LCNB CORP
Form 10-K
March 06, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2018
or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________________ to ______________________

Commission File Number 000-26121

LCNB Corp.

(Exact name of registrant as specified in its charter)

Ohio	31-1626393
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2 North Broadway, Lebanon, Ohio 45036
(Address of principal executive offices, including Zip Code)

(513) 932-1414
(Registrant's telephone number, including area code)

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

Title of Each Class	Name of each exchange on which registered
None	None

Securities registered pursuant to 12(g) of the Exchange Act:

COMMON STOCK, NO PAR VALUE
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically everyInteractive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

The aggregate market value of the registrant’s outstanding voting common stock held by nonaffiliates on June 30, 2018, determined using a per share closing price on that date of $19.70 as quoted on the NASDAQ Capital Market, was $247,700,000.00.

As of March 5, 2019, 13,308,557 common shares were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement included in the Notice of Annual Meeting of Shareholders to be held April 23, 2019, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2018 are incorporated by reference into Part III.

LCNB CORP.
For the Year Ended December 31, 2018

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

Certain statements made in this document regarding LCNB Corp.'s ("LCNB") financial condition, results of operations, plans, objectives, future performance and business, are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These forward-looking statements are identified by the fact they are not historical facts and include words such as "anticipate", "could", "may", "feel", "expect", "believe", "pl
and similar expressions.

These forward-looking statements reflect management's current expectations based on all information available to management and its knowledge of LCNB's business and operations. Additionally, LCNB's financial condition, results of operations, plans, objectives, future performance and business are subject to risks and uncertainties that may cause actual results to differ materially. These factors include, but are not limited to:

1. the success, impact, and timing of the implementation of LCNB's business strategies;
2. LCNB's ability to integrate recent and future acquisitions, including the recent merger with Columbus First Bancorp, Inc., may be unsuccessful, or may be more difficult, time-consuming or costly than expected;
3. LCNB may incur increased loan charge-offs in the future;
4. LCNB may face competitive loss of customers;
5. changes in the interest rate environment may have results on LCNB's operations materially different from those anticipated by LCNB's market risk management functions;
6. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
7. changes in regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB's operating results;
8. LCNB may experience difficulties growing loan and deposit balances;
9. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
10. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments;
11. difficulties with technology or data security breaches, including cyberattacks, that could negatively affect LCNB's ability to conduct business and its relationships with customers, vendors, and others; and
12. government intervention in the U.S. financial system, including the effects of recent legislative, tax, accounting and regulatory actions and reforms, including the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Jumpstart Our Business Startups Act, the Consumer Financial Protection Bureau, the capital ratios of Basel III as adopted by the federal banking authorities, and the Tax Cuts and Jobs Act.

Forward-looking statements made herein reflect management's expectations as of the date such statements are made. Such information is provided to assist shareholders and potential investors in understanding current and anticipated financial operations of LCNB and is included pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. LCNB undertakes no obligation to update any forward-looking statement to reflect events or circumstances that arise after the date such statements are made.

DESCRIPTION OF LCNB CORP.'S BUSINESS

General Description

LCNB Corp., an Ohio corporation formed in December 1998, is a financial holding company headquartered in Lebanon, Ohio. Substantially all of the assets, liabilities and operations of LCNB Corp. are attributable to its wholly-owned subsidiary, LCNB National Bank (the "Bank"). LCNB Risk Management, Inc., a captive insurance agency, was incorporated in Nevada by LCNB Corp. during the second quarter 2017. LCNB Corp. and its subsidiaries are herein collectively referred to as “LCNB.” The predecessor of LCNB Corp., the Bank, was formed as a national banking association in 1877. On May 19, 1999, the Bank became a wholly-owned subsidiary of LCNB Corp.

On January 11, 2013, LCNB consummated a merger with First Capital Bancshares, Inc. (“First Capital”) in a stock and cash transaction valued at approximately $20.2 million. Immediately following the merger of First Capital into LCNB, Citizens National Bank (“Citizens National”), a wholly-owned subsidiary of First Capital, was merged into the Bank. At that time, Citizens National’s six full–service offices became offices of LCNB. Three of these offices are located in Chillicothe, Ohio and one office is located in each of Frankfort, Ohio, Clarksburg, Ohio, and Washington Court House, Ohio. The office in Clarksburg, Ohio was closed on January 24, 2017.

On January 24, 2014, LCNB purchased all of the outstanding stock of Eaton National Bank & Trust Co. ("Eaton National") from its holding company, Colonial Banc Corp., in a cash transaction totaling $24.75 million. Upon consummation of the transaction, Eaton National was merged into the Bank and its five offices became offices of the Bank. Two of these offices are located in Eaton, Ohio and one office is located in each of New Paris, Ohio, Lewisburg, Ohio, and West Alexandria, Ohio.

On April 30, 2015, LCNB consummated a merger with BNB Bancorp, Inc. (“BNB”) in a stock and cash transaction valued at approximately $13.5 million. Immediately following the merger of BNB into LCNB, Brookville National Bank ("Brookville National"), a wholly-owned subsidiary of BNB, was merged into the Bank. At that time, Brookville National's two offices, both located in Brookville, Ohio, became offices of the Bank. The office located on Hay Avenue in Brookville was closed on November 10, 2017.

On May 31, 2018, LCNB consummated a merger with Columbus First Bancorp, Inc. (“CFB”) in a stock transaction valued at approximately $64.4 million. Immediately following the merger of CFB into LCNB, Columbus First Bank (“Columbus First”), a wholly-owned subsidiary of CFB, was merged into the Bank. At that time, Columbus First's sole office, located in Worthington, Ohio, became an office of the Bank.

The Bank is a full service community bank offering a wide range of commercial and personal banking services. Deposit services include checking accounts, NOW accounts, savings accounts, Christmas and vacation club accounts, money market deposit accounts, Lifetime Checking accounts (a senior citizen program), individual retirement accounts, and certificates of deposit. Additional supportive services include online banking, bill pay, mobile banking and telephone banking. Commercial customers also have both cash management and remote deposit capture products as potential options. Deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund, which is administered by the Federal Deposit Insurance Corporation (the “FDIC”).

Loan products offered include commercial and industrial loans, commercial and residential real estate loans, agricultural loans, construction loans, various types of consumer loans, and Small Business Administration loans. The Bank's residential mortgage lending activities consist primarily of loans for purchasing or refinancing personal residences, home equity lines of credit, and loans for commercial or consumer purposes secured by residential mortgages. Most fixed-rate residential real estate loans are sold to the Federal Home Loan Mortgage Corporation with servicing retained. Consumer lending activities include automobile, boat, home improvement and personal loans.

The Trust and Investment Management Division of the Bank provides complete trust administrative, estate settlement, and fiduciary services and also offers investment management of trusts, agency accounts, individual retirement accounts, and foundations/endowments.

Security brokerage services are offered by the Bank through arrangements with LPL Financial LLC, a registered broker/dealer. Licensed brokers offer a full range of investment services and products, including financial needs analysis, mutual funds, securities trading, annuities, and life insurance.

Other services offered include safe deposit boxes, night depositories, cashier's checks, bank-by-mail, ATMs, cash and transaction services, debit cards, wire transfers, electronic funds transfer, utility bill collections, notary public service, personal computer-based cash management services, 24-hour telephone banking, PC Internet banking, mobile banking, and other services tailored for both individuals and businesses.

The Bank is not dependent upon any one significant customer or specific industry. Business is not seasonal to any material degree.

The address of the main office of the Bank is 2 North Broadway, Lebanon, Ohio 45036; telephone (513) 932-1414.

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Primary Market Area

The Bank considers its primary market area to consist of counties where it has a physical presence and neighboring counties, which includes Southwestern and South Central Ohio. At December 31, 2018, the Bank had:

- 35 offices, including a main office in Warren County, Ohio and branch offices in Warren, Butler, Clinton, Clermont, Fayette, Franklin, Hamilton, Montgomery, Preble, and Ross Counties, Ohio,
- a loan production office in Franklin County, Ohio,
- an Operations Center in Warren County, Ohio,
- and 38 ATMs.

Competition

The Bank faces strong competition both in making loans and attracting deposits. The deregulation of the banking industry and the wide spread enactment of state laws that permit multi-bank holding companies as well as the availability of nationwide interstate banking has created a highly competitive environment for financial services providers. The Bank competes with other national and state banks, savings and loan associations, credit unions, finance companies, mortgage brokerage firms, realty companies with captive mortgage brokerage firms, mutual funds, insurance companies, brokerage and investment banking companies, and other financial intermediaries operating in its market and elsewhere, many of whom have substantially larger financial and managerial resources.

The Bank seeks to minimize the competitive effect of other financial institutions through a community banking approach that emphasizes direct customer access to the Bank's CEO and other officers in an environment conducive to friendly, informed, and courteous personal services. Management believes that the Bank is well positioned to compete successfully in its primary market area. Competition among financial institutions is based upon interest rates offered on deposit accounts, interest rates charged on loans and other credit and service charges, the quality and scope of the services rendered, the convenience of the banking facilities, and, in the case of loans to commercial borrowers, relative lending limits.

The ability to access and use technology is an increasingly competitive factor in the financial services industry. Technology relating to the delivery of financial services, the security and privacy of customer information, and the processing of information is evolving rapidly. LCNB must continually make technology investments to remain competitive in the financial services industry.

Management believes the commitment of the Bank to personal service, innovation, and involvement in the communities and primary market areas it serves, as well as its commitment to quality community banking service, are factors that contribute to its competitive advantage.

Supervision and Regulation

LCNB Corp., as a financial holding company, is regulated under the Bank Holding Company Act of 1956, as amended (the "Act"), and is subject to the supervision and examination of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board").

The Bank is subject to the provisions of the National Bank Act. The Bank is subject to primary supervision, regulation and examination by the Office of the Comptroller of the Currency (the "OCC"). The Bank is also subject to the rules and regulations of the Board of Governors of the Federal Reserve System and the FDIC.

LCNB Corp. and the Bank are subject to an extensive array of banking laws and regulations that are intended primarily for the protection of the Bank's customers and depositors. These laws and regulations govern such areas as permissible activities, loans and investments, and rates of interest that can be charged on loans and reserves. LCNB Corp. and the Bank also are subject to general U.S. federal laws and regulations and to the laws and regulations of the State of Ohio. Set forth below are brief descriptions of selected laws and regulations applicable to LCNB and the Bank.

The Financial Reform, Recovery and Enforcement Act of 1989 ("FIRREA") provides that a holding company and its controlled insured depository institutions are liable for any loss incurred by the FDIC in connection with the default of any FDIC assisted transaction involving an affiliated insured bank or savings association.

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The Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") substantially revised the bank regulatory and funding provisions of the Federal Deposit Insurance Act and several other federal banking statutes. Among its many reforms, FDICIA, as amended:

1. Required regulatory agencies to take "prompt corrective action" with financial institutions that do not meet minimum capital requirements;
2. Established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized;
3. Imposed significant restrictions on the operations of a financial institution that is not rated well-capitalized or adequately capitalized;
4. Prohibited a depository institution from making any capital distributions, including payments of dividends or paying any management fee to its holding company, if the institution would be undercapitalized as a result;
5. Implemented a risk-based premium system;
6. Required an audit committee to be comprised of outside directors;
7. Required a financial institution with more than $500 million in total assets to issue annual, audited financial statements prepared in conformity with U.S. generally accepted accounting principles; and
8. Required a financial institution with more than $1 billion in total assets to document, evaluate, and report on the effectiveness of the entity's internal control system and required an independent public accountant to attest to management's assertions concerning the bank's internal control system.

The members of an audit committee for banks with more than $1 billion in total assets must be independent of management. FDICIA does not relieve financial institutions that are public companies, such as LCNB, from internal control reporting and attestation requirements or audit committee independence requirements prescribed by the Sarbanes-Oxley Act of 2002 (see below).

The Gramm-Leach-Bliley Act, which amended the Bank Holding Company Act of 1956 and other banking related laws, was signed into law on November 12, 1999. The Gramm-Leach-Bliley Act repealed certain sections of the Glass-Steagall Act and substantially eliminated the barriers separating the banking, insurance, and securities industries. Effective March 11, 2000, qualifying bank holding companies could elect to become financial holding companies. Financial holding companies have expanded investment powers, including affiliating with securities and insurance firms and engaging in other activities that are "financial in nature or incidental to such financial activity," as defined in the act, or "complementary to a financial activity."

The Sarbanes-Oxley Act of 2002 ("SOX") became effective on July 30, 2002. The purpose of SOX is to strengthen accounting oversight and corporate accountability by enhancing disclosure requirements, increasing accounting and auditor regulation, creating new federal crimes, and increasing penalties for existing federal crimes. SOX directly impacts publicly traded companies, certified public accounting firms auditing public companies, attorneys who work for public companies or have public companies as clients, brokerage firms, investment bankers, and financial analysts who work for brokerage firms or investment bankers. Key provisions affecting LCNB include:

1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiaries is made known to the certifying officers by others within the company;
2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;
3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;
4.

Disgorgement requirements of incentive pay or stock-based compensation profits received within twelve months of the release of financial statements if the company is later required to restate those financial statements due to material noncompliance with any financial reporting requirement that resulted from misconduct;

5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;
6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and
7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

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In addition, the SEC adopted final rules on September 5, 2002, which rules were amended in December, 2005, requiring accelerated filing of quarterly and annual reports. Under the amended rules, "large accelerated filers" includes companies with a market capitalization of $700 million or more and "accelerated filers" includes companies with a market capitalization between $75 million and $700 million. Large accelerated filers are required to file their annual reports within 60 days of year-end and quarterly reports within 40 days. Accelerated filers are required to file their annual and quarterly reports within 75 days and 40 days, respectively. These new accelerated filing deadlines were effective for fiscal years ending on or after December 15, 2005. Under the amended rules, LCNB is considered an accelerated filer.

The Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the "Deposit Insurance Reform Acts") were both signed into law during February, 2006. The provisions of the Deposit Insurance Reform Acts included:

1. Merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund called the Deposit Insurance Fund, effective March 31, 2006;
2. Increasing insurance coverage for retirement accounts from $100,000 to $250,000, effective April 1, 2006; and
3. Eliminating a 1.25% hard target Designated Reserve Ratio, as defined, and giving the FDIC discretion to set the Designated Reserve Ratio within a range of 1.15% to 1.50% for any given year.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") became effective on July 21, 2010. The Dodd-Frank Act includes provisions that specifically affect financial institutions and other entities providing financial services and other corporate governance and compensation provisions that will affect most public companies.

The Dodd-Frank Act established a new independent regulatory body within the Federal Reserve System known as the Consumer Financial Protection Bureau (the "CFPB"). The CFPB has assumed responsibility for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks and non-banks. The CFPB has authority to supervise, examine, and take enforcement actions with respect to depository institutions with more than $10 billion in assets, non-bank mortgage industry participants, and other CFPB-designated non-bank providers of consumer financial services. The primary regulator for depository institutions with $10 billion or less in assets will continue to have primary examination and enforcement authority for these institutions. The regulations enforced, however, will be the regulations written by the CFPB.

The Dodd-Frank Act directs federal bank regulators to develop new capital requirements for holding companies and depository institutions that address activities that pose risk to the financial system, such as significant activities in higher risk areas, or concentrations in assets whose reported values are based on models.

The Dodd-Frank Act permanently raised the FDIC maximum deposit insurance amount to $250,000. In addition, the Dodd-Frank Act places a floor on the FDIC's reserve ratio at 1.35% of estimated insured deposits or the comparable percentage of the assessment base.

General corporate governance provisions included in the Dodd-Frank Act include expanding executive compensation disclosures to be included in the annual proxy statement, requiring non-binding shareholder advisory votes on executive compensation at annual meetings, enhancing independence requirements for compensation committee members and any advisers used by the compensation committee, and requiring the adoption of certain compensation policies including the recovery of executive compensation in the event of a financial statement restatement.

The Economic Growth, Regulatory Relief, and Consumer Protection Act ("Economic Growth Act") was signed into law on May 24, 2018. It scales back certain requirements of the Dodd-Frank Act and provides other regulatory relief. Certain provisions affecting LCNB include:

1. Reduced reporting requirements on call reports for the first and third quarters of a reporting year for banks with less than $5 billion in total consolidated assets;
2. Extended regulatory examination cycles from twelve to eighteen months for banks with less than $3 billion in total consolidated assets;
3. Requiring federal financial institution regulators to classify all qualifying investment-grade, liquid and readily-marketable municipal securities as level 2B liquid assets under the liquidity coverage ratio rule;
4. Exempting reciprocal deposits from treatment as brokered deposits under the FDIC's brokered deposits rule, up to the lesser of $5 billion or 20% of bank liabilities; and

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5. Simplifying regulatory capital requirements by providing that banks with less than $10 billion in total consolidated assets that meet a to-be-developed community bank leverage ratio of tangible equity to average assets will be deemed to be in compliance with capital and leverage requirements.

Noncompliance with laws and regulations by bank holding companies and banks can lead to monetary penalties and/or an increased level of supervision or a combination of these two items. Management is not aware of any current significant instances of noncompliance with laws and regulations and does not anticipate any problems maintaining compliance on a prospective basis. Recent regulatory inspections and examinations of LCNB and the Bank have not disclosed any significant instances of noncompliance.

The earnings and growth of LCNB are affected not only by general economic conditions, but also by the fiscal and monetary policies of the federal government and its agencies, particularly the Federal Reserve Board. Its policies influence the amount of bank loans and deposits and the interest rates charged and paid thereon and thus have an effect on earnings. The nature of future monetary policies and the effect of such policies on the future business and earnings of LCNB and the Bank cannot be predicted.

