LCNB CORP
Form 10-K
March 08, 2017

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, 2016
or
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________________________ to ________________________

Commission File Number 000-26121

LCNB Corp.

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

COMMON STOCK, NO PAR VALUE
(Title of Class)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted 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 and post such files).
Yes No
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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

The aggregate market value of the registrant’s outstanding voting common stock held by nonaffiliates on June 30, 2016, determined using a per share closing price on that date of $15.80 as quoted on the NASDAQ Capital Market, was $150,816,000.

As of March 7, 2017, 9,993,223 common shares were issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement included in the Notice of Annual Meeting of Shareholders to be held April 25, 2017, which Proxy Statement will be mailed to shareholders within 120 days from the end of the fiscal year ended December 31, 2016 are incorporated by reference into Part III.

LCNB CORP.
For the Year Ended December 31, 2016

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PART I

Item 1. Business

FORWARD-LOOKING STATEMENTS

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

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

1. the success, impact, and timing of the implementation of LCNB's business strategies;
2. LCNB may incur increased charge-offs in the future;
3. LCNB may face competitive loss of customers;
4. changes in the interest rate environment may have results on LCNB's operations materially different from those anticipated by LCNB's market risk management functions;
5. changes in general economic conditions and increased competition could adversely affect LCNB's operating results;
6. changes in other regulations and government policies affecting bank holding companies and their subsidiaries, including changes in monetary policies, could negatively impact LCNB's operating results;
7. LCNB may experience difficulties growing loan and deposit balances;
8. the current economic environment poses significant challenges for us and could adversely affect our financial condition and results of operations;
9. deterioration in the financial condition of the U.S. banking system may impact the valuations of investments LCNB has made in the securities of other financial institutions resulting in either actual losses or other than temporary impairments on such investments; and
10. the effects of the Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") and the regulations promulgated and to be promulgated thereunder, which may subject LCNB and its subsidiary to a variety of new and more stringent legal and regulatory requirements which adversely affect their respective businesses.

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

DESCRIPTION OF LCNB CORP.'S BUSINESS

General Description

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

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

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

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

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

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

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

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

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

banking, and other services tailored for both individuals and businesses.

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

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

Primary Market Area

The Bank considers its primary market area to consist of counties where it has a physical presence and neighboring counties, which includes Southwestern and South Central Ohio. At February 29, 2017, the Bank had 35 offices, including a main office in Warren County, Ohio and branch offices in Warren, Butler, Clinton, Clermont, Hamilton, Montgomery, Preble, Ross, and Fayette Counties, Ohio, and 39 ATMs.

Competition

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

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

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

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

Supervision and Regulation

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

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

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

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

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

1. Required regulatory agencies to take "prompt corrective action" with financial institutions that do not meet minimum capital requirements;

2. Established five capital tiers: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized;

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3. Imposed significant restrictions on the operations of a financial institution that is not rated well-capitalized or adequately capitalized;

4. Prohibited a depository institution from making any capital distributions, including payments of dividends or paying any management fee to its holding company, if the institution would be undercapitalized as a result;

5. Implemented a risk-based premium system;

6. Required an audit committee to be comprised of outside directors;

7. Required a financial institution with more than $500 million in total assets to issue annual, audited financial statements prepared in conformity with U.S. generally accepted accounting principles; and

8. Required a financial institution with more than $1 billion in total assets to document, evaluate, and report on the effectiveness of the entity's internal control system and required an independent public accountant to attest to management's assertions concerning the bank's internal control system.

The members of an audit committee for banks with more than $1 billion in total assets must be independent of management. FDICIA does not relieve financial institutions that are public companies, such as LCNB, from internal control reporting and attestation requirements or audit committee independence requirements prescribed by the Sarbanes-Oxley Act of 2002 (see below).
The Gramm-Leach-Bliley Act, which amended the Bank Holding Company Act of 1956 and other banking related laws, was signed into law on November 12, 1999. The Gramm-Leach-Bliley Act repealed certain sections of the Glass-Steagall Act and substantially eliminated the barriers separating the banking, insurance, and securities industries. Effective March 11, 2000, qualifying bank holding companies could elect to become financial holding companies. Financial holding companies have expanded investment powers, including affiliating with securities and insurance firms and engaging in other activities that are "financial in nature or incidental to such financial activity," as defined in the act, or "complementary to a financial activity."

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

1. Certification of financial reports by the chief executive officer ("CEO") and the chief financial officer ("CFO"), who are responsible for designing and monitoring internal controls to ensure that material information relating to the issuer and its consolidated subsidiary is made known to the certifying officers by others within the company;

2. Inclusion of an internal control report in annual reports that include management's assessment of the effectiveness of a company's internal control over financial reporting and a report by the company's independent registered public accounting firm attesting to the effectiveness of internal control over financial reporting;

3. Accelerated reporting of stock trades on Form 4 by directors and executive officers;

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

5. Disclosure in a company's periodic reports stating if it has adopted a code of ethics for its CFO and principal accounting officer or controller and, if such code of ethics has been implemented, immediate disclosure of any change in or waiver of the code of ethics;

6. Disclosure in a company's periodic reports stating if at least one member of the audit committee is a "financial expert," as that term is defined by the Securities and Exchange Commission (the "SEC"); and

7. Implementation of new duties and responsibilities for a company's audit committee, including independence requirements, the direct responsibility to appoint the outside auditing firm and to provide oversight of the auditing firm's work, and a requirement to establish procedures for the receipt, retention, and treatment of complaints from a company's employees regarding questionable accounting, internal control, or auditing matters.

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

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

1. Merging the Bank Insurance Fund and the Savings Association Insurance Fund into a new fund called the Deposit Insurance Fund, effective March 31, 2006;

2. Increasing insurance coverage for retirement accounts from $100,000 to $250,000, effective April 1, 2006; and

3. Eliminating a 1.25% hard target Designated Reserve Ratio, as defined, and giving the FDIC discretion to set the Designated Reserve Ratio within a range of 1.15% to 1.50% for any given year.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") became effective on July 21, 2010. The Dodd-Frank Act includes provisions that specifically affect financial institutions and other entities providing financial services and other corporate governance and compensation provisions that will affect most public companies.
The Dodd-Frank Act established a new independent regulatory body within the Federal Reserve System known as the of Consumer Financial Protection Bureau (the "CFPB"). The CFPB has assumed responsibility for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks and non-banks. The CFPB has authority to supervise, examine, and take enforcement actions with respect to depository institutions with more than $10 billion in assets, non-bank mortgage industry participants, and other CFPB-designated non-bank providers of consumer financial services. The primary regulator for depository institutions with $10 billion or less in assets will continue to have primary examination and enforcement authority for these institutions. The regulations enforced, however, will be the regulations written by the CFPB.

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

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

percentage of the assessment base.

General corporate governance provisions included in the Dodd-Frank Act include expanding executive compensation disclosures to be included in the annual proxy statement, requiring non-binding shareholder advisory votes on executive compensation at annual meetings, enhancing independence requirements for compensation committee members and any advisers used by the compensation committee, and requiring the adoption of certain compensation policies including the recovery of executive compensation in the event of a financial statement restatement. Noncompliance with laws and regulations by bank holding companies and banks can lead to monetary penalties and/or an increased level of supervision or a combination of these two items. Management is not aware of any current significant instances of noncompliance with laws and regulations and does not anticipate any problems maintaining compliance on a prospective basis. Recent regulatory inspections and examinations of LCNB and the Bank have not disclosed any significant instances of noncompliance.

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

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

Employees

As of December 31, 2016, LCNB employed 282 full-time equivalent employees. LCNB is not a party to any collective bargaining agreement. Management considers its relationship with its employees to be very good. Employee benefit programs are considered by management to be competitive with benefit programs provided by other financial institutions and major employers within LCNB’s market area.

Availability of Financial Information

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

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

Financial reports and other materials filed by LCNB with the SEC may also be read and copied at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained from the SEC by calling 1-800-SEC-0330. The SEC also maintains an internet site (www.sec.gov) that contains reports, proxy and information statements, and other information regarding registrants that file reports electronically, as LCNB does.

FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES

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

STATISTICAL INFORMATION

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

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

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

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

Investment Portfolio

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

	At December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Securities available-for-sale:			
U.S. Treasury notes	$28,145	72,846	62,560
U.S. Agency notes	85,400	139,889	83,637
U.S. Agency mortgage-backed securities	71,047	29,378	38,032
Certificates of deposit	—	249	3,086
Municipal securities	132,860	132,420	93,790
Mutual funds	2,482	2,466	2,461
Trust preferred securities	48	50	50
Equity securities	677	680	1,749
Total securities available-for-sale	320,659	377,978	285,365
Securities held-to-maturity:			
Municipal securities	41,003	22,633	22,725
Federal Reserve Bank stock	2,732	2,732	2,346
Federal Home Loan Bank stock	3,638	3,638	3,638
Total securities	$368,032	406,981	314,074

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Contractual maturities of securities at December 31, 2016, were as follows. Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale			Held-to-Maturity		
	Amortized Cost	Fair Value	Yield	Amortized Cost	Fair Value	Yield
	(Dollars in thousands)					
U.S. Treasury notes:						
Within one year	$—	—	— %	$—	—	— %
One to five years	17,063	17,099	1.91%	—	—	— %
Five to ten years	11,117	11,046	1.99%	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Treasury notes	28,180	28,145	1.94%	—	—	— %
U.S. Agency notes:						
Within one year	3,956	3,965	1.19%	—	—	— %
One to five years	21,994	22,074	1.65%	—	—	— %
Five to ten years	61,148	59,361	1.92%	—	—	— %
After ten years	—	—	— %	—	—	— %
Total U.S. Agency notes	87,098	85,400	1.82%	—	—	— %
Municipal securities (1):						
Within one year	8,408	8,499	3.60%	3,955	3,959	2.54%
One to five years	58,114	58,328	2.90%	4,125	4,068	2.99%
Five to ten years	59,685	58,882	3.07%	10,911	10,845	2.98%
After ten years	7,567	7,151	2.75%	22,412	22,618	5.18%
Total Municipal securities	133,774	132,860	3.01%	41,403	41,490	4.17%
U.S. Agency mortgage-backed securities	72,402	71,047	1.92%	—	—	— %
Mutual funds	2,527	2,482	2.10%	—	—	— %
Trust preferred securities	49	48	7.78%	—	—	— %
Equity securities	632	677	8.30%	—	—	— %
Totals	$324,662	320,659	2.36%	41,403	41,490	4.17%

(1) Yields on tax-exempt obligations are computed on a taxable-equivalent basis based upon a 34.2% statutory Federal income tax rate.

Excluding holdings in U.S. Treasury securities and U.S. Government Agencies, there were no investments in securities of any issuer that exceeded 10% of LCNB's consolidated shareholders' equity at December 31, 2016.

Loan Portfolio

Administration of the lending function is the responsibility of the Chief Lending Officer and certain senior lenders. Lenders perform their duties subject to oversight and policy direction from the Board of Directors and the Loan Committee. The Loan Committee consists of LCNB’s Chief Executive Officer/President, Chief Financial Officer, Cashier, Chief Lending Officer, Chief Credit Officer, Loan Operations Officer, Loan Review Officer, Credit Analysis

Officer, and the officers in charge of commercial, consumer, and real estate loans.

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Employees authorized to accept loan applications have various, designated lending limits for the approval of loans. A loan application for an amount outside a particular employee's lending limit needs to be approved by an employee with a lending limit sufficient for that loan. Residential and commercial real estate loans of any amount require the approval of two of the following designated officers: Chief Executive Officer/President, Chief Lending Officer, Chief Credit Officer, and the officers in charge of commercial, real estate, and consumer lending. Board approval is required on any loan with policy exceptions or that will exceed $3.0 million in aggregate credit to any one borrower or entity, as defined by the OCC in 12 C.F.R § 32.2(b).

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

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

	At December 31,									
	2016		2015		2014		2013		2012	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
	(Dollars in thousands)									
Commercial and industrial	$41,878	5.1 %	$45,275	5.9 %	$35,424	5.1 %	$29,337	5.1 %	$26,236	5.8 %
Commercial, secured by real estate	477,275	58.2 %	419,633	54.5 %	379,141	54.3 %	314,252	54.7 %	230,256	50.7 %
Residential real estate	265,788	32.5 %	273,139	35.4 %	254,087	36.4 %	215,587	37.6 %	183,132	40.4 %
Consumer	19,173	2.3 %	18,510	2.4 %	18,006	2.5 %	12,643	2.2 %	10,554	2.3 %
Agricultural	14,802	1.8 %	13,479	1.7 %	11,472	1.6 %	2,472	0.4 %	1,668	0.4 %
Other loans, including deposit overdrafts	633	0.1 %	665	0.1 %	680	0.1 %	91	— %	1,875	0.4 %
	819,549	100.0%	770,701	100.0%	698,810	100.0%	574,382	100.0%	453,721	100.0%
Deferred origination costs (fees), net	254		237		146		(28)		62	
Total loans	819,803		770,938		698,956		574,354		453,783	
Less allowance for loan losses	3,575		3,129		3,121		3,588		3,437	
Loans, net	$816,228		$767,809		$695,835		$570,766		$450,346	

As of December 31, 2016, there were no concentrations of loans exceeding 10% of total loans that are not already disclosed as a category of loans in the above table.

The following table summarizes the commercial and agricultural loan maturities and sensitivities to interest rate change at December 31, 2016:

	(In thousands)
Maturing in one year or less	$ 31,968

Maturing after one year, but within five years	62,997
Maturing beyond five years	438,990
Total commercial and agricultural loans	$ 533,955
Loans maturing beyond one year:	
Fixed rate	$ 185,231
Variable rate	316,756
Total	$ 501,987

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Risk Elements

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

	At December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Non-accrual loans	$5,725	1,723	5,599	2,961	2,283
Past-due 90 days or more and still accruing	23	559	203	250	128
Accruing restructured loans	11,731	13,723	14,269	15,151	13,343
Total	$17,479	16,005	20,071	18,362	15,754
Percent to total loans	2.13 %	2.08 %	2.87 %	3.20 %	3.47 %

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

At December 31, 2016, there were no material additional loans not classified as acquired credit impaired or already disclosed as non-accrual, accruing restructured, or accruing past due 90 days or more where known information about possible credit problems of the borrowers causes management to have serious doubts as to the ability of such borrowers to comply with present loan repayment terms.

Summary of Loan Loss Experience

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

Allocation of the Allowance for Loan Losses

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

	At December 31,									
	2016		2015		2014		2013		2012	
	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans	Amount	Percent of Loans in Each Category to Total Loans
	(Dollars in thousands)									
Commercial and industrial	$350	5.1 %	$244	5.9 %	$129	5.1 %	$175	5.1 %	$320	5.8 %
Commercial, secured by real estate	2,179	58.2 %	1,908	54.5 %	1,990	54.3 %	2,520	54.7 %	2,296	50.7 %
Residential real estate	885	32.5 %	854	35.4 %	926	36.4 %	826	37.6 %	712	40.4 %
Consumer	96	2.3 %	54	2.4 %	63	2.5 %	66	2.2 %	108	2.3 %
Agricultural	60	1.8 %	66	1.7 %	11	1.6 %	—	0.4 %	—	0.4 %
Other loans, including deposit overdrafts	5	0.1 %	3	0.1 %	2	0.1 %	1	— %	1	0.4 %
Unallocated	—	—	—	—	—	—	—	—	—	—
Total	$3,575	100.0 %	$3,129	100.0 %	$3,121	100.0 %	$3,588	100.0 %	$3,437	100.0 %

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Deposits

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

The following table presents the contractual maturity of time deposits of $100,000 or more at December 31, 2016:

	(In thousands)
Maturity within 3 months	$ 7,129
After 3 but within 6 months	2,588
After 6 but within 12 months	7,306
After 12 months	60,747
	$ 77,770

Return on Equity and Assets

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

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Item 1A. Risk Factors

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

New capital requirements could adversely affect LCNB's capital ratios
On July 2, 2013, the Federal Reserve Board approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. bank holding companies as well as state banks that are members of the Federal Reserve System and savings and loan holding companies (commonly known as Basel III). On July 9, 2013, the OCC adopted the same rules for national banks and federal savings associations, and the FDIC approved the same provisions, as an interim final rule, for state nonmember banks and state savings associations.

Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by banks and savings associations. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%.

The phase-in period for the final rules began for LCNB on January 1, 2015, with full compliance with all of the final rules' requirements phased in over a multi-year schedule. While management expects that LCNB's capital ratios under Basel III will continue to exceed the well capitalized minimum capital requirements, there can be no assurance that such will be the case. If LCNB is unable to meet or exceed the applicable minimum capital requirements, it may become subject to supervisory actions ranging in severity from losing its financial holding company status, to being precluded from making acquisitions or engaging in new activities or becoming subject to informal or formal regulatory enforcement actions.

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

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

rates of return, such as stocks, bonds, and mutual funds. If this occurs, LCNB may have to rely more heavily on borrowings as a source of funds in the future, which could negatively impact its net interest margin.

Gains from sales of mortgage loans may experience significant volatility.

Gains from sales of mortgage loans are highly influenced by the level and direction of mortgage interest rates, real estate activity, and refinancing activity. Current historically low market interest rates created a refinancing demand for residential fixed-rate mortgage loans. The increased volume of refinancing activity increased gains from sales of mortgage loans as LCNB sold most of these loans to the Federal Home Loan Mortgage Corporation. An increase in market interest rates may decrease the demand for refinanced loans and decrease the gains from sales of mortgage loans recognized in LCNB’s consolidated statements of income. Gains from sales of mortgage loans may also be impacted by changes in LCNB’s strategy to manage its residential mortgage portfolio. For example, LCNB may occasionally change the proportion of loan originations that are sold in the secondary market and instead add a greater proportion to its loan portfolio.

