CONSOLIDATED FINANCIAL STATEMENTS

Pioneer Bancshares, Inc. and Subsidiary
Years Ended December 31, 2017 and 2016
With Independent Auditor's Report

Pioneer Bancshares, Inc. and Subsidiary

Consolidated Financial Statements

Years Ended December 31, 2017 and 2016

Contents

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Independent Auditor's Report

Board of Directors
Pioneer Bancshares, Inc. and Subsidiary
Austin, Texas

Report on the Consolidated Financial Statements and Internal Control

We have audited the accompanying consolidated financial statements of Pioneer Bancshares, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheets as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements. We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in the *Internal Control - Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Management's Responsibility for the Financial Statements and Internal Control Over Financial Reporting

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement and whether effective internal control over financial reporting was maintained in all material respects.

An audit of consolidated financial statements involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit of consolidated financial statements also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

An audit of internal control over financial reporting involves performing procedures to obtain evidence about whether a material weakness exists. The procedures selected depend on the auditor's judgment, including the assessment of the risk that a material weakness exists. An audit of internal control over financial reporting also involves obtaining an understanding of internal control over financial reporting and testing and evaluating the design and operating effectiveness of internal control over financial reporting based on the assessed risk.

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

Definition and Inherent Limitations of Internal Control Over Financial Reporting

An entity's internal control over financial reporting is a process effected by those charged with governance, management, and other personnel, designed to provide reasonable assurance regarding the preparation of reliable consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audits were conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our audit of the Company's internal control over financial reporting included controls over the preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9-C).

An entity'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 entity; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the entity are being made only in accordance with authorizations of management and those charged with governance; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the entity'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 and correct, misstatements. Also, projections of any assessment 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.

Opinions

In our opinion, the consolidated financial statements referred to previously present fairly, in all material respects, the financial position of Pioneer Bancshares, Inc. and Subsidiary as of December 31, 2017 and 2016, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in the *Internal Control - Integrated Framework* (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The Computation of Adjusted Net Worth for Recertification of Supervised and Nonsupervised Mortgagees listed in the table of contents is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 6, 2018, on our consideration of the Company's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control over financial reporting and compliance.

BKD, LLP

Houston, Texas
April 6, 2018

Name of Engagement Partner: Deborah S. Scanlon
Federal Employer Identification Number: 44-0160260

Pioneer Bancshares, Inc. and Subsidiary

Consolidated Balance Sheets

(Dollars in thousands, except per share amounts)

	December 31	
	2017	2016
Assets		
Cash and due from banks	$ 4,545	$ 7,611
Interest-bearing deposits in financial institutions	180,272	72,657
Cash and cash equivalents	184,817	80,268
Time deposits in banks	3,215	7,732
Securities available for sale, at fair value	131,032	81,318
Securities held to maturity (fair value of $861 in 2017 and $955 in 2016)	790	845
Loans held for sale	1,767	1,292
Loans	862,813	879,123
Less allowance for loan losses	(8,021)	(7,898)
Loans, net	854,792	871,225
Premises and equipment, net	46,159	46,739
Cash surrender value of life insurance policies	24,502	26,843
Restricted investment securities	10,347	1,445
Net deferred tax asset	29,768	55,169
Accrued interest receivable and other assets	12,209	9,722
Total assets	$ 1,299,398	$ 1,182,598
Liabilities and shareholders' equity		
Liabilities		
Deposits		
Noninterest-bearing	$ 194,224	$ 192,243
Interest-bearing	737,202	837,270
Total deposits	931,426	1,029,513
Federal Home Loan Bank advances	225,000	-
Accrued interest payable and other liabilities	6,012	6,567
Total liabilities	1,162,438	1,036,080
Shareholders' equity		
Common stock, $1.00 par value, 10,000,000 shares authorized, 6,180,389 and 6,044,639 shares issued and outstanding at December 31, 2017 and 2016	6,180	6,045
Additional paid-in capital	260,849	258,936
Accumulated deficit	(128,210)	(116,652)
Accumulated other comprehensive loss	(1,859)	(1,811)
Total shareholders' equity	136,960	146,518
Total liabilities and shareholders' equity	$ 1,299,398	$ 1,182,598

See accompanying notes to consolidated financial statements.

Pioneer Bancshares, Inc. and Subsidiary
Consolidated Statements of Operations
(Dollars in thousands)

	Years Ended December 31	
	2017	2016
Interest income		
Loans	$ 44,049	$ 41,543
Securities	2,238	1,780
Other investments	993	629
Total interest income	47,280	43,952
Interest expense		
Deposits	6,694	6,165
Borrowed funds	814	3
Total interest expense	7,508	6,168
Net interest income	39,772	37,784
Provision for loan losses	539	2,153
Net interest income after provision for loan losses	39,233	35,631
Noninterest income		
Service charges	2,909	2,494
Gain on sale of loans	2,365	2,020
Income on life insurance assets	750	739
Other	2,116	488
Total noninterest income	8,140	5,741
Noninterest expense		
Salaries and employee benefits	19,468	23,659
Net occupancy and equipment	5,919	5,724
Data processing	3,554	3,850
Professional fees	1,326	2,243
FDIC insurance assessment	805	775
Amortization of intangible assets	549	520
Other	3,793	4,600
Total noninterest expense	35,414	41,371
Net income before income taxes	11,959	1
Income tax expense (benefit)	23,847	(21,748)
Net income (loss)	$ (11,888)	$ 21,749

See accompanying notes to consolidated financial statements.

Pioneer Bancshares, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income (Loss)

(Dollars in thousands)

	Years Ended December 31	
	2017	2016
Net income (loss)	$ (11,888)	$ 21,749
Other comprehensive income (loss), before tax:		
Securities available for sale:		
Net unrealized gain (loss) arising during period	443	(1,835)
Reclassification of loss to net income	(13)	-
Other comprehensive income (loss) before tax	430	(1,835)
Income tax expense (benefit) related to items of other comprehensive income (loss)	148	(642)
Other comprehensive income (loss), net of tax	282	(1,193)
Comprehensive income (loss), net	$ (11,606)	$ 20,556

See accompanying notes to consolidated financial statements.

Pioneer Bancshares, Inc. and Subsidiary

Consolidated Statements of Changes in Shareholders' Equity

(Dollars in thousands)

	Common Stock		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	
	Shares	Amount	Capital	Deficit	Loss	Total
Balance - January 1, 2016	3,637,234	$ 3,637	$ 212,726	$ (132,370)	$ (618)	$ 83,375
Common stock in lieu of preferred stock dividend	-	-	6,031	(6,031)	-	-
Fair value of consideration exchanged	2,379,884	2,380	39,268	-	-	41,648
Distribution to FCH shareholders for non-qualified shares	-	-	(522)	-	-	(522)
Additional paid-in capital in reverse merger	-	-	1,224	-	-	1,224
Stock option expense	-	-	74	-	-	74
Exercise of stock options	27,521	28	135	-	-	163
Comprehensive income, net	-	-	-	21,749	(1,193)	20,556
Balance - December 31, 2016	6,044,639	6,045	258,936	(116,652)	(1,811)	146,518
Reclassification of amounts within AOCI to RE due to tax reform	-	-	-	330	(330)	-
Stock option expense	-	-	491	-	-	491
Exercise of stock options and warrants	135,750	135	1,422	-	-	1,557
Comprehensive loss	-	-	-	(11,888)	282	(11,606)
Balance - December 31, 2017	6,180,389	$ 6,180	$ 260,849	$ (128,210)	$ (1,859)	$ 136,960

See accompanying notes to consolidated financial statements.

Pioneer Bancshares, Inc. and Subsidiary
Consolidated Statements of Cash Flows
(Dollars in thousands)

	Years Ended December 31	
	2017	2016
Operating activities		
Net income (loss)	$ (11,888)	$ 21,749
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	539	2,153
Depreciation and amortization	4,211	3,205
Amortization of loan origination fees and costs, net	1,300	1,393
Accretion related to acquired loans	(306)	(1,495)
Gain on sale of loans	(2,365)	(2,020)
Income on life insurance assets	(750)	(739)
Deferred tax expense (benefit)	23,647	(24,532)
Loans held for sale	(475)	(1,292)
Change in operating assets and liabilities:		
Accrued interest receivable and other assets	(2,106)	2,074
Accrued interest payable and other liabilities	(555)	2,994
Net cash provided by operating activities	11,252	3,490
Investing activities		
Maturity of time deposits in banks	4,517	4,689
Securities available for sale:		
Purchases	(586,412)	(266,916)
Proceeds from maturities, sales and pay downs	536,655	269,059
Maturity of security held to maturity	55	55
Purchase of loan	(13,558)	(11,613)
Mortgage/SBA loans sold	43,194	39,123
Net (increase) decrease in loans	(12,868)	(76,010)
Proceeds from sales of foreclosed assets	1,593	1,071
Purchases of bank premises and equipment, net	(2,538)	(13,737)
Proceeds from reduction in life insurance	3,091	-
Net (increase) decrease in restricted investment securities	(8,902)	1,904
Net cash received from acquisition	-	48,920
Net cash used in investing activities	(35,173)	(3,455)
Financing activities		
Net increase (decrease) in deposits	(98,087)	52,541
Exercise of stock options, warrants and other equity transactions, net	1,557	(359)
Proceeds from (repayment of) Federal Home Loan Bank short-term advances	330,000	(10,006)
Proceeds from Federal Home Loan Bank callable long-term borrowings	75,000	-
Repayment of Federal Home Loan Bank callable long-term borrowings	(180,000)	-
Net cash provided by financing activities	128,470	42,176
Net increase in cash and cash equivalents	104,549	42,211
Cash and cash equivalents at beginning of year	80,268	38,057
Cash and cash equivalents at end of year	$ 184,817	$ 80,268
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$ 7,838	$ 5,969
Fair value of consideration in the exchange	$ -	$ 41,648

See accompanying notes to consolidated financial statements.

1. Organization and Summary of Significant Accounting and Reporting Policies

Nature of Operations and Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Pioneer Bancshares, Inc. (and its wholly owned subsidiary, Pioneer Bank, SSB, referred to collectively as the Company). Intercompany balances and transactions have been eliminated in consolidation.

As described in Note 2, Business Combination, FC Holdings, Inc. (FCH) and Pioneer Bancshares, Inc. merged effective February 29, 2016, with the combined companies continuing as Pioneer Bancshares, Inc. This business combination also resulted in the merger of FCH's subsidiary, First Community Bank, N.A. and Pioneer Bank, SSB, with the combined banks operating under the Pioneer Bank brand. The merger has been accounted for as a reverse acquisition and, as a result, the historical financial statements presented for the Company are the historical financial statements of FCH.