A substantial portion of LCNB's cash revenues is derived from dividends paid by the Bank. These dividends are subject to various legal and regulatory restrictions. Generally, dividends are limited to the aggregate of current year retained net income, as defined, plus the retained net income of the two prior years. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines.

Employees

As of December 31, 2018, LCNB employed 325 full-time equivalent employees. LCNB is not a party to any collective bargaining agreement. Management considers its relationship with its employees to be very good. Employee benefit programs are considered by management to be competitive with benefit programs provided by other financial institutions and major employers within LCNB’s market area.

Availability of Financial Information

LCNB files unaudited quarterly financial reports on Form 10-Q, annual financial reports on Form 10-K, current reports on Form 8-K, and amendments to these reports are filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with the SEC. Copies of these reports are available free of charge in the shareholder information section of the Bank's website, www.lcnb.com, as soon as reasonably practicable after they are electronically filed or furnished to the SEC, or by writing to:

Robert C. Haines II
Executive Vice President, CFO
LCNB Corp.
2 North Broadway
P.O. Box 59
Lebanon, Ohio 45036

The SEC also maintains an internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that file reports electronically, as LCNB does.

FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

LCNB and its subsidiaries do not have any offices located in foreign countries and have no foreign assets, liabilities or related income and expense for the years presented.

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STATISTICAL INFORMATION

The following tables and certain tables appearing in Item 7, Management's Discussion and Analysis present additional statistical information about LCNB Corp. and its operations and financial condition. They should be read in conjunction with the consolidated financial statements and related notes and the discussion included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 7A, Quantitative and Qualitative Disclosures about Market Risk.

Distribution of Assets, Liabilities and Shareholders' Equity; Interest Rates and Interest Differential

The table presenting an average balance sheet, interest income and expense, and the resultant average yield for average interest-earning assets and average interest-bearing liabilities is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The table analyzing changes in interest income and expense by volume and rate is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

Investment Portfolio

The following table presents the carrying values of securities for the years indicated:

	At December 31,		
	2018	2017	2016
	(In thousands)		
Securities available-for-sale:			
U.S. Treasury notes	$2,235	2,259	28,145
U.S. Agency notes	78,340	83,261	85,400
U.S. Agency mortgage-backed securities	55,610	67,153	71,047
Municipal securities	102,236	122,540	132,860
Total securities available-for-sale	238,421	275,213	317,452
Securities held-to-maturity:			
Municipal securities	29,721	32,571	41,003
Equity securities with a readily determinable fair value:			
Mutual funds	1,559	1,542	1,482
Trust preferred securities	—	50	48
Equity securities	519	568	568
Equity securities without a readily determinable fair value:			
Mutual funds	2,000	1,000	1,000
Equity securities	99	99	99
Federal Reserve Bank stock	4,653	2,732	2,732
Federal Home Loan Bank stock	4,845	3,638	3,638
Total securities	$281,817	317,413	368,022

Beginning January 1, 2018, equity securities, including mutual funds and trust preferred securities, are no longer eligible for classification as available-for-sale or held-to-maturity. Equity securities with a readily determinable fair value are carried at fair value, with changes in fair value recognized in other operating income in the consolidated statements of income. Equity securities without a readily determinable fair value are measured at cost minus impairment, if any, plus or minus any changes resulting from observable price changes in orderly transactions, as defined, for identical or similar investments of the same issuer.

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Contractual maturities of securities at December 31, 2018, were as follows. Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale			Held-to-Maturity		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in thousands)					
U.S. Treasury notes:						
Within one year	$—	—	— %	$—		— %
One to five years	986	970	2.08%	—	—	— %
Five to ten years	1,292	1,265	2.06%	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Treasury notes	2,278	2,235	2.07%	—	—	— %
U.S. Agency notes:						
Within one year	5,000	4,965	1.41%	—	—	— %
One to five years	62,000	60,385	1.96%	—	—	— %
Five to ten years	13,708	12,990	1.96%	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Agency notes	80,708	78,340	1.93%	—	—	— %
Municipal securities (1):						
Within one year	9,768	9,734	2.26%	3,20095		3.15%
One to five years	49,885	49,474	2.82%	3,14069		2.89%
Five to ten years	42,336	41,378	2.91%	7,98287		3.39%
After ten years	1,724	1,650	2.89%	15,39073		5.80%
Total Municipal securities	103,713	102,236	2.81%	29,21024		4.56%
U.S. Agency mortgage-backed securities	57,584	55,610	2.46%	—	—	— %
Totals	$244,283	238,421	2.43%	29,21024		4.56%

(1) Yields on tax-exempt obligations are computed on a taxable-equivalent basis based upon a 21.0% statutory Federal income tax rate.

Excluding holdings in U.S. Treasury securities and U.S. Government Agencies, there were no investments in securities of any issuer that exceeded 10% of LCNB's consolidated shareholders' equity at December 31, 2018.

Loan Portfolio

Administration of the lending function is the responsibility of the Chief Lending Officer and certain senior portfolio lenders. Lenders perform their duties subject to oversight and policy direction from the Board of Directors and the Loan Committee. The Loan Committee consists of LCNB’s Chief Executive Officer, President, Chief Financial Officer, Chief Trust Officer, Chief Lending Officer, Chief Credit Officer, Loan Operations Officer, credit analysts, and the officers in charge of the commercial, agricultural, and retail loan portfolios.

LCNB CORP. AND SUBSIDIARIES

Many commercial loan officers are authorized to accept loan applications and have various, designated lending limits for the approval of loans. A loan application for an amount outside a particular officer's lending limit needs to be approved by an officer with a lending limit sufficient for that loan. Loans secured by residential or commercial real estate require the approval of two individuals with appropriate lending authority: Chief Executive Officer, President, Chief Lending Officer, Chief Credit Officer, Senior Vice President ("SVP") of Commercial Lending, SVP of Mortgage Lending, SVP of Consumer Lending, Assistant Vice President of Secondary Market Lending, or other board-designated lending officers. Board approval is required on any loan with critical policy exceptions or that will exceed 50% of the Bank's legal lending limit, rounded down to the previous $100,000, in aggregate credit to any one borrower or entity, as defined by the OCC in 12 C.F.R § 32.2(b).

Interest rates charged by the Bank vary with degree of risk, type of loan, amount, complexity, repricing frequency and other relevant factors associated with the loan.

The following table summarizes the distribution of the loan portfolio for the years indicated:

	At December 31,														
	2018			2017			2016			2015			2014		
	Amount	%		Amount	%		Amount	%		Amount	%		Amount	%	
	(Dollars in thousands)														
Commercial and industrial	$77,740	6.5	%	$36,057	4.2	%	$41,878	5.1	%	$45,275	5.9	%	$35,424	5.1	%
Commercial, secured by real estate	740,647	61.8	%	527,947	62.2	%	477,275	58.2	%	419,633	54.5	%	379,141	54.3	%
Residential real estate	349,127	29.1	%	251,582	29.6	%	265,788	32.5	%	273,139	35.4	%	254,087	36.4	%
Consumer	17,283	1.5	%	17,450	2.1	%	19,173	2.3	%	18,510	2.4	%	18,006	2.5	%
Agricultural	13,297	1.1	%	15,194	1.8	%	14,802	1.8	%	13,479	1.7	%	11,472	1.6	%
Other loans, including deposit overdrafts	450	—	%	539	0.1	%	633	0.1	%	665	0.1	%	680	0.1	%
	1,198,544	100.0	%	848,769	100.0	%	819,549	100.0	%	770,701	100.0	%	698,810	100.0	%
Deferred origination costs (fees), net	79			291			254			237			146		
Total loans	1,198,623			849,060			819,803			770,938			698,956		
Less allowance for loan losses	4,046			3,403			3,575			3,129			3,121		
Loans, net	$1,194,577			$845,657			$816,228			$767,809			$695,835		

As of December 31, 2018 and 2017, there were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table, except for loans secured by multifamily properties. Loans secured by multifamily properties, which are included in the commercial, secured by real estate category in the above table, totaled $129,266,000, or 10.8% of total loans, at December 31, 2018 and $85,853,000, or 10.1% of total loans, at December 31, 2017. There were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table at December 31, 2016, 2015, or 2014.

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The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2018:

	(In thousands)
Maturing in one year or less	$ 49,309
Maturing after one year, but within five years	104,701
Maturing beyond five years	677,674
Total commercial and agricultural loans	$ 831,684
Loans maturing beyond one year:	
Fixed rate	$ 290,995
Variable rate	491,380
Total	$ 782,375

Risk Elements

The following table summarizes non-accrual, past-due, and accruing restructured loans for the dates indicated:

	At December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Non-accrual loans	$2,951	2,965	5,725	1,723	5,599
Past-due 90 days or more and still accruing	149	—	23	559	203
Accruing restructured loans	10,516	10,469	11,731	13,723	14,269
Total	$13,616	13,434	17,479	16,005	20,071
Percent to total loans	1.14 %	1.58 %	2.13 %	2.08 %	2.87 %

LCNB is not committed to lend additional funds to debtors whose loans have been modified to provide a reduction or deferral of principal or interest because of deterioration in the financial position of the borrower.

At December 31, 2018, there were no material additional loans not classified as acquired credit impaired or already disclosed as non-accrual, accruing restructured, or accruing past due 90 days or more where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present loan repayment terms.

Summary of Loan Loss Experience

The table summarizing the activity related to the allowance for loan losses is included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

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Allocation of the Allowance for Loan Losses

The following table presents the allocation of the allowance for loan loss:

	At December 31,														
	2018			2017			2016			2015			2014		
	Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans		Amount	Percent of Loans in Each Category to Total Loans	
	(Dollars in thousands)														
Commercial and industrial	$400	6.5	%	$378	4.2	%	$350	5.1	%	$244	5.9	%	$129	5.1	%
Commercial, secured by real estate	2,745	61.8	%	2,178	62.2	%	2,179	58.2	%	1,908	54.5	%	1,990	54.3	%
Residential real estate	767	29.1	%	717	29.6	%	885	32.5	%	854	35.4	%	926	36.4	%
Consumer	87	1.5	%	76	2.1	%	96	2.3	%	54	2.4	%	63	2.5	%
Agricultural	46	1.1	%	53	1.8	%	60	1.8	%	66	1.7	%	11	1.6	%
Other loans, including deposit overdrafts	1	—	%	1	0.1	%	5	0.1	%	3	0.1	%	2	0.1	%
Total	$4,046	100.0	%	$3,403	100.0	%	$3,575	100.0	%	$3,129	100.0	%	$3,121	100.0	%

Deposits

The statistical information regarding average amounts and average rates paid for the deposit categories is included in the "Distribution of Assets, Liabilities and Shareholders' Equity" table included in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following table presents the contractual maturity of time deposits of $100,000 or more at December 31, 2018:

	(In thousands)
Maturity within 3 months	$ 11,564
After 3 but within 6 months	22,534
After 6 but within 12 months	34,534
After 12 months	66,637
	$ 135,269

Return on Equity and Assets

The statistical information regarding the return on assets, return on equity, dividend payout ratio, and equity to assets ratio is presented in Item 6, Selected Financial Data.

Item 1A. Risk Factors

There are risks inherent in LCNB's operations, many beyond management's control, which may adversely affect its financial condition and results from operations and should be considered in evaluating the Company. Credit, market, operational, liquidity, interest rate and other risks are described elsewhere in this report. Other risk factors may include the items described below.

Failure to meet regulatory capital requirements could adversely affect LCNB's business
The Bank is subject to regulations requiring it to satisfy minimum capital requirements, see Note 15 - Regulatory Matters of the consolidated financial statements for more information. While management expects that LCNB's capital ratios under Basel III will continue to exceed well capitalized minimum capital requirements, there can be no assurance that such will be the case. If LCNB is unable to meet or exceed applicable minimum capital requirements, it may become subject to supervisory actions including, but not limited to, requirements to raise additional capital or dispose of assets, the loss of its financial holding company status, limitations on its ability to engage in new acquisitions or new activities, or other informal or formal regulatory enforcement actions.

LCNB's earnings are significantly affected by market interest rates.
Fluctuations in interest rates may negatively impact LCNB's profitability. A primary source of income from operations is net interest income, which is equal to the difference between interest income earned on loans and investment securities and the interest paid for deposits and other borrowings. These rates are highly sensitive to many factors beyond LCNB's control, including general economic conditions, the slope of the yield curve (that is, the relationship between short and long-term interest rates), and the monetary and fiscal policies of the United States Federal government. LCNB expects the current level of interest rates and the current slope of the yield curve will cause further downward pressure on its net interest margin.

Increases in general interest rates could have a negative impact on LCNB's results of operations by reducing the ability of borrowers to repay their current loan obligations. Some residential real estate mortgage loans, most home equity line of credit loans, and many of LCNB's commercial loans have adjustable rates. Borrower inability to make scheduled loan payments due to a higher loan cost could result in increased loan defaults, foreclosures, and write-offs and may necessitate additions to the allowance for loan losses. In addition, increases in the general level of interest rates may decrease the demand for new consumer and commercial loans, thus limiting LCNB's growth and profitability. A general increase in interest rates may also result in deposit disintermediation, which is the flow of deposits away from banks and other depository institutions into direct investments that have the potential for higher rates of return, such as stocks, bonds, and mutual funds. If this occurs, LCNB may have to rely more heavily on borrowings as a source of funds in the future, which could negatively impact its net interest margin.

Gains from sales of mortgage loans may experience significant volatility.
Gains from sales of mortgage loans are highly influenced by the level and direction of mortgage interest rates, real estate activity, and refinancing activity. A decrease in market interest rates may create a refinancing demand for residential fixed-rate mortgage loans, which may cause an increase in gains from sales of mortgage loans if LCNB sells these loans in the secondary market. An increase in market interest rates may decrease the demand for refinanced loans and decrease the gains from sales of mortgage loans recognized in LCNB's consolidated statements of income. Gains from sales of mortgage loans may also be impacted by changes in LCNB's strategy to manage its residential mortgage portfolio. For example, LCNB may occasionally change the proportion of loan originations that are sold in the secondary market and instead add a greater proportion to its loan portfolio.

Banking competition in Ohio is intense.
LCNB faces strong competition for deposits, loans, trust accounts, and other services from other banks, savings banks, credit unions, mortgage brokers, and other financial institutions. Many of LCNB’s competitors include major financial institutions that have been in business for many years and have established customer bases, numerous branches, and substantially higher regulatory lending limits. Competitors in LCNB's market areas include U.S. Bank, PNC Bank, Fifth Third Bank, Chase, KeyBank, Park National Bank, Huntington National Bank, and First Financial Bank. In addition, credit unions are growing larger due to more flexible membership requirement regulations and are offering more financial services than they legally could in the past.

LCNB also competes with numerous real estate brokerage firms, some owned by realty companies, for residential real estate mortgage loans. Incentives offered by captive finance companies owned by the major automobile companies have limited the banking industry's opportunities for growth in the new automobile loan market. The banking industry now competes with brokerage firms and mutual fund companies for funds that would have historically been held as bank deposits. Technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of these competitors have fewer regulatory constraints and may have lower cost structures.

If LCNB is unable to attract and retain loan, deposit, brokerage, and trust customers, its growth and profitability levels may be negatively impacted.

Economic conditions in LCNB's market areas could adversely affect its financial condition and results of operations.
LCNB conducts its operations from offices that are located in nine Southwestern Ohio counties and in Franklin County, Ohio, from which substantially all of its customer base is drawn. Because of this geographic concentration of operations and customer base, LCNB's financial performance is heavily influenced by economic conditions in these areas. Any material deterioration in economic conditions in these markets could have material direct or indirect adverse impacts on LCNB's customers and on LCNB. Such deterioration could increase the number of customers experiencing financial distress, negatively impacting their ability to obtain new loans or to repay existing loans. As a result, LCNB may experience increases in the levels of impaired loans, increased charge-offs, and increased provisions for loan losses. Deteriorating economic conditions may also affect the ability of depositors to maintain or add to deposit balances and may affect the demand for loans, trust, brokerage, and other products and services offered by LCNB. Such losses and decreased demand could have material adverse effects on LCNB's financial position, results of operations, and cash flows.

The allowance for loan losses may be inadequate.
The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, the fair value of any underlying collateral, borrowers' cash flows, and current economic conditions that may affect borrowers' ability to make payments. Increases in the allowance result in an expense for the period. By its nature, the evaluation is imprecise and requires significant judgment. Actual results may vary significantly from management's assumptions. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are necessary, LCNB will incur additional expenses.
LCNB's loan portfolio includes a substantial amount of commercial and industrial loans and commercial real estate loans, which may have more risks than residential or consumer loans.
LCNB's commercial and industrial and commercial real estate loans comprise a substantial portion of its total loan portfolio. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity, residential mortgage, or consumer loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans, the size of loan balances, the effects of general economic conditions on income-producing properties, and the increased difficulty of evaluating and monitoring these types of loans.

The repayment of loans secured by commercial real estate is often dependent upon the successful operation, development, or sale of the related real estate or commercial business and may, therefore, be subject to adverse conditions in the real estate market or economy. If the cash flow from operations is reduced, the borrower's ability to repay the loan may be impaired. In such cases, LCNB may take one or more actions to protect its financial interest in the loan. Such actions may include foreclosure on the real estate securing the loan, taking possession of other collateral that may have been pledged as security for the loan, or modifying the terms of the loan. If foreclosed on, commercial real estate is often unique and may not be as salable as a residential home.