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

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

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

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

The allowance for loan losses may be inadequate.
The provision for loan losses is determined by management based upon its evaluation of the amount needed to maintain the allowance for loan losses at a level considered appropriate in relation to the estimated risk of losses inherent in the portfolio. In addition to historic charge-off percentages, factors taken into consideration to determine the adequacy of the allowance for loan losses include the nature, volume, and consistency of the loan portfolio, overall portfolio quality, a review of specific problem loans, the fair value of any underlying collateral, borrowers' cash flows, and current economic conditions that may affect borrowers' ability to make payments. Increases in the allowance result in an expense for the period. By its nature, the evaluation is imprecise and requires significant judgment. Actual results may vary significantly from management's assumptions. If, as a result of general economic conditions or a decrease in asset quality, management determines that additional increases in the allowance for loan losses are necessary, LCNB will incur additional expenses.

LCNB's loan portfolio includes a substantial amount of commercial and industrial loans and commercial real estate loans, which may have more risks than residential or consumer loans.

LCNB's commercial and industrial and commercial real estate loans comprise a substantial portion of its total loan portfolio. These loans generally carry larger loan balances and involve a greater degree of financial and credit risk than home equity, residential mortgage, or consumer loans. The increased financial and credit risk associated with these types of loans is a result of several factors, including the concentration of principal in a limited number of loans, the size of loan balances, the effects of general economic conditions on income-producing properties, and the increased difficulty of evaluating and monitoring these types of loans.

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

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

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

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

A decrease to the corporate federal income tax rate may impair the Company's deferred tax assets ("DTAs").
At December 31, 2016, LCNB's DTAs were approximately $1.6 million. While a decline in the corporate tax rate may lower the Company's tax provision expense, it may also significantly impair the value of the LCNB's DTAs in the year the rate decrease is enacted. Such impairment could have a material adverse effect on the Company's financial condition and results of operations.

LCNB is subject to environmental liability risk associated with lending activities.
A significant portion of the Bank's loan portfolio is secured by real property. During the ordinary course of business, the Bank may foreclose on and take title to properties securing certain loans. In doing so, there is a risk that hazardous or toxic substances could be found on these properties. If hazardous or toxic substances are found, the Bank may be liable for remediation costs, as well as for personal injury and property damage. Environmental laws may require the

Bank to incur substantial expenses and may materially reduce the affected property's value or limit the Bank's ability to use or sell the affected property. In addition, future laws or more stringent interpretations or enforcement policies with respect to existing laws may increase the Bank's exposure to environmental liability. Although the Bank has policies and procedures to perform an environmental review before initiating any foreclosure action on real property, these reviews may not be sufficient to detect all potential environmental hazards. The remediation costs and any other financial liabilities associated with an environmental hazard could have a material adverse effect on LCNB's financial condition and results of operations.

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The banking industry is highly regulated.
LCNB is subject to regulation, supervision, and examination by the Federal Reserve Board and the Bank is subject to regulation, supervision, and examination by the OCC. LCNB and the Bank are also subject to regulation and examination by the FDIC as the deposit insurer. The CFPB is responsible for most consumer protection laws and has broad authority, with certain exceptions, to regulate financial products offered by banks. Federal and state laws and regulations govern numerous matters including, but not limited to, changes in the ownership or control of banks, maintenance of adequate capital, permissible business operations, maintenance of deposit insurance, protection of customer financial privacy, the level of reserves held against deposits, restrictions on dividend payments, the making of loans, and the acceptance of deposits. See the previous section titled “Supervision and Regulation” for more information on this subject.
Federal regulators may initiate various enforcement actions against a financial institution that violates laws or regulations or that operates in an unsafe or unsound manner. These enforcement actions may include, but are not limited to, the assessment of civil money penalties, the issuance of cease-and-desist or removal orders, and the imposition of written agreements.

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

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

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

The financial services industry, as well as the broader economy, may be subject to new legislation, regulation, and government policy.
At this time, it is difficult to predict the legislative and regulatory changes that will result from the combination of a new President of the United States and the first year since 2010 in which both Houses of Congress and the White House have majority memberships from the same political party. In recent years, however, both the new President and senior members of the House of Representatives have advocated for significant reduction of financial services regulation, to include amendments to the Dodd-Frank Act and structural changes to the CFPB. The new Administration and Congress also may cause broader economic changes due to changes in governing ideology and governing style. New appointments to the Board of Governors of the Federal Reserve could affect monetary policy and interest rates and changes in fiscal policy could affect broader patterns of trade and economic growth. Future

legislation, regulation, and government policy could affect the banking industry as a whole, including LCNB's business and results of operations, in ways that are difficult to predict. In addition, LCNB's results of operations could be adversely affected by changes in the way in which existing statutes and regulations are interpreted or applied by courts and government agencies.

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

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

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

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

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

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

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

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

Item 1B. Unresolved Staff Comments

Not applicable

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Item 2. Properties

The Bank conducts its business from the following offices:

	Name of Office	Address	County	
1.	Main Office	2 North Broadway Lebanon, Ohio 45036	Warren	Owned
2.	Auto Bank	Silver and Mechanic Streets Lebanon, Ohio 45036	Warren	Owned
3.	Barron Street Office	1697 North Barron Street Eaton, Ohio 45320	Preble	Leased
4.	Bridge Street Office	1240 North Bridge Street Chillicothe, Ohio 45601	Ross	Owned
5.	Brookville Office	225 West Upper Lewisburg Salem Road Brookville, Ohio 45309	Montgomery	Owned
6.	Centerville Office	9605 Dayton-Lebanon Pike Centerville, Ohio 45458	Montgomery	Owned
7.	Chillicothe Office	33 West Main Street Chillicothe, Ohio 45601	Ross	Owned
8.	Clarksburg Office (closed January 24, 2017)	10820 Main Street Clarksburg, Ohio 43115	Ross	Owned
9.	Colerain Township Office	3209 West Galbraith Road Cincinnati, Ohio 45239	Hamilton	Owned
10.	Columbus Avenue Office	730 Columbus Avenue Lebanon, Ohio 45036	Warren	Owned
11.	Eaton Office	110 West Main Street Eaton, Ohio 45320	Preble	Owned
12.	Fairfield Office	765 Nilles Road Fairfield, Ohio 45014	Butler	Leased
13.	Frankfort Office	Springfield and Main Streets Frankfort, Ohio 45628	Ross	Owned
14.	Goshen Office	6726 Dick Flynn Blvd.	Clermont	Owned

	Goshen, Ohio 45122		
15. Hamilton Office	794 NW Washington Blvd. Hamilton, Ohio 45013	Butler	Owned
16. Hay Avenue Office	121 Hay Avenue Brookville, Ohio 45309	Montgomery	Owned
17. Hunter Office	3878 State Route 122 Franklin, Ohio 45005	Warren	Owned
18. Lewisburg Office	522 South Commerce Street Lewisburg, Ohio 45338	Preble	Owned

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	Name of Office	Address	County	
19.	Loveland Office	500 Loveland-Madeira Road Loveland, OH 45140	Hamilton	Owned
20.	Maineville Office	7795 South State Route 48 Maineville, Ohio 45039	Warren	Owned
21.	Mason/West Chester Office	1050 Reading Road Mason, Ohio 45040	Warren	Owned
22.	Middletown Office	4441 Marie Drive Middletown, Ohio 45044	Butler	Owned
23.	Monroe Office	101 Clarence F. Warner Drive Monroe, Ohio 45050	Butler	Owned
24.	New Paris Office	201 South Washington Street New Paris, Ohio 45347	Preble	Owned
25.	Oakwood Office	2705 Far Hills Avenue Oakwood, Ohio 45419	Montgomery	(2)
26.	Otterbein Office	Otterbein Retirement Community State Route 741 Lebanon, Ohio 45036	Warren	Leased
27.	Oxford Office (1)	30 West Park Place Oxford, Ohio 45056	Butler	(2)
28.	Rochester/Morrow Office	Route 22-3 at 123 Morrow, Ohio 45152	Warren	Owned
29.	South Lebanon Office	603 Corwin Nixon Blvd. South Lebanon, Ohio 45065	Warren	Owned
30.	Springboro/Franklin Office	525 West Central Avenue Springboro, Ohio 45066	Warren	Owned
31.	Warrior Office	Lebanon High School 1916 Drake Road Lebanon, Ohio 45036	Warren	Leased
32.	Washington Court House Office	100 Crossings Drive Washington Court House, Ohio 43160	Fayette	Owned

33. Waynesville Office	9 North Main Street Waynesville, Ohio 45068	Warren	Owned
34. West Alexandria Office	55 East Dayton Street West Alexandria, Ohio 45381	Preble	Owned
35. Western Avenue Office	1006 Western Avenue Chillicothe, Ohio 45601	Ross	Owned
36. Wilmington Office	1243 Rombach Avenue Wilmington, Ohio 45177	Clinton	Owned

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	Name of Office	Address	County	
37.	Operations Center (under construction)	105 North Broadway Lebanon, Ohio 45036	Warren	Owned

(1) Excess space in this office is leased to third parties.
(2) The Bank owns the Oakwood and Oxford office buildings and leases the land.