The Company, through its subsidiary banking operations, provides a broad line of financial products and services for small- to medium-size businesses and consumers. The Company operates from its headquarters in Austin, Texas and 20 banking offices located primarily in the Austin, Houston, San Antonio, and Dallas metro areas. Its primary deposit products are checking, savings, and term certificate accounts, and its primary lending products are commercial, construction and land development, commercial and residential mortgage, and consumer loans.

Substantially all of the Company's loans, commitments, and letters of credit have been granted to customers in the Company's market areas. Substantially all loans are secured by specific items of collateral including business assets, consumer assets, and commercial and residential real estate. Commercial loans are expected to be repaid from cash flow from operations of businesses, including the successful completion of construction and land development projects. The customers' ability to repay their loans is dependent on the real estate and general economic conditions in their respective market area.

The Company's primary sources of revenue are from lending and investing activities, along with fees for banking services provided.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America (GAAP) and prevailing practices within the banking industry. A summary of significant accounting policies follows.

Use of Estimates

In preparing financial statements in conformity with GAAP, management is required to make estimates and assumptions based on available information. These estimates and assumptions affect the reported amounts in the consolidated financial statements and the disclosures provided, and actual results could differ. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuations of foreclosed assets, valuation of deferred tax assets, and the estimated fair values of financial instruments. In addition, bank regulatory agencies may require the Company to recognize additional losses on loans and other assets based on their judgments about information available to them at the time of their examinations.

Cash and Cash Equivalents

Cash and cash equivalents include cash and deposits with other financial institutions that have an initial maturity of less than 90 days.

Cash on hand or on deposit with the Federal Reserve Bank of Dallas (FRB) to satisfy regulatory reserve and clearing requirements was $16.2 million and $14.6 million at December 31, 2017 and 2016.

The Company's largest correspondent bank balances are with BBVA Compass, Legacy Texas Bank, Texas Capital Bank, the FRB, Green Bank and Veritex Bank. The Federal Home Loan Bank of Dallas (FHLB) is another significant correspondent relationship. Interest-bearing and other deposits maintained with correspondent financial institutions often exceed the amount of insurance provided on such deposits. In monitoring this credit risk, the Company periodically evaluates the stability of the financial institutions with which it has deposits. The Company has cash deposits and overnight investments in correspondent financial institutions in excess of the amount insured by the federal government in the approximate amount of $157.1 million and $37.2 million at December 31, 2017 and 2016.

Time Deposits in Banks

Time deposits in banks have a maturity of more than 90 days and are carried at cost. Time deposits in banks are typically covered by deposit insurance.

Securities

Securities are classified between two categories at the time the securities are purchased: held to maturity and available for sale. The Company does not hold trading securities.

Debt securities that the Company has the positive intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized gains and losses reported in other comprehensive income (loss), net of tax. Securities available for sale may be sold as part of the Company's asset/liability strategy or in response to changes in interest risk, prepayment risk, and other economic factors.

Unrealized losses on held-to-maturity and available-for-sale securities are evaluated by management to determine whether declines in fair value below amortized cost are other than temporary. In estimating other-than-temporary impairment (OTTI) losses on debt securities, management considers a number of factors including, but not limited to, the length of time and the extent to which the fair value has been less than the amortized cost, the financial condition and near-term prospects of the issuer, and current market conditions. Management also assesses whether it intends to sell, or it is more likely than not that it will be required to sell, a security in an unrealized loss position before recovery of its amortized cost basis.

If either of the criteria regarding intent or requirement to sell is met, the entire difference between amortized cost and fair value is recognized as impairment through earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment is split in two components as follows: (1) OTTI related to credit loss, which must be recognized in the income statement and (2) OTTI related to other factors, which is recognized in other comprehensive income (loss).

Securities are accounted for on a trade-date basis. Premiums and discounts are amortized and accreted to operations using the level-yield method of accounting and adjusted for prepayments as applicable. The specific identification method is used to compute gains or losses on the sales of these assets.

Restricted Investment Securities

Restricted investment securities include FHLB stock, TIB-The Independent BankersBank stock, and Federal Agricultural Mortgage Corporation stock. Restricted investment securities are carried at cost on the consolidated balance sheets. These equity securities are “restricted” in that they can only be sold back to the respective institution or another member institution at par. Therefore, they are less liquid than other marketable equity securities. The Company views its investment in restricted stock as a long-term investment. Accordingly, when evaluating for impairment, the value is determined based on the ultimate recovery of the par value, rather than recognizing temporary declines in value. No other-than-temporary write-downs have been recorded on these securities.

Dividends and other distributions on these investments are recognized in interest income.

Loans Held for Sale

Certain commercial and residential mortgage loans are originated for sale in the secondary loan market. These loans are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. No unrealized losses were recognized during 2017 or 2016. To mitigate interest rate risk, fixed rate commitments may be obtained at the time loans are originated or identified for sale. Gains and losses on the sale of loans classified as available for sale are recorded on the trade date using the specific-identification method.

Loans

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported the principal balance outstanding, net of an allowance for loan losses and deferred fees or costs on originated loans. Interest on originated loans is recognized by using the simple interest method.

Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield over the contractual life of the loan. Interest income on mortgage and commercial loans is discontinued at the time the loan is 90 days delinquent (non-accrual status) unless the loan is well-secured and in process of collection. Consumer loans are typically charged off when they are 120 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful. Nonaccrual loans and loans past due 90 days still on accrual include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

All interest accrued but not received for loans placed on nonaccrual are reversed against interest income. Interest received on such loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. A loan may be returned to accrual status when all the principal and interest amounts contractually due are brought current and future principal and interest amounts contractually due are reasonably assured, which is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

Premiums paid on purchased loans are capitalized and recognized as an adjustment of the related loan yield over the contractual life of the loan, or a shorter period using prepayment history.

Purchased Credit Impaired Loans

As part of the business combination described in Note 2, the Company acquired loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The Company accounts for purchased credit impaired loans (PCI loans) according to Accounting Standards Codification (ASC) 310-30, *Accounting for Certain Loans or Debt Securities acquired in a Transfer*.

These purchased credit impaired loans are recorded at fair value, such that there is no carryover of the acquired entity’s allowance for loan losses. After acquisition, losses are recognized by an increase in the allowance for loan losses.

Purchased credit impaired loans are accounted for individually. The fair value of the PCI loan portfolio is estimated using key assumptions including default rates, loss severities, estimated recovery periods, and other factors that reflect current market conditions. The Company estimates the amount and timing of expected cash flows for each loan, and the expected cash flows in excess of amount paid is recorded as interest income over the remaining life of the loan (accretable yield). The excess of the loan's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable incurred credit losses. Loan losses are charged against the allowance when management believes the uncollectbility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance. Allocations of the allowance may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, should be charged off.

See Note 4 for additional information on the allowance for loan losses.

Premises and Equipment

Premises and equipment are carried at cost less accumulated depreciation and amortization. Premises and equipment purchased as part of the business combination described in Note 2 are carried at fair value, less accumulated depreciation and amortization since the date of merger. Depreciation expense is computed principally on the straight-line method over the estimated useful lives of the assets, generally three to thirty years. Leasehold improvements are amortized over the life of the lease or the estimated useful lives of the assets, whichever is shorter. Land is carried at cost.

Cash Surrender Value of Life Insurance Policies

The Company has purchased life insurance policies on certain key executives. Company owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet dates, which is the cash surrender value adjusted for charges or amounts due that are probable at settlement.

Foreclosed Assets and Other Real Estate Owned

Assets acquired by foreclosure are initially recorded at the fair value of the property, less any selling costs, as applicable, at the time of foreclosure establishing a new cost basis. If necessary, at the time of foreclosing, any excess of the related loan balance over fair value (less estimated costs to sell) is charged to the allowance for loan losses. Subsequent to foreclosure, the asset is carried at the lower of its new cost basis or fair value, less estimated costs to sell. Subsequent adjustments to reflect increases or decreases in value related to the new cost basis are recorded in earnings in the period such determination is assessed. For the years ended December 31, 2017 and 2016, $463 and zero relating to subsequent net increases in value have been recorded in other noninterest income.

Goodwill and Core Deposit Intangibles, Net

Goodwill resulting from business combinations is generally determined as the excess of the fair value of the consideration transferred over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill is not amortized, but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. Goodwill is the only intangible asset with an indefinite life on the Company's consolidated balance sheets.

The Company's core deposit intangibles arise from bank acquisitions and are amortized on a straight-line basis over their estimated useful lives of five years.

Stock Incentive Plans

The Company accounts for its stock incentive plans in accordance with ASC 718, *Compensation – Stock Compensation* which requires the compensation cost relating to share-based payment transactions be recognized in the consolidated financial statements, and also requires entities to measure the cost of employee services received in exchange for stock options based on the grant-date fair value of the award, and to recognize the cost over the period the employee is required to provide services for the award. The ASC guidance permits entities to use any option-pricing model that meets the fair value objective of ASC. As a result, compensation cost has been measured using the fair value of an award on the grant date and is recognized over the service period, which is usually the vesting period.

Off-Balance-Sheet Credit Related Financial Instruments

In the ordinary course of business, the Company has entered into commitments to extend credit, including commitments under commercial lines of credit and letters of credit. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. These financial instruments are recorded when they are funded. The Company calculates estimated losses on these commitments generally based on the historical loss factors for each type of loan commitment and carries an allowance, if required, in other liabilities, with any increases or decreases to the allowance included in noninterest expense.

Fair Values of Financial Instruments

The Company estimates the fair value of financial instruments based on the fair value hierarchy. Fair value estimates involve uncertainties and matters of judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of benchmarks for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the assets have been isolated from the Company, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Company does not maintain effective control over the transferred assets through an agreement to repurchase before their maturity.

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other comprehensive income (loss), net of applicable taxes. Other comprehensive income (loss) includes unrealized gains and losses on securities available for sale which are also recognized as a separate component of equity. The Company uses the specific identification method for reclassifying material stranded tax effects in accumulated other comprehensive income (loss) (AOCI) to earnings. The Company elected to apply the provisions of ASU 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. As a result, the Company reclassified $330 from AOCI to retained earnings.

Income Taxes

Income tax expense is the total of the current year income tax due or refundable and the change in deferred tax assets and liabilities.

The Company recognizes deferred tax assets and liabilities based on the differences in the carrying value and tax bases of assets and liabilities and for net operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates in the period of enactment.

Tax Cuts and Jobs Act. The Tax Cuts and Jobs Act was enacted on December 22, 2017. Among other things, the new law (i) establishes a new, flat corporate federal statutory income tax rate of 21%, (ii) eliminates the corporate alternative minimum tax and allows the use of any such carryforwards to offset regular tax liability for any taxable year, (iii) limits the deduction for net interest expense incurred by U.S. corporations, (iv) allows businesses to immediately expense, for tax purposes, the cost of new investments in certain qualified depreciable assets, (v) eliminates or reduces certain deductions related to meals and entertainment expenses, (vi) modifies the limitation on excessive employee remuneration to eliminate the exception for performance-based compensation and clarifies the definition of a covered employee and (vii) limits the deductibility of deposit insurance premiums. The Tax Cuts and Jobs Act also significantly changes U.S. tax law related to foreign operations; however, such changes do not currently impact us.

Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Deferred tax assets are recognized subject to management's judgment that realization is more likely than not (a probability of greater than 50%). The Company is subject to examination of income tax filings for the years 2005 and forward due to its continued tax loss position.

The Company files consolidated federal income tax returns. Under a tax sharing policy, federal income tax expense is allocated to individual subsidiaries as if the tax was calculated on a separate return basis. Interest and penalties, if any, are included in income tax expense.

Reclassifications

Certain reclassifications have been made to 2016 balances to conform to the 2017 presentation. All reclassifications have been applied consistently for the periods presented. The reclassifications had no impact on the Company's net income or shareholders' equity.

2. Business Combination

On August 13, 2015, Pioneer Bancshares, Inc. (PBI) and FC Holdings, Inc. (FCH) entered into an Agreement and Plan of Reorganization (the Agreement) to combine FCH and PBI. The merger became effective February 29, 2016, with the combined companies continuing as Pioneer Bancshares, Inc. The Agreement terms also effected the merger of FCH's subsidiary, First Community Bank, N.A. and PBI's subsidiary, Pioneer Bank, SSB, with the combined banks operating under the Pioneer Bank brand. Combining PBI and FCH presented opportunities to realize economies of scale, including cost savings, operational, marketing and other synergies as follows:

- Expanded and complimentary footprint in three distinct Texas markets (Dallas, Houston and Austin).
- Synergies associated with cost saves in personnel and data processing.
- Fuller, more robust product offering and knowledge in the commercial and mortgage sectors achieved with the merger of the two entities.

Under the Agreement terms, PBI issued 3,637,234 shares to the FCH shareholder group. Individual FCH shareholders designated under the Agreement terms as either an Accredited Investor or a Qualified Investor received 0.0403 shares of PBI common shares in exchange for each FCH common share. The other FCH common shareholders, also as defined in the Agreement, received the right to a cash payment equal to $0.9556 for each share of FCH common stock.

FCH's preferred stock was converted into FCH common shares prior to the effective date of the merger with PBI.

As a result of the merger and as intended by the Agreement, the FCH and PBI shareholder groups owned approximately 60% and 40%, respectively, of the total number of PBI common shares outstanding immediately after the effective date.

JLL/FCH Holdings I, LLC (JLL) owned 88.8% of FCH's common stock as of December 31, 2015, assuming the conversion of all of JLL's preferred stock into FCH common shares. JLL owns 53.9% and 55.1% of PBI's common shares outstanding as of December 31, 2017 and 2016 respectively.

While PBI was the acquiring entity for legal purposes, the merger is being accounted for as reverse acquisition under the provisions of ASC 805-40 – *Reverse Acquisitions*. Under this guidance, for accounting purposes, FCH is the acquirer in the merger and, as a result, the historical financial statements of the combined entity are the historical financial statements of FCH.

The merger transaction was recorded using the acquisition method of accounting. The assets and liabilities of PBI as of the February 29, 2016 effective date of the merger were recorded at their respective estimated fair values and combined with those of FCH. Any excess of the merger consideration over the estimated fair value of PBI's net identifiable assets was allocated to goodwill.

After the February 29, 2016 effective date of the merger, the consolidated financial statements include the results attributable to PBI.

The following table summarizes the purchase price calculation as of the merger date and the identifiable assets purchased and liabilities assumed at their estimated fair values. Fair value measurements for loans, securities, deposits, premises and equipment and equity capital are based on third-party valuations. The fair value of PBI common stock was estimated by analyzing similar transactions and taking into consideration the unique aspects involving a reverse acquisition between two privately held corporations.

(Dollars in thousands, except per share amounts)

Calculation of purchase price		
Shares of PBI common stock outstanding as of February 29, 2016		2,379,884
Estimated fair value per share of PBI common stock on February 29, 2016	$	17.50
Estimated fair value of PBI common stock	$	41,648
Allocation of Purchase Price		
Fair value of consideration transferred	$	41,648
Fair value of assets acquired and liabilities assumed		
Assets		
Cash and cash equivalents		27,806
Time deposits in banks		33,535
Securities		24,249
Loans		343,846
Premises and equipment		19,929
Cash surrender value of life insurance policies		8,000
Core deposit intangible asset		2,323
Net deferred tax asset		2,498
Other assets		3,012
Total assets		465,198
Liabilities		
Deposits		(423,175)
Other liabilities		(1,389)
Total liabilities		(424,564)
Net identifiable assets acquired		40,634
Goodwill as of February 29, 2016 and December 31, 2016	$	1,014
Adjustments to fair value of assets acquired		653
Goodwill as of December 31, 2017	$	1,667

The amount of goodwill recorded reflects the increased market share and related synergies that are expected to result from the merger and represents the excess purchase price over the estimated fair value of the net assets acquired. None of the goodwill is deductible for income tax purposes since the merger is accounted for as a tax-free exchange. The core deposit intangible reflects the estimated fair value of PBI's core deposits acquired with the merger and is being amortized over five years using the straight-line method.

Goodwill was increased by $1,602 due to changes in deferred tax assets related to 2016, offset by $949 due to adjustments to net servicing asset on SBA loan sales for 2016 and prior."

The tax-free exchange resulted in a carryover of tax attributes and tax basis to the Company's subsequent tax filings. The acquired net deferred tax asset includes $1.5 million of net operating loss carryforwards. The net operating loss carryforwards are subject to limitation as to the tax period in which they can be used to reduce future taxable income. Net operating loss carryforwards are also subject to regulatory capital adjustments until fully utilized.

(Dollars in thousands, except per share amounts)

Internal Revenue Code Section 382 provides rules that limit a corporation's ability to utilize net operating loss carryforwards after an equity ownership change of greater than 50 percentage points within a prescribed testing period, generally three years. An ownership change occurs when there is a greater than 50 percent shift in ownership amongst shareholders having at least a 5-percentage point ownership position. A third party analysis was performed and concluded that no Section 382 limitations were triggered as a result of ownership changes commensurate with the merger transaction.

Internal Revenue Code Section 382 limits the annual amount of net operating loss carryforwards that can be used to reduce taxable income in future years. Net operating loss carryforwards are also subject to regulatory capital adjustments until fully utilized.

As part of the business combination, the Company acquired loans for which there was, at acquisition, evidence of deterioration of credit quality since origination and it was probable, at acquisition, that all contractually required payments would not be collected. The contractual amount of acquired impaired loans was $3.8 million at the acquisition date , $1.1 and $1.3 million at December 31, 2017 and 2016 respectively. There was no provision for loan losses on acquired impaired loans in 2017 and 2016.

The following table summarizes the fair value of acquired impaired loans by class as of the February 29, 2016 acquisition date and the carrying value as of December 31, 2017 and 2016.

Acquired impaired loans	Fair Value February 29, 2016	Carrying Value December 31, 2017	Carrying Value December 31, 2016
Commercial	$ 142	$ -	$ 107
Commercial real estate	895	428	613
Total	$ 1,037	$ 428	$ 720

A reconciliation of the contractually required payments to the fair value of the acquired impaired loans at the acquisition date follows:

(Dollars in thousands, except per share amounts)

Acquired impaired loans	February 29, 2016
Contractually required payments including interest	$ 6,529
Less: Contractual cash flows not expected to be collected	(5,237)
Cash flows expected to be collected	1,292
Accretable yield	(255)
Estimated fair value	$ 1,037

Changes in the accretable yield for acquired impaired loans were as follows for the years ended December 31, 2017 and 2016.

Accretable Yield on Acquired Impaired Loans	2017	2016
Beginning balance	$ 87	$ -
Additions due to business combination	-	255
Reclassifications from nonaccretable to accretable	-	615
Accretion	(34)	(753)
Disposals	-	(30)
Ending balance	$ 53	$ 87

In accordance with the acquisition method of accounting, the acquired loans were recorded at fair value and the prior allowance for loan losses was eliminated.

Merger-related charges of approximately $7.8 million were expensed in 2016. These costs were primarily incurred for severance and retention employee benefits, professional services, and fees for early termination of existing data processing agreements.

3. Securities

Securities have been classified in accordance with management's intent. The Company's mortgage-backed securities have been issued by the Government National Mortgage Association (Ginnie Mae), Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). Mortgage-backed securities include collateralized mortgage obligations (CMOs). CMOs are a type of mortgage-backed security that creates separate pools of pass-through rates for different classes of holders with varying maturities, called tranches. SBA pools are the U.S. Small Business Administration guaranteed portion of pools of Section 504 loans. SBA guarantees have the full faith and credit backing of the federal government.

The amortized cost and estimated fair values of debt securities available for sale and held to maturity at December 31, 2017 and 2016, are summarized as follows:

(Dollars in thousands, except per share amounts)

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
2017				
Obligations of U.S. government-sponsored agencies	$ 24,927	$ -	$ (411)	$ 24,516
Mortgage-backed securities	48,404	124	(1,116)	47,412
Corporate debt securities	16,231	-	(215)	16,016
Obligations of state and political subdivisions:				
Tax-exempt	18,382	80	(334)	18,128
Taxable	24,020	1	(461)	23,560
SBA pools	1,431	-	(31)	1,400
Available for sale	$ 133,395	$ 205	$ (2,568)	$ 131,032
Obligations of state and political subdivisions held to maturity	$ 790	$ 71	$ -	$ 861
2016				
Obligations of U.S. government-sponsored agencies	$ 8,021	$ -	$ (178)	$ 7,843
Mortgage-backed securities	50,232	248	(1,451)	49,029
Corporate debt securities	17,573	18	(1,136)	16,455
Obligations of state and political subdivisions (tax-exempt)	6,802	-	(270)	6,532
SBA pools	1,483	-	(24)	1,459
Available for sale	$ 84,111	$ 266	$ (3,059)	$ 81,318
Obligations of state and political subdivisions held to maturity	$ 845	$ 110	$ -	$ 955

The mortgage-backed security investments are primarily related to residential mortgages for 2017 and 2016.

The amortized cost and estimated fair value of securities at December 31, 2017, by contractual maturities, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities, which include CMOs, are shown separately since they are not due at a single maturity date.

(Dollars in thousands, except per share amounts)

	Securities Available for Sale	
Amounts maturing in:	Amortized Cost	Estimated Fair Value
1 year or less	$ 1,004	$ 1,000
1 year through 5 years	11,138	10,918
5 years through 10 years	38,931	38,220
After 10 years	33,918	33,482
Mortgage-backed securities	48,404	47,412
	$ 133,395	$ 131,032

Available for sale debt securities with carrying amounts of approximately $53.4 million and $36.2 million were pledged to secure public deposits and other borrowings at December 31, 2017 and 2016.

