FARMERS NATIONAL BANC CORP /OH/
Form 10-K
March 05, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2018

or

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to

Commission file number 001-35296

Farmers National Banc Corp.

(Exact name of registrant as specified in its charter)

Ohio	34-1371693
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
20 South Broad Street, Canfield, Ohio	44406
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code: 330-533-3341

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

Title of each class	Name of each exchange on which registered
Common Shares, no par value	The NASDAQ Stock Market LLC

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

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T ((§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of June 30, 2018, the estimated aggregate market value of the registrant's common shares, no par value (the only common equity of the registrant), held by non-affiliates of the registrant was approximately $440.9 million based upon the last sales price as of June 30, 2018 reported on NASDAQ. (The exclusion from such amount of the market value of the common shares owned by any person shall not be deemed an admission by the registrant that such person is an affiliate of the registrant).

As of March 1, 2019, the registrant had outstanding 27,790,601 common shares, no par value.

DOCUMENTS INCORPORATED BY REFERENCE

Document	Part of Form 10-K into which Document is Incorporated
Portions of the registrant's definitive proxy statement for the 2019 Annual Meeting of Shareholders	III

FARMERS NATIONAL BANC CORP.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018

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PART I

Item 1. Business.

General

Farmers National Banc Corp.

Farmers National Banc Corp. (the “Company,” “Farmers,” “we,” “our” or “us”), is a financial holding company and was organized as a one-bank holding company in 1983 under the laws of the State of Ohio and registered under the Bank Holding Company Act of 1956, as amended (the “BHCA”). Amendments to the BHCA in 1999, allowed for a bank holding company to declare itself a financial holding company and thereby engage in financial activities, including securities underwriting and dealing, insurance agency and underwriting activities, and merchant banking activities. The Company made the declaration to become a financial holding company in 2016. For a bank holding company to be eligible to declare itself a financial holding company, all of the depository institution subsidiaries must be well-capitalized and well-managed and have satisfactory or better ratings under the Community Reinvestment Act. The Company operates principally through its wholly-owned subsidiaries, The Farmers National Bank of Canfield (the “Bank” or “Farmers Bank”), Farmers Trust Company (“Farmers Trust”), National Associates, Inc. (“NAI”) and Farmers National Captive, Inc. (“Captive”). Farmers National Insurance, LLC (“Farmers Insurance”) and Farmers of Canfield Investment Co. (“Investments or “Farmers Investments”) are wholly-owned subsidiaries of the Bank. The Company and its subsidiaries operate in the domestic banking, trust, retirement consulting, insurance and financial management industries.

The Company’s principal business consists of owning and supervising its subsidiaries. Although Farmers directs the overall policies of its subsidiaries, including lending practices and financial resources, most day-to-day affairs are managed by their respective officers. Farmers and its subsidiaries had 453 full-time equivalent employees at December 31, 2018.

The Company’s principal executive offices are located at 20 South Broad Street, Canfield, Ohio 44406, and its telephone number is (330) 533-3341. Farmers’ common shares, no par value, are listed on the NASDAQ Capital Market (the “NASDAQ”) under the symbol “FMNB.” Farmers’ business activities are managed and financial performance is primarily aggregated and reported in three lines of business, the Bank segment, the Trust segment and the Retirement Planning/Consulting segment. For a discussion of Farmers’ financial performance for the fiscal year ended December 31, 2018, see the Consolidated Financial Statements and Notes to the Consolidated Financial Statements found in Item 8 of this Annual Report on Form 10-K.

The Farmers National Bank of Canfield

During 2017, the Company acquired all outstanding stock of Monitor Bancorp, Inc. (“Monitor”), the holding company of Monitor Bank. Additional discussion about the acquisition can be found in the Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K. The Bank is a full-service national banking association engaged in commercial and retail banking mainly in Mahoning, Trumbull, Columbiana, Wayne, Holmes, Medina and Stark Counties in Ohio and two locations in Beaver County, Pennsylvania. The Bank’s commercial and retail banking services include checking accounts, savings accounts, time deposit accounts, commercial, mortgage and installment loans, home equity loans, home equity lines of credit, night depository, safe deposit boxes, money orders, bank checks, automated teller machines, internet banking, travel cards, “E” Bond transactions, MasterCard and Visa credit cards, brokerage services and other miscellaneous services normally offered by commercial banks.

A discussion of the general development of the Bank's business and information regarding its financial performance throughout 2018, is discussed in "Management Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of this Annual Report on Form 10-K.

The Bank faces significant competition in offering financial services to customers. Ohio has a high density of financial service providers, many of which are significantly larger institutions that have greater financial resources than the Bank, and all of which are competitors to varying degrees. Competition for loans comes principally from savings banks, savings and loan associations, commercial banks, mortgage banking companies, credit unions, insurance companies and other financial service companies. The most direct competition for deposits has historically come from savings and loan associations, savings banks, commercial banks and credit unions. Additional competition for deposits comes from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

Farmers Trust Company

During 2009, the Company acquired the Farmers Trust. Farmers Trust offers a full complement of personal and corporate trust services in the areas of estate settlement, trust administration and employee benefit plans. Farmers Trust operates four offices located in Boardman, Canton, Howland and Wooster, Ohio.

National Associates, Inc.

NAI of Cleveland, Ohio has been a part of the Company since the 2013 acquisition. The acquisition was part of the Company's plan to increase the levels of noninterest income and to complement the existing retirement services that were already being offered through Farmers Trust. NAI operates from its office located in Fairview Park, Ohio

Farmers National Captive, Inc.

Captive was formed during 2016 and is a wholly-owned insurance subsidiary of the Company that provides property and casualty insurance coverage to the Company and its subsidiaries. The Captive pools resources with thirteen similar insurance company subsidiaries of financial institutions to spread a limited amount of risk among themselves and to provide insurance where not currently available or economically feasible in today's insurance market place. The Captive does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Company.

Farmers National Insurance, LLC

Farmers Insurance was formed during 2009 and offers a variety of insurance products through licensed representatives. During 2016, the Bank completed the acquisition of the Bowers Insurance Agency, Inc. ("Bowers"). The transaction involved both cash and stock. All activity has been merged into Insurance. Farmers Insurance is a subsidiary of Farmers Bank and does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Bank.

Farmers of Canfield Investment Company

Farmers Investments was formed during 2014, with the primary purpose of investing in municipal securities. Farmers Investments is a subsidiary of Farmers Bank and does not account for a material portion of the revenue and, therefore, will not be discussed individually, but as part of the Bank.

Investor Relations

The Company maintains an Internet site at http://www.farmersbankgroup.com, which contains an Investor Relations section that provides access to the Company's filings with the Securities and Exchange Commission (the "Commission"). Farmers makes available free of charge on or through its website the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such documents filed or furnished pursuant to the Securities Exchange Act of 1934, as amended (the "Exchange Act") as soon as reasonably practicable after the Company has filed these documents with the Commission. In addition, the Company's filings with the Commission may be read and copied at the Commission's Public Reference Room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. These filings are also available on the Commission's web site at http://www.sec.gov free of charge as soon as reasonably practicable after the Company has filed the above referenced reports.

Supervision and Regulation

Introduction

The Company and its subsidiaries are subject to extensive regulation by federal and state regulatory agencies. The regulation of financial holding companies and their subsidiaries is intended primarily for the protection of consumers, depositors, borrowers, the Deposit Insurance Fund and the banking system as a whole and not for the protection of shareholders. This intensive regulatory environment, among other things, may restrict the Company's ability to diversify into certain areas of financial services, acquire depository institutions in certain markets or pay dividends on its common shares. It also may require the Company to provide financial support to its banking and other subsidiaries, maintain capital balances in excess of those desired by management and pay higher deposit insurance premiums as a result of the deterioration in the financial condition of depository institutions in general.

Significant aspects of the laws and regulations that have, or could have a material impact on Farmers and its subsidiaries are described below. These descriptions are qualified in their entirety by reference to the full text of the applicable statutes, legislation, regulations and policies, as they may be amended or revised by the U.S. Congress or state legislatures and federal or state regulatory agencies, as the case may be. Changes in these statutes, legislation, regulations and policies may have a material adverse effect on the Company and its business, financial condition or results of operations.

Regulatory Agencies

Financial Holding Company. Farmers elected to be a financial holding company. A bank holding company may elect to become a financial holding company if each of its subsidiary banks is well capitalized under the prompt corrective action regulations of the FDIC, is well managed, and has at least a satisfactory rating under the Community Reinvestment Act of 1977 (the "CRA"). Financial holding companies may engage in activities that are financial in nature, including affiliating with securities firms and insurance companies, which are not otherwise permissible for a bank holding company.

As a financial holding company, Farmers is subject to regulation under the BHCA and to inspection, examination and supervision by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). The Federal Reserve Board has extensive enforcement authority over financial and bank holding companies and may initiate enforcement actions for violations of laws and regulations and unsafe or unsound practices. The Federal Reserve Board may assess civil money penalties, issue cease and desist or removal orders and may require that a bank holding company divest subsidiaries, including subsidiary banks. Farmers is also required to file reports and other information with the Federal Reserve Board regarding its business operations and those of its subsidiaries.

Subsidiary Bank. The Bank is subject to regulation and examination primarily by the Office of the Comptroller of the Currency (the "OCC") and secondarily by the Federal Deposit Insurance Corporation (the "FDIC"). OCC regulations govern permissible activities, capital requirements, dividend limitations, investments, loans and other matters. The OCC has extensive enforcement authority over Farmers Bank and may impose sanctions on Farmers Bank and, under certain circumstances, may place Farmers Bank into receivership.

Farmers Bank is also subject to certain restrictions imposed by the Federal Reserve Act and Federal Reserve Board regulations regarding such matters as the maintenance of reserves against deposits, extensions of credit to Farmers or any of its subsidiaries, investments in the stock or other securities of Farmers or its subsidiaries and the taking of such stock or securities as collateral for loans to any borrower.

Non-Banking Subsidiaries. Farmers' non-banking subsidiaries are also subject to regulation by the Federal Reserve Board and other applicable federal and state agencies. In particular, Farmers Insurance is subject to regulation by the Ohio Department of Insurance, which requires, amongst other things, the education and licensing of agencies and individual agents and imposes business conduct rules.

Securities and Exchange Commission and The NASDAQ Stock Market LLC. The Company is also under the regulation and supervision of the Commission and certain state securities commissions for matters relating to the offering and sale of its securities. The Company is subject to disclosure and regulatory requirements of the Securities Act of 1933, as amended (the "Securities Act"), and the Exchange Act, and the regulations promulgated thereunder. Farmers common shares are listed on the NASDAQ under the symbol "FMNB" and the Company is subject to the rules for NASDAQ listed companies.

Federal Home Loan Bank. Farmers Bank is a member of the Federal Home Loan Bank of Cincinnati (the "FHLB"), which provides credit to its members in the form of advances. As a member of the FHLB, the Bank must maintain an investment in the capital stock of the FHLB in a specified amount. Upon the origination or renewal of a loan or advance, the FHLB is required by law to obtain and maintain a security interest in certain types of collateral. The FHLB is required to establish standards of community investment or service that its members must maintain for continued access to long-term advances from the FHLB. The standards take into account a member's performance under the CRA and its record of lending to first-time home buyers.

The Federal Deposit Insurance Corporation. The FDIC is an independent federal agency that insures the deposits, up to prescribed statutory limits, of federally-insured banks and savings associations and safeguards the safety and soundness of the financial institution industry. The Bank's deposits are insured up to applicable limits by the Deposit Insurance Fund of the FDIC and subject to deposit insurance assessments to maintain the Deposit Insurance Fund.

The FDIC may terminate insurance coverage upon a finding that an insured depository institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition, or has violated any applicable law, regulation, rule, order or condition enacted or imposed by the institution's regulatory agency.

Dodd-Frank Act - Basel III

In July 2013, the Federal banking regulators approved a final rule to implement the revised capital adequacy standards of the Basel Committee on Banking Supervision, commonly called Basel III, and to address relevant provisions of the Dodd-Frank Act. The final rule strengthens the definition of regulatory capital, increases risk-based capital requirements, makes selected changes to the calculation of risk-weighted assets and adjusts the prompt corrective action thresholds. Community banking organizations, such as the Company and the Bank, became subject to the new rule on January 1, 2015 and certain provisions of the new rule will be phased in over the period of 2015 through 2019.

The final rule:

- Permits banking organizations that had less than $15 billion in total consolidated assets as of December 31, 2009 to include in Tier 1 capital trust preferred securities and cumulative perpetual preferred stock that were issued and included in Tier 1 capital prior to May 19, 2010, subject to a limit of 25% of Tier 1 capital elements, excluding any non-qualifying capital instruments and after all regulatory capital deductions and adjustments have been applied to Tier 1 capital.
- Establishes new qualifying criteria for regulatory capital, including new limitations on the inclusion of deferred tax assets and mortgage servicing rights.
- Requires a minimum ratio of common equity Tier 1 capital to risk-weighted assets of 4.5%.
- Increases the minimum Tier 1 capital to risk-weighted assets ratio requirement from 4% to 6%.
- Retains the minimum total capital to risk-weighted assets ratio requirement of 8%.
- Establishes a minimum leverage ratio requirement of 4%.

- Retains the existing regulatory capital framework for 1-4 family residential mortgage exposures.
- Permits banking organizations that are not subject to the advanced approaches rule, such as the Company and the Bank, to retain, through a one-time election, the existing treatment for most accumulated other comprehensive income, such that unrealized gains and losses on securities available for sale will not affect regulatory capital amounts and ratios.

- Implements a new capital conservation buffer requirement for a banking organization to maintain a common equity capital ratio more than 2.5% above the minimum common equity Tier 1 capital, Tier 1 capital and total risk-based capital ratios in order to avoid limitations on capital distributions, including dividend payments, and certain discretionary bonus payments. The capital conservation buffer requirement will be phased in beginning on January 1, 2016 at 0.625% and will be fully phased in at 2.50% by January 1, 2019. A banking organization with a buffer of less than the required amount would be subject to increasingly stringent limitations on such distributions and payments as the buffer approaches zero. The new rule also generally prohibits a banking organization from making such distributions or payments during any quarter if its eligible retained income is negative and its capital conservation buffer ratio was 2.5% or less at the end of the previous quarter. The eligible retained income of a banking organization is defined as its net income for the four calendar quarters preceding the current calendar quarter, based on the organization's quarterly regulatory reports, net of any distributions and associated tax effects not already reflected in net income.
- Increases capital requirements for past-due loans, high volatility commercial real estate exposures and certain short-term commitments and securitization exposures.
- Expands the recognition of collateral and guarantors in determining risk-weighted assets.
- Removes references to credit ratings consistent with the Dodd Frank Act and establishes due diligence requirements for securitization exposures.