Item 3. Legal Proceedings

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

Item 4. Mine Safety Disclosures

Not Applicable

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PART II

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

LCNB had approximately 980 registered holders of its common stock as of December 31, 2016. The number of shareholders includes banks and brokers who act as nominees, each of whom may represent more than one shareholder. LCNB's stock trades on the NASDAQ Capital Market exchange under the symbol "LCNB."

Trade prices for shares of LCNB Common Stock and cash dividends per share declared and paid are set forth below. The trade prices shown below are interdealer without retail markups, markdowns, or commissions.

	2016			2015		
	High	Low	Dividends Declared	High	Low	Dividends Declared
First Quarter	$17.75	15.51	0.16	16.40	13.95	0.16
Second Quarter	17.24	15.69	0.16	17.88	15.01	0.16
Third Quarter	19.13	15.73	0.16	16.40	15.26	0.16
Fourth Quarter	25.00	16.55	0.16	17.18	15.07	0.16
Total dividends declared			0.64			0.64

It is expected that LCNB will continue to pay dividends on a similar schedule, to the extent permitted by business and potential factors beyond management's control.

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

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

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

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares. Through December 31, 2016, 290,444 shares have been purchased under this program. No shares were purchased under the Market Repurchase Program during 2016 and 2015.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. There is no limit to the number of shares that may be purchased under this program. A total of 466,018 shares have been purchased under this program since its inception through December 31, 2016. No shares were purchased under the Private Sale Repurchase Program during 2016 and 2015.

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

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

The following table shows information relating to stock options outstanding under the 2002 Plan and 2015 Plan at December 31, 2016:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance
Equity compensation plans approved by security holders	24,669	$ 12.17	433,962
Equity compensation plans not approved by security holders	—	—	—
Total	24,669	$ 12.17	433,962

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The graph below provides an indicator of cumulative total shareholder returns for LCNB as compared with the NASDAQ Composite, the SNL Midwest OTC-BB and Pink Sheet Banks, and the SNL Midwest Bank indexes. This graph covers the period from December 31, 2011 through December 31, 2016. The cumulative total shareholder returns included in the graph reflect the returns for the shares of common stock of LCNB. The information provided in the graph assumes that $100 was invested on December 31, 2011 in LCNB common stock, the NASDAQ Composite, and the SNL Midwest Bank Index and that all dividends were reinvested.

	Period Ending					
Index	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
LCNB Corp.	$ 100.00	110.94	149.93	131.71	148.83	219.25
NASDAQ Composite	$ 100.00	117.45	164.57	188.84	201.98	219.89
SNL Midwest Bank index	$ 100.00	120.36	164.78	179.14	181.86	242.99

Source : SNL Financial LC, Charlottesville, VA
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Item 6. Selected Financial Data

The following represents selected consolidated financial data of LCNB for the years ended December 31, 2012 through 2016 and are derived from LCNB's consolidated financial statements. Certain prior year data presented in this table have been reclassified to conform with the current year presentation. This data should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 8 of this Form 10-K and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures about Market Risk included in Items 7 and 7A, respectively, of this Form 10-K, and are qualified in their entirety thereby and by other detailed information elsewhere in this Form 10-K.

	For the Years Ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands, except ratios and per share data)				
Income Statement:					
Interest income	$43,750	42,659	39,477	33,497	29,938
Interest expense	3,504	3,328	3,590	4,065	4,889
Net interest income	40,246	39,331	35,887	29,432	25,049
Provision for loan losses	913	1,366	930	588	1,351
Net interest income after provision for loan losses	39,333	37,965	34,957	28,844	23,698
Non-interest income	10,853	10,123	9,142	9,090	9,049
Non-interest expenses	33,261	32,392	30,844	26,212	21,682
Income before income taxes	16,925	15,696	13,255	11,722	11,065
Provision for income taxes	4,443	4,222	3,386	2,942	2,795
Net income	$12,482	11,474	9,869	8,780	8,270
Dividends per common share	$0.64	0.64	0.64	0.64	0.64
Earnings per common share:					
Basic	1.26	1.18	1.06	1.12	1.23
Diluted	1.25	1.17	1.05	1.10	1.22
Balance Sheet:					
Securities	$368,032	406,981	314,074	279,021	276,970
Loans, net	816,228	767,809	695,835	570,766	450,346
Total assets	1,306,799	1,280,531	1,108,066	932,338	788,637
Total deposits	1,110,905	1,087,160	946,205	785,761	671,471
Short-term borrowings	42,040	37,387	16,645	8,655	13,756
Long-term debt	598	5,947	11,357	12,102	13,705
Total shareholders' equity	142,944	140,108	125,695	118,873	82,006
Selected Financial Ratios and Other Data:					
Return on average assets	0.96 %	0.94 %	0.88 %	0.93 %	1.02 %
Return on average equity	8.60 %	8.43 %	8.04 %	9.02 %	10.22 %
Equity-to-assets ratio	10.94 %	10.94 %	11.34 %	12.75 %	10.40 %
Dividend payout ratio	50.79 %	54.24 %	60.38 %	57.14 %	52.03 %
Net interest margin, fully taxable equivalent	3.51 %	3.64 %	3.66 %	3.57 %	3.52 %

First Capital merged with and into LCNB as of the close of business on January 11, 2013. As of the date of the merger, LCNB recorded additional loans of $98.9 million and additional deposits of $136.8 million.
An underwritten public offering of common stock was conducted during the fourth quarter 2013. The offering increased shareholders' equity by $26.9 million, which was the net proceeds LCNB received after deducting offering expenses. The proceeds were used to fund the acquisition of Eaton National on January 24, 2014 and the remainder was used for general corporate purposes.

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Eaton National merged with and into LCNB as of the close of business on January 24, 2014. As of the date of the merger, LCNB recorded additional loans of $115.9 million and additional deposits of $165.3 million.
BNB merged with and into LCNB as of the close of business on April 30, 2015. As of the date of the merger, LCNB recorded additional loans of $34.7 million and additional deposits of $99.1 million.

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

Introduction

The following is management's discussion and analysis of the consolidated financial condition and consolidated results of operations of LCNB. It is intended to amplify certain financial information regarding LCNB and should be read in conjunction with the consolidated financial statements and related notes contained in the 2016 Annual Report to Shareholders.

Overview

Net income for 2016 was $12,482,000 (basic and diluted earnings per share of $1.26 and $1.25, respectively), compared to $11,474,000 (basic and diluted earnings per share of $1.18 and $1.17) in 2015 and $9,869,000 (total basic and diluted earnings per share of $1.06 and $1.05) in 2014.

The following items significantly affected earnings for the years indicated:

1. The completion of a merger with BNB Bancorp, Inc. on April 30, 2015.
2. The completion of a merger with Eaton National Bank & Trust Co. on January 24, 2014.
3. Impaired loans with a carrying value of approximately $4.5 million were sold during the second quarter 2015, significantly improving LCNB's loan quality metrics.
4. Net gain on sales of securities was significantly greater in 2016 as compared to 2015 and 2014 due primarily to market rates at the time of the sales.
5. Other real estate owned expense was significantly greater in 2016 and 2015 as compared to 2014 because of valuation writedowns and losses on sales recognized during 2016 and 2015.
6. Other non-interest expense for 2016 included a $251,000 penalty incurred to pre-pay a Federal Home Loan Bank borrowing bearing an interest rate of 5.25%. The borrowing was pre-paid to reduce future interest expense.

