass</u>	<u>Watch</u>	<u>Substandard</u>	<u>Doubtful</u>
<u>December 31, 2016</u>				
Commercial	\$ 637,363	\$ 1,041	\$ -	\$ -
Real estate:				
Commercial real estate	16,899,550	238,193	-	-
Residential real estate	38,693,251	520,634	1,019,308	-
Agricultural real estate	5,274,145	716,115	342,219	-
Consumer	1,355,113	22,332	-	-
Other	<u>323,913</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 63,183,335</u>	<u>\$ 1,498,315</u>	<u>\$ 1,361,527</u>	<u>\$ -</u>
 <u>December 31, 2015</u>				
Commercial	\$ 519,751	\$ 5,451	\$ -	\$ -
Real estate:				
Commercial real estate	17,241,618	468,737	79,364	-
Residential real estate	39,363,114	1,282,650	440,976	-
Agricultural real estate	6,389,455	454,079	545,271	-
Consumer	1,443,328	15,129	7,790	795
Other	<u>330,389</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total	<u>\$ 65,287,655</u>	<u>\$ 2,226,046</u>	<u>\$ 1,073,401</u>	<u>\$ 795</u>

NOTE 4 – PREMISES AND EQUIPMENT

Year-end premises and equipment were as follows:

	<u>2016</u>	<u>2015</u>
Land and buildings	\$ 3,194,658	\$ 3,189,380
Furniture, fixtures and equipment	<u>973,924</u>	<u>1,017,618</u>
	4,168,582	4,206,998
Less: Accumulated depreciation and amortization	<u>(1,779,879)</u>	<u>(1,760,243)</u>
	<u>\$ 2,388,703</u>	<u>\$ 2,446,755</u>

Depreciation and amortization expense was \$104,979 and \$108,013 for 2016 and 2015.

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FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 5 – INCOME TAXES

The provision for income taxes at December 31 is summarized as follows:

	<u>2016</u>	<u>2015</u>
Current	\$ 314,548	\$ 315,715
Deferred	<u>(11,754)</u>	<u>(8,703)</u>
	<u>\$ 302,794</u>	<u>\$ 307,012</u>

The tax provision is less than that obtained by using the statutory rates primarily because of tax-exempt interest income of approximately \$430,000 and \$410,000, and nondeductible interest expense of approximately \$6,000 for both 2016 and 2015.

Gross deferred tax assets consist primarily of the allowance for loan losses and unrealized losses on available for sale securities. Gross deferred tax liabilities consist primarily of unrealized losses in available sale securities, depreciation and goodwill. Deferred taxes include the following amounts of deferred tax assets and liabilities at December 31, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Deferred tax assets	\$ 400,734	\$ 104,092
Deferred tax liabilities	<u>(1,208,314)</u>	<u>(1,256,480)</u>
	<u>\$ (807,580)</u>	<u>\$ (1,152,388)</u>

No valuation allowance for the realization of deferred tax assets is considered necessary.

The Company has no unrecognized tax benefits as of December 31, 2016 and 2015. The Company does not expect the total amount of unrecognized tax benefits to significantly increase in the next twelve months. Should the accrual of any interest or penalties relative to unrecognized tax benefits be necessary, it is the Company's policy to record such accruals in its income tax expense accounts; no such accruals existed as of December 31, 2016 and 2015. The Company and its subsidiaries file U.S. Corporation federal income tax returns and the Company files a Kentucky Corporation income tax return. These returns are subject to examination by taxing authorities for all years after 2012.

NOTE 6 - RETIREMENT PLAN

The Bank has a 401(k) profit sharing plan covering substantially all employees. Contributions to the Plan are made at the discretion of the Bank's Board of Directors. The Company recorded contribution expense of \$32,614 and \$30,813 for 2016 and 2015 for Company contributions approved by the Board of Directors.

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FIRST BANK OF KENTUCKY CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2016 and 2015

NOTE 7 – DEPOSITS

Time deposits of \$250,000 or more were \$4,389,729 and \$5,105,610 at year-end 2016 and 2015. At December 31, 2016, the scheduled maturities of all time deposits are as follows:

2017	\$ 12,994,159
2018	1,754,133
2019	690,649
2020	1,360,117
2021	2,291,032
Thereafter	<u>1,053,200</u>
	<u>\$ 20,143,290</u>

NOTE 8 – LINES OF CREDIT

The Company has a \$1,500,000 unsecured line of credit with Fifth Third Bank of Cincinnati, a third party financial institution. Interest is payable quarterly at the prime rate, 3.75% as of December 31, 2016. There were no outstanding balances at December 31, 2016 and 2015.