Various legislation affecting financial institutions and the financial industry will likely continue to be introduced in Congress, and such legislation may further change banking statutes and the operating environment of the Company in substantial and unpredictable ways, and could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance depending upon whether any of this potential legislation will be enacted, and if enacted, the effect that it or any implementing regulations, would have on the financial condition or results of operations of the Company or any of its subsidiaries.

Also, such statutes, regulations and policies are continually under review by Congress and state legislatures and federal and state regulatory agencies and are subject to change at any time, particularly in the current economic and regulatory environment. Any such change in statutes, regulations or regulatory policies applicable to the Company could have a material effect on the business of the Company.

Financial Holding Company Regulation

As a financial holding company, Farmers' activities are subject to extensive regulation by the Federal Reserve Board under the BHCA. Generally, in addition to the BHCA limits of banking, managing or controlling banks and other activities that the Federal Reserve Board has determined to be closely related to banking, financial holding company activities may include securities underwriting and dealing, insurance agency and underwriting activities and merchant banking activities. Under Federal Reserve Board policy, a financial holding company is expected to serve as a source of financial and managerial strength to each subsidiary and to commit resources to support those subsidiaries. Under this policy, the Federal Reserve Board may require the company to contribute additional capital to an undercapitalized subsidiary and may disapprove of the payment of dividends to the holding company's shareholders if the Federal Reserve Board believes the payment of such dividends would be an unsafe or unsound practice. The Dodd-Frank Act codified this policy as a statutory requirement.

The BHCA requires prior approval by the Federal Reserve Board for a bank holding company to directly or indirectly acquire more than a 5.0% voting interest in any bank or its parent holding company. Factors taken into consideration in making such a determination include the effect of the acquisition on competition, the public benefits expected to be received from the acquisition, the projected capital ratios and levels on a post-acquisition basis and the acquiring institution's record of addressing the credit needs of the communities it serves.

The BHCA also governs interstate banking and restricts Farmers' nonbanking activities to those determined by the Federal Reserve Board to be financial in nature, or incidental or complementary to such financial activity, without regard to territorial restrictions. Transactions among the Bank and its affiliates are also subject to certain limitations and restrictions of the Federal Reserve Board, as described more fully under the caption "Dividends and Transactions with Affiliates" in this Item 1.

The Gramm-Leach-Bliley Act of 1999 permits a qualifying bank holding company to elect to become a financial holding company and thereby affiliate with securities firms and insurance companies and engage in other activities that are financial in nature and not otherwise permissible for a bank holding company. Farmers elected to become a financial holding company during 2016.

Regulation of Nationally Chartered Banks

As a national banking association, Farmers Bank is subject to regulation under the National Banking Act and is periodically examined by the OCC. OCC regulations govern permissible activities, capital requirements, dividend limitations, investments, loans and other matters. Furthermore, Farmers Bank is subject, as a member bank, to certain rules and regulations of the Federal Reserve Board, many of which restrict activities and prescribe documentation to protect consumers. Under the Bank Merger Act, the prior approval of the OCC is required for a national bank to merge with, or purchase the assets or assume the deposits of, another bank. In reviewing applications to approve merger and other acquisition transactions, the OCC and other bank regulatory authorities may include among their considerations the competitive effect and public benefits of the transactions, the capital position of the combined organization, the applicant's performance under the CRA and fair housing laws, and the effectiveness of the entities in restricting money laundering activities. In addition, the establishment of branches by Farmers Bank is subject to the prior approval of the OCC. The OCC has the authority to impose sanctions on the Bank and, under certain circumstances, may place Farmers Bank into receivership.

The Bank is also an insured institution as a member of the Deposit Insurance Fund. As a result, it is subject to regulation and deposit insurance assessments by the FDIC.

Dividends and Transactions with Affiliates

The Company is a legal entity separate and distinct from the Bank and its other subsidiaries. The Company's principal source of funds to pay dividends on its common shares and service its debt is dividends from Farmers Bank and its other subsidiaries. Various federal and state statutory provisions and regulations limit the amount of dividends that Farmers Bank may pay to Farmers without regulatory approval. Farmers Bank generally may not, without prior regulatory approval, pay a dividend in an amount greater than its undivided profits after deducting statutory bad debt in excess of the Bank's allowance for loan losses. In addition, prior approval of the OCC is required for the payment of a dividend if the total of all dividends declared in a calendar year would exceed the total of Farmers Bank's net income for the year combined with its retained net income for the two preceding years.

In addition, Farmers and Farmers Bank are subject to other regulatory policies and requirements relating to the payment of dividends, including requirements to maintain adequate capital above regulatory minimums. The federal banking agencies are authorized to determine under certain circumstances that the payment of dividends would be an unsafe or unsound practice and to prohibit payment thereof. The federal banking agencies have stated that paying dividends that deplete a bank's capital base to an inadequate level would be an unsafe and unsound banking practice and that banking organizations should generally pay dividends only out of current operating earnings. In addition, in the current financial and economic environment, the Federal Reserve Board has indicated that financial holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels, unless both asset quality and capital are very strong. Thus, the ability of Farmers to pay dividends in the future is currently influenced, and could be further influenced, by bank regulatory policies and capital guidelines.

The Bank is subject to restrictions under federal law that limit the transfer of funds or other items of value to the Company and its nonbanking subsidiaries and affiliates, whether in the form of loans and other extensions of credit, investments and asset purchases or other transactions involving the transfer of value from a subsidiary to an affiliate or for the benefit of an affiliate. These regulations limit the types and amounts of transactions (including loans due

and extensions of credit) that may take place and generally require those transactions to be on an arm's-length basis. In general, these regulations require that any "covered transaction" by Farmers Bank with an affiliate must be secured by designated amounts of specified collateral and must be limited, as to any one of Farmers or its non-bank subsidiaries, to 10% of Farmers Bank's capital stock and surplus, and, as to Farmers and all such non-bank subsidiaries in the aggregate, to 20% of Farmers Bank's capital stock and surplus. The Dodd-Frank Act significantly expanded the coverage and scope of the limitations on affiliate transactions within a banking

organization including, for example, the requirement that the 10% capital limit on covered transactions apply to financial subsidiaries. "Covered transactions" are defined by statute to include a loan or extension of credit, as well as a purchase of securities issued by an affiliate, a purchase of assets (unless otherwise exempted by the Federal Reserve Board) from the affiliate, certain derivative transactions that create a credit exposure to an affiliate, the acceptance of securities issued by the affiliate as collateral for a loan and the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

Capital loans from the Company to the Bank are subordinate in right of payment to deposits and certain other indebtedness of the Bank. In the event of Farmers' bankruptcy, any commitment by Farmers to a federal bank regulatory agency to maintain the capital of Farmers Bank will be assumed by the bankruptcy trustee and entitled to a priority of payment.

The Federal Deposit Insurance Act of 1950, as amended, provides that, in the event of the "liquidation or other resolution" of an insured depository institution such as the Bank, the insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, nondeposit creditors, including the Company, with respect to any extensions of credit they have made to such insured depository institution.

Capital Adequacy

Both Farmers and Farmers Bank are subject to risk-based capital requirements imposed by their respective primary federal banking regulator. The Federal Reserve Bank monitors the capital adequacy of Farmers and the FDIC monitors the capital adequacy of Farmers Bank. The revised risk-based capital requirements applicable to bank holding companies and insured depository institutions, including the Company and the Bank, to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision ("Basel III") became effective for the Company and the Bank on January 1, 2015. The Basel III Rules require the maintenance of minimum amounts and ratios of common equity tier 1 capital, tier 1 capital and total capital to risk-weighted assets, and of tier 1 capital to adjusted quarterly average assets.

Under the Basel III Rules, common equity tier 1 capital consists of common stock and paid-in capital (net of treasury stock) and retained earnings. Common equity tier 1 capital is reduced by goodwill, certain intangible assets, net of associated deferred tax liabilities, deferred tax assets that arise from tax credit and net operating loss carryforwards, net of any valuation allowance, and certain other items as specified by the Basel III Rules.

Tier 1 capital includes common equity tier 1 capital and certain additional tier 1 items as provided under the Basel III Rules.

Basel III Rules allow for insured depository institutions to make a one-time election not to include most elements of accumulated other comprehensive income in regulatory capital and instead effectively use the existing treatment under the general risk-based capital rules. The Company and the Bank made this opt-out election in the first quarter of 2015 to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of our investment securities portfolio.

The Basel III Rules also changed the risk-weights of assets in an effort to better reflect credit risk and other risk exposures. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and the unsecured portion of non-residential mortgage loans that are 90 days past due or otherwise on nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable; a 250% risk weight (up from 100%) for mortgage servicing rights and deferred tax assets that are not deducted from capital; and increased risk weights (from 0% to up to 600%) for equity exposures.

The Basel III Rules limit capital distributions and certain discretionary bonus payments if the banking organization does not hold a “capital conservation buffer” consisting of 2.5% of common equity tier 1 capital, tier 1 capital and total capital to risk-weighted assets in addition to the amount necessary to meet minimum risk-based capital requirements. The capital conservation buffer began being phased in on January 1, 2016. When fully phased in on January 1, 2019, Basel III will require the Bank to maintain: (i) as a newly adopted international standard, a

minimum ratio of Common Equity Tier 1 ("CET1") to risk-weighted assets of 4.5%, plus a 2.5% capital conservation buffer (the "CCB") (which is added to the 4.5% CET1 ratio as that buffer is phased in, which will effectively result in a minimum ratio of CET1 to risk-weighted assets of 7.0%); (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.0%, plus the CCB (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% on full implementation); (iii) a minimum ratio of Total (Tier 1 plus Tier 2) capital to risk-weighted assets of at least 8.0%, plus the CCB (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) as a newly adopted international standard, a minimum leverage ratio of 3.0%, calculated as the ratio of Tier 1 capital to balance sheet exposures plus certain off-balance sheet exposures (computed as the average for each quarter of the month-end ratios for the quarter).

Prior to January 1, 2015, federal regulatory agencies required the Company and the Bank to maintain minimum tier 1 and total capital to risk-weighted assets of 4.0% and 8.0%, respectively, and tier 1 capital to average assets (tier 1 leverage ratio) of at least 4.0%. In order to be considered well capitalized under the rules in effect prior to January 1, 2015, the Company had to maintain tier 1 and total capital to risk-weighted assets of 6.0% and 10.0%, respectively, and a leverage ratio of 5.0%. Tier 1 capital consisted of common equity, retained earnings, certain types of preferred stock, qualifying minority interest and trust preferred securities, subject to limitations, and excluded goodwill and various intangible assets.

The Basel III final framework provides for a number of new deductions from and adjustments to CET1, including the deduction of mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in non-consolidated financial entities if any one such category exceeds 10.0% of CET1 or if all such categories in the aggregate exceed 15.0% of CET1.

The following is a summary of the other major changes from the current general risk-based capital rule:

- replacement of the external credit ratings approach to standards of creditworthiness with a simplified supervisory formula approach;
- stricter limitations on the extent to which mortgage servicing assets, deferred tax assets and significant investments in unconsolidated financial institutions may be included in common equity tier 1 capital and the risk weight to be assigned to any amounts of such assets not deducted; and
- increased risk weights for past-due loans, certain commercial real estate loans and some equity exposures, and selected other changes in risk weights and credit conversion factors.

Notwithstanding its release of the Basel III framework as a final framework, the Basel Committee is considering further amendments to Basel III, including imposition of additional capital surcharges on globally systemically important financial institutions. In addition to Basel III, the Dodd-Frank Act requires or permits federal banking agencies to adopt regulations affecting capital requirements in a number of respects, including potentially more stringent capital requirements for systemically important financial institutions. Accordingly, the regulations ultimately applicable to the Company may differ substantially from the currently published final Basel III framework. Requirements of higher capital levels or higher levels of liquid assets could adversely impact the Company's net income and return on equity.

Volcker Rule

In December 2013, five federal agencies adopted a final regulation implementing the Volcker Rule provision of the Dodd-Frank Act (the "Volcker Rule"). The Volcker Rule places limits on the trading activity of insured depository institutions and entities affiliated with a depository institution, subject to certain exceptions. The trading activity includes a purchase or sale as principal of a security, derivative, commodity future or option on any such instrument in order to benefit from short-term price movements or to realize short-term profits. The Volcker Rule exempts

specified U.S. Government, agency and/or municipal obligations, and it exempts trading conducted in certain capacities, including as a broker or other agent, through a deferred compensation or pension plan, as a fiduciary on behalf of customers, to satisfy a debt previously contracted, repurchase and securities lending agreements and risk-mitigating hedging activities.

The Volcker Rule also prohibits a banking entity from having an ownership interest in, or certain relationships with, a hedge fund or private equity fund, with a number of exceptions.

The Bank does not engage in any of the trading activities or own any of the types of funds prohibited by the Volcker Rule.

Prompt Corrective Action

The federal banking agencies have established a system of prompt corrective action to resolve certain of the problems of undercapitalized institutions. This system is based on five capital level categories for insured depository institutions: “well capitalized,” “adequately capitalized,” “undercapitalized,” “significantly undercapitalized,” and “critically undercapitalized.”

The federal banking agencies may (or in some cases must) take certain supervisory actions depending upon a bank’s capital level. For example, the banking agencies must appoint a receiver or conservator for a bank within 90 days after it becomes “critically undercapitalized” unless the bank’s primary regulator determines, with the concurrence of the FDIC, that other action would better achieve regulatory purposes. Banking operations otherwise may be significantly affected depending on a bank’s capital category. For example, a bank that is not “well capitalized” generally is prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market, and the holding company of any undercapitalized depository institution must guarantee, in part, specific aspects of the bank’s capital plan for the plan to be acceptable.

Federal law permits the OCC to order the pro rata assessment of shareholders of a national bank whose capital stock has become impaired, by losses or otherwise, to relieve a deficiency in such national bank’s capital stock. This statute also provides for the enforcement of any such pro rata assessment of shareholders of such national bank to cover such impairment of capital stock by sale, to the extent necessary, of the capital stock owned by any assessed shareholder failing to pay the assessment. As the sole shareholder of Farmers Bank, the Company is subject to such provisions.

Deposit Insurance

Substantially all of the deposits of the Bank are insured up to applicable limits by the Deposit Insurance Fund of the FDIC, and Farmers Bank is assessed deposit insurance premiums to maintain the Deposit Insurance Fund. The general insurance limit is $250,000 per separately insured depositor. This insurance is backed by the full faith and credit of the United States Government. Insurance premiums for each insured institution are determined based upon the institution’s capital level and supervisory rating provided to the FDIC by the institution’s primary federal regulator and other information deemed by the FDIC to be relevant to the risk posed to the Deposit Insurance Fund by the institution. The assessment rate is then applied to the amount of the institution’s deposits to determine the institution’s insurance premium.