Net Interest Income

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

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

	Years ended December 31,								
	2016			2015			2014		
	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Average Yield/ Rate
	(Dollars in thousands)								
Loans (1)	$792,526	35,600	4.49%	$740,626	35,285	4.76%	$679,223	32,706	4.82%
Federal funds sold	—	—	— %	452	1	0.22%	—	—	— %
Interest-bearing demand deposits	12,394	59	0.48%	12,245	30	0.24%	12,450	29	0.23%
Federal Reserve Bank stock	2,732	164	6.00%	2,495	152	6.09%	2,100	126	6.00%
Federal Home Loan Bank stock	3,638	146	4.01%	3,638	146	4.01%	3,571	146	4.09%
Investment securities:									
Taxable	243,559	4,582	1.88%	245,410	4,197	1.71%	219,131	3,757	1.71%
Non-taxable (2)	140,692	4,862	3.46%	115,215	4,315	3.75%	102,902	4,111	4.00%
Total earning assets	1,195,541	45,413	3.80%	1,120,081	44,126	3.94%	1,019,377	40,875	4.01%
Non-earning assets	112,909			107,919			104,413		
Allowance for loan losses	(3,318)			(2,888)			(3,275)		
Total assets	$1,305,132			$1,225,112			$1,120,515		
Savings deposits	$654,891	652	0.10%	$608,925	545	0.09%	$544,698	474	0.09%
IRA and time certificates	217,228	2,788	1.28%	219,562	2,464	1.12%	223,555	2,687	1.20%
Short-term borrowings	17,952	38	0.21%	15,105	24	0.16%	14,820	22	0.15%
Long-term debt	826	26	3.15%	6,177	295	4.78%	11,546	407	3.53%
Total interest-bearing liabilities	890,897	3,504	0.39%	849,769	3,328	0.39%	794,619	3,590	0.45%
Demand deposits	259,060			230,608			196,273		
Other liabilities	10,014			8,590			6,907		
Capital	145,161			136,145			122,716		
Total liabilities and capital	$1,305,132			$1,225,112			$1,120,515		
Net interest rate spread (3)			3.41%			3.55%			3.56%
Net interest income and net interest margin on a tax equivalent basis (4)		41,909	3.51%		40,798	3.64%		37,285	3.66%
Ratio of interest-earning assets to interest-bearing liabilities	134.20%			131.81%			128.29%		

(1) Includes non-accrual loans if any.

(2) Income from tax-exempt securities is included in interest income on a taxable-equivalent basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34.2% for 2016 and 34% for 2015 and 2014.

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

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

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

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

	For the years ended December 31,					
	2016 vs. 2015			2015 vs. 2014		
	Increase (decrease) due to			Increase (decrease) due to		
	Volume	Rate	Total	Volume	Rate	Total
	(In thousands)					
Interest income attributable to:						
Loans (1)	$2,395	(2,080)	315	2,929	(350)	2,579
Federal funds sold	(1)	—	(1)	1	—	1
Interest-bearing demand deposits	—	29	29	—	1	1
Federal Reserve Bank stock	14	(2)	12	24	2	26
Federal Home Loan Bank stock	—	—	—	3	(3)	—
Investment securities:						
Taxable	(32)	417	385	449	(9)	440
Non-taxable (2)	900	(353)	547	472	(268)	204
Total interest income	3,276	(1,989)	1,287	3,878	(627)	3,251
Interest expense attributable to:						
Savings deposits	43	64	107	57	14	71
IRA and time certificates	(26)	350	324	(47)	(176)	(223)
Short-term borrowings	5	9	14	—	2	2
Long-term debt	(193)	(76)	(269)	(227)	115	(112)
Total interest expense	(171)	347	176	(217)	(45)	(262)
Net interest income	$3,447	(2,336)	1,111	4,095	(582)	3,513

(1) Non-accrual loans, if any, are included in average loan balances.
(2) Change in interest income from non-taxable investment securities is computed based on interest income determined on a taxable-equivalent yield basis. Interest income has been divided by a factor comprised of the complement of the incremental tax rate of 34.2% for 2016 and 34% for 2015 and 2014, respectively.

2016 vs. 2015. Net interest income on a fully tax-equivalent basis for 2016 totaled $41,909,000, an increase of $1,111,000 from 2015. The increase resulted from an increase in total taxable-equivalent interest income of $1,287,000, slightly offset by an increase in total interest expense of $176,000.

The increase in taxable-equivalent interest income was due to a $75.5 million increase in total average interest-earning assets, slightly offset by a 14 basis point (a basis point equals 0.01%) decrease in the average rate earned on interest-earning assets. The increase in total average interest-earning assets reflects an increase of $51.9 million in average loans and a $25.5 million increase in non-taxable investment securities. The decrease in the average rate earned was primarily due to general decreases in market rates.

Interest expense increased primarily due to a 16 basis point increase in the average rate paid on IRA and time certificates and a 1 basis point increase in the average rate paid on savings deposits, partially offset by a 163 basis point decrease in the rate paid on long-term debt. The rate variance was partially offset by a $5.4 million decrease in average long-term debt. The decrease in the average rate paid on long-term debt and the decrease in the average balance of long-term debt was due to the pre-payment in full during the first quarter of 2016 of a $5.0 million borrowing from the Federal Home Loan Bank of Cincinnati bearing an interest rate of 5.25%. The borrowing was pre-paid to reduce future interest expense.

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

2015 vs. 2014. Net interest income on a fully tax-equivalent basis for 2015 totaled $40,798,000, an increase of $3,513,000 from 2014. The increase resulted from an increase in total taxable-equivalent interest income of $3,251,000 and a decrease in total interest expense of $262,000.

The increase in taxable-equivalent interest income was due to a $100.7 million increase in total average interest-earning assets, slightly offset by a 7 basis point decrease in the average rate earned on interest-earning assets. The increase in total average interest-earning assets reflects an increase of $61.4 million in average loans, partially from the BNB merger and partially from organic growth, and a $38.6 million increase in investment securities. The decrease in the average rate earned was primarily due to general decreases in market rates.

Interest expense decreased primarily due to a $5.4 million decrease in average long term debt, primarily due the payment in full of a $5.0 million advance from the Federal Home Loan Bank of Cincinnati during the first quarter 2015, and to a 6 basis point decrease in the average rate paid on total interest-bearing liabilities.

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

Provisions and Allowance for Loan Losses

The following table presents the total loan loss provision and the other changes in the allowance for loan losses for the years 2012 through 2016:

	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Balance – Beginning of year	$3,129	3,121	3,588	3,437	2,931
Loans charged off:					
Commercial and industrial	234	100	261	119	159
Commercial, secured by real estate	185	1,133	573	58	234
Residential real estate	127	304	652	244	486
Consumer	85	52	129	181	134
Agricultural	—	67	—	—	—
Other loans, including deposit overdrafts	119	74	79	67	85
Total loans charged off	750	1,730	1,694	669	1,098
Recoveries:					
Commercial and industrial	26	7	42	4	—
Commercial, secured by real estate	98	96	63	26	71
Residential real estate	52	107	40	31	7
Consumer	53	60	108	127	123
Agricultural	—	67	—	—	—
Other loans, including deposit overdrafts	54	35	44	44	52
Total recoveries	283	372	297	232	253
Net charge offs	467	1,358	1,397	437	845
Provision charged to operations	913	1,366	930	588	1,351
Balance - End of year	$3,575	3,129	3,121	3,588	3,437
Ratio of net charge-offs during the period to average loans outstanding	0.06 %	0.18 %	0.21 %	0.08 %	0.18 %
Ratio of allowance for loan losses to total loans at year-end	0.44 %	0.41 %	0.45 %	0.62 %	0.76 %

Charge-offs for the commercial, secured by real estate category had an elevated balance during 2015 due to the sale of impaired loans. Charge-offs for the commercial and industrial loan category for 2014 included a charge-off of $222,000 on one loan and charge-offs in the commercial, secured by real estate category for the same year included charge-offs totaling $469,000 on three loans.

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

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

LCNB continuously reviews the loan portfolio for credit risk through the use of its lending and loan review functions. Independent loan reviews analyze specific loans, providing validation that credit risks are appropriately identified and reported to the Loan Committee and Board of Directors. In addition, the Board of Directors' Audit Committee receives loan review reports throughout each year. New credits meeting specific criteria are analyzed prior to origination and are reviewed by the Loan Committee and Board of Directors.
Inputs from all of the Bank's credit risk identification processes are used by management to analyze and validate the adequacy and methodology of the allowance quarterly. The analysis includes two basic components: specific allocations for individual loans and general loss allocations for pools of loans based on average historic loss ratios for the thirty-six preceding months adjusted for identified economic and other risk factors. Due to the number, size, and complexity of loans within the loan portfolio, there is always a possibility of inherent undetected losses.

Non-Interest Income

2016 vs. 2015. Total non-interest income for 2016 was $730,000 greater than for 2015 primarily due to a $587,000 increase in net gains on sales of securities and secondarily to a $121,000 increase in bank owned life insurance income. Net gains from sales of securities increased primarily due to market rates at the times of sales. Bank owned life insurance income increased primarily due to $4 million of new policies purchased during the first quarter 2016. Increases in non-interest income was slightly offset by a $99,000 decrease in gains from sales of loans due to market pricing at the times of the sales.

2015 vs. 2014. Total non-interest income for 2015 was $981,000 greater than for 2014 primarily due to increases in trust income, net gains on sales of securities, and gains from sales of mortgage loans. Trust income increased $359,000 primarily due to an increase in the fair value of trust assets and brokerage accounts managed. Net gains from sales of securities increased $346,000 and gains from sales of loans increased $196,000 primarily due to higher sales volumes.