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The fair value of LCNB's investments could decline.
Most of LCNB's investment securities portfolio is designated as available-for-sale. Accordingly, unrealized gains and losses, net of tax, in the estimated fair value of the available-for-sale portfolio is recorded as other comprehensive income, a separate component of shareholders' equity. The fair value of LCNB's investment portfolio may decline, causing a corresponding decline in shareholders' equity. Management believes that several factors will affect the fair values of the investment portfolio including, but not limited to, changes in interest rates or expectations of changes, the degree of volatility in the securities markets, inflation rates or expectations of inflation, and the slope of the interest rate yield curve. These and other factors may impact specific categories of the portfolio differently and the effect any of these factors may have on any specific category of the portfolio cannot be predicted.

Many state and local governmental authorities have experienced deterioration of financial condition in recent years due to declining tax revenues, increased demand for services, and various other factors. To the extent LCNB has any municipal securities in its portfolio from issuers who are experiencing deterioration of financial condition or who may experience future deterioration of financial condition, the value of such securities may decline and could result in other-than-temporary impairment charges, which could have an adverse effect on LCNB's financial condition and results of operations. Additionally, a general, industry-wide decline in the fair value of municipal securities could significantly affect LCNB's financial condition and results of operations.

Changes in income tax laws or interpretations or in accounting standards could materially affect LCNB's financial condition or results of operations.
Changes in income tax laws could be enacted, or interpretations of existing income tax laws could change, causing an adverse effect to LCNB's financial condition or results of operations. Similarly, new accounting standards may be issued by the Financial Accounting Standards Board (the "FASB") or existing standards revised, changing the methods for preparing financial statements. These changes are not within LCNB's control and may significantly impact its reported financial condition and results of operations.

LCNB is subject to environmental liability risk associated with lending activities.
A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank's exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on LCNB's financial condition and results of operations.

The banking industry is highly regulated.
LCNB is subject to regulation, supervision, and examination by the Federal Reserve Board and the Bank is subject to regulation, supervision, and examination by the OCC. LCNB and the Bank are also subject to regulation and examination by the FDIC as the deposit insurer. The CFPB is responsible for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks. Federal and state laws and regulations govern numerous matters including, but not limited to, changes in the ownership or control of banks,

maintenance of adequate capital, permissible business operations, maintenance of deposit insurance, protection of customer financial privacy, the level of reserves held against deposits, restrictions on dividend payments, the making of loans, and the acceptance of deposits. See the previous section titled “Supervision and Regulation” for more information on this subject.

Federal regulators may initiate various enforcement actions against a financial institution that violates laws or regulations or that operates in an unsafe or unsound manner. These enforcement actions may include, but are not limited to, the assessment of civil money penalties, the issuance of cease-and-desist or removal orders, and the imposition of written agreements.

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Proposals to change the laws governing financial institutions are periodically introduced in Congress and proposals to change regulations are periodically considered by the regulatory bodies. Such future legislation and/or changes in regulations could increase or decrease the cost of doing business, limit or expand permissible activities, or affect the competitive balance among banks, savings associations, credit unions, and other financial institutions. The likelihood of any major changes in the future and their effects are impossible to predict.

FDIC deposit insurance assessments may materially increase in the future.
Deposits of LCNB are insured up to statutory limits by the FDIC and, accordingly, LCNB and other banks and financial institutions pay quarterly premiums to the FDIC to maintain the Deposit Insurance Fund. The likelihood and extent of future rate increases are indeterminable.

Future growth and expansion opportunities may contain risks.
From time to time LCNB may seek to acquire other financial institutions or parts of those institutions or may open new branch offices. It may also consider and enter into new lines of business or offer new products or services. Such activities involve a number of risks, which may include potential inaccuracies in estimates and judgments used to evaluate the expansion opportunity, diversion of management and employee attention, lack of experience in a new market or product or service, and difficulties in integrating a future acquisition or introducing a new product or service. There is no assurance that such growth or expansion activities will be successful or that they will achieve desired profitability levels.

LCNB’s controls and procedures may fail or be circumvented.
Management regularly reviews and updates LCNB’s internal controls, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of LCNB’s controls and procedures or failure to comply with regulations related to its controls and procedures could have a material adverse effect on LCNB’s business, results of operations, and financial condition.

LCNB’s information systems may experience an interruption, cyberattack, or other breach in security.
LCNB relies heavily on communications and information systems to conduct its business. Although significant resources are devoted to maintaining and regularly updating LCNB's data systems, there can be no assurance that these security measures will provide absolute security. Any failure, interruption, cyberattack, or other breach in security of these systems could result in failures or disruptions in LCNB’s customer relationship management, general ledger, deposit, loan, and other systems. While LCNB has policies and procedures designed to prevent or limit the effect of the failure, interruption, cyberattack, or other security breach of its information systems, there can be no assurance that any such occurrences will not occur or, if they do occur, that they will be adequately addressed. The occurrence of any failures, interruptions, cyberattacks, or other security breaches of LCNB’s information systems could significantly disrupt LCNB's operations, allow misappropriation of LCNB's confidential information, allow misappropriation of customer confidential information, damage LCNB’s reputation, result in a loss of customer business, subject LCNB to additional regulatory scrutiny, or expose LCNB to significant civil litigation and possible financial liability, any of which could have a material adverse effect on its financial condition and results of operations.

LCNB continually encounters technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. LCNB's future success depends, in part, upon its ability to address customer needs by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in LCNB's operations. LCNB may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to its customers. Failure to successfully keep pace with technological change affecting the financial services industry could negatively affect LCNB's growth, revenue and profit.

Emergence of non-bank alternatives to the financial system.
Consumers may decide not to use banks to complete their financial transactions. Technology and other changes, including the emergence of "Fintech Companies," are allowing parties to complete financial transactions through alternative methods that historically have involved banks. For example, consumers can complete transactions, such as paying bills and/or transferring funds, directly without the assistance of banks. The process of eliminating banks as intermediaries, known as "disintermediation," could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost of deposits as a source of funds could have a material adverse effect on our financial condition and results of operations.

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Risk factors related to LCNB's trust business.
Competition for trust business is intense. Competitors include other commercial bank and trust companies, brokerage firms, investment advisory firms, mutual fund companies, accountants, and attorneys.

LCNB's trust business is directly affected by conditions in the debt and equity securities markets. The debt and equity securities markets are affected by, among other factors, domestic and foreign economic conditions and the monetary and fiscal policies of the United States Federal government, all of which are beyond LCNB's control. Changes in economic conditions may directly affect the economic performance of the trust accounts in which clients' assets are invested. A decline in the fair value of the trust accounts caused by a decline in general economic conditions directly affects LCNB's trust fee income because such fees are primarily based on the fair value of the trust accounts. In addition, a sustained decrease in the performance of the trust accounts or a lack of sustained growth may encourage clients to seek alternative investment options.

The management of trust accounts is subject to the risk of mistaken distributions, poor investment choices, and miscellaneous other incorrect decisions. Such mistakes may give rise to surcharge actions by beneficiaries, with damages substantially in excess of the fees earned from management of the accounts.

LCNB's ability to pay cash dividends is limited.
LCNB is dependent upon the earnings of the Bank for funds to pay dividends on its common shares. The payment of dividends by LCNB and the Bank is subject to certain regulatory restrictions. As a result, any payment of dividends in the future will be dependent, in large part, on the ability of LCNB and the Bank to satisfy these regulatory restrictions and on the Bank's earnings, capital levels, financial condition, and other factors. Although LCNB's financial earnings and financial condition have allowed it to declare and pay periodic cash dividends to shareholders, there can be no assurance that the current dividend policy or the amount of dividend distributions will continue in the future.

Item 1B. Unresolved Staff Comments

Not applicable.

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Item 2. Properties

The Bank conducts its business from the following offices:

	Name of Office	Address	County	
1.	Main Office	2 North Broadway Lebanon, Ohio 45036	Warren	Owned
2.	Auto Bank	Silver and Mechanic Streets Lebanon, Ohio 45036	Warren	Owned
3.	Barron Street Office	1697 North Barron Street Eaton, Ohio 45320	Preble	Leased
4.	Bridge Street Office	1240 North Bridge Street Chillicothe, Ohio 45601	Ross	Owned
5.	Brookville Office	225 West Upper Lewisburg Salem Road Brookville, Ohio 45309	Montgomery	Owned
6.	Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Montgomery	Owned
7.	Chillicothe Office	33 West Main Street Chillicothe, Ohio 45601	Ross	Leased
8.	Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Hamilton	Owned
9.	Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Warren	Owned
10.	Eaton Office	110 West Main Street Eaton, Ohio 45320	Preble	Owned
11.	Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Butler	Leased
12.	Frankfort Office	Springfield and Main Streets Frankfort, Ohio 45628	Ross	Owned
13.	Goshen Office	6726 Dick Flynn Blvd. Goshen, Ohio 45122	Clermont	Owned
14.	Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Butler	Owned

15. Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Warren	Owned
16. Lewisburg Office	522 South Commerce Street Lewisburg, Ohio 45338	Preble	Owned
17. Loveland Office	500 Loveland-Madeira Road Loveland, Ohio 45140	Hamilton	Owned

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	Name of Office	Address	County	
18.	Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Warren	Owned
19.	Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Warren	Owned
20.	Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Butler	Owned
21.	Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Butler	Owned
22.	New Paris Office	201 South Washington Street New Paris, Ohio 45347	Preble	Owned
23.	Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	Montgomery	(2)
24.	Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Warren	Leased
25.	Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	Butler	(2)
26.	Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Warren	Owned
27.	South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Warren	Owned
28.	Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Warren	Owned
29.	Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Warren	Leased
30.	Washington Court House Office	100 Crossings Drive Washington Court House, Ohio 43160	Fayette	Owned
31.	Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Warren	Owned

32. West Alexandria Office	55 East Dayton Street West Alexandria, Ohio 45381	Preble	Owned
33. Western Avenue Office	1006 Western Avenue Chillicothe, Ohio 45601	Ross	Owned
34. Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	Clinton	Owned
35. Worthington Office	6877 North High Street Worthington, Ohio 43085	Franklin	Leased

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	Name of Office	Address	County	
36.	Loan Production Office	1500 West Third Ave., Suite 205 & 209 Grandview Heights, Ohio 43212	Franklin	Leased
37.	Operations Center	105 North Broadway Lebanon, Ohio 45036	Warren	(3)

(1) Excess space in this office is leased to third parties.
(2) The Bank owns the Oakwood and Oxford office buildings and leases the land.
(3) The Bank leases the Operations Center from the Warren County Port Authority. Upon expiration of the lease in 2027, the Bank has the option to purchase the property for $1.00.

Item 3. Legal Proceedings

Except for routine litigation incidental to its businesses, LCNB is not a party to any material pending legal proceedings and none of its property is the subject of any material proceedings.

Item 4. Mine Safety Disclosures

Not Applicable.

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LCNB CORP. AND SUBSIDIARIES

PART II

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

LCNB had approximately 1,044 registered holders of its common stock as of December 31, 2018. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. LCNB's stock trades on the NASDAQ Capital Market exchange under the symbol "LCNB."

LCNB depends on dividends from the Bank for the majority of its liquid assets, including the cash needed to pay dividends to its shareholders. National banking law limits the amount of dividends the Bank may pay to the sum of retained net income, as defined, for the current year plus retained net income for the previous two calendar years. Prior approval from the OCC, the Bank's primary regulator, would be necessary for the Bank to pay dividends in excess of this amount. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines. Management believes the Bank will be able to pay anticipated ordinary dividends to LCNB without needing to request approval.

During the period of this report, LCNB did not sell any of its securities that were not registered under the Securities Act.

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the "Market Repurchase Program" and the "Private Sale Repurchase Program." Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares. Through December 31, 2018, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2018.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's common stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. There is no limit to the number of shares that may be purchased under this program. A total of 487,418 shares have been purchased under this program since its inception through December 31, 2018. The following table sets forth information relating to private sale repurchases during the three months ended December 31, 2018, which were the only shares repurchased during 2018:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs

			Programs	
October 2018	—	—	—	Not applicable
November 2018	21,400	16.2766	21,400	Not applicable
December 2018	—	—	—	Not applicable

LCNB established an Ownership Incentive Plan (the "2002 Plan") during 2002 that allowed for the issuance of up to 200,000 shares of stock-based awards to eligible employees, as determined by the Board of Directors. The awards could be in the form of stock options, share awards, and/or appreciation rights. The 2002 Plan expired on April 16, 2012. Outstanding, unexercised options continue to be exercisable in accordance with their terms.

The 2015 Ownership Incentive Plan (the "2015 Plan") was approved by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted shares, and/or restricted share units. This plan provides for the issuance of up to 450,000 shares and will terminate on April 28, 2025, unless earlier terminated by the Compensation Committee.

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The following table shows information relating to stock options outstanding under the 2002 Plan and 2015 Plan at December 31, 2018:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders:			
2002 Plan	13,278	$ 11.98	—
2015 Plan	—	—	419,301
Equity compensation plans not approved by security holders	—	—	—
Total	13,278	$ 11.98	419,301

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The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank indexes. This graph covers the period from December 31, 2013 through December 31, 2018. The cumulative total shareholder returns included in the graph reflect the returns for the shares of common stock of LCNB. The information provided in the graph assumes that $100 was invested on December 31, 2013 in LCNB common stock, the NASDAQ Composite, and the SNL Midwest Bank Index and that all dividends were reinvested.

	Period Ending					
Index	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
LCNB Corp.	$ 100.00	87.85	99.27	146.24	132.74	101.93
NASDAQ Composite Index	$ 100.00	114.75	122.74	133.62	173.22	168.30
SNL Midwest Bank index	$ 100.00	108.71	110.36	147.46	158.46	135.31

Source: S&P Global Market Intelligence
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Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2014 through 2018 and are derived from LCNB's consolidated financial statements. Certain prior year data presented in this table have been reclassified to conform with the current year presentation. This data should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 8 of this Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk included in Items 7 and 7A, respectively, of this Form 10-K, and are qualified in their entirety thereby and by other detailed information elsewhere in this Form 10-K.

	For the Years Ended December 31,									
	2018		2017		2016		2015		2014	
	(Dollars in thousands, except per share data)									
Income Statement:										
Interest income	$54,594		44,463		43,750		42,659		39,477	
Interest expense	6,425		3,599		3,504		3,328		3,590	
Net interest income	48,169		40,864		40,246		39,331		35,887	
Provision for loan losses	923		215		913		1,366		930	
Net interest income after provision for loan losses	47,246		40,649		39,333		37,965		34,957	
Non-interest income	11,050		10,458		10,853		10,123		9,142	
Non-interest expenses	40,502		33,863		33,261		32,392		30,844	
Income before income taxes	17,794		17,244		16,925		15,696		13,255	
Provision for income taxes	2,949		4,272		4,443		4,222		3,386	
Net income	$14,845		12,972		12,482		11,474		9,869	
Dividends per common share	$0.65		0.64		0.64		0.64		0.64	
Earnings per common share:										
Basic	1.24		1.30		1.26		1.18		1.06	
Diluted	1.24		1.29		1.25		1.17		1.05	
Balance Sheet:										
Securities	$282,813		317,413		368,032		406,981		314,074	
Loans, net	1,194,577		845,657		816,228		767,809		695,835	
Total assets	1,636,927		1,295,638		1,306,799		1,280,531		1,108,066	
Total deposits	1,300,919		1,085,821		1,110,905		1,087,160		946,205	
Short-term borrowings	56,230		47,000		42,040		37,387		16,645	
Long-term debt	47,032		303		598		5,947		11,357	
Total shareholders' equity	218,985		150,271		142,944		140,108		125,695	
Selected Financial Ratios and Other Data:										
Return on average assets	1.00	%	0.99	%	0.96	%	0.94	%	0.88	%
Return on average equity	7.90	%	8.74	%	8.60	%	8.43	%	8.04	%
Equity-to-assets ratio	13.38	%	11.60	%	10.94	%	10.94	%	11.34	%
Dividend payout ratio	52.42	%	49.23	%	50.79	%	54.24	%	60.38	%
Net interest margin, fully taxable equivalent	3.63	%	3.58	%	3.51	%	3.64	%	3.66	%

BNB merged with and into LCNB as of the close of business on April 30, 2015. As of the date of the merger, LCNB recorded additional loans of $34.7 million and additional deposits of $99.1 million.

CFB merged with and into LCNB as of the close of business on May 31, 2018. As of the date of the merger, LCNB recorded additional loans of $284.0 million, additional deposits of $244.4 million, and additional long-term debt of $22.9 million.

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

Introduction

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of LCNB. It is intended to amplify certain financial information regarding LCNB and should be read in conjunction with the consolidated financial statements and related notes contained in the 2018 Annual Report to Shareholders.

Overview

Net income for 2018 was $14,845,000 (basic and diluted earnings per share of $1.24), compared to $12,972,000 (basic and diluted earnings per share of $1.30 and $1.29, respectively) in 2017 and $12,482,000 (basic and diluted earnings per share of $1.26 and $1.25, respectively) in 2016.

The following items significantly affected earnings for the years indicated:

- CFB merged with and into LCNB Corp. on May 31, 2018.
- Expenses related to the merger with CFB totaled $2,123,000 during 2018.
- Net gain on sales of securities was significantly greater in 2016 as compared to 2018 and 2017 primarily due to market rates at the time of the sales.
- Other real estate owned expense was greater in 2016 as compared to 2018 and 2017 because of valuation impairment recognized during 2016.
- Other non-interest expense for 2018 included $575,000 in net losses from sales of fixed assets, primarily due to losses incurred in the sale of two office buildings. Other non-interest expense for 2017 included $154,000 in organizational costs for LCNB Risk Management, Inc. and $113,000 in losses from sales of fixed assets, primarily due to the sale of a closed office building.
- The Tax Cuts and Jobs Act, which was signed into law on December 22, 2017, lowered LCNB's federal corporate income tax rate from 34% to 21%, beginning in 2018. In addition, LCNB revalued its net deferred tax liability position at the end of 2017 to reflect the reduction in its federal corporate income tax rate and this revaluation resulted in a one-time income tax benefit of approximately $224,000, or $0.02 of basic and diluted earnings per common share for the year ended December 31, 2017.