The FDIC assesses a quarterly deposit insurance premiums on each insured institution based on risk characteristics of the institution and may also impose special assessments in emergency situations. The premiums fund the Deposit Insurance Fund (“DIF”). Pursuant to the Dodd-Frank Act, the FDIC has established 2.0% as the designated reserve ratio (“DRR”), which is the amount in the DIF as a percentage of all DIF insured deposits. In March 2016, the FDIC adopted final rules designed to meet the statutory minimum DRR of 1.35% by September 30, 2010, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets of less than $10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%. Although the FDIC’s new rules reduced assessment rates on all banks, they imposed a surcharge on banks with assets of $10 billion or more to be paid until the DRR reaches 1.35%. The rules also provide assessment credits to banks with assets of less than $1 billion for the portion of their assessments that contribute to the increase of the DRR

to 1.35%. The rules further changed the method of determining risk-based assessment rates for established banks with less than $10 billion in assets to better ensure that banks taking on greater risks pay more for deposit insurance than banks that take on less risk.

In addition, all FDIC-insured institutions are required to pay assessments to fund interest payments on bonds issued by the Financing Corporation, which was established by the government to recapitalize a predecessor to the DIF. These assessments will continue until the Financing Corporation bonds mature in 2019.

As insurer, the FDIC is authorized to conduct examinations of and to require reporting by federally-insured institutions. It also may prohibit any federally-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the Deposit Insurance Fund. The FDIC also has the authority to take enforcement actions against insured institutions. Insurance of deposits may be terminated by the FDIC upon a finding that the institution has engaged or is engaging in unsafe and unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC or written agreement entered into with the FDIC. The management of the Bank does not know of any practice, condition or violation that might lead to termination of deposit insurance.

Fiscal and Monetary Policies

The Company's business and earnings are affected significantly by the fiscal and monetary policies of the federal government and its agencies. The Company is particularly affected by the policies of the Federal Reserve Board, which regulates the supply of money and credit in the United States in order to influence general economic conditions, primarily through open market operations in U.S. government securities, changes in the discount rate on bank borrowings and changes in the reserve requirements against depository institutions' deposits. These policies and regulations significantly affect the overall growth and distribution of loans, investments and deposits, as well as interest rates charged on loans and paid on deposits.

The monetary policies of the Federal Reserve board have had a significant effect on operations and results of financial institutions in the past and are expected to have significant effects in the future. In view of the changing conditions in the economy, the money markets and activities of monetary and fiscal authorities, Farmers can make no predictions as to future changes in interest rates, credit availability or deposit levels.

Community Reinvestment Act

The CRA requires depository institutions to assist in meeting the credit needs of their market areas consistent with safe and sound banking practice. Under the CRA, each depository institution is required to help meet the credit needs of its market areas by, among other things, providing credit to low and moderate-income individuals and communities. Depository institutions are periodically examined for compliance with the CRA and are assigned ratings. In order for a bank holding company to commence any new activity permitted by the BHCA, or to acquire any company engaged in any new activity permitted by the BHCA, each insured depository institution subsidiary of the bank holding company must have received a rating of at least "satisfactory" in its most recent examination under the CRA. Furthermore, banking regulators take into account CRA ratings when considering approval of a proposed transaction. Farmers received a rating of "satisfactory" in its most recent CRA examination.

Customer Privacy

Farmers Bank is subject to regulations limiting the ability of financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow customers to prevent disclosure of certain personal information to a nonaffiliated third party. These regulations affect how consumer information is transmitted and conveyed to outside vendors.

Anti-Money Laundering and the USA Patriot Act

The Uniting and Strengthening of America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the “USA Patriot Act”) and its related regulations require insured depository institutions, broker-dealers and certain other financial institutions to have policies, procedures and controls to detect, prevent, and report money laundering and terrorist financing. The USA Patriot Act and its regulations also provide for information sharing, subject to conditions, between federal law enforcement agencies and financial institutions, as well as among financial institutions, for counter-terrorism purposes. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal and reputational consequences for the institution. In addition, federal banking agencies are required, when reviewing bank holding company acquisition and bank merger applications, to take into account the effectiveness of the anti-money laundering policies, procedures and controls of the applicants.

Corporate Governance

The Sarbanes-Oxley Act of 2002 effected broad reforms to areas of corporate governance and financial reporting for public companies under the jurisdiction of the Commission. The Company's corporate governance policies include an Audit Committee Charter, a Compensation Committee Charter, Corporate Governance and Nominating Committee Charter and Code of Business Conduct and Ethics. The Board of Directors reviews the Company's corporate governance practices on a continuing basis. These and other corporate governance policies have been provided previously to shareholders and are available, along with other information on Farmers' corporate governance practices, on the Company's website at www.farmersbankgroup.com.

As directed by Section 302(a) of the Sarbanes-Oxley Act, the Company's chief executive officer and chief financial officer are each required to certify that the Company's Quarterly and Annual Reports do not contain any untrue statement of a material fact. The rules have several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls, they have made certain disclosures about the Company's internal controls to its auditors and the audit committee of the Board of Directors and they have included information in the Company's Quarterly and Annual Reports about their evaluation and whether there have been significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the evaluation.

Executive and Incentive Compensation

In June 2010, the Federal Reserve Board, OCC and FDIC issued joint interagency guidance on incentive compensation policies (the "Joint Guidance") intended to ensure that the incentive compensation policies of banking organizations do not undermine the safety and soundness of such organizations by encouraging excessive risk-taking. This principles-based guidance, which covers all employees that have the ability to materially affect the risk profile of an organization, either individually or as part of a group, is based upon the key principles that a banking organization's incentive compensation arrangements should: (i) provide incentives that do not encourage risk-taking beyond the organization's ability to effectively identify and manage risks; (ii) be compatible with effective internal controls and risk management; and (iii) be supported by strong corporate governance, including active and effective oversight by the organization's board of directors.

Pursuant to the Joint Guidance, the Federal Reserve Board will review as part of a regular, risk-focused examination process, the incentive compensation arrangements of financial institutions such as Farmers. Such reviews will be tailored to each organization based on the scope and complexity of the organization's activities and the prevalence of incentive compensation arrangements. The findings of the supervisory initiatives will be included in reports of examination and deficiencies will be incorporated into the institution's supervisory ratings, which can affect the institution's ability to make acquisitions and take other actions. Enforcement actions may be taken against an institution if its incentive compensation arrangements, or related risk-management control or governance processes, pose a risk to the organization's safety and soundness, and prompt and effective measures are not being taken to correct the deficiencies.

On February 7, 2011, the federal banking agencies initially issued jointly proposed rules on incentive-based compensation arrangements under applicable provisions of the Dodd-Frank Act (the "First Proposed Rules"). The First Proposed Rules generally apply to financial institutions with $1.0 billion or more in assets that maintain incentive-based compensation arrangements for certain covered employees.

In May 2016, the federal bank regulatory agencies issued a second joint notice of proposed rules (the "Second Proposed Joint Rules") likewise designed to prohibit incentive-based compensation arrangements that encourage inappropriate risks at financial institutions. The Second Proposed Joint Rules would also apply to covered financial

institutions with total assets of $1 billion or more, but the rules would differ for each of three categories of financial institutions:

- Level 1 – institutions with assets of $250 billion or more;
- Level 2 – institutions with assets of at least $50 billion and less than $250 billion; and
- Level 3 – institutions with assets of at least $1 billion and less than $50 billion.

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Farmers would be a Level 3 institution. Some of the requirements would apply only to Level 1 and Level 2 institutions. For all covered institutions, including Level 3 institutions, the proposed rules would:

- prohibit incentive-based compensation arrangements that are “excessive” or “could lead to material financial loss;”
- require incentive based compensation that is consistent with a balance of risk and reward, effective management and control of risk, and effective governance; and
- require board oversight, recordkeeping and disclosure to the appropriate regulatory agency.

Public companies will also be required, once stock exchanges impose additional listing requirements under the Dodd-Frank Act, to implement “clawback” procedures for incentive compensation payments and to disclose the details of the procedures which allow recovery of incentive compensation that was paid on the basis of erroneous financial information necessitating a restatement due to material noncompliance with financial reporting requirements. This clawback policy is intended to apply to compensation paid within a three year look-back window of the restatement and would cover all executives who received incentive awards.

The Dodd-Frank Act also provides shareholders the opportunity to cast a non-binding vote on executive compensation practices, imposes new executive compensation disclosure requirements, and contains additional considerations of the independence of compensation advisors.

Future Legislation

Various and significant legislation affecting financial institutions and the financial industry is from time to time introduced in the U.S. Congress and state legislatures, as well as by regulatory agencies. Such initiatives may include proposals to expand or contract the powers of bank holding companies and depository institutions or proposals to substantially change the financial institution regulatory system. It is likely that the Trump Administration and the U.S. Congress will pursue and potentially implement legislative or regulatory changes affecting financial institutions and the financial industry. In 2018, President Trump signed a bill reforming the Dodd-Frank Act and the Trump Administration has indicated its intent to loosen additional regulations. Such legislation could change the operating environment for Farmers and its subsidiaries in unpredictable ways, it could decrease the costs of doing business, expand permissible activities or affect the competitive balance among financial institutions. With the enactment and the continuing implementation of the Dodd-Frank Act and regulations thereunder, the nature and extent of future legislative and regulatory changes affecting financial institutions remains very unpredictable. Farmers cannot predict the scope and timing of any such future legislation and, if enacted, the effect that it could have on its business, financial condition or results of operations.

Summary

To the extent that the foregoing information describes statutory and regulatory provisions applicable to the Company or its subsidiaries, it is qualified in its entirety by reference to the full text of those provisions or agreements. Also, such statutes, regulations and policies are continually under review by the U.S. Congress and state legislatures as well as federal and state regulatory agencies and are subject to change at any time, particularly in the current economic and regulatory environment. Any such change in applicable statutes, regulations or regulatory policies could have a material effect on Farmers and its business, financial condition or results of operations.

Item 1A. Risk Factors.

The following are certain risk factors that could materially and negatively affect our business, results of operations, cash flows or financial condition. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause our actual results or financial condition to differ materially from those projected in forward-looking statements. The risks that are discussed below are not the only ones we face. If any of the following risks occur, our business, financial condition or results of operations could be negatively affected. Additional risks that are not presently known or that we presently deem to be immaterial could also have a material, adverse impact on our business, financial condition or results of operations.

Risks Relating to Economic and Market Conditions

Changes in economic, political, and market conditions may adversely affect our industry and our business.

Our success depends in part on national and local economic, political, and market conditions as well as governmental monetary and other financial policies. Conditions such as inflation, recession, unemployment, changes in interest rates, money supply, governmental fiscal policies and other factors beyond our control may adversely affect our asset quality, deposit levels and loan demand and, therefore, our earnings. Because we have a significant amount of real estate loans, additional decreases in real estate values could adversely affect the value of property used as collateral and our ability to sell the collateral upon foreclosure. Adverse changes in the economy may also have a negative effect on the ability of our borrowers to make timely repayments of their loans, which would have an adverse impact on our earnings. If during a period of reduced real estate values we are required to liquidate the collateral securing loans to satisfy the debt or to increase our allowance for loan losses, it could materially reduce our profitability and adversely affect our financial condition. Moreover, the Financial Accounting Standards Board may change its requirements for establishing the loan loss allowance. The majority of our loans are to individuals and businesses in Northeast Ohio. Consequently, further significant declines in the economy in the area could have a material adverse effect on our business, financial condition or results of operations. It is uncertain when the negative credit trends in our market will reverse, and, therefore, future earnings are susceptible to further declining credit conditions in the market in which we operate.

Changes in interest rates could adversely affect our income and financial condition.

Our earnings and cash flow are dependent upon our net interest income. Net interest income is the difference between the interest income generated by our interest-earning assets (consisting primarily of loans and, to a lesser extent, securities) and the interest expense generated by our interest-bearing liabilities (consisting primarily of deposits and wholesale borrowings). Our level of net interest income is primarily a function of the average balance of our interest-earning assets, the average balance of our interest-bearing liabilities and the spread between the yield on such assets and the cost of such liabilities. These factors are influenced by both the pricing and mix of our interest-earning assets and our interest-bearing liabilities which, in turn, are impacted by external factors, such as the local economy, competition for loans and deposits, the monetary policy of the Federal Reserve Board and market interest rates.

Interest rates are beyond our control, and they fluctuate in response to general economic conditions and the policies of various governmental and regulatory agencies, in particular, the Federal Reserve Board. Changes in monetary policy, including changes in interest rates, will influence the origination of loans, the purchase of investments, the generation of deposits and the rates received on loans and investment securities and paid on deposits. While we have taken measures intended to manage the risks of operating in a changing interest rate environment, there can be no assurance that such measures will be effective in avoiding undue interest rate risk. See additional interest rate risk discussion under the Market Risk section found in Item 7A of this Annual Report on Form 10-K.

Defaults by another larger financial institution could adversely affect financial markets generally.

The commercial soundness of many financial institutions may be closely interrelated as a result of credit, trading, clearing or other relationships between institutions. As a result, concerns about, or a default or threatened default by, one institution could lead to significant market-wide liquidity and credit problems, losses or defaults by other institutions. This is sometimes referred to as "systemic risk" and may adversely affect financial intermediaries, such as clearing agencies, clearing houses, banks, securities firms and exchanges, with which we and our subsidiaries interact on a daily basis, and therefore could adversely affect our business, financial condition or results of operations.

Risks Related to Our Business

We extend credit to a variety of customers based on internally set standards and judgment. We manage credit risk through a program of underwriting standards, the review of certain credit decisions and an on-going process of assessment of the quality of credit already extended. Our credit standards and on-going process of credit assessment might not protect us from significant credit losses.

We take credit risk by virtue of making loans, extending loan commitments and letters of credit and, to a lesser degree, purchasing non-governmental securities. Our exposure to credit risk is managed through the use of consistent underwriting standards that emphasize "in-market" lending, while avoiding highly leveraged transactions as well as excessive industry and other concentrations. Our credit administration function employs risk management techniques to ensure that loans adhere to corporate policy and problem loans are promptly identified. While these procedures are designed to provide us with the information needed to implement policy adjustments where necessary, and to take proactive corrective actions, there can be no assurance that such measures will be effective in avoiding undue credit risk.

We have significant exposure to risks associated with commercial real estate and residential real estate in our primary markets.

As of December 31, 2018, approximately 65.1% of our loan portfolio consisted of commercial real estate and residential real estate loans, including real estate development, construction and residential and commercial mortgage loans. Consequently, real estate-related credit risks are a significant concern for us. The adverse consequences from real estate-related credit risks tend to be cyclical and are often driven by national economic developments that are not controllable or entirely foreseeable by us or our borrowers. General difficulties in our real estate markets have recently contributed to increases in our non-performing loans, charge-offs and decreases in our income.