The following table shows gross unrealized losses and fair value by length of time for individual securities that have been in a continuous unrealized loss position at December 31, 2017 and 2016.

	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
2017				
Obligations of U.S. government-sponsored agencies	$ (192)	$ 17,225	$ (219)	$ 7,291
Mortgage-backed securities	(106)	12,357	(1,010)	32,240
Corporate debt securities	(90)	6,141	(125)	9,875
Obligations of state and political subdivisions: Tax-exempt	(159)	6,911	(175)	4,706
Taxable	(461)	22,549	-	-
SBA pools	-	-	(31)	1,400
	$ (1,008)	$ 65,183	$ (1,560)	$ 55,512
2016				
Obligations of U.S. government-sponsored agencies	$ (178)	$ 7,843	$ -	$ -
Mortgage-backed securities	(1,451)	38,633	-	-
Corporate debt securities	-	-	(1,136)	13,684
Obligations of state and political subdivisions (tax-exempt)	(270)	6,532	-	-
SBA pools	(24)	1,459	-	-
	$ (1,923)	$ 54,467	$ (1,136)	$ 13,684

The Company evaluates securities for other-than-temporary impairment on at least a quarterly basis and more frequently when economic, market, or security specific concerns warrant such evaluation. Consideration is given to the length of time and the extent to which the fair value has been less than amortized cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment for a period of time sufficient to allow for any anticipated recovery in fair value. In analyzing an issuer's financial condition, the Company may consider whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuers' financial condition. The Company conducts regular reviews of the bond agency ratings of securities and considers whether the securities were issued by or have principal and interest payments guaranteed by the federal government or its agencies. These reviews focus on the underlying rating of the issuer and also include the insurance rating of securities that have an insurance component or guarantee. The ratings and financial condition of the issuers are monitored, as well as the financial condition and ratings of the insurers and guarantors.

Management evaluates whether unrealized losses on securities represent impairment that is other than temporary. If credit impairment is identified, the carrying amount of the security is reduced with a charge to earnings. In making this evaluation, management first considers the reasons for the indicated impairment. These reasons could include changes in market rates relative to those available when the security was acquired, changes in market expectations about the timing of cash flows from securities that can be prepaid, changes in the market's perception of the issuer's financial health, the security's credit quality, and changes in liquidity risk. Management then considers the likelihood of a recovery in fair value sufficient to eliminate the indicated impairment and the length of time over which an anticipated recovery would occur, which could extend the security's maturity. Finally, management determines whether there is both the ability and intent to hold the impaired security until an anticipated recovery, in which case the impairment would be considered temporary. In making this assessment, management considers whether a security continues to be a suitable holding from the perspective of the Company's overall portfolio and asset/liability management strategies. During 2017 and 2016, management determined that there were no security impairments that were other than temporary. Accordingly, no security impairment losses were recognized.

There were no sales of securities in 2016 and one sale in 2017 for a loss of $13. We had $51.7 million of the securities portfolio pledged to public funds deposits as of December 31, 2017.

(Dollars in thousands, except per share amounts)

4. Loans and Allowance for Loan Losses

Loans at December 31 consisted of the following:

	2017	2016
Commercial:		
Commercial	$ 90,028	$ 100,156
Commercial real estate	288,271	277,885
Real estate construction and land	149,992	153,246
Total commercial	528,291	531,287
Consumer:		
Residential real estate first lien	152,136	157,533
Residential real estate second lien	157,600	157,137
Consumer other	21,683	28,919
Total consumer	331,419	343,589
	859,710	874,876
Net deferred loan origination costs and unamortized premium and discount	3,103	4,247
	$ 862,813	$ 879,123

Loan Origination and Risk Management

The Company has certain lending policies, guidelines and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews procedures and guidelines regularly and the Board approves these policies at least annually. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, portfolio composition, loan delinquencies, and nonaccrual and potential problem loans.

Commercial loans are underwritten after evaluating and understanding the borrower's scope of operations. Upon the determination of a legitimate credit need, the Company examines current and projected cash flows to determine the ability of the borrower to repay obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the grantor. The cash flows of the borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets such as accounts receivable or inventory and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the operating entity occupying the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The properties securing the Company's commercial real estate portfolio are diverse in terms of type and geographic location. This diversity helps reduce the Company's exposure to adverse economic events that affect any single market or industry. Management monitors and evaluates commercial real estate loans based on collateral, geography, occupancy, and risk grade criteria. As a general rule, the Company avoids financing single-purpose projects unless mitigated by other factors. The Company also utilizes third-party experts, primarily real estate appraisers, to provide insight and guidance about economic conditions and trends affecting market areas it serves. In addition, management tracks the level of owner-occupied commercial real estate loans versus non-owner occupied loans.

Construction loans are underwritten utilizing feasibility studies, independent appraisal reviews, sensitivity analysis of absorption and lease rates, and financial analysis of the developers and property owners. Construction loans are generally based upon estimates of costs and value associated with the completed project. Construction loans often involve the disbursement of funds with repayment substantially dependent on the ultimate success of the project. Sources of repayment for these types of loans may be permanent loan commitments from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are monitored by on-site inspections and are considered to have higher risks due to the nature of construction lending, general economic conditions and the availability of long-term financing.

The Company originates residential real estate and consumer loans utilizing a computer-based loan origination system to supplement the underwriting process. Management has developed policies and procedures to monitor and manage consumer loan risk. This activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk. Additionally, trend and outlook reports are reviewed by management on a regular basis. Underwriting standards for home equity loans are heavily influenced by statutory requirements, which include, but are not limited to, a maximum combined loan-to-value percentage of 80%, collection remedies, the number of such loans a borrower can have at one time and documentation requirements.

In 2017 and 2016, the Bank purchased $13.6 million and $11.6 million in residential real estate first lien loans from third parties, excluding the loans acquired in the business combination described in Note 2.

The portfolio consists of various types of loans outstanding predominantly to borrowers located in Texas.

(Dollars in thousands, except per share amounts)

The age analysis of loans was as follows:

	Loans Past Due and Still Accruing					
December 31, 2017	30-89 Days	90 Days or More	Total	Nonaccrual Loans	Current Loans	Total Loans
Commercial	$ 146	$ -	$ 146	$ 3,252	$ 86,630	$ 90,028
Commercial real estate	85	-	85	805	287,381	288,271
Real estate construction and land	87	-	87	595	149,310	149,992
Total commercial	318	-	318	4,652	523,321	528,291
Residential real estate first lien	1,909	190	2,099	682	149,355	152,136
Residential real estate second lien	159	-	159	313	157,128	157,600
Consumer other	98	-	98	42	21,543	21,683
Total consumer	2,166	190	2,356	1,037	328,026	331,419
	$ 2,484	$ 190	$ 2,674	$ 5,689	$ 851,347	$ 859,710
December 31, 2016						
Commercial	$ 872	$ 25	$ 897	$ 314	$ 98,945	$ 100,156
Commercial real estate	685	21	706	506	276,673	277,885
Real estate construction and land	506	503	1,009	-	152,237	153,246
Total commercial	2,063	549	2,612	820	527,855	531,287
Residential real estate first lien	1,251	263	1,514	61	155,958	157,533
Residential real estate second lien	493	-	493	416	156,228	157,137
Consumer other	410	-	410	9	28,500	28,919
Total consumer	2,154	263	2,417	486	340,686	343,589
	$ 4,217	$ 812	$ 5,029	$ 1,306	$ 868,541	$ 874,876

Troubled Debt Restructurings

The restructuring of a loan is considered a “troubled debt restructuring” (TDR) if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. Concessions may include reducing interest rates below market rates, principal forgiveness, restructuring amortization schedules and other actions intended to minimize potential losses. New TDRs for the years ended December 31, 2017 and 2016, are set forth in the following table:

(Dollars in thousands, except per share amounts)

2017	Number of Contracts		Amount
Commercial	1	$	134
Commercial real estate	1		452
Residential real estate first lien	1		3
2016			
Residential real estate first lien	3	$	245
Residential real estate second lien	6		188
Consumer other	1		27

The Company's TDRs were primarily the result of extending the amortization and/or maturity date of the loans. The Company did not forgive any principal or interest on any restructured loan. The modifications did not have any significant impact on the Company's determination of the allowance for loan losses. No TDRs defaulted in 2017 and 2016. Two TDRs totaling $89 were restored to accrual status in 2016 (none in 2017).

Impaired Loans

Loans are considered impaired when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the contractual terms of the loan agreement, including scheduled principal and interest payments. The Company individually assesses and evaluates for impairment loans over $100. Impairment is evaluated for loans below this threshold using an automated LTV analysis or discounted cash flow method, depending on collateral. The identification of loans that may be impaired is based on a loan review process whereby the Company maintains an internally classified loan list. Loans on this listing are classified as Substandard, or Doubtful based on probability of repayment, collateral valuation and related collectability. Additionally, loans meeting the criteria of a troubled debt restructuring are also considered impaired. Interest payments on impaired loans are typically applied to principal unless the loan remains on accrual status. Impaired loans, or portions thereof, are charged off when deemed uncollectible.

Interest income recognized after an originated loan is impaired is not material. No additional funds are committed to be advanced in connection with impaired loans.

Acquired loans are recorded at fair value with no allowance brought forward in accordance with acquisition accounting. Acquired impaired loans with an accretable yield are considered to be accruing and performing even though collection of contractual payments on the loans may be in doubt, because income continues to be accreted as long as expected cash flows are reasonably estimable.

(Dollars in thousands, except per share amounts)

The following table presents additional information regarding individually evaluated impaired loans:

	December 31, 2017				December 31, 2016			
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment
With no specific allowance recorded:								
Commercial	$ 2,740	$ 5,230	$ -	$ 1,587	$ 434	$ 437	$ -	$ 339
Commercial real estate	3,038	4,217	-	1,800	562	652	-	948
Real estate construction and land	1,701	1,701	-	851	-	-	-	-
Residential real estate first lien	959	979	-	633	306	345	-	306
Residential real estate second lien	958	983	-	576	193	196	-	193
Consumer other	40	51	-	41	42	44	-	42
With a specific allowance recorded:								
Commercial	$ 1,666	$ 2,688	$ 1,111	$ 833	$ -	$ -	$ -	$ -
Commercial real estate	452	487	47	226	-	-	-	-
Residential real estate second lien	526	548	152	604	681	702	55	1,768
Consumer other	95	95	15	66	37	41	3	31
Total:								
Commercial	$ 9,597	$ 14,323	$ 1,158	$ 5,297	$ 996	$ 1,089	$ -	$ 1,287
Consumer	2,578	2,656	167	1,920	1,259	1,328	58	2,340
	$ 12,175	$ 16,979	$ 1,325	$ 7,217	$ 2,255	$ 2,417	$ 58	$ 3,627

Credit Quality Indicators

As part of the on-going monitoring of the credit quality of the Company's loan portfolio, management tracks certain credit quality indicators including trends related to (i) the level of classified loans, (ii) the delinquency status of loans, (iii) net charge-offs, (iv) nonaccrual loans and (v) general economic conditions.