Net Interest Income

LCNB's primary source of earnings is net interest income, which is the difference between earnings from loans and other investments and interest paid on deposits and other liabilities. The following table presents, for the years indicated, average balances for interest-earning assets and interest-bearing liabilities, the income or expense related to each item, and the resulting average yields earned or rates paid.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

	Years ended December 31,								
	2018			2017			2016		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Loans (1)	$1,038,159	47,489	4.57%	$822,452	36,571	4.45%	$792,526	35,600	4.49%
Interest-bearing demand deposits	5,164	136	2.63%	7,972	88	1.10%	12,394	59	0.48%
Interest-bearing time deposits	4,008	58	1.45%	—	—	— %	—	—	— %
Federal Reserve Bank stock	3,268	196	6.00%	2,732	164	6.00%	2,732	164	6.00%
Federal Home Loan Bank stock	4,346	259	5.96%	3,638	182	5.00%	3,638	146	4.01%
Investment securities:									
Equity securities	3,782	104	2.75%	3,249	89	2.74%	3,230	115	3.56%
Debt securities, taxable	165,300	3,666	2.22%	205,669	4,239	2.06%	240,329	4,467	1.86%
Debt securities, non-taxable (2)	123,135	3,400	2.76%	143,394	4,815	3.36%	140,692	4,862	3.46%
Total earning assets	1,347,162	55,308	4.11%	1,189,106	46,148	3.88%	1,195,541	45,413	3.80%
Non-earning assets	145,601			123,800			112,909		
Allowance for loan losses	(3,822)			(3,405)			(3,318)		
Total assets	$1,488,941			$1,309,501			$1,305,132		
Savings deposits	$689,322	1,332	0.19%	$645,471	594	0.09%	$654,891	652	0.10%
IRA and time certificates	253,524	4,421	1.74%	205,540	2,784	1.35%	217,228	2,788	1.28%
Short-term borrowings	13,967	311	2.23%	23,976	209	0.87%	17,952	38	0.21%
Long-term debt	16,789	361	2.15%	421	12	2.85%	826	26	3.15%
Total interest-bearing liabilities	973,602	6,425	0.66%	875,408	3,599	0.41%	890,897	3,504	0.39%
Demand deposits	315,229			274,855			259,060		
Other liabilities	12,195			10,795			10,014		
Capital	187,915			148,443			145,161		
Total liabilities and capital	$1,488,941			$1,309,501			$1,305,132		
Net interest rate spread (3)			3.45%			3.47%			3.41%
Net interest income and net interest margin on a tax equivalent basis (4)		48,883	3.63%		42,549	3.58%		41,909	3.51%
Ratio of interest-earning assets to interest-bearing liabilities	138.37%			135.83%			134.20%		

(1) Includes non-accrual loans if any.

(2) Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 21% for 2018 and 34% for 2017 and 2016.

(3) The net interest spread is the difference between the average rate on total interest-earning assets and interest-bearing liabilities.

(4) The net interest margin is the taxable-equivalent net interest income divided by average interest-earning assets.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table presents the changes in interest income and expense for each major category of interest-earning assets and interest-bearing liabilities and the amount of change attributable to volume and rate changes for the years indicated. Changes not solely attributable to rate or volume have been allocated to volume and rate changes in proportion to the relationship of absolute dollar amounts of the changes in each.

	For the years ended December 31,					
	2018 vs. 2017			2017 vs. 2016		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	$9,840	1,078	10,918	1,334	(363)	971
Interest-bearing demand deposits	(40)	88	48	(27)	56	29
Interest-bearing time deposits	58	—	58	—	—	—
Federal Reserve Bank stock	32	—	32	—	—	—
Federal Home Loan Bank stock	39	38	77	—	36	36
Investment securities:						
Equity securities	15	—	15	1	(27)	(26)
Debt securities, taxable	(878)	305	(573)	(684)	456	(228)
Debt securities, non-taxable (2)	(627)	(788)	(1,415)	92	(139)	(47)
Total interest income	8,439	721	9,160	716	19	735
Interest expense attributable to:						
Savings deposits	43	695	738	(9)	(49)	(58)
IRA and time certificates	734	903	1,637	(154)	150	(4)
Short-term borrowings	(116)	218	102	17	154	171
Long-term debt	353	(4)	349	(12)	(2)	(14)
Total interest expense	1,014	1,812	2,826	(158)	253	95
Net interest income	$7,425	(1,091)	6,334	874	(234)	640

(1) Non-accrual loans, if any, are included in average loan balances.

(2) Change in interest income from non-taxable investment securities is computed based on interest income determined on a taxable-equivalent yield basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 21% for 2018 and 34% for 2017 and 2016.

2018 vs. 2017. Net interest income on a fully tax-equivalent basis for 2018 totaled $48,883,000, an increase of $6,334,000 from 2017. The increase resulted from an increase in total taxable-equivalent interest income of $9,160,000, partially offset by an increase in total interest expense of $2,826,000.

The increase in total interest income was due primarily to a $10,918,000 increase in loan interest income caused by a $215.7 million increase in average loans and secondarily to a 12 basis point (a basis point equals 0.01%) increase in the average rate earned on loans. Loans obtained through the merger with CFB were a significant component of the increase in average loans. Partially offsetting the increase in loan interest income was a $573,000 decrease in interest income from taxable debt securities and a $1,415,000 decrease in taxable-equivalent interest income from non-taxable debt securities. Interest income from taxable investment securities decreased due to a $40.4 million decrease in average taxable investment securities, partially offset by a 16 basis point increase in the average rate earned on these securities. Interest income from non-taxable investment securities decreased due to a $20.3 million decrease in average non-taxable debt securities and to a 60 basis point decrease in the average rate earned on these securities. One of the reasons for the 60 basis point decrease in the average rate earned on non-taxable debt securities was the decrease in the federal corporate tax rate to 21%, which decreased the effective yield earned on these securities. Decreases in debt securities were invested in the loan portfolio and used to pay down short-term borrowings.

The increase in total interest expense was primarily due to a $738,000 increase in interest paid on savings deposits and to a $1,637,000 increase in interest paid on IRA and time certificates. Interest paid on savings deposits increased due to a 10 basis point increase in the average rate paid and to a $43.8 million increase in average balances outstanding. Interest paid on IRA and time certificates increased due to a 39 basis point increase in the average rate paid and to a $48.0 million increase in average balances outstanding. Increases in average rates paid was primarily due to increases in market rates. Deposits obtained through the merger with CFB were a significant component of the increases in savings deposits and IRA and time certificates.

2017 vs. 2016. Net interest income on a fully tax-equivalent basis for 2017 totaled $42,549,000, an increase of $640,000 from 2016. The increase resulted from an increase in total taxable-equivalent interest income of $735,000, slightly offset by an increase in total interest expense of $95,000.

The increase in total interest income was due primarily to a $971,000 increase in loan interest income caused by a $29.9 million increase in average loans, partially offset by a 4 basis point decrease in the average rate earned on loans. Partially offsetting the increase in loan interest income was a $228,000 decrease in interest income from taxable investment securities and a $47,000 decrease in taxable-equivalent interest income from non-taxable investment securities. Interest income from taxable investment securities decreased due to a $34.6 million decrease in average taxable investment securities, partially offset by a 20 basis point increase in the average rate earned on these securities. Interest income from non-taxable investment securities decreased due to a 10 basis point decrease in the average rate earned on these securities, partially offset by a $2.7 million increase in non-taxable investment securities.

The increase in total interest expense was primarily due to a $171,000 increase in interest paid on short-term borrowings, partially offset by decreases in interest paid on savings deposits, IRA and time certificates, and long-term debt. Short-term borrowings increased due to a 66 basis point increase in the average rate paid and, secondarily, due to a $6.0 million increase in the average balance of borrowings outstanding. Interest paid on savings deposits decreased due to a 1 basis point decrease in the average rate paid and due to a $9.4 million decrease in average deposits outstanding. IRA and time certificates decreased due to an $11.7 million decrease in average certificates outstanding, largely offset by a 7 basis point increase in the average rate paid. Long-term debt decreased primarily due to a $405,000 decrease in average debt outstanding and to a 30 basis point decrease in the average rate paid.

Provisions and Allowance for Loan Losses

The following table presents the total loan loss provision and the other changes in the allowance for loan losses for the years 2014 through 2018:

	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Balance – Beginning of year	$3,403	3,575	3,129	3,121	3,588
Loans charged off:					
Commercial and industrial	—	—	234	100	261
Commercial, secured by real estate	145	462	185	1,133	573
Residential real estate	234	225	127	304	652
Consumer	135	90	85	52	129
Agricultural	—	—	—	67	—
Other loans, including deposit overdrafts	179	138	119	74	79
Total loans charged off	693	915	750	1,730	1,694
Recoveries:					
Commercial and industrial	1	99	26	7	42
Commercial, secured by real estate	239	113	98	96	63
Residential real estate	71	140	52	107	40
Consumer	13	114	53	60	108
Agricultural	—	—	—	67	—
Other loans, including deposit overdrafts	89	62	54	35	44
Total recoveries	413	528	283	372	297
Net charge offs	280	387	467	1,358	1,397
Provision charged to operations	923	215	913	1,366	930
Balance - End of year	$4,046	3,403	3,575	3,129	3,121
Ratio of net charge-offs during the period to average loans outstanding	0.03 %	0.05 %	0.06 %	0.18 %	0.21 %
Ratio of allowance for loan losses to total loans at year-end	0.34 %	0.40 %	0.44 %	0.41 %	0.45 %

Charge-offs for the commercial, secured by real estate category had an elevated balance during 2015 due to the sale of impaired loans.

Charge-offs and recoveries classified as “Other” include charge-offs and recoveries on checking and NOW account overdrafts. LCNB charges off such overdrafts when considered uncollectible, but no later than 60 days from the date first overdrawn.

LCNB continuously reviews the loan portfolio for credit risk through the use of its lending and loan review functions. Independent loan reviews analyze specific loans, providing validation that credit risks are appropriately identified and reported to the Loan Committee and Board of Directors. In addition, the Board of Directors’ Audit Committee receives loan review reports throughout each year. New credits meeting specific criteria are analyzed prior to origination and are reviewed by the Loan Committee and Board of Directors.

Inputs from all of the Bank's credit risk identification processes are used by management to analyze and validate the adequacy and methodology of the allowance quarterly. The analysis includes two basic components: specific allocations for individual loans and general loss allocations for pools of loans based on average historic loss ratios for the sixty preceding months adjusted for identified economic and other risk factors. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses.

Non-Interest Income

A comparison of non-interest income for 2018, 2017, and 2016 is as follows:

	2018	2017	2016	Increase (Decrease) 2018 vs. 2017	2017 vs. 2016
	(In thousands)				
Fiduciary income	$3,958	3,473	3,286	485	187
Service charges and fees on deposit accounts	5,590	5,236	5,008	354	228
Net gains (losses) on sales of securities	(8)	233	1,082	(241)	(849)
Bank owned life insurance income	738	867	746	(129)	121
Net gains from sales of loans	223	166	244	57	(78)
Other operating income	549	483	487	66	(4)
Total non-interest income	11,050	10,458	10,853	592	(395)

Reasons for material increases and decreases include:

- Fiduciary income increased during 2018 due to an increase in assets managed. Fiduciary income increased during 2017 due to an increase in assets managed and to fee adjustments.
- Service charges and fees on deposit accounts increased during 2018 primarily due to fees earned from an Insured Cash Sweep (ICS®) product that was introduced during the second quarter 2017 and from an increase in debit card income. Debit card income benefited from more cards outstanding due to the merger with CFB and greater depositor utilization of the cards. Service charges and fees on deposit accounts increased during 2017 due to fee adjustments on certain services and greater customer utilization of various services.
- Net gains (losses) on sales of securities were less during 2017 and 2018 as compared to 2016 primarily due to a lower volume of sales.
- Bank owned life insurance income was greater in 2017 primarily due to mortality benefits. No mortality benefits were received in 2018 or 2016.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Non-Interest Expense

A comparison of non-interest expense for 2018, 2017, and 2016 is as follows:

	2018	2017	2016	Increase (Decrease) 2018 vs. 2017	Increase (Decrease) 2017 vs. 2016
	(In thousands)				
Salaries and employee benefits	$21,279	18,585	18,215	2,694	370
Equipment expenses	1,138	1,172	1,048	(34)	124
Occupancy expense, net	2,861	2,613	2,271	248	342
State financial institutions tax	1,197	1,137	1,114	60	23
Marketing	1,119	873	696	246	177
Amortization of intangibles	922	751	753	171	(2)
FDIC premiums	419	423	547	(4)	(124)
ATM expense	580	572	721	8	(149)
Computer maintenance and supplies	990	882	790	108	92
Telephone expense	649	735	746	(86)	(11)
Contracted services	1,547	1,255	1,033	292	222
Other real estate owned	20	10	624	10	(614)
Merger-related expenses	2,123	118	—	2,005	118
Other non-interest expense	5,658	4,737	4,703	921	34
Total non-interest expense	40,502	33,863	33,261	6,639	602

Reasons for material increases and decreases include:

- Salaries and employee benefits were 14.5% greater in 2018 than in 2017 and 2017 was 2.0% greater than in 2016. The increases for both years were primarily due to salary and wage increases, newly hired employees, and increased health insurance costs, partially offset by net decreases in pension expenses. CFB employees retained and increased incentive payments were also factors during 2018. The number of full-time equivalent employees was 325 at December 31, 2018, 310 at December 31, 2017, and 282 at December 31, 2016.
- Equipment expenses were greater during 2018 and 2017 as compared to 2016 primarily due to depreciation expense on furniture and equipment purchased for the new Operations Center, which went into service during March 2017.
- Occupancy expense for 2018 increased primarily due to increased branch rental expense and increased depreciation of bank premises. The increase in branch rental expense primarily reflects rent paid for the new Worthington Office, previously the CFB office. Occupancy expense for 2017 increased primarily due to increased depreciation on bank premises and, secondarily, to increased maintenance-related expenses, both primarily due to the new Operations Center.
- Marketing expense increased in 2018 primarily due to promotion costs for new checking products introduced in 2018, increased marketing activities in the Columbus area, and expanded used of television, radio, and digital methods of advertising. Marketing expense increased in 2017 primarily due to expanded use of television and digital methods of advertising.
- FDIC premiums were lower in 2018 and 2017 as compared to 2016 primarily due to a change in the calculation method used to determine periodic premiums.
-

- ATM expense for 2017 decreased primarily due to a change in the ATM network that processes PIN-based transactions.
- Computer maintenance and supplies increased in 2017 and 2018 due to increased technology and software related expenditures designed to offer technological convenience to customers, to protect the integrity of its data systems and software, and to protect the confidentiality of customer information.
- Contracted services increased in 2018 due to additional fees paid for loan and deposit system upgrades and improvements and to general price increases on other contracted services. Contracted services for 2017 increased largely due to fees paid to professional placement services firms, enhanced utilization of loan review specialists, fees related to an after-hours call answering service, and costs related to moving departments from the Main Office to the Operations Center.

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- Other real estate owned expense was greater in 2016 primarily due to impairment charges recognized on a commercial property.
- Merger-related expenses for 2018 and 2017 are due to the acquisition of CFB and are primarily comprised of various professional fees, costs to prepare and distribute the proxy statement/prospectus, and costs to merge CFB's data system into LCNB's system.
- Other non-interest expense for 2018 included $575,000 in net losses from sales of fixed assets, primarily due to the sale of two office buildings. Other non-interest expense for 2017 included $154,000 in organizational costs for LCNB Risk Management, Inc. and $113,000 in losses from sales of fixed assets, primarily due to the sale of a closed office building. Other non-interest expense for 2016 included a $251,000 penalty incurred during the first quarter 2016 to pre-pay a Federal Home Loan Bank borrowing. The borrowing bore an interest rate of 5.25% and was paid off to reduce future interest expense.

Income Taxes

LCNB's effective tax rates for the years ended December 31, 2018, 2017, and 2016 were 16.6%, 24.8%, and 26.3%, respectively. The difference between the statutory rates of 21% for 2018 and 34% for 2017 and 2016 and the effective tax rates is primarily due to tax-exempt interest income from municipal securities, tax-exempt earnings from bank owned life insurance, tax-exempt earnings from LCNB Risk Management, Inc., and tax credits and losses related to investments in affordable housing tax credit limited partnerships.

As a result of the Tax Cuts and Jobs Act that was signed into law on December 22, 2017, LCNB revalued its net deferred tax liability position to reflect the reduction in its federal corporate income tax rate from 34% to 21%. This revaluation resulted in a one-time income tax benefit of approximately $224,000, or $0.02 of basic and diluted earnings per common share for the year ended December 31, 2017.

Assets

Total assets at December 31, 2018 were $341.3 million greater than at December 31, 2017 primarily due to the merger with CFB. The carrying values of loans, deposits, and long-term debt were significantly influenced by this merger. See Note 2 - Acquisitions (Unaudited) to the consolidated financial statements for a description of the merger and a summary of the estimated fair values of CFB's assets and liabilities added to LCNB's balance sheet.