Our business depends significantly on general economic conditions in the State of Ohio. Accordingly, the ability of our borrowers to repay their loans, and the value of the collateral securing such loans, may be significantly affected by economic conditions in the regions we serve or by changes in the local real estate markets. A significant decline in general economic conditions caused by inflation, recession, unemployment, acts of terrorism or other factors beyond our control could have an adverse effect on our business, financial condition or results of operations.

Our indirect lending exposes us to increased credit risks.

A portion of our current lending involves the purchase of consumer automobile installment sales contracts from automobile dealers located in Northeastern Ohio. These loans are for the purchase of new or late model used cars. We serve customers over a broad range of creditworthiness, and the required terms and rates are reflective of those risk profiles. While these loans have higher yields than many of our other loans, such loans involve significant risks in addition to normal credit risk. Potential risk elements associated with indirect lending include the limited personal contact with the borrower as a result of indirect lending through dealers, the absence of assured continued employment of the borrower, the varying general creditworthiness of the borrower, changes in the local economy and difficulty in monitoring collateral. While indirect automobile loans are secured, such loans are secured by depreciating assets and characterized by loan to value ratios that could result in us not recovering the full value of an outstanding loan upon default by the borrower. Delinquencies, charge-offs and repossessions of vehicles in this portfolio are always concerns. If general economic conditions worsen, we may experience higher levels of delinquencies, repossessions and charge-offs.

Commercial and industrial loans may expose us to greater financial and credit risk than other loans.

As of December 31, 2018, approximately 17.0% of our loan portfolio consisted of commercial and industrial loans. Commercial and industrial loans generally carry larger loan balances and can involve a greater degree of financial and credit risk than other loans. Any significant failure to pay on time by our customers would hurt our earnings and cause a significant increase in non-performing loans. The increased financial and credit risk associated with these types of loans are a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the size of loan balances, the effects of general economic conditions on income-producing properties and the increased difficulty of evaluating and monitoring these types of loans. In addition, when

underwriting a commercial or industrial loan, we may take a security interest in commercial real estate, and, in some instances upon a default by the borrower, we may foreclose on and take title to the property, which may lead to potential financial risks. An increase in non-performing loans could result in a net loss of earnings from these loans, an increase in the provision for loan losses and an increase in loan charge-offs, all of which could have a material adverse effect on our business, financial condition or results of operations.

Our allowance for loan loss may not be adequate to cover actual future losses.

We maintain an allowance for loan losses to cover current, probable incurred loan losses. Every loan we make carries a certain risk of non-repayment, and we make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of loans. Through a periodic review and consideration of the loan portfolio, management determines the amount of the allowance for loan losses by considering general market conditions, credit quality of the loan portfolio, the collateral supporting the loans and performance of customers relative to their financial obligations with us. The amount of future losses is susceptible to changes in economic, operating and other conditions, including changes in interest rates, which may be beyond our control, and these losses may exceed current estimates. We cannot fully predict the amount or timing of losses or whether the loss allowance will be adequate in the future. If our assumptions prove to be incorrect, our allowance for loan losses may not be sufficient to cover losses inherent in our loan portfolio, which will require additions to the allowance. Excessive loan losses and significant additions to our allowance for loan losses could have a material adverse impact on our business, financial condition or results of operations.

We are subject to certain risks with respect to liquidity.

"Liquidity" refers to our ability to generate sufficient cash flows to support our operations and to fulfill our obligations, including commitments to originate loans, to repay our wholesale borrowings and other liabilities and to satisfy the withdrawal of deposits by our customers. Our primary source of liquidity is our core deposit base, which is raised through our retail branch system. Core deposits – savings and money market accounts, time deposits less than $250 thousand and demand deposits—comprised approximately 93.8% of total deposits at December 31, 2018. Additional available unused wholesale sources of liquidity include advances from the FHLB, issuances through dealers in the capital markets and access to certificates of deposit issued through brokers. Liquidity is further provided by unencumbered, or unpledged, investment securities that totaled $202.4 million at December 31, 2018. An inability to raise funds through deposits, borrowings, the sale or pledging as collateral of loans and other assets could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could negatively affect our access to liquidity sources include a decrease in the level of our business activity due to a market downturn or negative regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as severe disruption of the financial markets or negative news and expectations about the prospects for the financial services industry as a whole, as evidenced by recent turmoil in the domestic and worldwide credit markets.

Our business strategy includes continuing our growth plans. Our business, financial condition or results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We intend to continue pursuing a profitable growth strategy both within our existing markets and in new markets. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in significant growth stages of development. We cannot assure that we will be able to expand our market presence in our existing markets or successfully enter new markets or that any such expansion will not adversely affect our results of operations. Failure to manage our growth effectively could have a material adverse effect on our business, future

prospects, financial condition or results of operations and could adversely affect our ability to successfully implement our business strategy. Also, if we grow more slowly than anticipated, our operating results could be materially adversely affected.

We may experience difficulties in integrating acquired businesses, or acquisitions may not perform as expected.

We completed the acquisition of Monitor in 2017 and Bowers in 2016. The successful integration of these acquisitions depends on our ability to manage the operations and personnel of the acquired businesses. Integrating operations is complex and requires significant efforts and expenses. Potential difficulties we may encounter as part of the integration process include the following:

- employees may voluntarily or involuntarily exit the Company because of the acquisitions;
- our management team may have its attention diverted while trying to integrate the acquired companies;
- we may encounter obstacles when incorporating the acquired operations into our operations;
- differences in business backgrounds, corporate cultures and management philosophies;
- potential unknown liabilities and unforeseen increased expenses;
- previously undetected operational or other issues; and
- the acquired operations may not otherwise perform as expected or provide expected results.

Any of these factors could adversely affect each company’s ability to maintain relationships with customers, suppliers, employees and other constituencies or our ability to achieve the anticipated benefits of the acquisition or could reduce each company’s earnings or otherwise adversely affect our business and financial results after the acquisition.

We may fail to realize all of the anticipated benefits of acquisitions, which could reduce our anticipated profitability.

We expect that our acquisitions will result in certain synergies, business opportunities and growth prospects, although we may not fully realize these expectations. Our assumptions underlying estimates of expected cost savings may be inaccurate or general industry and business conditions may deteriorate. In addition, our growth and operating strategies for acquired businesses may be different from the strategies that the acquired companies pursued. If these factors limit our ability to integrate or operate the acquired companies successfully or on a timely basis, our expectations of future results of operations, including certain cost savings and synergies expected to result from acquisitions, may not be met.

We may not be able to attract and retain skilled people.

Our success depends, in large part, on our ability to attract and retain key people. Competition for the best people in most activities in which we engage can be intense, and we may not be able to retain or hire the people we want or need. In order to attract and retain qualified employees, we must compensate them at market levels. If we are unable to continue to attract and retain qualified employees, or do so at rates necessary to maintain our competitive position, our performance, including our competitive position, could suffer, and, in turn, adversely affect our business, financial condition or results of operations.

Strong competition within our markets could reduce our ability to attract and retain business.

We encounter significant competition from banks, savings and loan associations, credit unions, mortgage banks, and other financial service companies in our markets. Some of our competitors offer a broader range of products and services than we can offer as a result of their size and ability to achieve economies of scale. Such competition includes major financial companies whose greater resources may afford them a marketplace advantage by enabling them to maintain more numerous banking locations and support extensive promotional and advertising campaigns. Our ability to maintain our history of strong financial performance and return on investment to shareholders will depend in part on our continued ability to compete successfully in our market. Our financial performance and return on investment to shareholders also depends on our ability to expand the scope of available financial services to our customers. In addition to other banks, competitors include securities dealers, brokers,

investment advisors and finance and insurance companies. The increasingly competitive environment is, in part, a result of changes in regulation, changes in technology and product delivery systems and the accelerating pace of consolidation among financial service providers.

Consumers may decide not to use banks to complete their financial transactions.

Technology and other changes are allowing parties to utilize alternative methods to complete financial transactions that historically have involved banks. For example, consumers can now maintain funds in brokerage accounts or mutual funds that would have historically been held as bank deposits. Consumers can also complete transactions such as paying bills and/or transferring funds directly without the assistance of banks. The process of eliminating banks as intermediaries could result in the loss of fee income, as well as the loss of customer deposits and the related income generated from those deposits. The loss of these revenue streams and the lower cost deposits as a source of funds could have a material adverse effect on our business, financial condition or results of operations.

We are exposed to operational risk.

Similar to any large organization, we are exposed to many types of operational risk, including reputational risk, legal and compliance risk, the risk of fraud or theft by employees or outsiders, unauthorized transactions by employees or operational errors, including clerical or record-keeping errors or those resulting from faulty or disabled computer or telecommunications systems.

Negative public opinion can result from our actual or alleged conduct in any number of activities, including lending practices, corporate governance and acquisitions and from actions taken by government regulators and community organizations in response to those activities. Negative public opinion can adversely affect our ability to attract and keep customers, and can expose us to litigation and regulatory action.

Given the volume of transactions we process, certain errors may be repeated or compounded before they are discovered and successfully rectified. Our necessary dependence upon automated systems to record and process our transaction volume may further increase the risk that technical system flaws or employee tampering or manipulation of those systems will result in losses that are difficult to detect. We may also be subject to disruptions of our operating systems arising from events that are wholly or partially beyond our control (for example, computer viruses or electrical or telecommunications outages), which may give rise to disruption of service to customers and to financial loss of liability. We are further exposed to the risk that our external vendors may be unable to fulfill their contractual obligations (or will be subject to the same risk of fraud or operational errors by their respective employees as we are) and to the risk that our (or our vendors') business continuity and data security systems prove to be inadequate.

Unauthorized disclosure of sensitive or confidential customer information, whether through a data breach of our computer systems by cyber-attack or otherwise, could severely harm our business.

As part of our financial institution business, we collect, process and retain sensitive and confidential client and customer information on behalf of our subsidiaries and other third parties. Despite the security measures we have in place, our facilities and systems, and those of our third-party service providers, may be vulnerable to security breaches, acts of vandalism, computer viruses, misplaced or lost data, programming and/or human errors or other similar events. If information security is breached, information could be lost or misappropriated, resulting in financial loss or costs to us or damages to others. Any security breach involving the misappropriation, loss or other unauthorized disclosure of confidential customer information, whether by us or by our vendors, could severely damage our reputation, expose us to the risks of litigation and liability, or disrupt our operations, and have a material adverse effect on our business, financial condition or results of operations. We have not experienced any material loss relating to a cyber-attack or other information security breach, but there can be no assurance that we will not suffer such attacks or attempted breaches, or incur resulting losses, in the future. Our risks with respect to these threats remains heightened due to the evolving sophistication and frequency of such threats. As cyber-attacks and other attempted information security threats continue to evolve, we may be required to spend significant additional

resources in efforts to modify and enhance our protective measures or in investigating or remediating of security breaches or vulnerabilities.

We depend on our subsidiaries for dividends, distributions and other payments.

As a financial holding company, we are a legal entity separate and distinct from our subsidiaries. Our principal source of funds to pay dividends on our common shares is dividends from these subsidiaries. Federal and state statutory provisions and regulations limit the amount of dividends that our banking and other subsidiaries may pay to us without regulatory approval. In the event our subsidiaries become unable to pay dividends to us, we may not be able to pay dividends on our outstanding common shares. Accordingly, our inability to receive dividends from our subsidiaries could also have a material adverse effect on our business, financial condition and results of operations. Further discussion of our ability to pay dividends can be found under the caption "Dividends and Transactions with Affiliates" in Item 1 of this Annual Report on Form 10-K.

We may elect or be compelled to seek additional capital in the future, but that capital may not be available when it is needed.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Federal banking agencies have proposed extensive changes to their capital requirements; including raising required amounts and eliminating the inclusion of certain instruments from the calculation of capital. The final form of such regulations and their impact on the Company is unknown at this time, but may require us to raise additional capital. In addition, we may elect to raise capital to support our business or to finance acquisitions, if any, or for other anticipated reasons. Our ability to raise additional capital, if needed, will depend on financial performance, conditions in the capital markets, economic conditions and a number of other factors, including the satisfaction or release of preemptive rights in the event of a common share offering, many of which are outside our control. Therefore, there can be no assurance additional capital can be raised when needed or that capital can be raised on acceptable terms. Impairment to our ability to raise capital may have a material adverse effect on our business, financial condition or results of operations.

Risks Related to the Legal and Regulatory Environment

Increases in FDIC insurance premiums may have a material adverse effect on our earnings.

The FDIC maintains the Deposit Insurance Fund to resolve the cost of bank failures. Since late 2008, the FDIC has taken various actions intended to maintain a strong funding position and restore reserve ratios of the Deposit Insurance Fund. Those actions included increasing assessment rates for all insured institutions, requiring riskier institutions to pay a larger share of premiums by factoring in rate adjustments based on secured liabilities and unsecured debt levels, and imposing special assessments. In addition, in 2011 the FDIC approved a final rule that changed the deposit insurance assessment base and assessment rate schedule, adopted a new large-bank pricing assessment scheme and set a target size for the Deposit Insurance Fund. The rule, as mandated by the Dodd-Frank Act, finalized a target size for the Deposit Insurance Fund at 2 percent of insured deposits. The FDIC recently adopted rules revising assessments in a manner that benefits banks with assets of less than $10 billion, although there can be no assurance that such assessments will not change in the future.

We have a limited ability to control the amount of premiums we are required to pay for FDIC insurance. If there are additional financial institution failures or other significant legislative or regulatory changes, the FDIC may be required to increase assessment rates or take actions similar to those taken after 2008. Increases in FDIC insurance assessment rates may materially adversely affect our results of operations and our ability to continue to pay dividends on our common shares at the current rate or at all.

Legislative or regulatory changes or actions, or significant litigation, could adversely impact us or the businesses in which we are engaged.

The financial services industry is extensively regulated. We are subject to extensive state and federal regulation, supervision and legislation that govern almost all aspects of our operations. Laws and regulations may change from time to time and are primarily intended for the protection of consumers, depositors and the Deposit Insurance Fund, and not to benefit our shareholders. The impact of any changes to laws and regulations or other actions by regulatory agencies may negatively impact us or our ability to increase the value of our business. Regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the imposition of restrictions on the operation of an institution, the classification of assets by an institution and the adequacy of an institution's allowance for loan losses. Additionally, actions by regulatory agencies or significant litigation against us could cause us to devote significant time and resources to defending our business and may lead to penalties that materially affect our shareholders and us.

In addition to laws, regulations and actions directed at the operations of banks, proposals to reform the housing finance market consider winding down Fannie Mae and Freddie Mac, which could negatively affect our sales of loans.