The Company utilizes a risk grading matrix to assign a risk grade to each of its commercial loans. Loans are graded on a scale of 1 to 9. A description of the general characteristics of the 9 risk grades is as follows.

Pass—Grades 1, 2, 3, 4, 5, 6

While there is no formal regulatory definition for Pass credits, credits not otherwise rated Watch, Substandard, or Doubtful are considered to be Pass credits. The Company utilizes a granular approach in assigning Pass risk grades to account for, among other things, the financial strength and capacity of the borrower and/or guarantors, and the nature, quality, liquidity, and quantity of the collateral held. Grade 1 loans are fully secured by cash or cash equivalent collateral. Grade 2 loans are fully secured by properly margined marketable securities, bonds, or cash surrender value of life insurance. Grade 3 borrowers have strong financial condition and abundant debt service capacity. The loan is well secured or the strength of the borrower/guarantor may warrant unsecured credit. The loan is performing as agreed, and the financial characteristics and trends exceed industry statistics. Grade 4 borrowers have satisfactory and stable financial condition. The borrower has satisfactory debt service capacity and the loan is well secured. The loan is performing as agreed, and the financial characteristics and trends fall in line with industry statistics. Grade 5 borrowers have satisfactory financial condition. Cash flow may be strained, but the loan is still generally performing as agreed. Collateral values adequately preclude loss. Financial characteristics and trends lag industry statistics. Grade 6 borrowers exhibit less than satisfactory financial condition. Stress on cash flow has resulted in payment delinquencies or outside support to make timely payments. Collateral values adequately preclude loss. There may be limited noncompliance with loan covenants.

Watch—Grade 7

Watch is not a recognized regulatory category, but it is extensively used by banks in their credit risk rating activities. For a Grade 7, the borrower's financial condition is deficient. Payment delinquencies may be more common. Collateral values still protect from loss, but margins are narrow. Loan may be reliant on secondary sources of repayment, including liquidation of collateral and guarantor support. Substantial noncompliance with loan covenants exists.

Substandard—Grade 8

A Substandard asset, or a Grade 8 loan, is inadequately protected by the current sound worth and 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 distinct possibility that the bank will sustain some loss if the deficiencies are not corrected. Substandard loans are placed on nonaccrual when management doubts a borrower’s ability to meet payment obligations, which typically occurs when principal or interest payments are 90 days or more past due.

Doubtful—Grade 9

An asset classified Doubtful, or a Grade 9 loan, has all the weaknesses inherent in one 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.

(Dollars in thousands, except per share amounts)

The credit risk profile of commercial loans aggregated by internally assigned grades was as follows:

December 31, 2017	Commercial		Commercial Real Estate		Real Estate Construction and Land	
Pass	$ 85,525	95.0 %	$ 280,231	97.2 %	$ 148,262	98.8 %
Watch	1,251	1.4	7,235	2.5	1,135	0.8
Nonaccrual	3,252	3.6	805	0.3	595	0.4
Total	$ 90,028	100.0 %	$ 288,271	100.0 %	$ 149,992	100.0 %
December 31, 2016						
Pass	$ 95,007	94.9 %	$ 268,692	96.7 %	$ 151,480	98.8 %
Watch	4,835	4.8	8,687	3.1	1,766	1.2
Nonaccrual	314	0.3	506	0.2	-	-
Total	$ 100,156	100.0 %	$ 277,885	100.0 %	$ 153,246	100.0 %

The credit risk profile in 2017 and 2016 of consumer loans aggregated by internally assigned grade was as follows:

December 31, 2017	Residential Real Estate First Lien		Residential Real Estate Second Lien		Consumer Other	
Pass	$ 151,240	99.4 %	$ 154,667	98.1 %	$ 21,512	99.2 %
Watch	214	0.1	2,620	1.7	129	0.6
Nonaccrual	682	0.5	313	0.2	42	0.2
Total	$ 152,136	100.0 %	$ 157,600	100.0 %	$ 21,683	100.0 %
December 31, 2016						
Pass	$ 157,232	99.8 %	$ 153,801	97.9 %	$ 28,762	99.5 %
Watch	240	0.2	2,920	1.8	148	0.5
Nonaccrual	61	-	416	0.3	9	-
Total	$ 157,533	100.0 %	$ 157,137	100.0 %	$ 28,919	100.0 %

Allowance for Loan Losses

The allowance for loan losses is a valuation allowance for probable losses on loans. The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses and is reduced by net charge-offs. All losses are charged to the allowance when the loss actually occurs or when a determination is made that a loss is confirmed. Consumer loans are generally charged off when the loan principal and interest is deemed not collectible and no later than 120 days past due unless the loan is well secured and in the process of collection. Subsequent recoveries, if any, are credited to the allowance. The Company's allowance for loan losses consists of two components including a specific reserve on individual loans that are considered impaired and a general component based upon potential but unidentified losses inherent in the loan portfolio.

If an individually evaluated loan is considered impaired, a specific valuation allowance is allocated through an increase to the allowance for loan losses, if necessary, so that the loan is reported net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of the collateral. Impaired loans or portions thereof, are charged-off when deemed uncollectible.

The general component of the allowance is based on, among other things, the historical loan loss experience for each loan segment, the growth, composition and diversification of the loan portfolio, delinquency and loan classification trends, estimated value of the underlying collateral, and the results of recent regulatory examinations. Also, new credit products and policies, economic conditions, concentrations of credit risk, and the experience and abilities of lending personnel are also taken into consideration.

The Company maintains an independent loan review process, performed by a third party that reviews and evaluates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

There are numerous factors that enter into the evaluation of the allowance for loan losses. Some are quantitative while others require qualitative judgments. Although the Company believes that the processes for determining an appropriate level for the allowance adequately address the various factors that could potentially result in loan losses, the processes and their elements include features that may be susceptible to significant change. Any unfavorable differences between the actual outcome of credit-related events and the Company's estimates and projections could require an additional provision for loan losses, which would negatively impact results of operations in future periods. Management believes that, given the procedures followed in estimating potential losses in the loan portfolio, the various components used in the current estimation processes are appropriate.

Generally, a commercial loan, or a portion thereof, is charged-off immediately when it is determined, through the analysis of any available current financial information with regards to the borrower, that the borrower is incapable of servicing unsecured debt, there is little or no prospect for near term improvement and no realistic strengthening action of significance is pending or, in the case of secured debt, when it is determined, through analysis of current information with regards to the Company's collateral position, that amounts due from the borrower are in excess of the calculated current fair value of the collateral. Notwithstanding the foregoing, generally, commercial loans that become past due 180 cumulative days are classified as a loss and charged-off. Generally, a consumer loan, or a portion thereof, is charged-off in accordance with regulatory guidelines which provide that such loans be charged-off when the Company becomes aware of the loss, such as from a triggering event that may include new information about a borrower's intent/ability to repay the loan, bankruptcy, fraud or death, among other things, but in no case should the charge-off exceed specified delinquency timeframes. Such delinquency timeframes state that closed-end retail loans that become past due 120 cumulative days and open-end retail loans that become past due 180 cumulative days should be classified as a loss and charged-off.

Concentration risk limits have been established, among other things, for certain industry concentrations, large balance, highly leveraged credit relationships that exceed specified risk grades, and loans originated with policy, credit and/or collateral exceptions that exceed specified risk grades.

The allowance for loan losses and recorded investment in loans by loan type for the years ended December 31, 2017 and 2016, follow:

(Dollars in thousands, except per share amounts)

	Commercial	Commercial Real Estate	Real Estate Construction and Land	Residential Real Estate	Consumer Other	Total
Allowance for Loan Losses:						
Balance January 1, 2016	$ 892	$ 1,400	$ 676	$ 2,472	$ 392	$ 5,832
Charge-offs	(25)	(52)	-	(81)	(45)	(203)
Recoveries	43	8	1	28	36	116
Provision	54	1,334	1,150	(146)	(239)	2,153
Balance December 31, 2016	964	2,690	1,827	2,273	144	7,898
Charge-offs	(57)	(38)	-	(196)	(183)	(474)
Recoveries	6	12	-	34	6	58
Provision	942	(301)	(290)	41	147	539
Balance December 31, 2017	$ 1,855	$ 2,363	$ 1,537	$ 2,152	$ 114	$ 8,021
Ending balance individually evaluated for impairment:						
December 31, 2016	$ -	$ -	$ -	$ 55	$ 3	$ 58
December 31, 2017	$ 1,110	$ 47	$ -	$ 78	$ 6	$ 1,241
Ending balance collectively evaluated for impairment:						
December 31, 2016	$ 964	$ 2,690	$ 1,827	$ 2,218	$ 141	$ 7,840
December 31, 2017	$ 745	$ 2,316	$ 1,537	$ 2,074	$ 108	$ 6,780
Loans:						
December 31, 2016						
Individually evaluated for impairment	$ 434	$ 562	$ -	$ 1,180	$ 79	$ 2,255
Collectively evaluated for impairment	99,616	276,709	153,246	313,490	28,840	871,901
Purchased credit impaired	106	614	-	-	-	720
Total loans evaluated for impairment	$ 100,156	$ 277,885	$ 153,246	$ 314,670	$ 28,919	$ 874,876
December 31, 2017						
Individually evaluated for impairment	$ 4,406	$ 3,490	$ 1,701	$ 2,443	$ 135	$ 12,175
Collectively evaluated for impairment	85,622	284,167	148,291	307,253	21,548	846,881
Purchased credit impaired	-	614	-	40	-	654
Total loans evaluated for impairment	$ 90,028	$ 288,271	$ 149,992	$ 309,736	$ 21,683	$ 859,710

(Dollars in thousands, except per share amounts)

5. Premises and Equipment

Premises and equipment consist of the following at December 31:

	2017	2016
Land and premises	$ 49,689	$ 48,509
Leasehold improvements	5,386	5,065
Furniture, fixtures and equipment	12,938	12,271
Construction in progress	81	270
	68,094	66,115
Less accumulated depreciation and amortization	21,935	19,376
Premises and equipment, net	$ 46,159	$ 46,739

Depreciation expense for the years ended December 31, 2017 and 2016, was $3.1 million and $2.2 million.

The Company leases operating facilities, branch locations, and equipment under noncancelable operating leases expiring from 2018 to 2022. Generally, renewal periods are for five years. Rent expense for the years ended December 31, 2017 and 2016, relating to operating leases amounted to $2.1 million and $2.0 million. Future minimum lease payments at December 31, 2017, under noncancelable operating leases are as follows:

2018	$ 1,531
2019	1,288
2020	1,038
2021	719
2022	262
	$ 4,838

At December 31, 2017, future minimum lease receipts under noncancelable operating subleases totaled $5.5 million. It is expected that in the normal course of business, leases that expire will be renewed or replaced by leases on other property.