Interest-bearing time deposits of $996,000 at December 31, 2018 were obtained through the merger with CFB. The original amount at May 31, 2018 was $10.4 million and LCNB has not been renewing the time deposits as they mature. This line item represents certificates of deposit with individual balances of less than $250,000 invested in various financial institutions.

Equity securities without a readily determinable fair value increased $1.0 million, from $1.1 million at December 31, 2017 to $2.1 million at December 31, 2018. The increase represents an additional investment in a mutual fund.

Available-for-sale and held-to-maturity debt securities at December 31, 2018 were respectively $36.8 million less and $2.9 million less than at December 31, 2017. Management used the decrease in investment funds to fund loan growth and to maintain liquidity.

Federal Reserve Bank stock at December 31, 2018 was $1.9 million greater than at December 31, 2017 due to additional stock purchased.

Federal Home Loan Bank stock at December 31, 2018 was $1.2 million greater than at December 31, 2017. The additional stock was obtained through the merger with CFB.

Net loans at December 31, 2018 were $348.9 million greater than at December 31, 2017. The merger with CFB added approximately $282.1 million to LCNB's loan portfolio at the merger date. The balance of the increase is due to organic growth.

Net premises and equipment at December 31, 2018 was $2.3 million less than at December 31, 2017 primarily due to the sale of two office buildings.

Goodwill at December 31, 2018 was $29.0 million greater than at December 31, 2017 due to goodwill recorded from the merger with CFB.

Core deposit and other intangibles at December 31, 2018 was $1.3 million greater than at December 31, 2017 primarily due to a $2.1 million core deposit intangible recorded from the merger with CFB, partially offset by amortization of intangibles.

Liabilities and Shareholders' Equity

Total deposits at December 31, 2018 were $215.1 million greater than at December 31, 2017. The merger with CFB added approximately $244.4 million of deposits to LCNB's balance sheet as of the merger date. Of the remaining net decrease, approximately $10.2 million was due to public fund deposits by local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. Historically, public fund deposits tend to be at their lowest balances at year-ends.

Short-term borrowings at December 31, 2018 were $9.2 million greater than at December 31, 2017. The additional borrowings were used for liquidity purposes.

Long-term debt at December 31, 2018 was $46.7 million greater than at December 31, 2017. LCNB borrowed $31.0 million from the FHLB during 2018 and assumed $22.9 million of long-term debt from CFB. These additions were partially offset by
payoffs of matured debt. The borrowings were used to fund loan growth and for general liquidity purposes.

Total shareholders' equity at December 31, 2018 was $68.7 million greater than at December 31, 2017 primarily due to
common stock issued to CFB shareholders, which had a closing date fair value of $63.6 million.

Liquidity

LCNB Corp. depends on dividends from the Bank for the majority of its liquid assets, including the cash needed to pay dividends to its shareholders. National banking law limits the amount of dividends the Bank may pay to the sum of retained net income for the current year plus retained net income for the previous two years. Prior approval from the Office of the Comptroller of the Currency, the Bank's primary regulator, is necessary for the Bank to pay dividends in excess of this amount. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines. Management believes the Bank will be able to pay anticipated dividends to LCNB without needing to request approval. The Bank is not aware of any reasons why it would not receive such approval, if required.

Effective liquidity management ensures that cash is available to meet the cash flow needs of borrowers and depositors, as well as meeting LCNB's operating cash needs. Primary funding sources include customer deposits with the Bank, short-term and long-term borrowings from the Federal Home Loan Bank, short-term line of credit arrangements totaling $40.0 million with two correspondent banks, and interest and repayments received from LCNB's loan and investment portfolios.

Total remaining borrowing capacity with the Federal Home Loan Bank at December 31, 2018 was approximately $45.7 million. One of the factors limiting remaining borrowing capacity is ownership of FHLB stock. LCNB could increase its borrowing capacity by purchasing additional FHLB stock. In addition, additional borrowings of approximately $35.8 million were available through the line of credit arrangements at quarter-end.

Management closely monitors the level of liquid assets available to meet ongoing funding needs. It is management's intent to maintain adequate liquidity so that sufficient funds are readily available at a reasonable cost. LCNB experienced no liquidity or operational problems as a result of current liquidity levels.

Commitments to extend credit at December 31, 2018 totaled $245.8 million, including standby letters of credit totaling $1,080,000, and are more fully described in Note 14 - Commitments and Contingent Liabilities to LCNB's consolidated financial statements. Since many commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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LCNB CORP. AND SUBSIDIARIES

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

The following table provides information concerning LCNB's contractual obligations at December 31, 2018:

	Payments due by period				
	Total	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
	(In thousands)				
Short-term borrowings	$56,230	56,230	—	—	—
Long-term debt obligations	47,032	6,052	30,980	10,000	—
Operating lease obligations	4,868	449	761	400	3,258
Estimated pension plan contribution for 2019	160	160	—	—	—
Funding commitments for affordable housing tax credit limited partnerships	3,372	1,024	1,462	316	570
Estimated capital expenditure obligations	185	185	—	—	—
Certificates of deposit:					
$100,000 and over	135,269	68,632	48,461	17,780	396
Other time certificates	161,601	67,458	68,132	24,205	1,806
Total	$408,717	200,190	149,796	52,701	6,030

The following table provides information concerning LCNB's commitments at December 31, 2018:

		Amount of Commitment Expiration Per Period			
	Total Amounts Committed	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
	(In thousands)				
Commitments to extend credit	$28,015	28,015	—	—	—
Unused lines of credit	216,727	73,815	68,937	22,052	51,923
Standby letters of credit	1,080	1,080	—	—	—
Total	$245,822	102,910	68,937	22,052	51,923

Capital Resources

LCNB and the Bank are required by banking regulators to meet certain minimum levels of capital adequacy. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on LCNB's and the Bank's financial statements. These minimum levels are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). Common Equity Tier 1 Capital is the sum of common stock, related surplus, and retained earnings, net of treasury stock, accumulated other comprehensive income, and other adjustments. The first three ratios, which are based on the degree of credit risk in the Bank's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. Information summarizing the regulatory capital of the Bank at December 31, 2018 and 2017 and corresponding regulatory minimum requirements is included in Note 15 - Regulatory Matters of the consolidated financial statements.

The FDIC, the insurer of deposits in financial institutions, has adopted a risk-based insurance premium system based in part on an institution's capital adequacy. Under this system, a depository institution is required to pay successively higher premiums depending on its capital levels and its supervisory rating by its primary regulator. It is management's intention to maintain sufficient capital to permit the Bank to maintain a "well capitalized" designation, which is the FDIC's highest rating.

On April 17, 2001, LCNB's Board of Directors authorized three separate stock repurchase programs, two of which continue to be in effect – the "Market Repurchase Program" and the "Private Sale Repurchase Program." Any shares purchased will be held for future corporate purposes.

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock, as restated for a 100% stock dividend issued in May, 2007, through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares, as restated for a stock dividend. Through December 31, 2018, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2018.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. A total of 487,418 shares, as restated for the stock dividend, had been purchased under this program at December 31, 2018, with 21,400 shares having been purchased during 2018.

LCNB established an Ownership Incentive Plan during 2002 that allowed for stock-based awards to eligible employees. Under the plan, awards could be in the form of stock options, share awards, and/or appreciation rights. The plan provided for the issuance of up to 200,000 shares, as restated for a stock dividend. The plan expired on April 16, 2012. Any outstanding unexercised options, however, continue to be exercisable in accordance with their terms.

The 2015 Ownership Incentive Plan (the "2015 Plan") was approved by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

Critical Accounting Policies

Allowance for Loan Losses. The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Subsequent recoveries, if any, are credited to the allowance. The allowance is an amount that management believes will be adequate to absorb inherent losses in the loan portfolio, based on evaluations of the collectability of loans and prior loan loss experience. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions that may affect the borrowers' ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.
The allowance consists of specific and general components. The specific component relates to loans that are classified as doubtful, substandard, or special mention. For such loans an allowance is established when the discounted cash flows or collateral value 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, which include trends in underperforming loans, trends in the volume and terms of loans, economic trends and conditions, concentrations of credit, trends in the quality of loans, and borrower financial statement exceptions.

Based on its evaluations, management believes that the allowance for loan losses will be adequate to absorb estimated losses inherent in the current loan portfolio.

Acquired Credit Impaired Loans. LCNB accounts for acquisitions using the acquisition method of accounting, which requires that assets acquired and liabilities assumed be measured at their fair values at the acquisition date. Acquired loans are reviewed to determine if there is evidence of deterioration in credit quality since inception and if it is probable that LCNB will be unable to collect all amounts due under the contractual loan agreements. The analysis includes expected prepayments and estimated cash flows including principal and interest payments at the date of acquisition. The amount in excess of the estimated future cash flows is not accreted into earnings. The amount in excess of the estimated future cash flows over the book value of the loan is accreted into interest income over the remaining life of the loan (accretable yield). LCNB records these loans on the acquisition date at their net realizable value. Thus, an allowance for estimated future losses is not established on the acquisition date. Subsequent to the date of acquisition, expected future cash flows on loans acquired are updated and any losses or reductions in estimated cash flows which arise subsequent to the date of acquisition are reflected as a charge through the provision for loan losses. An increase in the expected cash flows adjusts the level of the accretable yield recognized on a prospective basis over the remaining life of the loan. Due to the number, size, and complexity of loans within the acquired loan portfolio, there is always a possibility of inherent undetected losses.

Accounting for Intangibles. LCNB’s intangible assets at December 31, 2018 are composed primarily of goodwill and core deposit intangibles related to acquisitions of other financial institutions. It also includes mortgage servicing rights recorded from sales of fixed-rate mortgage loans to the Federal Home Loan Mortgage Corporation and mortgage servicing rights acquired through the acquisition of Eaton National Bank & Trust Co and Columbus First Bancorp, Inc. Goodwill is not subject to amortization, but is reviewed annually for impairment. Core deposit intangibles are being amortized on a straight line basis over their respective estimated weighted average lives. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

Fair Value Accounting for Debt Securities. Debt securities classified as available-for-sale are carried at estimated fair value. Unrealized gains and losses, net of taxes, are reported as accumulated other comprehensive income or loss in shareholders’ equity. Fair value is estimated using market quotations for U.S. Treasury investments. Fair value for the majority of the remaining available-for-sale securities is estimated using the discounted cash flow method for each security with discount rates based on rates observed in the market.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Market risk for LCNB is primarily interest rate risk. LCNB attempts to mitigate this risk through asset/liability management strategies designed to decrease the vulnerability of its earnings to material and prolonged changes in interest rates. LCNB does not use derivatives such as interest rate swaps, caps or floors to hedge this risk. LCNB has not entered into any market risk instruments for trading purposes.

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis (IRSA) and Economic Value of Equity (EVE) analysis for measuring and managing interest rate risk. The IRSA model is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any downward scenarios of more than 100 basis points to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the December 31, 2018 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income and a decrease in interest rates at all shock levels will have a negative effect on net interest income. The changes in net interest income for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in Net Interest Income	% Change in Net Interest Income
Up 400	$ 60,699	3,157	5.49 %
Up 300	59,918	2,376	4.13 %
Up 200	59,104	1,562	2.71 %
Up 100	58,328	786	1.37 %
Base	57,542	—	— %
Down 100	56,873	(669)	(1.16)%

IRSA shows the effect on net interest income during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the December 31, 2018 EVE analysis indicates that an increase or decrease in interest rates would have a positive effect on the EVE for all shock levels. The changes in the EVE for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in EVE	% Change in EVE
Up 400	$ 221,236	3,637	1.67 %
Up 300	222,913	5,314	2.44 %
Up 200	223,365	5,766	2.65 %
Up 100	221,683	4,084	1.88 %
Base	217,599	—	— %
Down 100	218,042	443	0.20 %

The IRSA and EVE simulations discussed above are not projections of future income or equity and should not be relied on as being indicative of future operating results. Assumptions used, including the nature and timing of interest rate levels, yield curve shape, prepayments on loans and securities, deposit decay rates, pricing decisions on loans and deposits, and reinvestment or replacement of asset and liability cash flows, are inherently uncertain and, as a result, the models cannot precisely measure future net interest income or equity. Furthermore, the models do not reflect actions that borrowers, depositors, and management may take in response to changing economic conditions and interest rate levels.

Item 8. Financial Statements and Supplementary Data
REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

LCNB Corp. ("LCNB") is responsible for the preparation, integrity, and fair presentation of the consolidated financial statements included in this annual report. Management of LCNB and its subsidiaries is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15f. LCNB's internal control over financial reporting is a process designed under the supervision of LCNB's Chief Executive Officer and the Chief Financial Officer. The purpose is to provide reasonable assurance to the Board of Directors regarding the reliability of financial reporting and the preparation of LCNB's consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Management maintains internal controls over financial reporting. The internal controls contain control processes and actions are taken to correct deficiencies as they are identified. The internal controls are evaluated on an ongoing basis by LCNB's management and Audit Committee. Even effective internal controls, no matter how well designed, have inherent limitations – including the possibility of circumvention or overriding of controls – and therefore can provide only reasonable assurance with respect to financial statement preparation. Also, because of changes in conditions, internal control effectiveness may vary over time.

Management assessed LCNB's internal controls as of December 31, 2018, in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2018, LCNB's internal control over financial reporting met the criteria.

BKD LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of LCNB's internal control over financial reporting as of December 31, 2018.

Submitted by:

LCNB Corp.

/s/ Steve P. Foster	/s/ Robert C. Haines II
Steve P. Foster	Robert C. Haines II
Chief Executive Officer	Executive Vice President &
March 6, 2019	Chief Financial Officer
	March 6, 2019

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LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee
LCNB Corp.
Lebanon, Ohio

Opinion on the Internal Control Over Financial Reporting

We have audited LCNB Corp.'s (Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework: (2013) issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated financial statements of the Company and our report dated March 6, 2019, expressed an unqualified opinion thereon.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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Definitions and Limitations of Internal Control Over Financial Reporting

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

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

/s/ BKD, LLP
BKD, LLP

Cincinnati, Ohio
March 6, 2019

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LCNB CORP. AND SUBSIDIARIES

Report of Independent Registered Public Accounting Firm

To the Shareholders, Board of Directors and Audit Committee
LCNB Corp.
Lebanon, Ohio

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of LCNB Corp. (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, shareholders’ equity and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively referred to as the “financial statements”). In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (“PCAOB”), the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 6, 2019, expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits.

We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ BKD, LLP
BKD, LLP

We have served as the Company’s auditor since 2014.

Cincinnati, Ohio
March 6, 2019

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LCNB CORP. AND SUBSIDIARIES

FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
At December 31,
(Dollars in thousands)

	2018	2017
ASSETS:		
Cash and due from banks	$18,310	21,159
Interest-bearing demand deposits	1,730	4,227
Total cash and cash equivalents	20,040	25,386
Interest-bearing time deposits	996	—
Investment securities:		
Equity securities with a readily determinable fair value, at fair value	2,078	2,160
Equity securities without a readily determinable fair value, at cost	2,099	1,099
Debt securities, available-for-sale, at fair value	238,421	275,213
Debt securities, held-to-maturity, at cost	29,721	32,571
Federal Reserve Bank stock, at cost	4,653	2,732
Federal Home Loan Bank stock, at cost	4,845	3,638
Loans, net	1,194,577	845,657
Premises and equipment, net	32,627	34,927
Goodwill	59,221	30,183
Core deposit and other intangibles	5,042	3,799
Bank owned life insurance	28,723	27,985
Other assets	13,884	10,288
TOTAL ASSETS	$1,636,927	1,295,638
LIABILITIES:		
Deposits:		
Non-interest-bearing	$322,571	283,212
Interest-bearing	978,348	802,609
Total deposits	1,300,919	1,085,821
Short-term borrowings	56,230	47,000
Long-term debt	47,032	303
Accrued interest and other liabilities	13,761	12,243
TOTAL LIABILITIES	1,417,942	1,145,367
COMMITMENTS AND CONTINGENT LIABILITIES	—	—
SHAREHOLDERS' EQUITY:		
Preferred shares - no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares - no par value; authorized 19,000,000 shares at December 31, 2018 and 2017; issued 14,070,303 and 10,776,686 shares at December 31, 2018 and 2017, respectively	141,170	76,977
Retained earnings	94,547	87,301
	(12,013)	(11,665)

Treasury shares at cost, 775,027 and 753,627 shares at December 31, 2018 and 2017, respectively		
Accumulated other comprehensive loss, net of taxes	(4,719)	(2,342)
TOTAL SHAREHOLDERS' EQUITY	218,985	150,271
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$1,636,927	1,295,638

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
For the years ended December 31,
(Dollars in thousands, except per share data)

	2018	2017	2016
INTEREST INCOME:			
Interest and fees on loans	$ 47,489	36,571	35,600
Dividends on equity securities:			
With a readily determinable fair value	65	63	66
Without a readily determinable fair value	39	26	49
Interest on debt securities:			
Taxable	3,666	4,239	4,467
Non-taxable	2,686	3,130	3,199
Other investments	649	434	369
TOTAL INTEREST INCOME	54,594	44,463	43,750
INTEREST EXPENSE:			
Interest on deposits	5,753	3,378	3,440
Interest on short-term borrowings	311	209	38
Interest on long-term debt	361	12	26
TOTAL INTEREST EXPENSE	6,425	3,599	3,504
NET INTEREST INCOME	48,169	40,864	40,246
PROVISION FOR LOAN LOSSES	923	215	913
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	47,246	40,649	39,333
NON-INTEREST INCOME:			
Fiduciary income	3,958	3,473	3,286
Service charges and fees on deposit accounts	5,590	5,236	5,008
Net gains (losses) on sales of securities	(8)	233	1,082
Bank owned life insurance income	738	867	746
Net gains from sales of loans	223	166	244
Other operating income	549	483	487
TOTAL NON-INTEREST INCOME	11,050	10,458	10,853
NON-INTEREST EXPENSE:			
Salaries and employee benefits	21,279	18,585	18,215
Equipment expenses	1,138	1,172	1,048
Occupancy expense, net	2,861	2,613	2,271
State financial institutions tax	1,197	1,137	1,114
Marketing	1,119	873	696
Amortization of intangibles	922	751	753
FDIC premiums	419	423	547
ATM expense	580	572	721
Computer maintenance and supplies	990	882	790
Telephone expense	649	735	746
Contracted services	1,547	1,255	1,033
Other real estate owned	20	10	624