Non-Interest Expense

2016 vs. 2015. Total non-interest expense was $869,000 greater in 2016 than in 2015 primarily due to a $622,000 increase in salaries and employee benefits, a $251,000 penalty incurred to pre-pay a now high-rate Federal Home Loan Bank borrowing, a $135,000 increase in other real estate owned expense, and a $191,000 increase in various contracted services. Salaries and employee benefits increased primarily due to salary and wage increases, employees retained from the BNB acquisition, and an increase in the number of employees in addition to the acquisition. The FHLB advance had an interest rate of 5.25% and was paid off to reduce interest expense on long-term debt. Other real estate owned expense increased primarily due to writedowns recognized prior to the sale of a commercial property. These increases were partially offset by the absence of merger-related expenses during the 2016 period.

2015 vs. 2014. Total non-interest expense was $1,548,000 greater in 2015 than in 2014 primarily due to a $1,831,000 increase in salaries and employee benefits, partially offset by a $757,000 decrease in merger related expenses (consisting primarily of professional fees, data system conversion costs, and employee severance payments). Salaries and employee benefits increased due to salary and wage increases, employees retained from the BNB and Eaton National acquisitions, an increase in the number of employees outside of the acquisitions, and increased retirement plan expenses. Costs related to the acquisition of BNB in April 2015 were less than the costs associated with the acquisition of Eaton National in January 2014.

Amortization of intangibles increased $126,000 due to amortization of BNB's core deposit intangible. Other real estate owned expenses increased $204,000 primarily due to impairment charges recognized on a commercial property.

Income Taxes

LCNB's effective tax rates for the years ended December 31, 2016, 2015, and 2014 were 26.3%, 26.9%, and 25.5%, respectively. The difference between the statutory rate of 34.2% for 2016 and 34.0% for 2015 and 2014 and the effective tax rate is primarily due to tax-exempt interest income and tax-exempt earnings from bank owned life insurance. The statutory rate for 2016 is higher because LCNB's taxable income is slightly above the next tax bracket.

Assets

Available-for-sale investment securities at December 31, 2016 was $57.3 million lower than the balance at December 31, 2015. During 2016, LCNB purchased $124.9 million in new securities. These additions were more than offset by sales, maturities, and calls of investment securities.

Held-to-maturity investment securities at December 31, 2016 was $18.4 million greater than at December 31, 2015. Purchases during 2016 totaled $25.0 million, mostly from government entities within LCNB's market area. These additions were partially offset by maturities and calls of other held-to-maturity securities.

Net loans at year-end 2016 was $48.4 million greater than at year-end 2015, primarily due to a $57.6 million increase in the commercial, secured by real estate category. The increase in the loan portfolio does not reflect $11.2 million of residential fixed-rate real estate loans that were originated and sold to the Federal Home Loan Mortgage Corporation during 2016.

Net premises and equipment at December 31, 2016 was $8.1 million greater than at December 31, 2015 primarily due to land
and construction costs paid during 2016 for construction of a new Operations Center in Lebanon, Ohio.

Bank owned life insurance at December 31, 2016 was $4.7 million greater than at December 31, 2015 primarily due to the
purchase of $4.0 million of new policies during the first quarter of 2016.

Liabilities

Total deposits at December 31, 2016 were $23.7 million greater than at December 31, 2015, including a $21.0 million increase in non-interest-bearing deposits and a $2.7 million increase in interest-bearing deposits. Total deposits increased despite a $9.4 million decrease in public fund deposits from local government entities. Public fund deposits can be relatively volatile due to seasonal tax collections and the financial needs of the local entities. Historically, public fund deposits tend to be at their lowest balances at year-ends.

Short-term borrowings at December 31, 2016 was $4.7 million greater than at December 31, 2015 primarily due to the decrease in public fund deposits.

Long-term debt at December 31, 2016 was $5.3 million less than at December 31, 2015 primarily due to the early payment in
full of a $5.0 million borrowing from the FHLB during January 2016. The borrowing had an interest rate of 5.25% and its payment will reduce future interest expense.

Liquidity

Liquidity is the ability to have funds available at all times to meet the commitments of LCNB. These commitments may include paying dividends to shareholders, funding new loans for borrowers, funding withdrawals by depositors, paying general and administrative expenses, and funding capital expenditures. Sources of liquidity include growth in deposits, principal payments received on loans, proceeds from the sale of loans, the sale or maturation of investment

securities, cash generated by operating activities, and the ability to borrow funds. Management closely monitors the level of liquid assets available to meet ongoing funding requirements. It is management's intent to maintain adequate liquidity so that sufficient funds are readily available at a reasonable cost. LCNB experienced no liquidity or operational problems during the past year as a result of current liquidity levels.

The liquidity of LCNB is enhanced by the fact that 85.0% of total deposits at December 31, 2016 were "core" deposits. Core deposits, for this purpose, are defined as total deposits less public funds and certificates of deposit greater than $100,000.

Liquid assets include cash and cash equivalents, federal funds sold and securities available-for-sale. Except for investments in the stock of the Federal Reserve Bank and the Federal Home Loan Bank of Cincinnati (“FHLB”) and certain local municipal securities, all of LCNB's investment portfolio is classified as "available-for-sale" and can be readily sold to meet liquidity needs, subject to certain pledging commitments for public funds, repurchase agreements, and other requirements. At December 31, 2016, LCNB's liquid assets amounted to $339.5 million or 26.0% of total assets, compared to $393.0 million or 30.7% of total assets at December 31, 2015. The ratio for 2016 is less than 2015 because of a decrease in securities available-for-sale.

An additional source of funding is borrowings from the FHLB. Long-term advances totaling $598,000 and short-term advances totaling $25.0 million were outstanding at December 31, 2016. LCNB is approved to borrow up to $64.0 million in short-term advances through the FHLB's Cash Management Advance program. Total remaining available borrowing capacity with the FHLB, including short-term advances available through the Cash Management Advance program, at December 31, 2016 was approximately $79.5 million. One of the factors limiting availability of FHLB borrowings is a bank's ownership of FHLB stock. LCNB could increase its available borrowing capacity by purchasing more FHLB stock.

Besides short-term FHLB advances, short-term borrowings may include repurchase agreements, federal funds purchased, and advances from lines of credit with two other financial institutions. At December 31, 2016, LCNB could borrow up to $30 million through the lines of credit and up to $10 million under a federal funds arrangements with another financial institution.

Commitments to extend credit at December 31, 2016 totaled $123.6 million, including standby letters of credit totaling $0.7 million, and are more fully described in Note 14 - Commitments and Contingent Liabilities to LCNB's consolidated financial statements. Since many commitments to extend credit may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

The following table provides information concerning LCNB's contractual obligations at December 31, 2016:

	Payments due by period				
	Total	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years
	(In thousands)				
Short-term borrowings	$42,040	42,040	—	—	—
Long-term debt obligations	598	295	303	—	—
Operating lease obligations	4,785	448	491	353	3,493
Estimated pension plan contribution for 2017	189	189	—	—	—
Commitment to purchase municipal security when issued	235	235	—	—	—
Funding commitments for affordable housing tax credit limited partnerships	1,617	610	587	145	275
Estimated capital expenditure obligations	4,750	4,750	—	—	—
Certificates of deposit:					
$100,000 and over	77,770	17,023	27,698	32,132	917
Other time certificates	136,994	46,165	41,455	47,491	1,883
Total	$268,978	111,755	70,534	80,121	6,568

The following table provides information concerning LCNB's commitments at December 31, 2016:

	Amount of Commitment Expiration Per Period			
Total Amounts Committed	1 year or less	Over 1 through 3 years	Over 3 through 5 years	More than 5 years

	(In thousands)				
Commitments to extend credit	$15,819	15,819	—	—	—
Unused lines of credit	107,076	41,790	28,480	17,131	19,675
Standby letters of credit	657	657	—	—	—
Total	$123,552	58,266	28,480	17,131	19,675

Capital Resources

LCNB and the Bank are required by banking regulators to meet certain minimum levels of capital adequacy. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on LCNB's and the Bank's financial statements. These minimum levels are expressed in the form of certain ratios. Capital is separated into Tier 1 capital (essentially shareholders' equity less goodwill and other intangibles) and Tier 2 capital (essentially the allowance for loan losses limited to 1.25% of risk-weighted assets). Common Equity Tier 1 Capital is the sum of common stock, related surplus, and retained earnings, net of treasury stock, accumulated other comprehensive income, and other adjustments. The first three ratios, which are based on the degree of credit risk in the Bank's assets, provide for weighting assets based on assigned risk factors and include off-balance sheet items such as loan commitments and stand-by letters of credit. Information summarizing the regulatory capital of LCNB and the Bank at December 31, 2016 and 2015 and corresponding regulatory minimum requirements is included in Note 15 - Regulatory Matters of the consolidated financial statements.