NOTE 9 – COMMITMENTS AND OFF-BALANCE SHEET RISK

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance-sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of financial instruments with off-balance-sheet risk was as follows at year-end.

	<u>2016</u>		<u>2015</u>	
	<u>Fixed</u> <u>Rate</u>	<u>Variable</u> <u>Rate</u>	<u>Fixed</u> <u>Rate</u>	<u>Variable</u> <u>Rate</u>
Commitments to make loans (at market rates)	\$ 1,201,050	\$ 439,250	\$ 1,221,550	\$ 1,139,700
Unused lines of credit	4,480,455	585,710	2,961,068	464,440

Commitments to make loans are generally made for periods of 180 days or less. The fixed rate loan commitments at December 31, 2016 had interest rates ranging from 4.00% to 4.75% and maturities ranging from 1 years to 20 years.

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NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Investment Securities: The fair values for investment securities are determined by quoted market prices, if available (Level 1). For securities where quoted prices are not available, fair values are calculated based on market prices of similar securities (Level 2).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Real Estate Owned: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Appraisals for both collateral-dependent impaired loans and real estate owned are performed by certified general appraisers (for commercial properties) or certified residential appraisers (for residential properties) whose qualifications and licenses have been reviewed and verified by the Company. Once received, a member of the loan department reviews the assumptions and approaches utilized in the appraisal as well as the overall resulting fair value in comparison with independent data sources such as

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FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

recent market data or industry-wide statistics. On an annual basis, the Company compares the actual selling price of collateral that has been sold to the most recent appraised value to determine what additional adjustment should be made to the appraisal value to arrive at fair value on a case-by-case basis.

Assets and Liabilities Measured on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below:

	Fair Value Measurements at December 31 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>2016</u>			
Assets:			
Obligations of U.S government agencies	\$ -	\$ 21,601,458	\$ -
Obligations of states and political subdivisions	-	20,231,118	-
<u>2015</u>			
Assets:			
Obligations of U.S government agencies	\$ -	\$ 22,537,238	\$ -
Obligations of states and political subdivisions	-	17,713,715	-

No assets were measured at fair value on a non-recurring basis at December 31, 2016.

Assets measured at fair value on a non-recurring basis at December 31, 2015 are summarized below:

	Fair Value Measurements at December 31 Using		
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>2015</u>			
Impaired loans:			
Real estate:			
Commercial real estate	\$ -	\$ -	\$ 54,750
Residential real estate	-	-	232,441

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 10 – FAIR VALUES OF FINANCIAL INSTRUMENTS (Continued)

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral dependent loans, had a carrying amount of \$300,206, with a valuation allowance of \$13,015 at December 31, 2015, resulting in an additional provision for loan losses of \$13,015 for the year ended December 31, 2015.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at December 31, 2015:

<u>2015</u>	<u>Fair Value</u>	<u>Valuation Technique(s)</u>	<u>Unobservable Input(s)</u>	<u>Valuation Discount</u>
Impaired loans - commercial real estate	\$ 54,750	Sales comparison approach	Adjustment for differences between the comparable sales, aging and specific borrower information	16%
residential real estate	\$ 232,441	Sales comparison approach	Adjustment for differences between the comparable sales, aging and specific borrower information	1%

NOTE 11 – CONCENTRATION OF CREDIT RISK

The Bank grants commercial, residential and consumer related loans to customers primarily located in Mason and adjoining counties in Kentucky and Ohio. Although the Bank has a diverse loan portfolio, the debtors' ability to perform is somewhat dependent upon the local economy.

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FIRST BANK OF KENTUCKY CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2016 and 2015

NOTE 12 – REGULATORY MATTERS

Banks are subject to regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and, additionally for banks, prompt corrective action regulations, involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet capital requirements can initiate regulatory action. The final rules implementing Basel Committee on Banking Supervision’s capital guidelines for U.S. banks (Basel III rules) became effective for the Company on January 1, 2015 with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. Under Basel III rules the bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.5% by 2019. The capital conservation buffer for 2016 is 0.0625%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. Management believes as of December 31, 2016 and 2015, the Bank met all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. If adequately capitalized, regulatory approval is required to accept brokered deposits. If undercapitalized, capital distributions are limited, as is asset growth and expansion, and capital restoration plans are required. At year-end 2016 and 2015, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that management believes have changed the institution’s category.