Merger-related expenses	2,123	118	—
Other non-interest expense	5,658	4,737	4,703
TOTAL NON-INTEREST EXPENSE	40,502	33,863	33,261
INCOME BEFORE INCOME TAXES	17,794	17,244	16,925
PROVISION FOR INCOME TAXES	2,949	4,272	4,443
NET INCOME	$ 14,845	12,972	12,482
Earnings per common share:			
Basic	$ 1.24	1.30	1.26
Diluted	1.24	1.29	1.25
Weighted average common shares outstanding:			
Basic	11,935,350	10,005,575	9,948,057
Diluted	11,942,253	10,012,511	9,976,370

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the years ended December 31,
(Dollars in thousands)

	2018	2017	2016
Net income	$14,845	12,972	12,482
Other comprehensive income (loss):			
Net unrealized gain (loss) on available-for-sale securities (net of tax expense (benefit) of $(516), $285, and $(1,242) for 2018, 2017, and 2016, respectively)	(1,939)	585	(2,390)
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of tax expense (benefit) of $(2), $81, and $370 for 2018, 2017 and 2016, respectively)	6	(152)	(712)
Change in nonqualified pension plan unrecognized net gain (loss) and unrecognized prior service cost (net of tax expense (benefit) of $21, $(53), and $128 for 2018, 2017, and 2016, respectively)	81	(158)	249
Other comprehensive income (loss)	(1,852)	275	(2,853)
TOTAL COMPREHENSIVE INCOME	$12,993	13,247	9,629

SUPPLEMENTAL INFORMATION:
COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX, AS OF YEAR-END:

	2018	2017	2016
Net unrealized loss on securities available-for-sale	$(4,631)	(2,200)	(2,633)
Net unfunded benefit (liability) for nonqualified pension plan	(88)	(142)	16
Balance at year-end	$(4,719)	(2,342)	(2,617)

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
For the years ended December 31,
(Dollars in thousands, except share data)

	Common Shares Outstanding	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2015	9,925,547	$76,908	74,629	(11,665)	236	140,108
Net income			12,482			12,482
Other comprehensive loss, net of taxes					(2,853)	(2,853)
Dividend Reinvestment and Stock Purchase Plan	21,088	379				379
Repurchase of stock warrants		(1,545)				(1,545)
Exercise of stock options	51,390	592				592
Excess tax benefit on exercise and forfeiture of stock options		61				61
Compensation expense relating to stock options		5				5
Compensation expense relating to restricted stock	—	90				90
Common stock dividends, $0.64 per share			(6,375)			(6,375)
Balance, December 31, 2016	9,998,025	76,490	80,736	(11,665)	(2,617)	142,944
Net income			12,972			12,972
Other comprehensive income, net of taxes					275	275
Dividend Reinvestment and Stock Purchase Plan	17,609	360				360
Exercise of stock options	3,398	51				51
Compensation expense relating to stock options		1				1
Compensation expense relating to restricted stock	4,027	75				75
Common stock dividends, $0.64 per share			(6,407)			(6,407)
Balance, December 31, 2017	10,023,059	76,977	87,301	(11,665)	(2,342)	150,271
Cumulative effect of changes in accounting principles (1)			525		(525)	—
Balance at December 31, 2017, as adjusted	10,023,059	76,977	87,826	(11,665)	(2,867)	150,271
Net income			14,845			14,845
Other comprehensive loss, net of taxes					(1,852)	(1,852)
Dividend Reinvestment and Stock Purchase Plan	22,936	416				416

Stock issued for acquisition of Columbus First Bancorp, Inc.	3,253,060	63,598				63,598
Exercise of stock options	6,987	72				72
Repurchase of common stock	(21,400)			(348)		(348)
Compensation expense relating to restricted stock	10,634	107				107
Common stock dividends, $0.65 per share			(8,124)			(8,124)
Balance, December 31, 2018	13,295,276	$141,170	94,547	(12,013)	(4,719)	218,985

(1) Represents the impact of adopting Accounting Standards Update No. 2018-02 and No. 2016-01. See Note 1 of the consolidated financial statements for more information.

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31,
(Dollars in thousands)

	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$14,845	12,972	12,482
Adjustments to reconcile net income to net cash flows from operating activities-			
Depreciation, amortization and accretion	4,073	3,308	2,557
Provision for loan losses	923	215	913
Impact of Tax Cuts and Jobs Act on Accumulated Other Comprehensive Income	—	486	—
Deferred income tax provision (benefit)	228	1,478	928
Increase in cash surrender value of bank owned life insurance	(738)	(760)	(746)
Bank owned life insurance death benefits in excess of cash surrender value	—	(107)	—
Realized (gain) loss from equity securities	73	(15)	(8)
Realized (gain) loss from sales of debt securities available-for-sale	8	(218)	(1,074)
Realized loss from sale of premises and equipment	575	113	33
Realized loss from sale and impairment of other real estate owned and repossessed assets	14	3	534
Origination of mortgage loans for sale	(8,924)	(7,513)	(11,217)
Realized gains from sales of loans	(223)	(166)	(244)
Proceeds from sales of loans	9,033	7,588	11,353
Penalty for prepayment of long-term debt	—	—	251
Compensation expense related to stock options	—	1	5
Compensation expense related to restricted stock	107	75	90
Changes in:			
Accrued income receivable	215	(4)	(216)
Other assets	(1,811)	(269)	(791)
Other liabilities	1,344	948	634
TOTAL ADJUSTMENTS	4,897	5,163	3,002
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	19,742	18,135	15,484
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sales of equity securities	127	43	173
Proceeds from sales of debt securities available-for-sale	8,545	43,203	92,282
Proceeds from maturities and calls of debt securities:			
Available-for-sale	24,249	25,012	84,529
Held-to-maturity	6,281	14,057	6,640
Purchases of equity securities	(1,118)	(80)	(204)
Purchases of debt securities:			
Available-for-sale	—	(26,932)	(124,730)
Held-to-maturity	(3,431)	(5,625)	(25,010)
Proceeds from maturities of interest-bearing time deposits	9,354	—	—
Purchase of Federal Reserve Bank stock	(1,921)	—	—
Net increase in loans	(65,842)	(29,692)	(48,153)
Purchase of bank owned life insurance	—	—	(4,000)
Proceeds from bank owned life insurance mortality benefits	—	189	—

Proceeds from sales of other real estate owned and repossessed assets	21	971	526
Additions to other real estate owned	—	—	(182)
Purchases of premises and equipment	(600)	(6,617)	(9,450)
Proceeds from sales of premises and equipment	651	272	63
Net cash received from acquisition of Columbus First Bancorp, Inc.	12,896	—	—
NET CASH FLOWS PROVIDED BY (USED IN) INVESTING ACTIVITIES	(10,788)	14,801	(27,516)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in deposits	(29,332)	(25,084)	23,745
Net increase (decrease) in short-term borrowings	(770)	4,960	4,653
Proceeds from long-term debt	31,000	—	—
Principal payments on long-term debt	(7,214)	(295)	(5,349)
Penalty for prepayment of long-term debt	—	—	(251)
Proceeds from issuance of common stock	65	41	52
Repurchase of common stock	(348)	—	—
Repurchase of stock warrants	—	—	(1,545)
Proceeds from exercise of stock options	72	51	592
Excess tax benefit from exercise of stock options and vesting of restricted common stock	—	—	61
Cash dividends paid on common stock	(7,773)	(6,088)	(6,048)
NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES	(14,300)	(26,415)	15,910
NET CHANGE IN CASH AND CASH EQUIVALENTS	(5,346)	6,521	3,878
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	25,386	18,865	14,987
CASH AND CASH EQUIVALENTS AT END OF YEAR	$20,040	25,386	18,865

LCNB CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
For the years ended December 31,
(Dollars in thousands)

	2018	2017	2016
SUPPLEMENTAL CASH FLOW INFORMATION:			
CASH PAID DURING THE YEAR FOR:			
Interest	$5,908	3,577	3,542
Income taxes	1,950	2,185	4,420
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITY:			
Transfer from loans to other real estate owned and repossessed assets	244	974	32

LCNB purchased all of the common stock of Columbus First Bancorp, Inc. on May 31, 2018. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	342,256
Less common stock issued	63,598
Less cash paid for the common stock	783
Liabilities assumed	277,875

The accompanying notes to consolidated financial statements are an integral part of these statements.

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LCNB CORP. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2018

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

LCNB Corp. (the "Company" or “LCNB”), an Ohio corporation formed in December 1998, is a financial holding company whose principal activity is the ownership of LCNB National Bank (the "Bank"). The Bank was founded in 1877 and provides full banking services, including trust and brokerage services, to customers primarily in Southwestern Ohio and Franklin County Ohio and contiguous areas.

BASIS OF PRESENTATION
The consolidated financial statements include the accounts of the Company and its subsidiaries. Significant intercompany accounts and transactions are eliminated in consolidation. The accounting and reporting policies of the Company conform with U.S. generally accepted accounting principles and with general practices in the banking industry.

Certain prior period data presented in the financial statements have been reclassified to conform with the current year presentation. These reclassifications had no effect on net income.

USE OF ESTIMATES
The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS
For purposes of reporting cash flows, cash and cash equivalents include cash, balances due from banks, federal funds sold, and interest-bearing demand deposits with original maturities of twelve months or less. Deposits with other banks routinely have balances greater than FDIC insured limits. Management considers the risk of loss to be very low with respect to such deposits.

INVESTMENT SECURITIES
Certain municipal debt securities that management has the positive intent and ability to hold to maturity are classified as “held-to-maturity” and recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as “available-for-sale” and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income, a separate component of shareholders’ equity. Amortization of premiums and accretion of discounts are recognized as adjustments to interest income using the level-yield method. Realized gains or losses from the sale of securities are recorded on the trade date and are computed using the specific identification method.

Declines in the fair value of securities below their cost that are deemed to be other-than-temporarily impaired, and for which the Company does not intend to sell the securities and it is not more likely than not that the securities will be sold before the anticipated recovery of the impairment, are separated into losses related to credit factors and losses related to other factors. The losses related to credit factors are recognized in earnings and losses related to other factors are recognized in other comprehensive income. In estimating other than temporary impairment losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company's consolidated statements of income as of December 31, 2018, 2017, and 2016, do not reflect any such impairment.

Beginning January 1, 2018, equity securities are measured at fair value with changes in fair value recognized in net income.

Federal Home Loan Bank ("FHLB") stock is an equity interest in the Federal Home Loan Bank of Cincinnati. It can be sold only at its par value of $100 per share and only to the FHLB or to another member institution. In addition, the equity ownership rights are more limited than would be the case for a public company because of the oversight role exercised by the Federal Housing Finance Agency in the process of budgeting and approving dividends. Federal Reserve Bank stock is similarly restricted in marketability and value. Both investments are carried at cost, which is their par value.

FHLB and Federal Reserve Bank stock are both subject to minimum ownership requirements by member banks. The required investments in common stock are based on predetermined formulas.

LOANS

The Company's loan portfolio includes most types of commercial and industrial loans, commercial loans secured by real estate, residential real estate loans, consumer loans, agricultural loans and other types of loans. Most of the properties collateralizing the loan portfolio are located within the Company's market area.

Loans are stated at the principal amount outstanding, net of unearned income, deferred origination fees and costs, and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. The delinquency status of a loan is based on contractual terms and not on how recently payments have been received. Generally, a loan is placed on non-accrual status when it is classified as impaired or there is an indication that the borrower's cash flow may not be sufficient to make payments as they come due, unless the loan is well secured and in the process of collection. Subsequent cash receipts on non-accrual loans are recorded as a reduction of principal and interest income is recorded once principal recovery is reasonably assured. The current year's accrued interest on loans placed on non-accrual status is charged against earnings. Previous years' accrued interest is charged against the allowance for loan losses. Non-accrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer a reasonable doubt as to the timely collection of interest or principal.

Loan origination fees and certain direct loan origination costs are deferred and the net amount amortized as an adjustment of loan yields. These amounts are being amortized over the lives of the related loans.

In the ordinary course of business, the Company enters into off-balance sheet financial instruments consisting of commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the financial statements when they are funded. The credit risk associated with these commitments is evaluated in a manner similar to the allowance for loan losses.

Loans acquired from mergers are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans. Management estimates the cash flows expected to be collected at acquisition using a third-party risk model, which incorporates the estimate of key assumptions, such as default rates, severity, and prepayment speeds.

Impaired loans acquired are accounted for under FASB ASC 310-30. Factors considered in evaluating whether an acquired loan was impaired include delinquency status and history, updated borrower credit status, collateral information, and current loan-to-value information. The difference between contractually required payments at the time of acquisition and the cash flows expected to be collected is referred to as the nonaccretable difference. The interest component of the cash flows expected to be collected is referred to as the accretable yield and is recognized as interest income over the remaining contractual life of the loan using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows will result in a reclassification from the nonaccretable difference to the accretable yield.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. Consumer loans are charged off when they reach 120 days past due. Subsequent recoveries, if any, are credited to the allowance.

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(Continued)
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk of losses inherent in the portfolio. Current methodology used by management to estimate the allowance takes into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, historic categorical trends, current delinquency levels as related to historical levels, portfolio growth rates, changes in composition of the portfolio, the current economic environment, as well as current allowance adequacy in relation to the portfolio. Management is cognizant that reliance on historical information coupled with the cyclical nature of the economy, including credit cycles, affects the allowance. Management considers all of these factors prior to making any adjustments to the allowance due to the subjectivity and imprecision involved in allocation methodology. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of specific and general components. The specific component relates to loans that are specifically reviewed for impairment. For such loans, 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 loans not specifically reviewed for impairment and homogeneous loan pools, such as residential real estate and consumer loans. The general component is measured for each loan category separately based on each category's average of historical loss experience over a trailing sixty month period, adjusted for qualitative factors. Such qualitative factors may include current economic conditions if different from the five-year historical loss period, trends in underperforming loans, trends in volume and terms of loan categories, concentrations of credit, and trends in loan quality.

A loan is considered impaired when management believes, based on current information and events, it is probable that the Bank will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. An impaired loan is measured by the present value of expected future cash flows using the loan's effective interest rate. An impaired collateral-dependent loan may be measured based on collateral value. Smaller-balance homogeneous loans, including residential mortgage and consumer installment loans, that are not evaluated individually are collectively evaluated for impairment.

PREMISES AND EQUIPMENT
Premises and equipment are stated at cost less accumulated depreciation. Land is stated at cost. Depreciation is computed on both the straight-line and accelerated methods over the estimated useful lives of the assets, generally 15 to 40 years for premises and 3 to 10 years for equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Costs incurred for maintenance and repairs are expensed as incurred. Premises and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of a particular asset may not be recoverable.

OTHER REAL ESTATE OWNED
Other real estate owned includes properties acquired through foreclosure. Such property is held for sale and is initially recorded at fair value, less costs to sell, establishing a new cost basis. Fair value is primarily based on a property appraisal obtained at the time of transfer and any periodic updates that may be obtained thereafter. The allowance for loan losses is charged for any write down of the loan's carrying value to fair value at the date of transfer. Any subsequent reductions in fair value and expenses incurred from holding other real estate owned are

charged to other non-interest expense. Costs, excluding interest, relating to the improvement of other real estate owned are capitalized. Gains and losses from the sale of other real estate owned are included in other non-interest expense.

GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. Goodwill is not amortized, but is instead subject to an annual review for impairment.

Mortgage servicing rights on originated mortgage loans that have been sold are initially recorded at their estimated fair values. Mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income. Such assets are periodically evaluated as to the recoverability of their carrying value.

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(Continued)
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company's other intangible assets relate to core deposits acquired from business combinations. These intangible assets are amortized on a straight-line basis over their estimated useful lives. Management evaluates whether events or circumstances have occurred that indicate the remaining useful life or carrying value of the amortizing intangible should be revised.

BANK OWNED LIFE INSURANCE
The Company has purchased life insurance policies on certain officers of the Company. The Company is the beneficiary of these policies and has recorded the estimated cash surrender value in other assets in the consolidated balance sheets. Income on the policies, based on the increase in cash surrender value and any incremental death benefits, is included in non-interest income in the consolidated statements of income.

AFFORDABLE HOUSING TAX CREDIT LIMITED PARTNERSHIP
LCNB has elected to account for its investment in an affordable housing tax credit limited partnership using the proportional amortization method described in FASB Accounting Standards Update ("ASU") 2014-01, "Investments - Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects (A Consensus of the FASB Emerging Issues Task Force)." Under the proportional amortization method, an investor amortizes the initial cost of the investment to income tax expense in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense. The investment in the limited partnership is included in other assets and the unfunded amount is included in accrued interest and other liabilities in LCNB's consolidated balance sheets.