Even a reduction in regulatory restrictions could adversely affect our operations and our shareholders if less restrictive regulation increases competition within the industry generally or within our markets.

Our results of operations, financial condition or liquidity may be adversely impacted by issues arising in foreclosure practices, including delays in the foreclosure process, related to certain industry deficiencies, as well as potential losses in connection with actual or projected repurchases and indemnification payments related to mortgages sold into the secondary market.

Previous announcements of deficiencies in foreclosure documentation by several large seller/servicer financial institutions have raised various concerns relating to mortgage foreclosure practices. The integrity of the foreclosure process is important to our business, as an originator and servicer of residential mortgages. As a result of our continued focus of concentrating our lending efforts in our primary markets in Ohio, as well as servicing loans for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), we do not anticipate suspending any of our foreclosure activities. We previously reviewed our foreclosure procedures and concluded they are generally conservative in nature and do not present the significant documentation deficiencies underlying other industry foreclosure problems. Nevertheless, we could face delays and challenges in the foreclosure process arising from claims relating to industry practices generally, which could adversely affect recoveries and our financial results, whether through increased expenses of litigation and property maintenance, deteriorating values of underlying mortgaged properties or unsuccessful litigation results generally.

In addition, in connection with the origination and sale of residential mortgages into the secondary market, we make certain representations and warranties, which, if breached, may require us to repurchase such loans, substitute other loans or indemnify the purchasers of such loans for actual losses incurred in respect of such loans. Although we believe that our mortgage documentation and procedures have been appropriate and are generally conservative in nature, it is possible that we will receive repurchase requests in the future and we may not be able to reach favorable settlements with respect to such requests. It is therefore possible that we may increase our reserves or may sustain losses associated with such loan repurchases and indemnification payments.

Environmental liability associated with commercial lending could have a material adverse effect on our business, financial condition or results of operations.

A significant portion of our loan portfolio is secured by real property. During the ordinary course of business, we may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, we may be liable for remediation costs, as well as for personal injury and property damage. In addition, we own and operate certain properties that may be subject to similar environmental liability risks.

Environmental laws may require us to incur substantial expenses and may materially reduce the affected property’s value or limit our ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase our exposure to environmental liability. Although we have policies and procedures requiring the performance of an environmental site assessment before initiating any foreclosure action on real property, these assessments may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on our business, financial condition or results of operations.

Impairment of investment securities, goodwill, other intangible assets, or deferred tax assets could require charges to earnings, which could result in a negative impact on our results of operations.

In assessing the impairment of investment securities, we consider the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuers, whether the market decline was affected by macroeconomic conditions and whether we have the intent to sell the debt security or will be required to sell the debt security before its anticipated recovery. Under current accounting standards, goodwill and certain other intangible assets with indeterminate lives are no longer amortized but, instead, are assessed for impairment periodically or when impairment indicators are present. Assessment of goodwill and such other intangible assets could result in circumstances where the applicable intangible asset is deemed to be impaired for accounting purposes. Under such circumstances, the intangible asset's impairment would be reflected as a charge to earnings in the period. Deferred tax assets are only recognized to the extent it is more likely than not they will be realized. Should management determine it is not more likely than not that the deferred tax assets will be realized, a valuation allowance with a change to earnings would be reflected in the period. This was realized as a result of the enactment on December 22, 2017, of H.R.1, known as the "Tax Cuts and Jobs Act" which, among other things, reduced the corporate income tax rate to 21% effective January 1, 2018. As a result of passage of the new tax law, Farmers completed a revaluation of its net deferred tax assets. The Company's deferred tax assets, net of deferred tax liabilities, represent corporate tax benefits anticipated to be realized in the future. The reduction in the federal corporate tax rate, effective January 1, 2018, reduces these benefits. Farmers reduced its net deferred tax assets by approximately $1.8 million in the fourth quarter of 2017, representing an impact on earnings per share of approximately $0.06 per diluted share based fourth quarter weighted average diluted shares outstanding of approximately 27.5 million.

Changes and uncertainty in tax laws, including the recently enacted Tax Cuts and Jobs Act, could adversely affect our performance.

We are subject to extensive federal, state and local taxes, including income, excise, sales/use, payroll, financial institutions tax, withholding and ad valorem taxes. Changes to our taxes could have a material adverse effect on our results of operations and, as described in the above risk discussion and below, the fair value of net deferred tax assets. In addition, our customers are subject to a wide variety of federal, state and local taxes. Changes in taxes paid by our customers may adversely affect their ability to purchase homes or consumer products, which could adversely affect their demand for our loans and deposit products. In addition, such negative effects on our customers could result in defaults on the loans we have made and decrease the value of mortgage-backed securities in which we have invested.

The Tax Cuts and Jobs Act, among other changes, imposes additional limitations on the federal income tax deductions individual taxpayers may take for mortgage loan interest payments and for payments of state and local taxes, including real property taxes. The Tax Cuts and Jobs Act also imposes additional limitations on the deductibility of business interest expense and eliminates other deductions in their entirety, including deductions for certain home equity loan interest payments. Such limits and eliminations may result in customer defaults on loans we have made and decrease the value of mortgage-backed securities in which we have invested.

Anti-takeover provisions could delay or prevent an acquisition or change in control by a third party.

Provisions of the Ohio General Corporation Law, our Amended Articles of Incorporation, and our Amended Code of Regulations, including a staggered board and supermajority voting requirements, could make it more difficult for a third party to acquire control of us or could have the effect of discouraging a third party from attempting to acquire control of us.

We may be a defendant from time to time in the future in a variety of litigation and other actions, which could have a material adverse effect on our business, financial condition or results of operations.

Our subsidiaries and we may be involved from time to time in the future in a variety of litigation arising out of our business. Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our business, financial condition or results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms, if at all.

Item 1B. Unresolved Staff Comments.

There are no matters of unresolved staff comments from the Commission staff.

Item 2. Properties.

Farmers National Banc Corp.'s Properties

The Company does not own any property. The Company's operations are conducted at Farmers Bank's main office, which is located at 20 and 30 S. Broad St., Canfield, Ohio.

Farmers National Bank Property

The Bank’s main office is located at 20 and 30 S. Broad St., Canfield, Ohio. The other locations of Farmers Bank are:

Office Building	40 & 46 S. Broad St., Canfield, Ohio
Austintown Office	22 N. Niles-Canfield Rd., Youngstown, Ohio
Lake Milton Office	17817 Mahoning Avenue, Lake Milton, Ohio
Cornersburg Office	3619 S. Meridian Rd., Youngstown, Ohio
Colonial Plaza Office	401 E. Main St., Canfield, Ohio
Western Reserve Office	102 W. Western Reserve Rd., Youngstown, Ohio
Salem Office	2424 E. State St., Salem, Ohio
Columbiana Office	340 State Rt. 14, Columbiana, Ohio
Damascus Office	29053 State Rt. 62, Damascus, Ohio
Poland Office	106 McKinley Way W., Poland, Ohio
Niles Office	1 S. Main St., Niles, Ohio
Niles Drive Up	170 E. State St., Niles, Ohio
Girard Office	121 N. State St., Girard, Ohio
Eastwood Office	5845 Youngstown-Warren Rd., Niles, Ohio
Niles Operation Center	51 S. Main St., Niles, Ohio
Canton Office	4518 Fulton Dr. NW, Suite 100, Canton, Ohio
McClurg Road Office	42 McClurg Rd., Boardman, Ohio
Howland Office	1625 Niles-Cortland Rd., Warren, Ohio
Fairlawn Office	2820 W. Market St., Suite 120, Akron, Ohio
Wealth Management Bldg.	2 S. Broad St., Canfield, Ohio
Alliance Office	310 W. State St., Alliance, Ohio
Midway Office	7227 E. Lincoln Way, Apple Creek, Ohio
Dalton Office	12 W. Main St., Dalton, Ohio
Calcutta Office	15703 State Rt. 170, Calcutta, Ohio
East Liverpool Office	617 Bradshaw Ave., East Liverpool, Ohio
Kidron Office	4950 Kidron Rd., Kidron, Ohio
Lisbon Office	131 E. Lincoln Way, Lisbon, Ohio
Lodi Office	106 Ainsworth St., Lodi, Ohio
Massillon Office	211 Lincoln Way E., Massillon, Ohio
Mayflower Office	2312 Lincoln Way NW, Massillon, Ohio
Mount Eaton Office	15974 E. Main St., Mount Eaton, Ohio
Orrville Main Office	112 W. Market St., Orrville, Ohio
West High Street Office	1320 W. High St., Orrville, Ohio
Seville Office	4885 Atlantic Dr., Seville, Ohio
Smithville Office	153 E. Main St., Smithville, Ohio
Burbank Road Office	4192 Burbank Rd., Wooster, Ohio
Downtown Wooster Office	305 W. Liberty St., Wooster, Ohio
Midland Office	629 Midland Ave., Midland, Pennsylvania
Beachwood Lending Office	27600 Chagrin Blvd., Suite 300, Woodmere, Ohio
Big Prairie Office	13210 State Route 226, Big Prairie, Ohio
Beaver Lending Office	501 3rd St., Beaver, Pennsylvania

The Bank owns all locations except the Colonial Plaza, Canton, Alliance, East Liverpool, Fairlawn, and Downtown Wooster offices, and the Beaver and Beachwood lending offices, which are leased.

Farmers Trust Company Property

Farmers Trust operates from four locations owned and leased by the Bank:

Boardman Office	42 McClurg Rd., Boardman, Ohio
Howland Office	1625 Niles-Cortland Rd., Warren, Ohio
Canton Office	4518 Fulton Dr. NW, Suite 100, Canton, Ohio
Downtown Wooster Office	305 W. Liberty St., Wooster, Ohio

The Bank owns the Boardman and Howland offices and leases space to Farmers Trust. The Canton and Wooster locations are leased from third parties.

Farmers National Insurance, LLC Property

Farmers Insurance operates from two locations, which are owned by the Bank:

Wealth Management Building	2 S. Broad St., Canfield, Ohio
Bowers Group Building	339 N. High St., Cortland, Ohio

National Associates, Inc. Property

NAI operates from one location, which is leased:

Fairview Park	22720 Fairview Center Dr., Suite 100, Fairview Park, Ohio

Item 3. Legal Proceedings.

In the normal course of business, the Company and its subsidiaries are at times subject to pending and threatened legal actions, some for which the relief or damages sought are substantial. Although Farmers is not able to predict the outcome of such actions, after reviewing pending and threatened actions with counsel, management believes that, based on the information currently available, the outcome of such actions, individually or in the aggregate, would not have a material adverse effect on the results of operations or stockholders' equity of the Company. However, it is possible that the ultimate resolution of these matters, if unfavorable, may be material to the results of operations in a particular future period as the time and amount of any resolution of such actions and its relationship to the future results of operations are not known.

Item 4. Mine Safety Disclosures

Not applicable.

Part II

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

Market Information regarding the Company's Common Shares.

Farmers' common shares currently trade under the symbol "FMNB" on the Nasdaq Capital Market. Farmers had 27,790,601 common shares outstanding and approximately 3,357 holders of record of common shares at March 1, 2019. The following table sets forth price ranges and dividend information for Farmers' common shares for the calendar quarters indicated. Quotations reflect inter-dealer prices without retail mark-up, mark-down or commission, and may not represent actual transactions. Certain limitations and restrictions on the ability of Farmers to continue to pay quarterly dividends are described under the caption "Capital Resources" in Item 7 of this Part II, and under the caption "Dividends and Transactions with Affiliates" in Item 1 of Part I.

Quarter Ended	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
High	$ 15.90	$ 16.75	$ 16.90	$ 15.48
Low	$ 12.80	$ 13.56	$ 14.95	$ 11.56
Cash dividends paid per share	$ 0.07	$ 0.07	$ 0.08	$ 0.08

Quarter Ended	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
High	$ 14.90	$ 15.25	$ 15.65	$ 15.95
Low	$ 12.13	$ 12.65	$ 12.90	$ 13.35
Cash dividends paid per share	$ 0.05	$ 0.05	$ 0.06	$ 0.06

Purchases of Common Shares by Farmers.

In September 2012, the Company announced that its Board of Directors approved a share repurchase program under which the Company was authorized to repurchase up to 920,000 shares of its common stock in the open market or in privately negotiated transactions, subject to market and other conditions (the "Program"). The Program may be modified, suspended or terminated by the Company at any time. There were no shares repurchased during the course of 2018 and 2017. 19,900 shares of its common stock were repurchased by the Company in 2016.

Item 6. Selected Financial Data.

SELECTED FINANCIAL DATA

(Table Dollar Amounts in Thousands except Per Share Data)

For the Years Ending December 31,	2018	2017	2016	2015	2014
Summary of Earnings					
Total Interest and Dividend Income					
(including fees on loans)	$91,766	$80,527	$72,498	$53,827	$40,915
Total Interest Expense	13,265	6,881	4,378	4,090	4,579
Net Interest Income	78,501	73,646	68,120	49,737	36,336
Provision for Loan Losses	3,000	3,350	3,870	3,510	1,880
Noninterest Income	25,499	24,051	23,244	18,306	15,303
Noninterest Expense	62,717	61,567	59,452	53,979	38,162
Income Before Income Taxes	38,283	32,780	28,042	10,554	11,597
Income Taxes	5,714	10,069	7,485	2,499	2,632
NET INCOME	$32,569	$22,711	$20,557	$8,055	$8,965
Per Share Data					
Basic Earnings Per Share	$1.18	$0.82	$0.76	$0.36	$0.48
Diluted Earnings Per Share	1.16	0.82	0.76	0.36	0.48
Cash Dividends Paid	0.30	0.22	0.16	0.12	0.12
Book Value at Year-End	9.44	8.79	7.88	7.35	6.71
Tangible Book Value (1)	7.86	7.14	6.21	5.76	6.23
Balances at Year-End					
Total Assets	$2,328,864	$2,159,069	$1,966,113	$1,869,902	$1,136,967
Earning Assets	2,076,969	1,998,245	1,819,455	1,735,843	1,074,434
Total Deposits	1,799,720	1,604,719	1,524,756	1,409,047	915,703
Short-Term Borrowings	244,759	289,565	198,460	225,832	59,136
Long-Term Borrowings	6,033	6,994	15,036	22,153	28,381
Loans Held for Sale	1,237	272	355	1,769	511
Net Loans	1,722,248	1,565,066	1,416,783	1,287,887	656,220
Total Stockholders' Equity	262,320	242,074	213,216	198,047	123,560
Average Balances					
Total Assets	$2,230,380	$2,082,447	$1,924,914	$1,482,527	$1,141,047
Total Stockholders' Equity	247,965	228,963	211,408	162,086	120,352
Significant Ratios					
Return on Average Assets (ROA)	1.46 %	1.09 %	1.07 %	0.54 %	0.79 %
Return on Average Equity (ROE)	13.13	9.92	9.72	4.97	7.45
Average Earning Assets/Average Assets	93.01	92.35	91.49	91.91	93.02
Average Equity/Average Assets	11.12	10.99	10.98	10.93	10.55
Loans/Deposits	96.20	98.30	93.63	92.04	72.50

Allowance for Loan Losses/Total Loans	0.78	0.78	0.76	0.69	1.15
Allowance for Loan Losses/Nonperforming Loans	175.81	160.04	132.83	85.96	89.99
Efficiency Ratio (Tax equivalent basis)(2)	57.93	59.66	61.59	75.26	70.24
Net Interest Margin	3.87	3.99	4.01	3.81	3.59
Dividend Payout Rate	25.53	26.47	21.03	33.32	24.95
Tangible Common Equity Ratio (3)	9.56	9.31	8.75	8.50	10.17

(1) Tangible book value per share is Total Stockholders' Equity minus goodwill and other intangible assets divided by the number of shares outstanding.