Actual capital levels and minimum required levels, exclusive of the conservation buffer, are presented below:

	<u>Actual</u>		<u>Required for Capital Adequacy Purposes</u>		<u>To Be Well Capitalized Under Prompt Corrective Action Regulations</u>	
	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>	<u>Amount</u>	<u>Ratio</u>
<u>2016</u>						
Total Capital to risk weighted assets	\$ 21,009,000	31.80%	\$ 5,284,800	8.0%	\$ 6,606,000	10.0%
Tier 1 (Core) Capital to risk weighted assets	20,449,000	30.96	3,963,600	6.0	5,284,800	8.0
Common Tier 1 (CET1)	20,449,000	30.96	2,972,700	4.5	4,293,900	6.5
Tier 1 (Core) Capital to average assets	20,449,000	16.90	4,838,680	4.0	6,048,350	5.0
<u>2015</u>						
Total Capital to risk weighted assets	\$ 20,359,000	30.08%	\$ 5,293,920	8.0%	\$ 6,617,400	10.0%
Tier 1 (Core) Capital to risk weighted assets	19,815,000	29.90	3,970,440	6.0	5,293,920	8.0
Common Tier 1 (CET1)	19,815,000	29.90	2,977,830	4.5	4,301,310	6.5
Tier 1 (Core) Capital to average assets	19,815,000	16.80	4,723,360	4.0	5,904,200	5.0

(Continued)

FIRST BANK OF KENTUCKY CORPORATION
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 December 31, 2016 and 2015

NOTE 12 – REGULATORY MATTERS (Continued)

Dividend Restrictions—The Company’s principal source of funds for dividend payments is dividends received from the Bank. Banking regulations limit the amount of dividends that may be paid without prior approval of regulatory agencies. Under these regulations, the amount of dividends that may be paid in any calendar year is limited to the current year’s net profits, combined with the retained net profits of the preceding two years, subject to the capital requirements described above. During 2017, the Bank could, without prior approval, declare dividends of approximately \$1,098,000 plus any 2017 net profits retained to the date of the dividend declaration.

NOTE 13 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following is changes in accumulated other comprehensive income (loss) by component, net of tax, for the years ending December 31, 2016 and 2015:

	Unrealized Gains and Losses on Available-for-Sale <u>Securities</u>
<u>December 31, 2016</u>	
Beginning balance	\$ 87,704
Other comprehensive income before reclassification	(610,354)
Amounts reclassified from accumulated other comprehensive income	<u>(36,164)</u>
Net current period other comprehensive income	<u>(646,518)</u>
Ending balance	<u>\$ (558,814)</u>
<u>December 31, 2015</u>	
Beginning balance	\$ (18,740)
Other comprehensive income before reclassification	135,313
Amounts reclassified from accumulated other comprehensive income	<u>(28,869)</u>
Net current period other comprehensive income	<u>106,444</u>
Ending balance	<u>\$ 87,704</u>

(Continued)

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NOTE 13 – ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) (Continued)

The following is significant amounts reclassified out of each component of accumulated other comprehensive income (Loss) for the year ending December 31, 2016:

<u>Details about Accumulated Other Comprehensive Income Components</u>	<u>Amount Reclassified From Accumulated Other Comprehensive Income</u>	<u>Affected Line Item in the Statement Where Net Income Is Presented</u>
Unrealized gains and losses on available-for-sale securities	\$ 54,794 <u>(18,630)</u>	Net gain on sale of securities Tax expense
	<u>\$ 36,164</u>	Net of tax

The following is significant amounts reclassified out of each component of accumulated other comprehensive income (Loss) for the year ending December 31, 2015:

<u>Details about Accumulated Other Comprehensive Income Components</u>	<u>Amount Reclassified From Accumulated Other Comprehensive Income</u>	<u>Affected Line Item in the Statement Where Net Income Is Presented</u>
Unrealized gains and losses on available-for-sale securities	\$ 43,741 <u>(14,872)</u>	Net gain on sale of securities Tax expense
	<u>\$ 28,869</u>	Net of tax

NOTE 14 – RELATED-PARTY TRANSACTIONS

Loans to principal officers, directors, and their affiliates during 2016 were as follows:

Beginning balance	\$ 774,000
Reclassifications	199,592
New loans	54,635
Repayments	<u>(208,257)</u>
Ending balance	<u>\$ 819,970</u>

Deposits from principal officers, directors, and their affiliates at year-end 2016 and 2015 were \$2,351,206 and \$1,988,000.