6. Core Deposit Intangibles

Changes in the carrying amount of the Company's core deposit intangibles for the years ended December 31, 2017 and 2016, are as follows:

(Dollars in thousands, except per share amounts)

	Core Deposit Intangibles
Balance, January 1, 2016	$ 217
Merger addition	2,323
Less amortization	(520)
Balance, December 31, 2016	2,020
Less amortization	(549)
Balance, December 31, 2017	$ 1,471

The carrying amount of core deposit intangibles before accumulated amortization was $2.3 million and $7.4 million at December 31, 2017 and 2016. Accumulated amortization was $0.9 million and $5.4 million at December 31, 2017 and 2016.

Estimated future amortization expense is $465 for 2018, 2019 and 2020, and $76 for 2021.

7. Deposits

Time deposits that meet or exceed the FDIC Insurance limit of $250 at December 31, 2017 and 2016 were $64.1 million and $74.7 million.

At December 31, 2017, the scheduled maturities of all time deposits were as follows:

2018	$ 236,806
2019	71,714
2020	30,300
2021	27,546
2022	2,184
2023	112
	$ 368,662

The Company had brokered deposits of $3.0 million and zero at December 31, 2017 and 2016.

8. FHLB Advances

The Company utilizes FHLB advances to supplement deposits to fund its lending and investment activities. FHLB advances due in 2018 are considered short-term borrowings and the advance below maturing in 2032 is callable in December 2018. At December 31, 2017 and 2016, the Company had $225 million and zero in FHLB advances as shown in the following table.

(Dollars in thousands, except per share amounts)

Maturity	Interest Rate		Balance
January 3, 2018	1.24 %	$	100,000
January 12, 2018	1.38		50,000
February 14, 2018	1.44		50,000
December 15, 2032	1.39		25,000
		$	225,000

The highest month end balance in 2017 was $225 million. These advances are secured by a pledge of loans, and at December 31, 2017, the Company had an additional $164 million available under this line. These advances are subject to restrictions or penalties in the event of prepayment.

9. Shareholders' Equity

Common Stock

FCH's preferred stock was converted into 53,064,664 FCH common shares prior to the effective time of the merger with PBI. FCH Series C preferred stock unpaid dividends and interest was converted into 6,030,750 FCH common shares and 927,118 FCH treasury shares were cancelled. 90,255,858 FCH common shares were exchanged for 3,637,234 PBI common shares. 552,005 FCH common shares were cancelled for $522 in cash. 2,379,884 PBI common shares were retained by PBI shareholders.

10. Related-Party Transactions

Related parties include the Company's executive officers, directors, shareholders, and their affiliates, in which they directly or indirectly have 5% or more beneficial ownership.

Loans

In the opinion of management, loans to related parties were entered into in the ordinary course of business, and were made on the same terms and conditions as similar transactions with unaffiliated persons. Loans to such borrowers are summarized as follows at December 31:

		2017		2016
Beginning balance, January 1	$	2,111	$	-
Acquired in Merger		-		960
New loans during the period		895		1,360
Repayments during the period		(2,741)		(209)
Ending balance, December 31	$	265	$	2,111

Unfunded Commitments

The Company had no unfunded commitments to executive officers, directors, shareholders, and their affiliates, with 10% or more ownership as of December 31, 2017 and 2016.

Deposits

Deposits from related parties held by the Company at December 31, 2017 and 2016, amounted to approximately $2.9 million and $4.8 million.

11. Stock Incentive Plan

The Company has shareholder approved share-based compensation plans that are accounted for under ASC 718, *Compensation – Stock Compensation*, which require companies to record compensation cost for share-based payment transactions with employees in return for employment service. The Company assumed 300,000 outstanding stock options that had been granted under the 2007 Stock Incentive Plan of legacy Pioneer Bancshares, Inc. No further share awards are allowed under the 2007 Stock Incentive Plan. Additionally, the Company assumed 2,000 options under the 2015 Equity Incentive Plan (the 2015 Plan) of legacy Pioneer Bancshares, Inc. in conjunction with the merger. All options assumed are 100% vested and able to be exercised. The 2015 Plan allows for the issuance of up to 614,500 shares of the Company's common stock in the form of stock options, stock appreciation rights, restricted stock, restricted stock units, performance units and performance shares to selected directors, executive officers, and employees. The maximum aggregate number of shares that may be issued pursuant to all awards under the Plan will increase annually on the first day of each fiscal year following the adoption of the Plan by thirty thousand (30,000) shares. Shares issued in connection with stock compensation awards are issued from available authorized shares and may not be granted with an exercise price less than the fair market value of the Company's common stock on the date the option is granted and may not be exercised later than ten years after the grant date.

There were no restricted stock awards issued or outstanding at December 31, 2017 and 2016.

The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model that uses the assumptions noted in the following table. Expected volatilities are based on implied volatilities and other factors. The expected term of stock options is based on employees actual vesting behavior and expected volatilities are based on historical volatilities of the Company's common stock. The risk-free rate for periods within the contractual life of the option is based on the United States Treasury yield curve in effect at the time of grant.

The fair value of stock options granted during 2017 and during 2016 was $22.50. The following valuation assumptions were used for options granted:

(Dollars in thousands, except per share amounts)

	2017	2016
Expected volatility	25.81%	10.94%
Expected dividends	-	-
Expected term	6.5 years	5 years
Risk-free rate	2.19%	1.28%

A summary of option activity under the Plan for the years ended December 31, 2017 and 2016 is presented below:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Assumed in conjunction with the merger	302,000	$ 13.87	4.34	$ 2,607
Granted	215,000	22.50	9.16	
Exercised	(60,750)	11.95	-	641
Forfeited	(33,250)	21.53	-	
Outstanding at December 31, 2016	423,000	17.93	6.80	1,934
Granted	127,500	22.50		
Exercised	(88,250)	12.11	-	917
Forfeited	(63,250)	20.53	-	
Outstanding at December 31, 2017	399,000	$ 20.32	7.52	$ 868
Exercisable at December 31, 2017	156,100	$ 16.94	5.83	$ 868

The weighted-average remaining vesting period is 2.30 years.

For the years ended December 31, 2017 and 2016, $1,068 and $186 cash was received from option exercises and the tax benefit realized from option exercises was $0 and $50. The Company recognized $491 and $74 in compensation expense for stock options, which is included in salaries and employee benefits, and the income tax benefit was $172 and $25. As of December 31, 2017, unrecognized compensation costs related to nonvested share-based compensation arrangements granted under the Plan totaled $1,318. That cost is expected to be recognized over a period of 2.3 years.

12. Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Company enters into various transactions, which, in accordance with GAAP, are not included on the accompanying consolidated balance sheets. The Company enters into these transactions to meet the financing needs of its customers. These financial instruments include commitments to extend credit for loans in process, commercial lines of credit, overdraft protection lines, and standby letters of credit, at both fixed and variable rates of interest. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of the Company's involvement in particular classes of financial instruments.

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

The following is a summary of the various financial instruments whose contract amounts represent credit risk at December 31:

	2017	2016
Commitments to extend credit (including guidance lines)	$ 105,857	$ 164,120
Standby letters of credit	$ 1,693	$ 1,134

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being fully drawn upon, the total commitment amounts disclosed above do not necessarily represent future cash requirements. Some of the loans that have outstanding commitments may be subject to participation agreements in which the Company will sell off a percentage of the commitment when funded, pursuant to the participation agreement.

The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if considered necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Standby letters of credit are written conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in funding loan facilities.

13. Income Taxes

Deferred Tax Assets and Liabilities

The Company recognizes deferred tax assets and liabilities for future tax consequences arising from differences between the carrying amounts of existing assets and liabilities under GAAP and their respective tax bases, and for net operating loss carryforwards. The Company evaluates the recoverability of its deferred tax assets at each year-end, weighing all positive and negative evidence, and establishes or maintains a valuation allowance for these assets if it is determined that it is more likely than not that some or all of the deferred tax assets will not be realized. The weight given to the evidence is commensurate with the extent to which the evidence can be objectively verified. If negative evidence exists, positive evidence of greater weight is necessary to support a conclusion that a valuation allowance is not needed.

The frame work for assessing the recoverability of deferred tax assets requires all evidence available to be weighed, including:

1. the sustainability of recent profitability required to realize the deferred tax assets;

2. the cumulative net income or losses in consolidated statements of operations in recent years;

3. unsettled circumstances that, if unfavorably resolved, would adversely affect future operations and profit levels on a continuing basis in future years;

4. the carryforward periods for net operating losses.

As of December 31, 2014, we had a valuation allowance against our deferred tax assets of $52.8 million. After weighing all of the evidence as of December 31, 2015, we determined that the positive evidence in favor of releasing a portion of the valuation allowance outweighed the negative evidence against releasing a portion of the allowance. Therefore, we concluded that it was more likely than not that $31.3 million of our deferred tax assets would be realized. As a result, we released $31.3 million of our valuation allowance on our deferred tax assets as of December 31, 2015. After the merger in February 2016, we released the remaining $21.5 million of our valuation allowance.

The positive evidence that weighed in favor of releasing the allowance in 2016 and 2015, and ultimately outweighed the negative evidence against releasing the allowance was the following:

1. our three-year cumulative income position as of December 31, 2016;

2. our profitability in 2014, 2015 and 2016, and our expectations regarding the sustainability of these profits;

3. our increased projected earnings resulting from the merger;

4. the strong credit profile of our loan portfolio;

5. our balanced and well managed interest rate risk position; and

6. our net operating loss carryforwards will not expire until 2025 through 2036.

We recognized benefits for federal income taxes of $21.5 million in our consolidated statement of operations for the year ended December 31, 2016 due to the release of the valuation allowance, partially offset by our provisions for federal income taxes. The balance of our net deferred tax assets was $55.2 million as of December 31, 2016. In December 2017, the U.S. Congress reduced the corporate tax rate beginning in 2018 from 35% to 21%. As a result, our net deferred tax asset was reduced in 2017 by $20 million due to the tax rate reduction effective December 22, 2017. At December 31, 2017, our net operating loss carryforward was $123 million.

(Dollars in thousands, except per share amounts)

The following table displays our deferred tax assets and deferred tax liabilities as of December 31, 2017 and 2016:

	2017	2016
Deferred tax assets:		
Net operating losses and charitable contribution carryovers	$ 25,832	$ 46,249
AMT tax credit	313	131
Allowance for credit losses	1,684	2,764
Interest on nonaccrual loans	42	69
Goodwill	1,563	3,182
Stock options	137	56
Fair value adjustment to loans	112	268
Fair value adjustment to time deposits	27	92
Depreciation	245	185
Liability for excess lease payments	36	127
Executive supplemental income payable	89	164
Other-than-temporary impairment	151	252
Unrealized loss on available for sale securities	494	978
Other	26	1,814
Subtotal	30,751	56,331
Deferred tax liabilities:		
Deferred loan fees and costs	(615)	(902)
Partnership investments	(12)	(23)
Core deposit intangibles	(76)	(237)
SBA servicing asset	(280)	-
Subtotal	(983)	(1,162)
Net deferred tax asset	$ 29,768	$ 55,169

Income Tax Expense (Benefit)

The following table displays the components of our expense (benefit) for income taxes for the years ended December 31, 2017 and 2016.