(2) The efficiency ratio is calculated by dividing total noninterest expense by net interest income plus noninterest income.

(3) The tangible common equity ratio is calculated by dividing total common stockholders' equity by total assets, after reducing both amounts by intangible assets. The tangible common equity ratio is not required by U.S. GAAP or by applicable bank regulatory requirements, but is a metric used by management to evaluate the adequacy of our capital levels. Since there is no authoritative requirement to calculate the tangible common equity ratio, our tangible common equity ratio is not necessarily comparable to similar capital measures disclosed or used by other companies in the financial services industry. Tangible common equity and tangible assets are non U.S. GAAP financial measures and should be considered in addition to, not as a substitute for or superior to, financial measures determined in accordance with U.S. GAAP. With respect to the calculation of the actual unaudited tangible common equity ratio as of December 31, 2018, reconciliations of tangible common equity to U.S. GAAP total common stockholders' equity and tangible assets to U.S. GAAP total assets are set forth below:

Reconciliation of Common Stockholders' Equity to Tangible Common Equity

December 31,	2018	2017	2016	2015	2014
Stockholders' Equity	$262,320	$242,074	$213,216	$198,047	$123,560
Less Goodwill and other intangibles	43,952	45,369	45,154	42,911	8,813
Tangible Common Equity	$218,368	$196,705	$168,062	$155,136	$114,747

Reconciliation of Total Assets to Tangible Assets

December 31,	2018	2017	2016	2015	2014
Total Assets	$2,328,864	$2,159,069	$1,966,113	$1,869,902	$1,136,967
Less Goodwill and other intangibles	43,952	45,369	45,154	42,911	8,813
Tangible Assets	$2,284,912	$2,113,700	$1,920,959	$1,826,991	$1,128,154

Acquisitions have occurred during the five year periods represented above that makes comparability difficult. The current year impact of enacted federal tax reform makes comparability difficult too. See Note 2 – Business Combinations and Note 17 – Income Taxes for additional details.

Reconciliation of Net Income, Excluding Merger Related Expenses and Deferred Tax Asset Adjustment

December 31,	2018	2017	2016	2015	2014
Net income	$32,569	$22,711	$20,557	$8,055	$8,965
Acquisition related costs - tax equated	(158)	283	412	4,831	0
Deferred tax asset adjustment	0	1,793	0	0	0
Net income - adjusted	32,411	24,787	20,969	12,886	8,965
Average basic shares outstanding	27,675	27,568	27,000	22,678	18,675
EPS excluding acquisition costs and deferred tax asset adjustment	$1.17	$0.90	$0.78	$0.57	$0.48

Reconciliation of Return on Average Assets and Average Equity, Excluding Merger Related Expenses and Deferred Tax Asset Adjustment

December 31,	2018	2017	2016	2015	2014
ROA excluding merger related expenses (4)	1.45 %	1.19 %	1.09 %	0.87 %	0.79 %
ROE excluding merger related expenses (5)	13.07 %	10.83 %	9.92 %	7.95 %	7.45 %

(4) Net income - adjusted divided by average assets
(5) Net income - adjusted divided by average equity

Average Balance Sheets and Related Yields and Rates

(Table Dollar Amounts in Thousands except Per Share Data)

Years ended December 31,	2018 AVERAGE BALANCE	INTEREST	RATE	2017 AVERAGE BALANCE	INTEREST	RATE	2016 AVERAGE BALANCE	INTEREST	RATE
EARNING ASSETS									
Loans (1) (3) (5)	$1,632,541	$80,192	4.91%	$1,493,550	$70,573	4.73%	$1,344,308	$63,757	4.74%
Taxable securities (2)	202,270	4,928	2.44	213,634	4,899	2.29	240,087	5,058	2.11
Tax-exempt securities (2) (5)	194,302	7,195	3.70	167,824	7,293	4.35	132,550	5,581	4.21
Equity securities (4) (5)	11,382	652	5.73	10,285	537	5.22	9,613	515	5.36
Federal funds sold and other cash	34,006	644	1.89	37,880	394	1.04	34,579	166	0.48
Total earning assets	2,074,501	93,611	4.51	1,923,173	83,696	4.35	1,761,137	75,077	4.26
NONEARNING ASSETS									
Cash and due from banks	33,843			32,696			32,833		
Premises and equipment	21,778			22,953			23,927		
Allowance for Loan Losses	(12,859)			(11,567)			(9,728)		
Unrealized gains on securities	(9,121)			(781)			4,576		
Other assets (1)	122,238			115,973			112,169		
Total Assets	$2,230,380			$2,082,447			$1,924,914		
INTEREST-BEARING LIABILITIES									
Time deposits	$293,725	$4,210	1.43%	$242,650	$2,565	1.06%	$245,384	$1,835	0.75%
Brokered time deposits	68	2	2.35	0	0	0.00	0	0	0.00
Savings deposits	465,283	1,015	0.22	521,099	728	0.14	540,626	685	0.13
Demand deposits	506,099	2,912	0.58	405,062	1,197	0.30	333,712	701	0.21
Short term borrowings	281,063	4,936	1.76	270,949	2,167	0.80	211,713	689	0.33
Long term borrowings	6,491	190	2.93	9,739	224	2.30	19,886	468	2.35
Total Interest-Bearing Liabilities	1,552,729	13,265	0.85	1,449,499	6,881	0.47	1,351,321	4,378	0.32
NONINTEREST-BEARING LIABILITIES AND STOCKHOLDERS' EQUITY									
Demand deposits	415,968			390,230			348,003		
Other Liabilities	13,718			13,755			14,182		

Stockholders' equity	247,965			228,963			211,408		
Total Liabilities and Stockholders' Equity	$2,230,380			$2,082,447			$1,924,914		
Net interest income and interest rate spread		$80,346	3.66%		$76,815	3.88%		$70,699	3.94%
Net interest margin			3.87%			3.99%			4.01%

(1) Non-accrual loans and overdraft deposits are included in other assets.
(2) Includes unamortized discounts and premiums. Average balance and yield are computed using the average historical amortized cost.

(3) Interest on loans includes fee income of $4.1 million, $3.7 million and $3.9 million for 2018, 2017 and 2016, respectively, and is reduced by amortization of $2.7 million, $2.7 million and $2.5 million for 2018, 2017 and 2016, respectively.

(4) Equity securities include restricted stock, which is included in other assets on the consolidated balance sheets.

(5) For 2018, adjustments of $357 thousand and $1.5 million were made to tax equate income on tax exempt loans and tax exempt securities. For 2017, adjustments of $639 thousand and $2.5 million were made to tax equate income on tax exempt loans and tax exempt securities. For 2016, adjustments of $648 thousand and $1.9 million were made to tax equate income on tax exempt loans and tax exempt securities. These adjustments are based on a marginal federal income tax rate of 21% for 2018 and 35% for 2017 and 2016, less disallowances.

RATE AND VOLUME ANALYSIS

(Table Dollar Amounts in Thousands except Per Share Data)

The following table analyzes by rate and volume the dollar amount of changes in the components of the interest differential:

	2018 change from 2017			2017 change from 2016		
	Net Change	Change Due To Volume	Change Due To Rate	Net Change	Change Due To Volume	Change Due To Rate
Tax Equivalent Interest Income						
Loans	$9,619	$ 6,568	$3,051	$6,816	$ 7,078	$(262)
Taxable securities	29	(4,434)	4,463	(159)	(557)	398
Tax-exempt securities	(98)	1,151	(1,249)	1,712	1,485	227
Equity securities	115	57	58	22	36	(14)
Funds sold and other cash	250	(40)	290	228	16	212
Total interest income	$9,915	$ 3,302	$6,613	$8,619	$ 8,058	$561
Interest Expense						
Time deposits	$1,645	$ 540	$1,105	$730	$ (20)	$750
Brokered time deposits	2	2	0	0	0	0
Savings deposits	287	(78)	365	43	(25)	68
Demand deposits	1,715	299	1,416	496	150	346
Short term borrowings	2,769	81	2,688	1,478	193	1,285
Long term borrowings	(34)	(75)	41	(244)	(239)	(5)
Total interest expense	$6,384	$ 769	$5,615	$2,503	$ 59	$2,444
Increase (decrease) in tax equivalent net interest income	$3,531	$ 2,533	$998	$6,116	$ 7,999	$(1,883)

The amount of change not solely due to rate or volume changes was allocated between the change due to rate and the change due to volume based on the relative size of the rate and volume changes.

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

The following presents a discussion and analysis of Farmers' financial condition and results of operations by its management. The review highlights the principal factors affecting earnings and the significant changes in balance sheet items for the years 2018, 2017 and 2016. Financial information for prior years is presented when appropriate. The objective of this financial review is to enhance the reader's understanding of the accompanying tables and charts, the consolidated financial statements, notes to financial statements and financial statistics appearing elsewhere in this Annual Report on Form 10-K. Where applicable, this discussion also reflects management's insights of known events and trends that have or may reasonably be expected to have a material effect on Farmers' business, financial condition or results of operations.

Cautionary Note Regarding Forward Looking Statements

This Annual Report on Form 10-K contains "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are not statements of historical fact, but rather statements based on Farmers' current expectations, beliefs and assumptions regarding the future of Farmers' business, future plans and strategies, projections, anticipated events and trends, its intended results and future performance, the economy and other future conditions. Forward-looking statements are preceded by terms such as "will," "would," "should," "could," "may," "expect," "estimate," "believe," "anticipate," "intend," or variations of these words, or similar expressions. Forward-looking statements are not a guarantee of future performance, and actual future results could differ materially from those contained in forward-looking information. Because forward-looking statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict and many of which are outside of our control. Numerous uncertainties, risks, and changes could cause or contribute to Farmers' actual results, performance, and achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, without limitation, risks and uncertainties detailed from time to time in Farmers' filings with the Securities and Exchange Commission, including without limitation the risk factors disclosed in Item 1A, "Risk Factors" of this Annual Report on Form 10-K.

Readers are cautioned not to put undue reliance on forward-looking statements, which speak only as of the date thereof. The following list, which is not intended to be an all-encompassing list of risks and uncertainties affecting the Company, summarizes several factors that could cause the Company's actual results to differ materially from those anticipated or expected in these forward-looking statements:

- general economic conditions in market areas where Farmers conducts business, which could materially impact credit quality trends;
- business conditions in the banking industry;
- the regulatory environment;
- fluctuations in interest rates;
- demand for loans in the market areas where Farmers conducts business;
- rapidly changing technology and evolving banking industry standards;
- competitive factors, including increased competition with regional and national financial institutions;
- new service and product offerings by competitors and price pressures; and
- other similar items.

Other factors not currently anticipated may also materially and adversely affect Farmers' business, financial condition, results of operations or cash flows. There can be no assurance that future results will meet expectations. Farmers does not undertake, and expressly disclaims, any obligation to update or alter any statements whether as a result of new information, future events or otherwise, except as may be required by applicable law.

Results of Operations

Comparison of Operating Results for the Years Ended December 31, 2018 and 2017.

The Company's net income totaled $32.6 million during 2018, compared to $22.7 million for 2017. On a per share basis, diluted earnings per share were $1.16 as compared to $0.82 diluted earnings per share for 2017. Return on average assets and return on average equity were 1.46% and 13.13%, respectively, for the year ending December 31, 2018, compared to 1.09% and 9.92% for 2017. The return on average tangible equity increased from 13.48% in 2017 to 15.95% in 2018.

On December 22, 2017, H.R.1, known as the "Tax Cuts and Jobs Act," was signed into law. H.R.1, among other things, reduced the corporate income tax rate to 21% effective January 1, 2018. As a result of passage of the new tax law, Farmers' effective tax rate decreased from 30.72% for the year ended December 31, 2017 to 14.92% for the year ended December 31, 2018. It is important to note that also as a result of the new tax law, Farmers determined that its net deferred tax assets needed to be reduced in the fourth quarter of 2017 by approximately $1.8 million, representing an impact on earnings per share of approximately $0.06 per diluted share for that fourth quarter, based on that quarter's weighted average diluted shares outstanding of approximately 28 million.

On August 15, 2017, the Company completed the acquisition of Monitor, the holding company for Monitor Bank. The transaction involved both cash and 465,787 shares of stock totaling $7.5 million. Pursuant to the terms of the merger agreement, common shareholders of Monitor were entitled to elect to receive consideration in cash or in common shares, without par value, of the Farmers National Banc Corp., subject to an overall limitation of 85% of the Monitor common shares being exchanged for Farmers common shares and 15% exchanged for cash. The per share cash consideration of $769.38 is equal to Monitor's March 31 tangible book value multiplied by 1.25. Based on the volume weighted average closing price of Farmers common shares for the 20 trading days ended August 11, 2017 of $14.04, the final stock exchange ratio was 54.80, resulting in an implied value per Monitor common share of $769.38.

Net Interest Income

Net interest income, the principal source of the Company's earnings, represents the difference between interest income on interest-earning assets and interest expense on interest-bearing liabilities. For 2018, taxable equivalent net interest income increased $3.5 million, or 4.6%, from 2017. Interest-earning assets averaged $2.075 billion during 2018, increasing $151.3 million compared to 2017. The Company's interest-bearing liabilities increased 7.1% from $1.449 billion in 2017 to $1.553 billion in 2018.

The Company finances its earning assets with a combination of interest-bearing and interest-free funds. The interest-bearing funds are composed of deposits, short-term borrowings and long-term debt. Interest paid for the use of these funds is the second factor in the net interest income equation. Interest-free funds, such as demand deposits and stockholders' equity, require no interest expense and, therefore, contribute significantly to net interest income.