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

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

Under the Market Repurchase Program, LCNB was originally authorized to purchase up to 200,000 shares of its stock, as restated for a 100% stock dividend issued in May, 2007, through market transactions with a selected stockbroker. On November 14, 2005, the Board of Directors extended the Market Repurchase Program by increasing the shares authorized for repurchase to 400,000 total shares, as restated for a stock dividend. Through December 31, 2016, 290,444 shares, as restated for the stock dividend, had been purchased under this program. No shares were purchased under this program during 2016.

The Private Sale Repurchase Program is available to shareholders who wish to sell large blocks of stock at one time. Because LCNB's stock is not widely traded, a shareholder releasing large blocks may not be able to readily sell all shares through normal procedures. Purchases of blocks will be considered on a case-by-case basis and will be made at prevailing market prices. A total of 466,018 shares, as restated for the stock dividend, had been purchased under this program at December 31, 2016. No shares were purchased under this program during 2016.

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

The 2015 Ownership Incentive Plan (the "2015 Plan") was approved by LCNB's shareholders at the annual meeting on April 28, 2015 and allows for stock-based awards to eligible employees, as determined by the Compensation Committee of the Board of Directors. Awards may be made in the form of stock options, appreciation rights, restricted

shares, and/or restricted share units. The 2015 Plan provides for the issuance of up to 450,000 shares. The 2015 Plan will terminate on April 28, 2025 and is subject to earlier termination by the Compensation Committee.

On January 9, 2009, LCNB issued 13,400 shares of Fixed Rate Cumulative Preferred Stock, Series A and a warrant for the purchase of 217,063 common shares of LCNB stock at an exercise price of $9.26 per share to the U.S. Treasury Department. LCNB allocated $583,000 of the proceeds from the preferred stock issuance to the warrant. The warrant carried a ten year term and was 100% vested at grant. On October 21, 2009, LCNB redeemed the preferred stock that had been issued under the Capital Purchase Program agreement. LCNB redeemed the warrant during the first quarter 2016.

Critical Accounting Policies

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

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

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

Accounting for Intangibles. LCNB’s intangible assets at December 31, 2016 are composed primarily of goodwill and core deposit intangibles related to acquisitions of other financial institutions. It also includes mortgage servicing rights recorded from sales of fixed-rate mortgage loans to the Federal Home Loan Mortgage Corporation and mortgage servicing rights acquired through the acquisition of Eaton National Bank & Trust Co. Goodwill is not subject to amortization, but is reviewed annually for impairment. Core deposit intangibles are being amortized on a straight line basis over their respective estimated weighted average lives. Mortgage servicing rights are capitalized by allocating the total cost of loans between mortgage servicing rights and the loans based on their estimated fair values. Capitalized mortgage servicing rights are amortized to loan servicing income in proportion to and over the period of estimated servicing income, subject to periodic review for impairment.

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

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

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

The Bank's Asset and Liability Management Committee ("ALCO") primarily uses a combination of Interest Rate Sensitivity Analysis (IRSA) and Economic Value of Equity (EVE) analysis for measuring and managing interest rate risk. The IRSA model is used to estimate the effect on net interest income during a one-year period of instantaneous and sustained movements in interest rates, also called interest rate shocks, of 100, 200, and 300 basis points. Management considers the results of any significant downward scenarios to not be meaningful in the current interest rate environment. The base projection uses a current interest rate scenario. As shown below, the December 31, 2016 IRSA indicates that an increase in interest rates at all shock levels will have a positive effect on net interest income. The changes in net interest income for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in Net Interest Income	% Change in Net Interest Income
Up 300	$ 43,790	2,663	6.48 %
Up 200	42,857	1,730	4.21 %
Up 100	41,968	841	2.04 %
Base	41,127	—	— %

IRSA shows the effect on net interest income during a one-year period only. A more long-range model is the EVE analysis, which shows the estimated present value of future cash inflows from interest-earning assets less the present value of future cash outflows for interest-bearing liabilities for the same rate shocks. As shown below, the December 31, 2016 EVE analysis indicates that an increase in interest rates would have a negative effect on the EVE for all shock levels. The changes in the EVE for all rate assumptions are within LCNB’s acceptable ranges.

Rate Shock Scenario in Basis Points	Amount (In thousands)	$ Change in EVE	% Change in EVE
Up 300	$ 135,135	(4,595)	(3.29)%
Up 200	135,815	(3,915)	(2.80)%
Up 100	136,397	(3,333)	(2.39)%
Base	139,730	—	— %

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

interest rate levels.

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LCNB CORP. AND SUBSIDIARY

Item 8. Financial Statements and Supplementary Data

REPORT OF MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

Management assessed LCNB's internal controls as of December 31, 2016, in relation to criteria for effective internal control over financial reporting described in "Internal Control – Integrated Framework (2013)" issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on this assessment, management believes that, as of December 31, 2016, LCNB's internal control over financial reporting met the criteria.

BKD LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of LCNB's internal control over financial reporting as of December 31, 2016.

Submitted by:

LCNB Corp.

/s/ Steve P. Foster	/s/ Robert C. Haines II
Steve P. Foster	Robert C. Haines II
Chief Executive Officer & President	Executive Vice President &
March 8, 2017	Chief Financial Officer
	March 8, 2017

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LCNB CORP. AND SUBSIDIARY

Report of Independent Registered Public Accounting Firm

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

We have audited LCNB Corp. and subsidiary's (Company) internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Company's management's assessment of internal control over financial reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of reliable financial statements in accordance with accounting principles generally accepted in the United States of America. Because management's assessment and our audit were also conducted to meet the reporting requirements of Section 112 of the Federal Deposit Insurance Corporation Improvement Act (FDICIA), our examination of LCNB Corp.'s internal control over financial reporting included controls over the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and with the instructions to the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C).(A) A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention, or timely detection and correction of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. In our opinion, LCNB Corp. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of LCNB Corp. and subsidiaries and our report dated March 8, 2017, expressed an unqualified opinion thereon.

/s/ BKD, LLP

BKD, LLP

Indianapolis, Indiana
March 8, 2017

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LCNB CORP. AND SUBSIDIARY

Report of Independent Registered Public Accounting Firm

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

We have audited the accompanying consolidated balance sheets of LCNB Corp. and subsidiary as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2016. The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LCNB Corp. and subsidiary as of December 31, 2016 and 2015, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2016, in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), LCNB Corp. and subsidiary's internal control over financial reporting as of December 31, 2016, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 8, 2017, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ BKD, LLP
BKD, LLP

Indianapolis, Indiana
March 8, 2017

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LCNB CORP. AND SUBSIDIARY

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

	2016	2015
ASSETS:		
Cash and due from banks	$18,378	14,155
Interest-bearing demand deposits	487	832
Total cash and cash equivalents	18,865	14,987
Investment securities:		
Available-for-sale, at fair value	320,659	377,978
Held-to-maturity, at cost	41,003	22,633
Federal Reserve Bank stock, at cost	2,732	2,732
Federal Home Loan Bank stock, at cost	3,638	3,638
Loans, net	816,228	767,809
Premises and equipment, net	30,244	22,100
Goodwill	30,183	30,183
Core deposit and other intangibles	4,582	5,396
Bank owned life insurance	27,307	22,561
Other assets	11,358	10,514
TOTAL ASSETS	$1,306,799	1,280,531
LIABILITIES:		
Deposits:		
Non-interest-bearing	$271,332	250,306
Interest-bearing	839,573	836,854
Total deposits	1,110,905	1,087,160
Short-term borrowings	42,040	37,387
Long-term debt	598	5,947
Accrued interest and other liabilities	10,312	9,929
TOTAL LIABILITIES	1,163,855	1,140,423
COMMITMENTS AND CONTINGENT LIABILITIES		
SHAREHOLDERS' EQUITY:		
Preferred shares - no par value, authorized 1,000,000 shares, none outstanding	—	—
Common shares - no par value; authorized 19,000,000 and 12,000,000 shares at December 31, 2016 and 2015, respectively; issued 10,751,652 and 10,679,174 shares at December 31, 2016 and 2015, respectively	76,490	76,908
Retained earnings	80,736	74,629
Treasury shares at cost, 753,627 shares at December 31, 2016 and 2015	(11,665)	(11,665)
Accumulated other comprehensive income (loss), net of taxes	(2,617)	236
TOTAL SHAREHOLDERS' EQUITY	142,944	140,108