(Dollars in thousands, except per share amounts)

	2017	2016
Current income tax expense	$ 200	$ 2,784
Deferred income tax expense (benefit)	23,647	(24,532)
Income tax expense (benefit)	$ 23,847	$ (21,748)

Income tax expense (benefit) at the statutory rate of 35% for the years ended December 31, 2017 and 2016 differs from federal income tax for financial reporting purposes as follows:

	2017	2016
Tax expense calculated at statutory rate	$ 4,186	$ -
Changes resulting from:		
Effect of tax rate deduction on net deferred tax asset	19,967	-
Nondeductible acquisition expenses	-	88
Other nondeductible expense	20	41
Tax-exempt interest income	(52)	(5)
Other tax-exempt income	(262)	(259)
Other	(12)	(98)
Tax expense (benefit) before valuation benefit	23,847	(233)
Valuation benefit	-	(21,515)
Income tax expense (benefit)	$ 23,847	$ (21,748)

There were no unrecognized tax benefits as of December 31, 2017 and 2016 that would reduce the Company's effective tax rate in future periods.

14. Commitments and Contingencies

The Company and its subsidiary, the Bank, are subject to claims and lawsuits that arise primarily in the ordinary course of business. Based on information presently available and advice received from legal counsel representing the Company and the Bank, it is the opinion of management that the disposition or ultimate determination of such claims and lawsuits will not have a material adverse effect on the financial position of the Company.

The Company has employment agreements with certain executive officers. These agreements provide for severance payments up to two times base compensation and a bonus payment upon the occurrence of a change in control. In connection with the Pioneer merger, $4.7 million was paid to certain executive officers in February 2016.

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and the amount or range of loss can be reasonably estimated. Management does not believe there are now any such matters that will have a material effect on the consolidated financial statements.

15. Regulatory Matters

Regulatory Capital Compliance

The Company and the Bank are subject to various regulatory capital requirements administered by their primary federal banking agencies. Any institution that fails to meet its minimum capital requirements is subject to actions by regulators that could have a direct material effect on the Company's and the Bank's financial statements. Under the regulatory capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital practices based on its assets, liabilities, and certain off-balance-sheet items, as calculated under regulatory accounting practices. The Company's capital amount and the Bank's classification under the prompt corrective action guidelines are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Dividend Policy

The ability of a subsidiary bank to pay dividends depends on its earnings and capital levels and may be limited by their regulator's directives or orders. A bank generally must obtain regulatory approval of a dividend if the total dividends declared during the current year, including the proposed dividend, exceed net income for the current year and retained net income for the prior two years. The Bank's current practice is not to pay dividends, except to cover the expenses of the Company.

To meet capital adequacy requirements, the Company and the Bank must maintain minimum capital amounts and ratios as defined in the regulations. As of December 31, 2017, the Company and the Bank were classified as well capitalized under Prompt Corrective Action Provisions, as defined. To be categorized as well capitalized, the Company must maintain minimum total risk-based capital, Tier I risk-based capital, common equity Tier I risk-based capital and Tier I leverage ratios as set for in the table. There are no conditions or events since that notification that management believes have changed the Company's category. The Company's and the Bank's actual capital amounts and ratios for 2017 and 2016 are presented in the following table:

(Dollars in thousands, except per share amounts)

	Actual		Minimum Capital Requirement		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
December 31, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
Pioneer Bancshares, Inc.						
Total capital (to risk-weighted assets)	$ 117,889	12.3%	$ 88,979	9.25%	N/A	N/A
Tier I capital (to risk-weighted assets)	109,864	11.4	69,740	7.25	N/A	N/A
Tier I leverage (to adjusted average assets)	109,864	8.6	50,811	4.0	N/A	N/A
Common equity tier I capital (to risk-weighted assets)	109,864	11.4	55,311	5.75	N/A	N/A
Pioneer Bank						
Total capital (to risk-weighted assets)	$ 117,502	12.2%	$ 88,979	9.25%	$ 96,193	10.0%
Tier I capital (to risk-weighted assets)	109,477	11.4	69,740	7.25	76,954	8.0
Tier I leverage (to adjusted average assets)	109,477	8.6	50,686	4.0	63,358	5.0
Common equity tier I capital (to risk-weighted assets)	109,477	11.4	55,311	5.75	65,525	6.5
December 31, 2016						
Pioneer Bancshares, Inc.						
Total capital (to risk-weighted assets)	$ 109,585	11.3%	$ 83,991	8.625%	N/A	N/A
Tier I capital (to risk-weighted assets)	101,687	10.4	64,515	6.625	N/A	N/A
Tier I leverage (to adjusted average assets)	101,687	8.9	45,559	4.0	N/A	N/A
Common equity tier I capital (to risk-weighted assets)	101,687	10.4	49,908	5.125	N/A	N/A
Pioneer Bank						
Total capital (to risk-weighted assets)	$ 108,209	11.1%	$ 83,836	8.625%	$ 97,201	10.0%
Tier I capital (to risk-weighted assets)	100,308	10.3	64,396	6.625	77,761	8.0
Tier I leverage (to adjusted average assets)	100,308	9.0	44,406	4.0	55,507	5.0
Common equity tier I capital (to risk-weighted assets)	100,308	10.3	49,815	5.125	63,181	6.5

The Basel III Capital Rules, a new comprehensive capital framework for U.S. banking organizations, became effective for the Company and the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). When fully phased in on January 1, 2019, the Basel III Capital Rules will require us to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% “capital conservation buffer” (which is added to the 4.5% Common Equity Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% total capital ratio as that buffer is phased in, effectively resulting in a minimum total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019).

16. Fair Value Disclosures

ASC 820, *Fair Value Measurements and Disclosures*, specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. These inputs are summarized in the three broad levels listed below:

Level 1 – Quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date. There are no Level 1 securities.

Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities) or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets include U.S. government and government agency mortgage-backed debt securities.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair values requires significant management judgment or estimation. Level 3 assets include certain securities, impaired loans, foreclosed assets and other real estate owned.

(Dollars in thousands, except per share amounts)

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

	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total Fair Value
Securities available for sale:				
Obligations of U.S. government-sponsored agencies	$ -	$ 24,516	$ -	$ 24,516
Mortgage-backed securities	-	47,412	-	47,412
Corporate debt securities	-	16,016	-	16,016
Obligations of state and political subdivisions: Tax-exempt	-	18,128	-	18,128
Taxable	-	23,560	-	23,560
SBA Pools	-	-	1,400	1,400
December 31, 2017	$ -	$ 129,632	$ 1,400	$ 131,032
Obligations of U.S. government-sponsored agencies	$ -	$ 7,843	$ -	$ 7,843
Mortgage-backed securities	-	49,029	-	49,029
Corporate debt securities	-	16,455	-	16,455
Obligations of state and political subdivisions (tax-exempt)	-	6,532	-	6,532
SBA Pools	-	-	1,459	1,459
December 31, 2016	$ -	$ 79,859	$ 1,459	$ 81,318

The fair value of Level 3 SBA Pools is determined by an independent third party. The approach to determine fair value involves benchmarking yield and price levels based on borrower type and similar structure, as well as the seasoning of pools. Pricing on SBA pools is evaluated monthly.

The following table presents a reconciliation of recurring Level 3 assets for the years ended December 31, 2017 and 2016:

	SBA Pools	
	2017	2016
January 1 Balance	$ 1,459	$ 3,301
Loss included in other comprehensive loss	(7)	(110)
Amortization of premium	(2)	(40)
Maturities and pay downs	(50)	(1,692)
December 31 Balance	$ 1,400	$ 1,459

Certain financial instruments are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). For assets measured at fair value on a nonrecurring basis during 2017 and 2016 that were still held on the consolidated balance sheets at December 31, 2017 and 2016, the following table provides the carrying value of the related individual assets at period end and the level of valuation assumption used.

(Dollars in thousands, except per share amounts)

	December 31, 2017		December 31, 2016	
	Total	Level 3	Total	Level 3
Impaired loans	$ 2,739	$ 2,739	$ 718	$ 718
Foreclosed assets	763	763	311	311
Other real estate owned	721	721	842	842
Total	$ 4,223	$ 4,223	$ 1,871	$ 1,871

Impaired Loans

The fair value of impaired loans (if not collateral dependent) is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. If repayment is expected solely from the collateral, impaired loans are reported at the fair value of the underlying collateral. Collateral values are estimated using Level 2 inputs based on observable market data, typically in the case of real estate collateral, or Level 3 inputs based on customized discounting criteria, typically in the case of non-real estate collateral such as inventory, accounts receivable, equipment or other business assets.

Foreclosed Assets

Foreclosed assets are adjusted to fair value less estimated costs to sell upon transfer of the loans to foreclosed assets. Subsequently, these assets are carried at the lower of carrying value or fair value less estimated costs to sell. Fair value is generally based upon independent market prices or appraised values of the property.

Other Real Estate Owned

Other real estate owned is recorded at the lower of cost or appraised value.

The table below outlines the valuation techniques, unobservable inputs and the range of quantitative inputs used in valuations on a nonrecurring basis:

(Dollars in thousands, except per share amounts)

Nonrecurring Measurements	Valuation Technique	Unobservable Input	Range
Impaired loans	Discounted expected cash flows	Expected loss rates	0-100%
		Discount rates	4-9%
Foreclosed assets	Appraisals	Discounts for carrying and closing costs	0-10%
Other real estate owned	Net book value at transfer	Discounts for carrying and closing costs	0-10%

The following table summarizes the carrying values and estimated fair values of certain financial instruments not recorded at fair value on a regular basis as of December 31:

	2017		2016	
Financial assets	Carrying Amount	Estimated Fair Values	Carrying Amount	Estimated Fair Values
Cash and cash equivalents	$ 184,817	$ 184,817	$ 80,268	$ 80,268
Time deposits in banks	3,215	3,207	7,732	7,786
Securities held to maturity	790	861	845	955
Restricted investment securities	10,347	10,347	1,445	1,445
Loans held for sale	1,767	1,767	1,292	1,292
Loans, net	854,792	848,671	871,225	879,328
Financial liabilities				
Noninterest-bearing deposits	$ 194,224	$ 194,224	$ 192,243	$ 192,243
Interest-bearing deposits	737,202	739,008	837,270	839,196
Federal Home Loan Bank advances	225,000	221,454	-	-

The fair value estimates are based on pertinent information available to management as of December 31, 2017 and 2016. Although management is not aware of any factors that would significantly affect the estimated fair value amounts, such amounts have not been comprehensively revalued for purposes of these consolidated financial statements since that date, and, therefore, current estimates of fair value may differ significantly from the amounts presented herein. The following is a description of valuation methodologies used for assets and liabilities recorded at fair value, nonfinancial assets and nonfinancial liabilities, and for estimating fair value for financial instruments not recorded at fair value.