The profit margin, or spread, on invested funds is a key performance measure. The Company monitors two key performance indicators - net interest spread and net interest margin. The net interest spread represents the difference between the average rate earned on interest-earning assets and the average rate paid on interest-bearing liabilities. The net interest spread in 2018 was 3.66%, decreasing from 3.88% in 2017. The net interest margin represents the overall profit margin – net interest income as a percentage of total interest-earning assets. This performance indicator gives

effect to interest earned for all investable funds including the substantial volume of interest-free funds. For 2018, the net interest margin, measured on a fully taxable equivalent basis, decreased to 3.87%, compared to 3.99% in 2017. The net interest margin, excluding the impact of amortization and accretion from acquisitions, decreased 13 basis point to 3.83% for the year ended December 31, 2018. The accretion added $69.5 thousand per month during 2018 and will continue over the next several years.

The decrease in net interest margin is mainly due to pressure on increasing deposit rates as the Federal Reserve Bank continued to raise the federal funds interest rate in 2018. The federal funds interest rate increased 4 times for a total of 100 basis points during the year. Total taxable equivalent interest income was $93.6 million for 2018, which is $9.9 million more than the $83.7 million reported in 2017. In comparing the years ending December 31, 2018 and 2017, yields on earning assets increased 16 basis points while the cost of interest bearing liabilities increased 38 basis points. Average loans increased $139.0 million, or 9.3%, in 2018, and the loan yield increased eighteen basis points to 4.91%. Tax equated income from securities, federal funds and other increased $296 thousand, or 2.3%, in 2018. Farmers saw its yields on these assets decrease slightly from 3.05% in 2017 to 3.04% in 2018 and the average balance of investment securities and federal funds sold also increased from $429.6 million in 2017 to $442.0 million in 2018.

The increase in the federal funds interest rate as mentioned above impacted the cost of short-term borrowings and interest-bearing deposits during 2018. Total interest expense amounted to $13.3 million for 2018, a 92.8% increase from $6.9 million reported in 2017. Interest-bearing deposits increased $96.4 million or 8.2% and increases in interest rates paid on deposits resulted in a $3.6 million or 81.3% increase in interest expense on deposit balances. Other borrowings balances increased only $6.9 million or 2.5%, however the interest expense related to these borrowings increased $2.7 million or 114%. The total cost of interest-bearing deposits and borrowings increased from 0.47% in 2017 to 0.85% in 2018.

Management will continue to evaluate future changes in interest rates and the shape of the treasury yield curve so that assets and liabilities may be priced accordingly to minimize the impact on the net interest margin.

Noninterest Income

Total noninterest income increased by $1.4 million or 6% in 2018. The increase in noninterest income is due to several factors. Trust fee income increased from $6.4 million to $7.1 million, representing an increase of $695 thousand or 10.8%, resulting from growth in new customers and an increase in market value of trust assets. Commissions from the sale of investment products increased $184 thousand or 20% during 2018. Debit card interchange fees increased $262 thousand or 8.5% as customers continue to increase their use of debit cards to make purchases of goods and services. Insurance agency commissions also increased to $2.6 million compared to $2.4 million in 2017 and service charges on deposit accounts increased from $4.1 million in 2017 to $4.3 million in 2018. These increases were offset by a decrease in income from the sale of mortgage loans of $337 thousand and a decrease in retirement plan consulting fees of $173 thousand. The Bank and the Company expect noninterest income to increase during 2019 as management continues to focus on growing the various sources of noninterest income.

Noninterest Expenses

Noninterest expense for 2018 was $62.7 million, compared to $61.6 million in 2017, representing an increase of $1.1 million, or 1.8%. Most of the increase was from salaries and employee benefits, which grew $1.2 million or 3.5%, mainly due to merit increases in salaries and a 1.8% increase the number of full time equivalent employees from 445 to 453. Other operating expenses increased by $309 thousand or 4.2%, and state and local taxes increased by $224 thousand or 13.5%. These increases were offset by a drop in merger related expenses of $1 million. Excluding expenses related to acquisition activities, noninterest expenses measured as a percentage of average assets decreased from 2.93% in 2017 to 2.82% in 2018.

The Company’s tax equivalent efficiency ratio for the twelve-month period ended December 31, 2018 was 57.93%, compared to 59.66% for the same period in 2017. The main factors leading to the improvement in the efficiency ratio was the increase in net interest income and noninterest income, along with the stabilized level of noninterest expenses relative to average assets as explained in the preceding paragraph. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of tax equivalent net interest income plus non-interest income, excluding

security gains and losses and intangible amortization. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor and keep the increases in other expenses to a minimum.

Income Taxes

Income tax expense totaled $5.7 million for 2018 and $10.1 million in 2017. Income taxes are computed using the appropriate effective tax rates for each period. The decrease in the current year tax expense is primarily attributable to the previously mentioned reduction in the corporate income tax rate from 35% to 21% as a result of the Tax Cuts and Jobs Act. The income tax expense of $10.1 million in 2017 was also impacted by the $1.8 million adjustment increase to income tax expense as a result of the write-down of the Company's deferred tax asset from 35% to 21%. The effective tax rates are less than the statutory tax rate primarily due to nontaxable interest and dividend income. The effective income tax rate was 14.9% for 2018 and 30.7% for 2017. We anticipate that the effective rate in 2019 will be in the range of 15% to 16%. Refer to Note 16 to the consolidated financial statements for additional information regarding the effective tax rate.

Comparison of Operating Results for the Years Ended December 31, 2017 and 2016.

The Company's net income totaled $22.7 million during 2017, compared to $20.6 million for 2016. On a per share basis, diluted earnings per share were $0.82 as compared to $0.76 diluted earnings per share for 2016. Excluding a $1.8 million adjustment of the net deferred tax asset resulting from the Tax Cut and Jobs Act that became law in December 2017 and $524 thousand in expenses related to acquisition activities, net income for 2017 would have been $24.8 million, or $0.90 per share. Common comparative ratios for results of operations include the return on average assets and return on average stockholders' equity. For 2017, the return on average equity was 9.92%, compared to 9.72% for 2016. The return on average assets was 1.09% for 2017 and 1.07% for 2016. Excluding expenses related to acquisition activities, the return on average assets and return on average stockholders' equity for 2017 would have been 1.19% and 10.83% in 2017, while the return on average tangible equity would have been 13.48%.

Net Interest Income

For 2017, taxable equivalent net interest income increased $6.1 million, or 8.7%, from 2016. Interest-earning assets averaged $1.9 billion during 2017, increasing $162 million compared to 2016. The Company's interest-bearing liabilities increased 7.3% from $1.35 billion in 2016 to $1.45 billion in 2017. The previously mentioned acquisition of Monitor increased interest-earning assets by $38.1 million and interest-bearing liabilities by $17.8 million at the completion date.

Total taxable equivalent interest income was $83.7 million for 2017, which is $8.6 million more than the $75.1 million reported in 2016. In comparing the years ending December 31, 2017 and 2016, yields on earning assets increased 9 basis points while the cost of interest bearing liabilities increased 15 basis points. Average loans increased $149.2 million, or 11.1%, in 2017, and the loan yield decreased one basis point to 4.73%. Tax equated income from securities, federal funds and other increased $1.8 million, or 15.9%, in 2017. Farmers saw its yields on these assets increase slightly from 2.72% in 2016 to 3.05% in 2017. The average balance of investment securities and federal funds sold also increased from $416.8 million in 2016 to $429.6 million in 2017.

Total interest expense amounted to $6.9 million for 2017, a 57.2% increase from $4.4 million reported in 2016. The increase in 2017 is the result of a $49.1 million or 4.4% increase in interest-bearing deposits and a $49.1 million or 21.2% increase in other borrowings. The cost of interest-bearing liabilities increased from 0.32% in 2016 to 0.47% in 2017.

Noninterest Income

Total noninterest income increased by $807 thousand or 3.5% in 2017. The increase in noninterest income is due to several factors. Gains on the sale of mortgage loans increased from $2.8 million to $3.1 million, representing an

increase of $300 thousand or 8%. Insurance agency commissions also increased to $2.4 million compared to $1.6 million in 2016 and service charges on deposit accounts increased from $4.0 million in 2016 to $4.1 million in 2017, reflecting the size of the company after previous bank acquisitions. Debit card interchange fees also increased $430 thousand or 16.1%. These increases were offset by a decrease in other operating income of $478 thousand and a decrease in investment commissions of $291 thousand.

Noninterest Expenses

Noninterest expense for 2017 was $61.6 million, compared to $59.5 million in 2016, representing an increase of $2.1 million, or 3.6%. Most of the increase was from salaries and employee benefits, which increased $2.9 million or 8.9%, mainly due to an increase in salaries, as the acquisition of Bowers Insurance Agency, Inc. (Bowers) was completed on June 1, 2016 which resulted in seven months of expense in 2016 compared to a full year in 2017. The Company also experienced an increase in employee health care insurance expense in 2017. The Company's full time equivalent employees ("FTE") increased by 1.0% from December 31, 2016 to December 31, 2017. Other operating expenses decreased by $1.0 million as a result of increased efficiencies gained as the Company grew in 2017. Excluding expenses related to acquisition activities, noninterest expenses measured as a percentage of average assets decreased from 3.06% in 2016 to 2.93% in 2017.

The Company's tax equivalent efficiency ratio for the 12 month period ended December 31, 2017 was 59.66%, compared to 61.59% for the same period in 2016. Excluding expenses related to acquisition activities, the efficiency ratio for the year ended December 31, 2017 improved to 58.79% compared to 60.99% in 2016. The main factors leading to the improvement in the efficiency ratio was the increase in net interest income and noninterest income, along with the stabilized level of noninterest expenses relative to average assets as explained in the preceding paragraph. The efficiency ratio is calculated as follows: non-interest expense divided by the sum of tax equivalent net interest income plus non-interest income, excluding security gains and losses and intangible amortization. This ratio is a measure of the expense incurred to generate a dollar of revenue. Management will continue to closely monitor and keep the increases in other expenses to a minimum.

Income Taxes

Income tax expense totaled $10.1 million for 2017 and $7.5 million in 2016. The increase in the current year tax expense can be mainly attributed to the 16.9% increase in income before taxes. The previously mentioned Tax Cuts and Jobs Act also added $1.8 million to 2017's income tax expense as a result of the write-down of the Company's deferred tax asset from 35% to 21%. The effective tax rates are less than the statutory tax rate primarily due to nontaxable interest and dividend income. The effective income tax rate was 30.7% for 2017 and 26.7% for 2016.

Liquidity

Farmers maintains, in the opinion of management, liquidity sufficient to satisfy depositors' requirements and meet the credit needs of customers. The Company depends on its ability to maintain its market share of deposits as well as acquiring new funds. The Company's ability to attract deposits and borrow funds depends in large measure on its profitability, capitalization and overall financial condition.

Principal sources of liquidity include assets considered relatively liquid, such as short-term investment securities, federal funds sold and cash and due from banks.

Along with its liquid assets, Farmers has additional sources of liquidity available which help to insure that adequate funds are available as needed. These other sources include, but are not limited to, loan repayments, the ability to obtain deposits through the adjustment of interest rates and the purchasing of federal funds and borrowings on approved lines of credit at two major domestic banks. At December 31, 2018, Farmers had not borrowed against these lines of credit. Management feels that its liquidity position is more than adequate and will continue to monitor the position on a monthly basis. The Company also has additional borrowing capacity with the FHLB, as well as access to the Federal Reserve Discount Window, which provides an additional source of funds. The Company views its membership in the FHLB as a solid source of liquidity. As of December 31, 2018, the Bank is eligible to borrow an additional $309 million from the FHLB under various fixed rate and variable rate credit facilities. Advances

outstanding from the FHLB at December 31, 2018 amounted to $243.8 million.

Farmers' primary investing activities are originating loans and purchasing securities. During 2018, net cash used by investing activities amounted to $180.5 million, compared to $137.1 million used in 2017. Net increases in loans were $160.2 million in 2018, compared to $132.3 million in 2017. The cash used by lending activities during 2017 can be attributed to the activity in the commercial real estate, commercial and industrial, residential real estate, and agricultural loan portfolios. Purchases of securities available for sale were $70.9 million in 2018, compared to $114.6 million in 2017, and proceeds from maturities and sales of securities available for sale were $53.3 million in 2018, compared to $97.6 million in 2017. Net cash of $16.3 million was received as a result of the acquisition of Monitor in 2017.

Farmers' primary financing activities are obtaining deposits, repurchase agreements and other borrowings. Net cash provided by financing activities amounted to $140.9 million for 2018, compared to $122.4 million in 2017. The majority of this increase can be attributed to the net change in deposits. The increase in deposits was $195 million in 2018 compared to an increase of $45.4 million in 2017. Short-term borrowings decreased $44.8 million in 2018 compared to an increase of $91.1 million in 2018. The decrease in short-term borrowings is mainly a result of the growth in deposit balances, which allowed the Company to pay down short-term Federal Home Loan Bank Advances during the year.

Loan Portfolio

Maturities and Sensitivities of Loans to Interest Rates

The following schedule shows the composition of loans and the percentage of loans in each category at the dates indicated. Balances include unamortized loan origination fees and costs.

Years Ended December 31,	2018		2017		2016		2015		2014	
Commercial Real Estate	$578,181	33.3 %	$512,502	32.5 %	$445,966	31.2 %	$408,534	31.5 %	$222,573	33.5 %
Commercial	244,742	14.1	219,973	13.9	204,359	14.3	199,457	15.4	120,139	18.1
Residential Real Estate	492,133	28.4	468,884	29.7	430,195	30.1	394,582	30.4	183,853	27.7
Consumer	221,795	12.8	212,935	13.5	218,100	15.3	185,077	14.3	137,276	20.7
Agricultural	198,989	11.4	163,087	10.4	129,015	9.1	109,215	8.4	11	0.0
Total Loans	$1,735,840	100.0%	$1,577,381	100.0%	$1,427,635	100.0%	$1,296,865	100.0%	$663,852	100.0%

The following schedule sets forth maturities based on remaining scheduled repayments of principal for commercial and commercial real estate loans listed above as of December 31, 2018:

Types of Loans	1 Year or less	1 to 5 Years	Over 5 Years
Commercial	$58,805	$122,477	$63,460
Commercial Real Estate	$17,490	$133,792	$426,899
Agricultural	$18,369	$28,335	$152,285

The amounts of commercial, commercial real estate and agricultural loans as of December 31, 2018, based on remaining scheduled repayments of principal, are shown in the following table:

Loan Sensitivities	1 Year or less	Total

		Over 1 Year	
Floating or Adjustable Rates of Interest	$ 68,989	$593,881	$662,870
Fixed Rates of Interest	25,675	333,367	359,042
Total Loans	$ 94,664	$927,248	$1,021,912

Total loans were $1.7 billion at year-end 2018, compared to $1.6 billion at year-end 2017. Loans grew 10% organically during the past twelve months. The organic increase in loans is a direct result of Farmers' focus on loan growth utilizing a talented lending and credit team, while adhering to a sound underwriting discipline. Most of the increase in loans has occurred in the commercial real estate, agricultural, residential real estate and commercial loan portfolios. Loans comprised 78.7% of the Bank's average earning assets in 2018, compared to 77.7% in 2017. The Company has also experienced growth in its originated loans portfolio as a result of loans previously acquired from earlier bank mergers being renewed and recorded into the originated book. The product mix in the loan portfolio includes commercial loans comprising 14.1%, residential real estate loans 28.4%, commercial real estate loans 33.3%, consumer loans 12.8% and agricultural loans 11.4% at December 31, 2018, compared with 13.9%, 29.7%, 32.5%, 13.5% and 10.4%, respectively, at December 31, 2017.