FAIR VALUE MEASUREMENTS
Accounting guidance establishes a fair value hierarchy to prioritize the inputs to valuation techniques used to measure fair value. A financial instrument's level within the hierarchy is based on the lowest level of input that is significant to the fair value measurement. The three broad input levels are:

- Level 1 – quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the reporting date;
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability either directly or indirectly; and
- Level 3 - inputs that are unobservable for the asset or liability.

Accounting guidance permits, but does not require, companies to measure many financial instruments and certain other items, including loans and debt securities, at fair value. The decision to elect the fair value option is made individually for each instrument and is irrevocable once made. Changes in fair value for the selected instruments are recorded in earnings. The Company did not select any financial instruments for the fair value election in 2018 or 2017.

Beginning January 1, 2018, equity securities are required to be measured at fair value with changes in fair value recognized in net income.

ADVERTISING EXPENSE
Advertising costs are expensed as incurred and are recorded as a marketing expense, a component of non-interest expense.

PENSION PLANS

Eligible employees of the Company hired before 2009 participate in a multiple-employer qualified noncontributory defined benefit retirement plan. This plan is accounted for as a multi-employer plan because assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

Citizens National had a qualified noncontributory, defined benefit pension plan, which has been assumed by the Company, that covers eligible employees hired before May 1, 2005. This is a single employer plan.

TREASURY STOCK

Common shares repurchased are recorded at cost. Cost of shares retired or reissued is determined using the weighted average method.

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LCNB CORP. AND SUBSIDIARIES
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(Continued)
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

STOCK OPTIONS AND RESTRICTED STOCK AWARD PLANS
The cost of employee services received in exchange for stock option grants is the grant-date fair value of the award estimated using an option-pricing model. The compensation cost for restricted stock awards is based on the market price of the Company's common stock at the date of grant multiplied by the number of shares granted that are expected to vest. The estimated cost is recognized on a straight-line basis over the period the employee is required to provide services in exchange for the award, usually the vesting period. The Company uses a Black-Scholes pricing model and related assumptions for estimating the fair value of stock option grants and a five-year vesting period for stock options and restricted stock.

REVENUE RECOGNITION
Accounting Standards Codification 606, "Revenue from Contracts with Customers" ("ASC 606") provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Revenue generated from financial instruments, including loans and investment securities, are not included in the scope of ASC 606. The adoption of ASC 606 did not result in a change to the accounting for any of LCNB's revenue streams that are within the scope of the amendments. Revenue-generating activities that are within the scope of ASC 606 and that are presented as non-interest income in LCNB's consolidated statements of income include:

- Fiduciary income - this includes periodic fees due from trust and investment services customers for managing the customers' financial assets. Fees are generally charged on a quarterly or annual basis and are recognized ratably throughout the period, as the services are provided on an ongoing basis.
- Service charges and fees on deposit accounts - these include general service fees charged for deposit account maintenance and activity and transaction-based fees charged for certain services, such as debit card, wire transfer, or overdraft activities. Revenue is recognized when the performance obligation is completed, which is generally after a transaction is completed or monthly for account maintenance services.

INCOME TAXES
Deferred income taxes are determined using the asset and liability method of accounting. Under this method, the net deferred tax asset or liability is determined based on the tax effects of 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.

Management analyzes material tax positions taken in any income tax return for any tax jurisdiction and determines the likelihood of the positions being sustained in a tax examination. 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.

EARNINGS PER SHARE
Basic earnings per share allocated to common shareholders is calculated using the two-class method and is computed by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is adjusted for the dilutive effects of stock based compensation and warrants and is calculated using the two-class method or the treasury stock method. The diluted average number of common shares outstanding has been increased for the assumed exercise of stock based

compensation and warrants with the proceeds used to purchase treasury shares at the average market price for the period.

ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"

ASU No. 2014-09 was issued in May 2014 and was adopted by LCNB as of January 1, 2018. It supersedes most current revenue recognition guidance for contracts to transfer goods or services or other nonfinancial assets. Lease contracts, insurance contracts, and most financial instruments are not included in the scope of this update. ASU No. 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Additional disclosures providing information about contracts with customers are required. Adoption did not have a material impact on LCNB's results of operations or financial position.

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(Continued)
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU No. 2016-01, "Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities"
ASU No. 2016-01 was issued in January 2016 and was adopted by LCNB as of January 1, 2018. It applies to all entities that hold financial assets or owe financial liabilities. It makes targeted changes to generally accepted accounting principles for public companies as follows:

1. Requires most equity investments to be measured at fair value with changes in fair value recognized in net income.
2. Simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value.
3. Eliminates the requirement 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 on the balance sheet.
4. Requires use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes.
5. Requires an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
6. Requires separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
7. Clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity’s other deferred tax assets.

Adoption of ASU No. 2016-01 did not have a material impact on LCNB's results of operations or financial position. Upon adoption on January 1, 2018, LCNB reclassified net unrealized gain on equity securities, net of taxes, of $33,000 from accumulated other comprehensive income into retained earnings. Before adoption, equity securities were included with investment securities, available for sale in the consolidated balance sheets and dividends received were included in interest on investment securities, taxable in the consolidated statements of income. After adoption, equity securities are separate line items in the consolidated balance sheets and the consolidated statements of income. Changes in the fair value of equity securities are included in other operating income in the consolidated statements of income.

ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost"
ASU No. 2017-07 was issued in March 2017 and was adopted by LCNB as of January 1, 2018. It applies to all employers that offer to their employees defined benefit pension plans, other postretirement benefit plans, or other types of benefits accounted for under Topic 715. The amendments in this update require that an employer report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost, as defined, are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments in this update are to be applied retrospectively for the presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the income statement. Adoption of ASU No. 2017-07 did not have a material impact on LCNB's results of operations or financial position.

ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting"
ASU No. 2017-09 was issued in May 2017 and was adopted by LCNB on January 1, 2018. It applies to any entity that changes the terms or conditions of a share-based payment award. The amendments in this update provide that an entity would not apply modification accounting under the guidance in Topic 718 if the fair value, vesting conditions, and classification of the awards are the same immediately before and after the modification. The amendments are to be applied prospectively and are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Adoption of ASU No. 2017-09 did not have a material impact on LCNB's results of operations or financial position.

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(Continued)
NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income"
ASU No. 2018-02 was issued in February 2018 and is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and LCNB early adopted the ASU as of January 1, 2018. ASU No. 2018-02 addresses a narrow-scope financial reporting issue that arose as a consequence of the passage of H.R. 1, known as the “Tax Cuts and Jobs Act.” Generally Accepted Accounting Principles requires adjustment of deferred tax assets and liabilities for the effect of a change in tax laws or rates with the effect to be included in income from continuing operations in the reporting period that includes the enactment date. This guidance is applicable even in situations in which the related income tax effects of items in accumulated other comprehensive income were originally recognized in other comprehensive income rather than in income from continuing operations. As a consequence, the tax effects of items within accumulated other comprehensive income, referred to as stranded tax effects in the update, do not reflect the appropriate tax rate. The amendments in ASU No. 2018-02 allow a reclassification from accumulated other comprehensive income to retained earnings for the stranded tax effects resulting from the Tax Cuts and Jobs Act. Because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. Upon adoption, LCNB reclassified stranded tax effects of $492,000 into retained earnings as of January 1, 2018.

RECENT ACCOUNTING PRONOUNCEMENTS NOT YET EFFECTIVE
ASU No. 2016-02, "Leases (Topic 842)"
ASU No. 2016-02 was issued in February 2016 and requires a lessee to recognize in the statement of financial position a liability to make lease payments ("the lease liability") and a right-of-use asset representing its right to use the underlying asset for the lease term, initially measured at the present value of the lease payments. When measuring assets and liabilities arising from a lease, the lessee should include payments to be made in optional periods only if the lessee is reasonably certain, as defined, to exercise an option to the lease or not to exercise an option to terminate the lease. Optional payments to purchase the underlying asset should be included if the lessee is reasonably certain it will exercise the purchase option. Most variable lease payments should be excluded except for those that depend on an index or a rate or are in substance fixed payments.

A lessee shall classify a lease as a finance lease if it meets any of five listed criteria:
1. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for the major part of the remaining economic life of the underlying asset.
4. The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or exceeds substantially all of the fair value of the underlying asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

For finance leases, a lessee shall recognize in the statement of income interest on the lease liability separately from amortization of the right-of-use asset. Amortization of the right-of-use asset shall be on a straight-line basis, unless another basis is more representative of the pattern in which the lessee expects to consume the right-of-use asset’s future economic benefits. If the lease does not meet any of the five criteria, the lessee shall classify it as an operating lease and shall recognize a single lease cost on a straight-line basis over the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such leases generally on a straight-line basis over the lease term.

The amendments in this update are to be applied using a modified retrospective approach, as defined, and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted. As of January 1, 2019, LCNB recognized discounted right of use assets and lease liabilities totaling approximately $5.9 million for the leases disclosed in Note 8 - Leases.

ASU No. 2016-13, "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments"
ASU No. 2016-13 was issued in June 2016 and, once effective, will significantly change current guidance for recognizing impairment of financial instruments. Current guidance requires an "incurred loss" methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. ASU No. 2016-13 replaces the incurred loss impairment methodology with a new methodology that reflects expected credit losses over the lives of the loans and requires consideration of a broader range of information to inform credit loss estimates. The ASU requires an organization to estimate all expected credit losses for financial assets measured at amortized cost, including loans and held-to-maturity debt securities, based on historical experience, current conditions, and reasonable and supportable forecasts. Additional disclosures are required.

ASU No. 2016-13 also amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. Under the new guidance, entities will determine whether all or a portion of the unrealized loss on an available-for-sale debt security is a credit loss. Any credit loss will be recognized as an allowance for credit losses on available-for-sale debt securities rather than as a direct reduction of the amortized cost basis of the investment, as is currently required. As a result, entities will recognize improvements to estimated credit losses on available-for-sale debt securities immediately in earnings rather than as interest income over time, as currently required.

ASU No. 2016-13 eliminates the current accounting model for purchased credit impaired loans and debt securities. Instead, purchased financial assets with credit deterioration will be recorded gross of estimated credit losses as of the date of acquisition and the estimated credit losses amounts will be added to the allowance for credit losses. Thereafter, entities will account for additional impairment of such purchased assets using the models listed above.

ASU No. 2016-13 will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While LCNB's Loan Committee expects that the implementation of ASU No. 2016-13 will increase the balance of the allowance for loan losses, it is continuing to evaluate the potential impact on LCNB's results of operations and financial position. The Loan Committee has completed analyzing its data collection efforts and is currently analyzing its pool segmentation and reporting mechanisms to prepare for adoption of this ASU. The financial statement impact of this new standard cannot be reasonably estimated at this time.

ASU No. 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment"
ASU No. 2017-04 was issued in January 2017 and applies to public and other entities that have goodwill reported in their financial statements. To simplify the subsequent measurement of goodwill, this ASU eliminates Step 2 from the goodwill impairment test. In computing the implied fair value of goodwill under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities, including unrecognized assets and liabilities, following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in this update, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of

goodwill allocated to that reporting unit. A public business entity that is an SEC filer should adopt the amendments in this update on a prospective basis for its annual or any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Adoption of ASU No. 2017-04 is not expected to have a material impact on LCNB's results of operations or financial position.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement"
ASU No. 2018-13 was issued in August 2018 and applies to all entities that are required to make disclosures about recurring or nonrecurring fair value measurements. The amendments in this update modify fair value disclosure requirements, including the deletion, modification, and addition of certain targeted disclosures. The amendments are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. An entity is permitted to early adopt any removed or modified disclosures upon issuance of the update and delay adoption of the additional disclosures until the effective date. The amendments are to be applied on a retrospective basis to all periods presented upon adoption, except for certain amendments described in the update that are to be applied prospectively for only the most recent interim or annual period presented in the initial fiscal year of adoption. Adoption of ASU No. 2018-13 will not have a material impact on LCNB's results of operations or financial position.

ASU No. 2018-14, "Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20): Disclosure Framework - Changes to the Disclosure Requirements for Defined Benefit Plans"
ASU No. 2018-14 was issued in August 2018. The amendments in this update modify disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans, including the deletion, modification, and addition of certain targeted disclosures. The amendments are effective for public business entities for fiscal years beginning after December 15, 2020. Early adoption is permitted. The amendments are to be applied on a retrospective basis to all periods presented upon adoption. Adoption of ASU No. 2018-14 will not have a material impact on LCNB's results of operations or financial position.

ASU No. 2018-15, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract"
ASU No. 2018-15 was issued in August 2018 and applies to entities that are a customer in a hosting arrangement, as defined, that is accounted for as a service contract. The amendments in this update require an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. Capitalized implementation costs are to be expensed over the term of the hosting arrangement. The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption is permitted, including adoption in any interim period. The amendments can be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. Adoption of ASU No. 2018-15 is not expected to have a material impact on LCNB's results of operations or financial position.

NOTE 2 – ACQUISITIONS

On December 20, 2017, LCNB and Columbus First Bancorp, Inc. (“CFB”) entered into an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which CFB merged with and into LCNB on May 31, 2018. LCNB entered into this transaction with the expectation that it would be accretive to income and expand its presence in the Columbus market area. Immediately following the merger of CFB into LCNB, Columbus First Bank, a wholly-owned subsidiary of CFB, merged into the Bank. Columbus First Bank operated from one full-service office located in Worthington, Ohio. That office became a branch of the Bank after the merger.

Under the terms of the Merger Agreement, the shareholders of CFB received two shares of LCNB common shares for each outstanding CFB common share. Unexercised stock options of CFB were canceled in exchange for a cash payment.

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NOTE 2 – ACQUISITIONS (Continued)

The merger with CFB was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at their estimated fair values as of the merger date. The estimated fair values reported in LCNB's Form 10-Q for the quarterly period ended June 30, 2018 were preliminary, as the pricing study had not been finalized at that time. The following table summarizes the preliminary balances at June 30, 2018, revisions to the preliminary balances, and the balances at December 31, 2018 (in thousands):

	June 30, 2018	Fair Value Adjustments	December 31, 2018
Consideration Paid:			
Common shares issued (3,253,060 shares issued at $19.55 per share)	63,598	—	63,598
Cash paid to cancel share based payment awards	783	—	783
	64,381	—	64,381
Identifiable Assets Acquired:			
Cash and cash equivalents	13,679	—	13,679
Interest-bearing time deposits	10,350	—	10,350
Federal Home Loan Bank stock	1,207	—	1,207
Loans, net	282,748	(615)	282,133
Loans held for sale, net	1,819	—	1,819
Premises and equipment	102	—	102
Core deposit intangible	2,089	88	2,177
Other real estate owned	35	—	35
Deferred income taxes	—	352	352
Other assets	2,022	(658)	1,364
Total identifiable assets acquired	314,051	(833)	313,218
Liabilities Assumed:			
Deposits	245,036	(606)	244,430
Short-term borrowings	10,000	—	10,000
Long-term debt	22,920	23	22,943
Deferred income taxes	200	(200)	—
Other liabilities	491	11	502
Total liabilities assumed	278,647	(772)	277,875
Total Identifiable Net Assets Acquired	35,404	(61)	35,343
Goodwill resulting from merger	28,977	61	29,038

As permitted by ASC No. 805-10-25, Business Combinations, the above estimated amounts may be adjusted up to one year after the closing date of the acquisition to reflect any new information obtained about facts and circumstances existing at the acquisition date. Any changes in the estimated fair values will be recognized in the period the adjustment is identified.

The amount of goodwill recorded reflects LCNB's expansion in the Columbus market and related synergies that are expected to result from the acquisition and represents the excess purchase price over the estimated fair value of the net assets acquired. The goodwill will not be amortizable on LCNB's financial records and will not be deductible for tax purposes. Goodwill will be subject to an annual test for impairment and the amount impaired, if any, will be charged to expense at the time of impairment.

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NOTE 2 – ACQUISITIONS (Continued)

The core deposit intangible will be amortized over the estimated weighted average economic life of the various core deposit types.

Direct costs related to the acquisition were expensed as incurred and are recorded as a merger-related expense in the consolidated statements of income.

CFB's results of operations are included in the consolidated statements of income from the date of the merger. The amount of CFB's revenue (net interest income plus non-interest income) and net income, excluding merger-related expenses, included in LCNB's consolidated condensed statement of income for the year ended December 31, 2018 were as follows (in thousands):

Total revenue	$6,972
Net income	3,896

The following table presents unaudited pro forma information as if the merger with CFB had occurred on January 1, 2016 (in thousands). This pro forma information gives effect to certain adjustments, including purchase accounting fair value adjustments, amortization of the core deposit intangible, and related income tax effects. It does not include merger and data conversion costs. The pro forma information does not necessarily reflect the results of operations that would have occurred had the merger with CFB occurred in 2016. In particular, expected operational cost savings are not reflected in the pro forma amounts.