Cash and Cash Equivalents

For these short-term instruments, the carrying amount is a reasonable estimate of fair value.

Time Deposits in Banks

The fair value of time deposits in banks is estimated using the rates currently offered for deposits with similar remaining maturities.

Securities Held to Maturity

For securities held to maturity, fair value equals the quoted market price, if available. If a quoted market price is not available, fair value is estimated using the quoted market price for similar securities.

Restricted Investment Securities

Restricted investment securities consist primarily of FHLB stock and other investments. For these investments, cost, which is generally the carrying amount, is a reasonable estimate of fair value.

Loans

The fair value of loans is estimated by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. The carrying amount of loans held for sale approximates fair value due to the insignificant time between origination and date of sale. The carrying amount is the amount funded and accrued interest.

Deposits

The fair value of demand deposits, savings accounts, and certain money market deposits is the amount payable on demand at the reporting date. The fair value of fixed-maturity certificates of deposit is estimated using the rates currently offered for deposits of similar remaining maturities.

Federal Home Loan Bank Advances

Fair values of these borrowings are calculated by discounting their future cash flows. The discount rate used is equal to the rate currently offered on new borrowings that have a term equal to the same remaining maturities.

Unrecognized Financial Instruments

The fair value of commitments to extend credit is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreement and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date.

The Company has reviewed the unfunded portion of the commitments to extend credit as well as standby and other letters of credit, and has determined that fair value of such financial instruments is not material.

Nonfinancial Instruments

The Company has not considered the value of long-term relationships with depositors, commonly known as core deposit intangibles, when estimating the fair value of deposit liabilities. These intangibles are considered to be separate intangible assets that are not financial instruments. Nonetheless, financial institutions' core deposits have typically traded at premiums to their book value under both historical and current market conditions.

17. Employee Benefit Plans

The Company has an executive supplemental income plan (ESI) that provides life insurance benefits and retirement benefits for certain officers and former employees. Benefits from the ESI are payable from the Company's general unpledged assets. The Company recognizes the cost of providing benefits under these plans by charging to earnings a periodic accrual for estimated future retirement benefits. The provision for expense under the ESI plan was approximately $36 and $39 for 2017 and 2016. Payments totaled $79 in 2017 and 2016. The related accrued liability was approximately $426 and $469 at December 31, 2017 and 2016, and is included in other liabilities in the accompanying consolidated financial statements.

The Bank has invested in single premium Bank-Owned Life Insurance (BOLI) and is the owner and beneficiary of the life insurance policies. The Bank insures key employees and holds the policies until maturity. This BOLI investment provides an asset to assist in financing the Bank's employee benefit costs, while generating investment yields with strong underlying credit quality. Increases in the cash value will be used to offset employee benefit costs.

The Company is the beneficiary of group whole life insurance policies covering participants of the ESI and the BOLI. The cash surrender value of the related policies is approximately $24.5 million and $26.8 million at December 31, 2017 and 2016.

The Company has adopted a 401(k) retirement plan (the 401(k) Plan) for the benefit of substantially all employees. The 401(k) Plan allows employees to defer a portion of their salary to the 401(k) Plan, not to exceed the maximum limits established by the Internal Revenue Service. The Company matches 100% of the deferral not over 3% of the employee's salary, plus 50% of the deferral contributions over 3% of the employee's salary, up to a maximum match of 4%. The Company may also make discretionary contributions annually as approved by the Board of Directors. For the years ended December 31, 2017 and 2016, the Company's contributions under the 401(k) Plan totaled $463 and $373.

(Dollars in thousands, except per share amounts)

18. Parent Company Only Financial Information

Parent company only financial information follows:

BALANCE SHEETS

	December 31	
ASSETS	2017	2016
Cash	$ 529	$ 1,686
Investment in bank subsidiary	131,262	135,574
Net deferred tax asset	5,313	9,616
Total assets	$ 137,104	$ 146,876
LIABILITIES AND EQUITY		
Other liabilities	$ 144	$ 358
Shareholders' equity	136,960	146,518
Total liabilities and shareholders' equity	$ 137,104	$ 146,876

STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Years Ended December 31	
	2017	2016
Other income	$ -	$ 3
Other expense	-	(133)
Income (loss) before income tax and undistributed income (loss) in bank subsidiary	-	(130)
Income tax (expense) benefit	(4,303)	9,436
Undistributed income (loss) in bank subsidiary	(7,585)	12,443
Net income (loss)	$ (11,888)	$ 21,749
Comprehensive income (loss)	$ (11,606)	$ 20,556

(Dollars in thousands, except per share amounts)

STATEMENTS OF CASH FLOWS

	Years Ended December 31	
Operating activities:	2017	2016
Net income (loss)	$ (11,888)	$ 21,749
Undistributed (income) loss in bank subsidiary	7,585	(12,443)
Deferred tax expense (benefit)	4,303	(9,436)
Change in other assets and other liabilities	(214)	251
Net cash from operating activities	(214)	121
Investing activities:		
Net cash received from acquisition	-	1,160
Capital contribution to bank subsidiary	(2,500)	-
Net cash from investing activities	(2,500)	1,160
Financing activities:		
Exercise of stock options, warrants and other, net	1,557	(359)
Net change in cash	(1,157)	922
Beginning cash	1,686	764
Ending cash	$ 529	$ 1,686

19. Subsequent Events

Management has evaluated subsequent events through April 6, 2018, which was the date the accompanying consolidated financial statements were available to be issued.

Supplementary Information

(Dollars in thousands, except per share amounts)

Computation of Adjusted Net Worth for Recertification of Supervised Lender:

FHA Servicing Portfolio at December 31, 2017	$	212,000
FHA Originations - FHA-insured Title II loan originations during the year ended December 31, 2017		166,000
FHA Purchases - FHA-insured Title II third-party originator purchases during the year ended December 31, 2017		1,046,000
Total FHA loan activity		1,424,000
FHA-insured Title II loan originations retained at December 31, 2017		
FHA-insured Title II third-party originator purchases retained at December 31, 2017		212,000
Adjustments		212,000
Total adjusted FHA loan activity	$	1,212,000
Net worth required	$	1,000,000
Stockholders' equity (net worth) per balance sheet	$	131,262,000
Less unacceptable assets		12,678,000
Adjusted net worth		118,584,000
Minimum net worth required		1,000,000
Adjusted net worth above (below) required minimum amount	$	117,584,000

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of the Consolidated Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Directors
Pioneer Bancshares, Inc. and Subsidiary
Austin, Texas

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Pioneer Bancshares, Inc. and Subsidiary (the Company), which comprise the consolidated balance sheet as of December 31, 2017, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for the year then ended and the related notes to the consolidated financial statements, and have issued our report thereon dated April 6, 2018. We have also audited the internal control over financial reporting of the Company as of December 31, 2017, and issued our report thereon dated April 6, 2018.

Internal Control over Financial Reporting

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

Management of the Company is responsible for establishing and maintaining effective internal control. In planning and performing our audit, we considered the Company's internal control as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Company's consolidated financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our report dated April 6, 2018, on our audit of the Company's internal control as of December 31, 2017, expressed an unmodified opinion thereon.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Company's consolidated financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain additional matters that we reported to the Company's management in a separate letter dated April 6, 2018.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion over compliance. This communication is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Company's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

BKD, LLP

Houston, Texas
April 6, 2018

BKD
CPAs & Advisors

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Independent Auditor's Report on Compliance for the Major HUD Program and on Internal Control over Compliance Required by the *Consolidated Audit Guide for Audits of HUD Programs*

Board of Directors
Pioneer Bancshares, Inc. and Subsidiary
Austin, Texas

Report on Compliance for the Major HUD Program

We have audited Pioneer Bancshares, Inc. and Subsidiary's (the Company), compliance with the compliance requirements described in the *Consolidated Audit Guide for Audits of HUD Programs* (the Audit Guide) that could have a direct and material effect on the Company's major U.S. Department of Housing and Urban Development (HUD) program for the year ended December 31, 2017. The Company's major HUD program and the related direct and material compliance requirements are as follows:

Name of Major HUD Program	Direct and Material Compliance Requirements
Federal Housing Authority Insurance Program - Title II	Quality control plan; loan origination; loan settlement; loan servicing; federal financial and activity reports; lender annual recertification, adjusted net worth, liquidity and licensing; escrow accounts and kickbacks

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts and grants applicable to its HUD program.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for the Company's major HUD program based on our audit of the compliance requirements referred to above. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and the Audit Guide. Those standards and the Audit Guide require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major HUD program occurred. An audit includes examining, on a test basis, evidence about the Company's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for the major HUD program. However, our audit does not provide a legal determination of the Company's compliance.

Opinion on the Major HUD Program

In our opinion, the Company complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on its major HUD program for the year ended December 31, 2017.

Other Matters

We noted certain matters that we are required to report to management of the Company in a separate written communication. These matters are described in our management letter dated April 6, 2018.

Report on Internal Control Over Compliance

Management of the Company is responsible for establishing and maintaining effective internal control over compliance with the compliance requirements referred to above. In planning and performing our audit on compliance, we considered the Company's internal control over compliance with the requirements that could have a direct and material effect on the major HUD program to determine audit procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for the major HUD program and to test and report on internal control over compliance in accordance with the Audit Guide, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Company's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a HUD program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance such that there is a reasonable possibility that material noncompliance with a compliance requirement of a HUD program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a compliance requirement of a HUD program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Audit Guide. Accordingly, this report is not suitable for any other purpose.

BKD, LLP

Houston, Texas
April 6, 2018

Pioneer Bancshares, Inc. and Subsidiary
Schedule of Findings, Questioned Costs and Recommendations
Year Ended December 31, 2017

Corrective Actions Not Started or in Process

- Our audit disclosed no findings that are required to be reported herein under the Audit Guide.

Corrective Actions Completed

- Our audit disclosed no findings that are required to be reported herein under the Audit Guide.

Pioneer Bancshares, Inc. and Subsidiary

Schedule of the Status of Prior Audit Findings, Questioned Costs and Recommendations

Year Ended December 31, 2017

Reference Number	Summary of Findings	Status
1.	Audit report dated April 21, 2017, for the year ended December 31, 2016, issued by BKD, LLP.	No matters are reportable.
2.	There were no reports issued by HUD OIG or other federal agencies or contract administrators during the period covered by this audit.	
3.	There were no letters or reports issued by HUD management during the period covered by this audit.	