Loans contributed 85.7% of total taxable equivalent interest income in 2018 and 84.3% in 2017. Loan yields were 4.91% in 2018, 40 basis points greater than the average rate for total earning assets. Management recognizes that while the loan portfolio holds some of the Bank's' highest yielding assets, it is inherently the most risky portfolio. Accordingly, management attempts to balance credit risk versus return with conservative credit standards. Management has developed and maintains comprehensive underwriting guidelines and a loan review function that monitors credits during and after the approval process. To minimize risks associated with changes in the borrower's future repayment capacity, the Bank generally requires scheduled periodic principal and interest payments on all types of loans and normally requires collateral. Commercial loans at December 31, 2018 increased 11.3% from year-end 2017 with outstanding balances of $244.7 million. The Bank's commercial loans are granted to customers within the immediate trade area of the Bank. The mix is diverse, covering a wide range of borrowers, business types and local municipalities. The Bank monitors and controls concentrations within a particular industry or segment of the economy. These loans are made for purposes such as equipment purchases, capital and leasehold improvements, the purchase of inventory, general working capital and small business lines of credit.

Residential real estate mortgage loans increased 5% to $492.1 million at December 31, 2018, compared to $468.9 million in 2017. Farmers originated both fixed rate and adjustable rate mortgages during 2018. Fixed rate terms are generally limited to fifteen-year terms while adjustable rate products are offered with maturities up to thirty years.

Commercial real estate loans increased from $512.5 million at December 31, 2017 to $578.2 million at December 31, 2018, an increase of $65.7 million or 12.8%. The Company's commercial real estate loan portfolio includes loans for owner occupied and non-owner occupied real estate. These loans are made to finance properties such as office and industrial buildings, hotels and retail shopping centers.

The growth in the commercial and commercial real estate loan portfolios was consistent with the improvements in the local economy. Several new projects announced in the Company's market area, along with relatively decreased levels of unemployment have led small business owners to expand or make additional investments in their operations.

Agricultural loans increased from $163.1 million in 2017 to $199.0 million in 2018, an increase of $35.9 million or 22%. The Company's agricultural loan portfolio contains a diverse mix of dairy, crops, land, poultry and cattle loans.

Summary of Loan Loss Experience

The following is an analysis of the allowance for loan losses for the periods indicated:

Years Ended December 31,	2018	2017	2016	2015	2014
Balance at Beginning of Year	$12,315	$10,852	$8,978	$7,632	$7,568
Charge-Offs:					
Commercial Real Estate	0	(207)	(349)	(536)	(151)
Commercial	(220)	(375)	(245)	(290)	(185)
Residential Real Estate	(318)	(162)	(188)	(320)	(585)
Consumer	(2,318)	(2,542)	(2,019)	(2,058)	(2,213)
Total Charge-Offs	(2,856)	(3,286)	(2,801)	(3,204)	(3,134)
Recoveries on Previous Charge-Offs:					
Commercial Real Estate	126	592	15	130	125
Commercial	190	66	45	9	29
Residential Real Estate	148	100	112	122	77
Consumer	669	641	633	779	1,087
Total Recoveries	1,133	1,399	805	1,040	1,318
Net Charge-Offs	(1,723)	(1,887)	(1,996)	(2,164)	(1,816)
Provision For Loan Losses	3,000	3,350	3,870	3,510	1,880
Balance at End of Year	$13,592	$12,315	$10,852	$8,978	$7,632
Ratio of Net Charge-offs to Average Loans Outstanding	0.10 %	0.13 %	0.15 %	0.22 %	0.28 %
Allowance for Loan Losses/Total Loans	0.78	0.78	0.76	0.69	1.15

Provisions charged to operations amounted to $3 million in 2018, compared to $3.4 million in 2017, a decrease of $350 thousand. This decrease is primarily due to the lower level of net charge-offs as a percentage of loans outstanding in 2018. Net charge-offs for the year ended December 31, 2018 were $1.7 million, $164 thousand or 8.7% less than net charge-offs for the year ended December 31, 2017. The allowance for loan losses to total loans remained at 0.78% at December 31, 2018 and 2017. When the acquired loans from previous mergers are excluded the ratio is 0.92% at December 31, 2018 and 0.97% at December 31, 2017, and compares similarly with the periods prior to 2016 presented in the above table. Additionally, when loans collectively evaluated for impairment, which excludes acquired loans, are compared to the allowance for loan losses for loans collectively evaluated for impairment the ratio is 0.96% for the year ended December 31, 2018, compared to 0.97% for the year ended December 31, 2017. Nonperforming loans to total loans decreased slightly from 0.49% at December 31, 2017 to 0.45% at December 31, 2018. In determining the estimate of the allowance for loan losses, management computes the historical loss percentage based upon the loss history of the past 12 quarters. The Company believes that using a loss history of the previous 12 quarters helps mitigate volatility in the timing of charge-offs and better reflects probable incurred losses.

The provision for loan losses charged to operating expense is based on management's judgment after taking into consideration all factors connected with the collectability of the existing loan portfolio. Management evaluates the loan portfolio in light of economic conditions, changes in the nature and volume of the loan portfolio, industry standards and other relevant factors. Specific factors considered by management in determining the amounts charged to operating expenses include previous charge-off experience, the status of past due interest and principal payments,

the quality of financial information supplied by loan customers and the general condition of the industries in the community to which loans have been made.

The allowance for loan losses increased $1.3 million during the year. Aside from the various credit quality metrics discussed above, another reason for the increase in the current year allowance for loan losses was an increase in the size of the loan portfolio. Loan growth in 2018 amounted to 10%.

At December 31, 2018, commercial loans collectively evaluated for impairment totaled $264.2 million with an allowance allocation of $2.1 million compared to commercial loans collectively evaluated for impairment of $225.3 million with an allowance for loan losses of $2.0 million at December 31, 2017. The commercial loan portfolio experienced a provision of $112 thousand, compared to a $446 thousand provision in 2017. Impaired loans are carried at the fair value of the underlying collateral, less estimated disposition costs, if repayment of the loan is expected to be solely dependent on the sale of the collateral. Otherwise, impaired loans are carried at the present value of expected cash flows.

Typically, commercial and commercial real estate loans are identified as impaired when they become ninety days past due, or earlier if management believes it is probable that the Company will not collect all amounts due under the terms of the loan agreement. When Farmers identifies a loan as impaired and concludes that the loan is collateral dependent, Farmers performs an internal collateral valuation as an interim measure. Farmers typically obtains an external appraisal to validate its internal collateral valuation as soon as is practical and adjusts the associated specific loss reserve, if necessary.

The ratio of the allowance for loan losses to non-performing loans at December 31, 2018 improved to 175.81%, compared to 160.04% at December 31, 2017. Increases in nonaccrual loans in the residential real estate loan and agricultural loan portfolios were offset by decreases in the commercial real estate and commercial loan portfolios. The balance in the allowance for loan losses increased in 2018, with the increased loan portfolio size, to $13.6 million compared to $12.3 million in 2017.

Nonperforming Assets December 31,	2018	2017	2016	2015	2014
Nonaccrual loans:					
Commercial Real Estate	$422	$717	$1,410	$3,803	$3,273
Commercial	946	1,192	1,361	1,609	1,645
Residential Real Estate	4,166	4,038	2,636	3,116	2,881
Consumer	495	660	396	457	126
Agricultural	736	56	686	73	83
Total Nonaccrual Loans	$6,765	$6,663	$6,489	$9,058	$8,008
Loans Past Due 90 Days or More	966	1,032	1,681	1,387	473
Total Nonperforming Loans	$7,731	$7,695	$8,170	$10,445	$8,481
Other Real Estate Owned	0	171	482	942	148
Total Nonperforming Assets	$7,731	$7,866	$8,652	$11,387	$8,629
Loans modified in troubled debt restructurings	$5,520	$4,980	$7,007	$9,325	$8,110
TDRs included in Nonaccrual Loans	$2,997	$2,624	$3,113	$4,733	$1,436
Percentage of Nonperforming Loans to Total Loans	0.45 %	0.49 %	0.57 %	0.81 %	1.28 %
Percentage of Nonperforming Assets to Total Assets	0.33 %	0.36 %	0.44 %	0.61 %	0.76 %
Loans Delinquent 30-89 days	8,877	10,191	12,746	9,129	5,426
Percentage of Loans Delinquent 30-89 days to Total Loans	0.51 %	0.65 %	0.89 %	0.70 %	0.82 %

The Company has forgone interest income of approximately $440 thousand from nonaccrual loans as of December 31, 2018 that would have been earned, over the life of the loans, if all loans had performed in accordance with their original terms.

Net charge-offs as a percentage of average loans outstanding decreased from 0.13% for 2017 to 0.10% for 2018 as a result of the larger loan portfolio and improved loan quality. Net charge-offs decreased from $1.9 million in 2017 to $1.7 million in 2018. An increase in gross charge-offs was experienced in the residential real estate loan portfolios of $156 thousand, but that was offset by decreases in the commercial real estate, commercial and industrial and consumer loan portfolios of $207 thousand, $155 thousand and $224 thousand, respectively.

The following table summarizes the Company's allocation of the allowance for loan losses for the past five years:

December 31,	2018		2017		2016		2015		2014	
	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans	Amount	Loans to Total Loans
Commercial Real Estate	$5,036	42.1 %	$4,260	40.0 %	$3,577	37.4 %	$3,127	37.5 %	$2,676	33.5 %
Commercial	2,093	16.8	2,011	16.8	1,874	17.2	1,373	17.8	1,420	18.1
Residential Real Estate	2,837	28.3	2,521	29.7	2,205	30.1	1,845	30.4	1,689	27.7
Consumer	2,963	12.8	2,848	13.5	2,766	15.3	2,160	14.3	1,663	20.7
Unallocated	663	0	675	0	430	0	473	0	184	0
	$13,592	100.0 %	$12,315	100.0 %	$10,852	100.0 %	$8,978	100.0 %	$7,632	100.0 %

The allowance allocated to each of the four loan categories should not be interpreted as an indication that charge-offs in 2018 occurred in the same proportions or that the allocation indicates future charge-off trends. The allowance allocated to the one-to-four family real estate loan category and the consumer loan category is based upon the Company's allowance methodology for homogeneous loans, and increases and decreases in the balances of those portfolios. In previous years, the indirect installment loan category has represented the largest percentage of loan losses. The consumer loan category represents approximately 12.8% of total loans and in 2018, the gross charge-offs accounted for 81.2% of the losses of the entire loan portfolio. For the commercial loan category, which represents 16.8% of the total loan portfolio, management relies on the Bank's internal loan review procedures and allocates accordingly based on loan classifications. The gross charge-offs in the commercial loan portfolio, was $220 thousand for 2018.

There were no loans other than those identified above, that management has known information about possible credit problems of borrowers and their ability to comply with the loan repayment terms. Management is actively monitoring certain borrowers' financial condition and loans which management wants to more closely monitor due to special circumstances. These loans and their potential loss exposure have been considered in management's analysis of the adequacy of the allowance for loan losses.

Loan Commitments and Lines of Credit

In the normal course of business, the Bank has extended various commitments for credit. Commitments for mortgages, revolving lines of credit and letters of credit generally are extended for a period of one month up to one year. Normally, no fees are charged on any unused portion, but an annual fee of two percent is charged for the issuance of a letter of credit.

As of December 31, 2018, there were no concentrations of loans exceeding 10% of total loans that are not disclosed as a category of loans. As of that date, there were also no other interest-earning assets that are either nonaccrual, past due, restructured or non-performing.

Investment Securities

The investment securities portfolio increased $10.8 million in 2018. This increase is a result of asset growth in 2018 and maintaining the security portfolio at a constant level, as a percentage of total assets. The Company's investment strategy is to maintain a diverse investment security portfolio with a higher concentration in tax-free municipal securities and mortgage-backed securities that are issued by U.S. Government sponsored enterprises. Farmers sold $16.2 million in securities in 2018, resulting in net security gains of $271 thousand. Farmers recognized market appreciation on faster paying mortgage-backed securities and recognized losses on lower rated municipal securities, and reinvested in new mortgage-backed securities and higher rated municipal securities to further diversify the securities portfolio. During 2014, the Company created the Investment subsidiary to hold municipal securities and take advantage of more favorable tax treatment. At December 31, 2018, the Investment entity had a balance of $97.4 million in general market municipal securities.

Farmers' objective in managing the investment portfolio is to preserve and enhance corporate liquidity through investment in primarily short and intermediate term securities which are readily marketable and of the highest credit quality. In general, investment in securities is limited to those funds the Bank feels it has in excess of funds used to satisfy loan demand and operating considerations.

The Volcker Rule places limits on the trading activity of insured depository institutions and entities affiliated with a depository institution, subject to certain exceptions. The Bank does not engage in any of the trading activities or own any of the types of funds regulated by the Volcker Rule.

Mortgage-backed securities are created by the pooling of mortgages and issuance of a security. Mortgage-backed securities typically represent a participation interest in a pool of single-family or multi-family mortgages. Prepayment estimates for mortgage-backed securities are performed at purchase to ensure that prepayment assumptions are reasonable considering the underlying collateral for the mortgage-backed securities at issue and current mortgage interest rates and to determine the yield and estimated maturity of the mortgage-backed security portfolio. Prepayments that are faster than anticipated may shorten the life of the security and may result in faster amortization of any premiums paid and thereby reduce the net yield on such securities. During periods of increasing mortgage interest rates, refinancing generally slows as do the prepayments of the underlying mortgages and the related security. All holdings of mortgage-backed securities were issued by U.S. Government sponsored enterprises.

The following table shows the carrying value of investment securities by type of obligation at the dates indicated:

Type

December 31,	2018	2017
U.S. Treasury securities	$1,447	$4,278
U.S. government sponsored enterprise debt securities	4,562	4,639
Mortgage-backed securities - residential and collateralized mortgage obligations	171,119	177,571
Small Business Administration	11,930	14,212
Obligations of states and political subdivisions	211,944	191,003
Corporate bonds	1,188	1,234
Equity securities	495	394
Other investments measured at net asset value	6,635	5,185