	2018	2017	2016
Total revenue	$64,558	63,779	61,602
Net income	17,858	15,852	14,407
Basic earnings per common share	1.22	1.20	1.09
Diluted earnings per common share	1.22	1.19	1.09

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NOTE 3 - INVESTMENT SECURITIES

The amortized cost and estimated fair value of equity and debt securities at December 31 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2018				
Debt Securities Available-for-Sale:				
U.S. Treasury notes	$ 2,278	—	43	2,235
U.S. Agency notes	80,708	—	2,368	78,340
U.S. Agency mortgage-backed securities	57,584	7	1,981	55,610
Municipal securities:				
Non-taxable	86,059	77	1,422	84,714
Taxable	17,654	102	234	17,522
	$ 244,283	186	6,048	238,421
Debt Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 26,021	84	635	25,470
Taxable	3,700	—	146	3,554
	$ 29,721	84	781	29,024
2017				
Equity Securities with a Readily Determinable Fair Value:				
Mutual funds	$ 1,586	2	46	1,542
Trust preferred securities	49	1	—	50
Equity securities	475	97	4	568
	$ 2,110	100	50	2,160
Debt Securities Available-for-Sale:				
U.S. Treasury notes	$ 2,283	—	24	2,259
U.S. Agency notes	84,837	57	1,633	83,261
U.S. Agency mortgage-backed securities	68,347	33	1,227	67,153
Municipal securities:				
Non-taxable	102,849	343	1,018	102,174
Taxable	20,313	175	122	20,366
	$ 278,629	608	4,024	275,213
Debt Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 28,871	101	227	28,745
Taxable	3,700	—	95	3,605
	$ 32,571	101	322	32,350

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(Continued)

NOTE 3 - INVESTMENT SECURITIES (Continued)

Information concerning debt securities with gross unrealized losses at December 31, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	Less Than Twelve Months		Twelve Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2018				
Available-for-Sale:				
U.S. Treasury notes	$—	—	2,235	43
U.S. Agency notes	4,988	7	73,351	2,361
U.S. Agency mortgage-backed securities	137	—	55,217	1,981
Municipal securities:				
Non-taxable	14,264	49	58,211	1,373
Taxable	—	—	14,407	234
	$19,389	56	203,421	5,992
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$366	1	18,588	634
Taxable	400	1	3,154	145
	$766	2	21,742	779
2017				
Available-for-Sale:				
U.S. Treasury notes	$2,259	24	—	—
U.S. Agency notes	33,651	344	44,560	1,289
U.S. Agency mortgage-backed securities	24,433	142	41,080	1,085
Municipal securities:				
Non-taxable	36,348	315	24,197	703
Taxable	11,068	114	1,032	8
	$107,759	939	110,869	3,085
Held-to-Maturity:				
Municipal securities:				
Non-taxable	$9,824	133	3,542	94
Taxable	—	—	3,205	95
	$9,824	133	6,747	189

Management has determined that the unrealized losses at December 31, 2018 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because the Company does not have the intent to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their amortized cost, the Company does not consider these investments to be other-than-temporarily impaired.

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NOTE 3 - INVESTMENT SECURITIES (Continued)

Contractual maturities of debt securities at December 31, 2018 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$14,768	14,699	3,200	3,195
Due from one to five years	112,871	110,829	3,143	3,069
Due from five to ten years	57,336	55,633	7,982	7,787
Due after ten years	1,724	1,650	15,396	14,973
	186,699	182,811	29,721	29,024
U.S. Agency mortgage-backed securities	57,584	55,610	—	—
	$244,283	238,421	29,721	29,024

Debt securities with a market value of $106,568,000 and $108,751,000 at December 31, 2018 and 2017, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

Certain information concerning the sale of equity and debt securities available-for-sale for the years ended December 31 was as follows (in thousands):

	2018	2017	2016
Proceeds from sales	$8,545	43,246	92,455
Gross realized gains	21	247	1,103
Gross realized losses	29	14	21

Beginning January 1, 2018, equity securities with a readily determinable fair value are carried at fair value, with changes in fair value recognized in other operating income in the consolidated statements of income. Equity securities without a readily determinable fair value are measured at cost minus impairment, if any, plus or minus any changes resulting from observable price changes in orderly transactions, as defined, for identical or similar investments of the same issuer. LCNB was not aware of any impairment or observable price change adjustments that needed to be made at December 31, 2018 on its investments in equity securities without a readily determinable fair value.

The amortized cost and estimated fair value of equity securities with a readily determinable fair value at December 31 are summarized as follows (in thousands):

	2018		2017	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Mutual funds	$1,651	1,559	1,586	1,542
Trust preferred securities	—	—	49	50
Equity securities	471	519	475	568
Total equity securities with a readily determinable fair value	$2,122	2,078	2,110	2,160

Certain information concerning changes in fair value of equity securities with a readily determinable fair value for the year ended December 31, 2018 was as follows (in thousands):

Net losses recognized	$(73)

Less net realized gains on equity securities sold	20
Unrealized losses recognized and still held at period end	$(93)

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(Continued)

NOTE 4 - LOANS

Major classifications of loans at December 31 were as follows (in thousands):

	2018	2017
Commercial and industrial	$77,740	36,057
Commercial, secured by real estate	740,647	527,947
Residential real estate	349,127	251,582
Consumer	17,283	17,450
Agricultural	13,297	15,194
Other loans, including deposit overdrafts	450	539
	1,198,544	848,769
Deferred origination costs, net	79	291
	1,198,623	849,060
Less allowance for loan losses	4,046	3,403
Loans-net	$1,194,577	845,657

Non-accrual, past-due, and accruing restructured loans at December 31 were as follows (dollars in thousands):

	2018	2017
Non-accrual loans:		
Commercial and industrial	$—	—
Commercial, secured by real estate	1,767	2,183
Residential real estate	1,007	604
Agricultural	177	178
Total non-accrual loans	2,951	2,965
Past-due 90 days or more and still accruing	149	—
Total non-accrual and past-due 90 days or more and still accruing	3,100	2,965
Accruing restructured loans	10,516	10,469
Total	$13,616	13,434
Percentage of total non-accrual and past-due 90 days or more and still accruing to total loans	0.26 %	0.35 %
Percentage of total non-accrual, past-due 90 days or more and still accruing, and accruing restructured loans to total loans	1.14 %	1.58 %

Interest income that would have been recorded during 2018 and 2017 if loans on non-accrual status at December 31, 2018 and 2017 had been current and in accordance with their original terms was approximately $187,000 and $202,000, respectively.

The Company is not committed to lend additional funds to debtors whose loans have been modified to provide a reduction or deferral of principal or interest because of deterioration in the financial position of the borrower.

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NOTE 4 - LOANS (Continued)

The allowance for loan losses and recorded investment in loans for the years ended December 31 were as follows (in thousands):

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
2018							
Allowance for loan losses:							
Balance, beginning of year	$ 378	2,178	717	76	53	1	3,403
Provision charged to expenses	21	473	213	133	(7)	90	923
Losses charged off	—	(145)	(234)	(135)	—	(179)	(693)
Recoveries	1	239	71	13	—	89	413
Balance, end of year	$ 400	2,745	767	87	46	1	4,046
Individually evaluated for impairment	$ 10	3	49	—	—	—	62
Collectively evaluated for impairment	390	2,742	718	87	46	1	3,984
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of year	$ 400	2,745	767	87	46	1	4,046
Loans:							
Individually evaluated for impairment	$ 268	15,101	1,558	36	177	—	17,140
Collectively evaluated for impairment	76,609	718,709	344,751	17,363	13,135	114	1,170,681
Acquired credit impaired loans	922	6,315	3,229	—	—	336	10,802
Balance, end of year	$ 77,799	740,125	349,538	17,399	13,312	450	1,198,623
2017							
Allowance for loan losses:							
Balance, beginning of year	$ 350	2,179	885	96	60	5	3,575
Provision charged to expenses	(71)	348	(83)	(44)	(7)	72	215
Losses charged off	—	(462)	(225)	(90)	—	(138)	(915)
Recoveries	99	113	140	114	—	62	528
Balance, end of year	$ 378	2,178	717	76	53	1	3,403
Individually evaluated for impairment	$ 8	146	29	8	—	—	191
Collectively evaluated for impairment	370	2,032	688	68	53	1	3,212
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of year	$ 378	2,178	717	76	53	1	3,403

Loans:							
Individually evaluated for impairment	$ 303	11,289	1,351	47	177	—	13,167
Collectively evaluated for impairment	34,792	512,259	248,674	17,516	15,033	137	828,411
Acquired credit impaired loans	1,008	4,048	2,024	—	—	402	7,482
Balance, end of year	$ 36,103	527,596	252,049	17,563	15,210	539	849,060

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December 31, 2018
(Continued)

NOTE 4 - LOANS (Continued)

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
2016							
Allowance for loan losses:							
Balance, beginning of year	$ 244	1,908	854	54	66	3	3,129
Provision charged to expenses	314	358	106	74	(6)	67	913
Losses charged off	(234)	(185)	(127)	(85)	—	(119)	(750)
Recoveries	26	98	52	53	—	54	283
Balance, end of year	$ 350	2,179	885	96	60	5	3,575
Individually evaluated for impairment	$ 9	55	100	13	—	—	177
Collectively evaluated for impairment	341	1,832	785	83	60	5	3,106
Acquired credit impaired loans	—	292	—	—	—	—	292
Balance, end of year	$ 350	2,179	885	96	60	5	3,575

The risk characteristics of LCNB's material loan portfolio segments were as follows:

Commercial and Industrial Loans. LCNB’s commercial and industrial loan portfolio consists of loans for various purposes, including loans to fund working capital requirements (such as inventory and receivables financing) and purchases of machinery and equipment. LCNB offers a variety of commercial and industrial loan arrangements, including term loans, balloon loans, and lines of credit. Most commercial and industrial loans have a fixed rate, with maturities ranging from one year to ten years. Commercial and industrial loans are offered to businesses and professionals for short and medium terms on both a collateralized and uncollateralized basis. Commercial and industrial loans typically are underwritten on the basis of the borrower’s ability to make repayment from the cash flow of the business. Collateral, when obtained, may include liens on furniture, fixtures, equipment, inventory, receivables, or other assets. As a result, such loans involve complexities, variables, and risks that require thorough underwriting and more robust servicing than other types of loans.

Commercial, Secured by Real Estate Loans. Commercial real estate loans include loans secured by a variety of commercial, retail, and office buildings, religious facilities, multifamily (more than four-family) residential properties, construction and land development loans, and other land loans. Commercial real estate loan products generally amortize over five to twenty-five years and are payable in monthly principal and interest installments. Some have balloon payments due within one to ten years after the origination date. The majority have adjustable interest rates with adjustment periods ranging from one to ten years, some of which are subject to established “floor” interest rates.

Commercial real estate loans are underwritten based on the ability of the property, in the case of income producing property, or the borrower’s business to generate sufficient cash flow to amortize the debt. Secondary emphasis is placed upon global debt service, collateral value, financial strength of any and all guarantors, and other factors. Commercial real estate loans are generally originated with a 75% to 85% maximum loan to appraised value ratio, depending upon borrower occupancy.

Residential Real Estate Loans. Residential real estate loans include loans secured by first or second mortgage liens on one to four-family residential property. Home equity lines of credit and mortgage loans secured by owner-occupied agricultural property are included in this category. First and second mortgage loans are generally amortized over five to thirty years with monthly principal and interest payments. Home equity lines of credit generally have a five year or less draw period with interest only payments followed by a repayment period with monthly payments based on the amount outstanding. LCNB offers both fixed and adjustable rate mortgage loans. Adjustable rate loans are available with adjustment periods ranging between one to ten years and adjust according to an established index plus a margin, subject to certain floor and ceiling rates. Home equity lines of credit have a variable rate based on the Wall Street Journal prime rate plus a margin.

LCNB does not originate reverse mortgage loans or residential real estate loans generally considered to be “subprime.”

NOTE 4 - LOANS (Continued)

Residential real estate loans are underwritten primarily based on the borrower's ability to repay, prior credit history, and the value of the collateral. LCNB requires private mortgage insurance for first mortgage loans that have a loan to appraised value ratio of greater than 80%.
Consumer Loans. LCNB's portfolio of consumer loans generally includes secured and unsecured loans to individuals for household, family and other personal expenditures. Secured loans include loans to fund the purchase of automobiles, recreational vehicles, boats, and similar acquisitions. Consumer loans made by LCNB generally have fixed rates and terms ranging up to 72 months, depending upon the nature of the collateral, size of the loan, and other relevant factors.

Consumer loans generally have higher interest rates, but pose additional risks of collectability and loss when compared to certain other types of loans. Collateral, if present, is generally subject to damage, wear, and depreciation. The borrower's ability to repay is of primary importance in the underwriting of consumer loans.

Agricultural Loans. LCNB's portfolio of agricultural loans includes loans for financing agricultural production or for financing the purchase of equipment used in the production of agricultural products. LCNB's agricultural loans are generally secured by farm machinery, livestock, crops, vehicles, or other agricultural-related collateral.

The Company uses a risk-rating system to quantify loan quality. A loan is assigned to a risk category based on relevant information about the ability of the borrower to service the debt including, but not limited to, current financial information, historical payment experience, credit documentation, public information, and current economic trends. The categories used are:

- Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.

- Other Assets Especially Mentioned (OAEM) - loans in this category are currently protected but are potentially weak. These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.

- Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Company will sustain some loss if the deficiencies are not corrected.

- Doubtful – loans classified in this category have all the weaknesses inherent in loans classified 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.

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(Continued)

NOTE 4 - LOANS (Continued)

An analysis of the Company's loan portfolio by credit quality indicators at December 31 is as follows (in thousands):

	Pass	OAEM	Substandard	Doubtful	Total
2018					
Commercial & industrial	$74,530	89	3,180	—	77,799
Commercial, secured by real estate	718,233	768	21,124	—	740,125
Residential real estate	344,432	—	5,106	—	349,538
Consumer	17,381	—	18	—	17,399
Agricultural	13,116	—	196	—	13,312
Other	450	—	—	—	450
Total	$1,168,142	857	29,624	—	1,198,623
2017					
Commercial & industrial	$35,683	176	244	—	36,103
Commercial, secured by real estate	506,833	2,180	18,583	—	527,596
Residential real estate	250,039	—	2,010	—	252,049
Consumer	17,522	—	41	—	17,563
Agricultural	14,233	—	977	—	15,210
Other	539	—	—	—	539
Total	$824,849	2,356	21,855	—	849,060

The Company evaluates the loan risk grading system definitions and allowance for loan loss methodology on an ongoing basis. No significant changes were made to either during the past year.

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December 31, 2018
(Continued)

NOTE 4 - LOANS (Continued)

A loan portfolio aging analysis at December 31 is as follows (in thousands):

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
2018							
Commercial & industrial	$626	173	—	799	77,000	77,799	—
Commercial, secured by real estate	347	141	347	835	739,290	740,125	—
Residential real estate	905	536	1,046	2,487	347,051	349,538	149
Consumer	14	—	—	14	17,385	17,399	—
Agricultural	19	—	178	197	13,115	13,312	—
Other	114	—	—	114	336	450	—
Total	$2,025	850	1,571	4,446	1,194,177	1,198,623	149
2017							
Commercial & industrial	$—	—	—	—	36,103	36,103	—
Commercial, secured by real estate	124	—	598	722	526,874	527,596	—
Residential real estate	362	135	496	993	251,056	252,049	—
Consumer	29	2	—	31	17,532	17,563	—
Agricultural	—	—	177	177	15,033	15,210	—
Other	82	—	—	82	457	539	—
Total	$597	137	1,271	2,005	847,055	849,060	—

LCNB CORP. AND SUBSIDIARIES
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December 31, 2018
(Continued)

NOTE 4 - LOANS (Continued)

Impaired loans, including acquired credit impaired loans, for the years ended December 31 were as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2018					
With no related allowance recorded:					
Commercial & industrial	$ 926	1,457	—	945	71
Commercial, secured by real estate	21,266	22,451	—	17,353	1,136
Residential real estate	4,122	4,872	—	3,580	258
Consumer	13	13	—	32	3
Agricultural	177	177	—	177	—
Other	336	475	—	379	41
Total	$ 26,840	29,445	—	22,466	1,509
With an allowance recorded:					
Commercial & industrial	$ 264	269	10	279	17
Commercial, secured by real estate	150	150	3	153	11
Residential real estate	665	684	49	583	37
Consumer	23	23	—	24	1
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	$ 1,102	1,126	62	1,039	66
Total:					
Commercial & industrial	$ 1,190	1,726	10	1,224	88
Commercial, secured by real estate	21,416	22,601	3	17,506	1,147
Residential real estate	4,787	5,556	49	4,163	295
Consumer	36	36	—	56	4
Agricultural	177	177	—	177	—
Other	336	475	—	379	41
Total	$ 27,942	30,571	62	23,505	1,575

NOTE 4 - LOANS (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
2017					
With no related allowance recorded:					
Commercial & industrial	$ 1,015	1,100	—	685	88
Commercial, secured by real estate	12,677	13,608	—	14,113	1,068
Residential real estate	2,822	3,516	—	3,216	546
Consumer	6	6	—	20	2
Agricultural	177	177	—	269	12
Other	402	554	—	441	55
Total	$ 17,099	18,961	—	18,744	1,771
With an allowance recorded:					
Commercial & industrial	$ 296	301	8	311	18
Commercial, secured by real estate	2,660	2,660	146	2,739	45
Residential real estate	553	572	29	596	19
Consumer	41	41	8	43	3
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	$ 3,550	3,574	191	3,689	85
Total:					
Commercial & industrial	$ 1,311	1,401	8	996	106
Commercial, secured by real estate	15,337	16,268	146	16,852	1,113
Residential real estate	3,375	4,088	29	3,812	565
Consumer	47	47	8	63	5
Agricultural	177	177	—	269	12
Other	402	554	—	441	55
Total	$ 20,649	22,535	191	22,433	1,856

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(Continued)

NOTE 4 - LOANS (Continued)

	Average Recorded Investment	Interest Income Recognized
2016		
With no related allowance recorded:		
Commercial & industrial	$ 998	151
Commercial, secured by real estate	15,274	1,140
Residential real estate	3,736	369
Consumer	37	29
Agricultural	392	136
Other	481	77
Total	$ 20,918	1,902