TOTAL LIABILITES AND SHAREHOLDERS' EQUITY	$1,306,799	1,280,531

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

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

	2016	2015	2014
INTEREST INCOME:			
Interest and fees on loans	$ 35,600	35,285	32,706
Interest on investment securities:			
Taxable	4,582	4,197	3,757
Non-taxable	3,199	2,848	2,713
Other investments	369	329	301
TOTAL INTEREST INCOME	43,750	42,659	39,477
INTEREST EXPENSE:			
Interest on deposits	3,440	3,009	3,161
Interest on short-term borrowings	38	24	22
Interest on long-term debt	26	295	407
TOTAL INTEREST EXPENSE	3,504	3,328	3,590
NET INTEREST INCOME	40,246	39,331	35,887
PROVISION FOR LOAN LOSSES	913	1,366	930
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	39,333	37,965	34,957
NON-INTEREST INCOME:			
Trust income	3,286	3,262	2,903
Service charges and fees on deposit accounts	5,008	4,920	4,838
Net gain on sales of securities	1,082	495	149
Bank owned life insurance income	746	625	671
Gains from sales of loans	244	343	147
Other operating income	487	478	434
TOTAL NON-INTEREST INCOME	10,853	10,123	9,142
NON-INTEREST EXPENSE:			
Salaries and employee benefits	18,215	17,593	15,762
Equipment expenses	1,048	1,257	1,316
Occupancy expense, net	2,271	2,307	2,232
State franchise tax	1,114	1,001	955
Marketing	696	720	703
Amortization of intangibles	753	700	574
FDIC premiums	547	598	660
ATM expense	721	698	624
Computer maintenance and supplies	790	782	794
Telephone expense	746	707	690
Contracted services	1,033	842	880
Other real estate owned	624	489	285
Merger-related expenses	—	643	1,400
Other non-interest expense	4,703	4,055	3,969
TOTAL NON-INTEREST EXPENSE	33,261	32,392	30,844

INCOME BEFORE INCOME TAXES	16,925	15,696	13,255
PROVISION FOR INCOME TAXES	4,443	4,222	3,386
NET INCOME	$ 12,482	11,474	9,869
Earnings per common share:			
Basic	$ 1.26	1.18	1.06
Diluted	1.25	1.17	1.05
Weighted average common shares outstanding:			
Basic	9,948,057	9,704,965	9,297,019
Diluted	9,976,370	9,811,467	9,406,346

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

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

	2016	2015	2014
Net income	$12,482	11,474	9,869
Other comprehensive income (loss):			
Net unrealized gain (loss) on available-for-sale securities (net of tax expense (benefit) of $(1,242), $(169), and $1,476 for 2016, 2015, and 2014, respectively)	(2,390)	(329)	2,865
Reclassification adjustment for net realized gain on sale of available-for-sale securities included in net income (net of taxes of $370, $168, and $51 for 2016, 2015 and 2014, respectively)	(712)	(327)	(98)
Change in nonqualified pension plan unrecognized net gain (loss) and unrecognized prior service cost (net of tax expense (benefit) of $128, $55, and $(133) for 2016, 2015, and 2014, respectively)	249	107	(260)
Other comprehensive income (loss)	(2,853)	(549)	2,507
TOTAL COMPREHENSIVE INCOME	$9,629	10,925	12,376
SUPPLEMENTAL INFORMATION:			
COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX, AS OF YEAR-END:			
Net unrealized gain (loss) on securities available-for-sale	$(2,633)	469	1,125
Net unfunded liability for nonqualified pension plan	16	(233)	(340)
Balance at year-end	$(2,617)	236	785

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

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

	Common Shares Outstanding	Common Shares	Retained Earnings	Treasury Shares	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance, December 31, 2013	9,287,536	$66,785	65,475	(11,665)	(1,722)	118,873
Net income			9,869			9,869
Other comprehensive income (loss), net of taxes					2,507	2,507
Dividend Reinvestment and Stock Purchase Plan	23,782	372				372
Compensation expense relating to stock options		24				24
Common stock dividends, $0.64 per share			(5,950)			(5,950)
Balance, December 31, 2014	9,311,318	67,181	69,394	(11,665)	785	125,695
Net income			11,474			11,474
Other comprehensive income (loss), net of taxes					(549)	(549)
Dividend Reinvestment and Stock Purchase Plan	24,610	390				390
Acquisition of BNB Bancorp, Inc.	560,132	9,063				9,063
Exercise of stock options	13,449	152				152
Excess tax (benefit) expense on exercise and forfeiture of stock options		13				13
Compensation expense relating to stock options		19				19
Compensation expense relating to restricted stock	16,038	90				90
Common stock dividends, $0.64 per share			(6,239)			(6,239)
Balance, December 31, 2015	9,925,547	76,908	74,629	(11,665)	236	140,108
Net income			12,482			12,482
Other comprehensive income (loss), net of taxes					(2,853)	(2,853)
Dividend Reinvestment and Stock Purchase Plan	21,088	379				379
Repurchase of stock warrants		(1,545)				(1,545)
Exercise of stock options	51,390	592				592
Excess tax benefit on exercise and forfeiture of stock options and vesting of restricted common stock		61				61
Compensation expense relating to stock options		5				5

Compensation expense relating to restricted stock		90				90
Common stock dividends, $0.64 per share			(6,375)			(6,375)
Balance, December 31, 2016	9,998,025	$76,490	80,736	(11,665)	(2,617)	142,944

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

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

	2016	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$12,482	11,474	9,869
Adjustments to reconcile net income to net cash flows from operating activities-			
Depreciation, amortization and accretion	2,557	2,997	2,991
Provision for loan losses	913	1,366	930
Deferred income tax provision (benefit)	928	(58)	192
Increase in cash surrender value of bank owned life insurance	(746)	(625)	(671)
Realized gain on sales of securities available-for-sale	(1,082)	(495)	(149)
Realized loss (gain) on sale of premises and equipment	33	(1)	(128)
Realized loss from sale and write-downs of other real estate owned and repossessed assets	534	378	85
Origination of mortgage loans for sale	(11,217)	(7,725)	(7,480)
Realized gains from sales of loans	(244)	(343)	(147)
Proceeds from sales of loans	11,353	7,809	7,552
Penalty for prepayment of long-term debt	251	—	—
Compensation expense related to stock options	5	19	24
Compensation expense related to restricted stock	90	90	—
Changes in:			
Income receivable	(216)	(160)	414
Other assets	(791)	(3,302)	1,898
Other liabilities	634	1,815	560
TOTAL ADJUSTMENTS	3,002	1,765	6,071
NET CASH FLOWS FROM OPERATING ACTIVITIES	15,484	13,239	15,940
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from sales of investment securities available-for-sale	92,455	97,981	67,296
Proceeds from maturities and calls of investment securities:			
Available-for-sale	84,529	29,700	36,716
Held-to-maturity	6,640	3,515	4,688
Purchases of investment securities:			
Available-for-sale	(124,934)	(163,859)	(92,180)
Held-to-maturity	(25,010)	(3,413)	(11,090)
Proceeds from redemption of Federal Reserve Bank stock	—	—	41
Purchase of Federal Reserve Bank stock	—	(256)	(743)
Proceeds from sale of impaired loans	—	4,559	—
Net increase in loans	(48,153)	(42,530)	(10,081)
Purchase of bank owned life insurance	(4,000)	—	—
Proceeds from redemption of bank owned life insurance	—	—	3,633
Proceeds from sales of other real estate owned and repossessed assets	526	245	750
Additions to other real estate owned	(182)	(20)	(45)
Purchases of premises and equipment	(9,450)	(504)	(1,052)
Proceeds from sales of premises and equipment	63	22	179

Net cash acquired from (paid for) acquisition	—	8,993	(9,114)
NET CASH FLOWS USED IN INVESTING ACTIVITIES	(27,516)	(65,567)	(11,002)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase (decrease) in deposits	23,745	41,822	(4,797)
Net increase in short-term borrowings	4,653	20,742	7,339
Principal payments on long-term debt	(5,349)	(5,410)	(745)
Penalty for prepayment of long-term debt	(251)	—	—
Proceeds from issuance of common stock	52	66	58
Repurchase of stock warrants	(1,545)	—	—
Proceeds from exercise of stock options	592	152	—
Excess tax benefit from exercise of stock options and vesting of restricted common stock	61	13	—
Cash dividends paid on common stock	(6,048)	(5,915)	(5,636)
NET CASH FLOWS PROVIDED BY (USED IN) FINANCING ACTIVITIES	15,910	51,470	(3,781)
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,878	(858)	1,157
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	14,987	15,845	14,688
CASH AND CASH EQUIVALENTS AT END OF YEAR	$18,865	14,987	15,845
SUPPLEMENTAL CASH FLOW INFORMATION:			
CASH PAID DURING THE YEAR FOR:			
Interest	$3,542	3,396	3,502
Income taxes	4,420	4,820	2,610
SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING ACTIVITY:			
Transfer from loans to other real estate owned and repossessed assets	32	79	435

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

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

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

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

Declines in the fair value of securities below their cost that are deemed to be other-than-temporarily impaired and for which the Company does not intend to sell the securities and it is not more likely than not that the securities will be sold before the anticipated recovery of the impairment are separated into losses related to credit factors and losses related to other factors. The losses related to credit factors are recognized in earnings and losses related to other factors are recognized in other comprehensive income. In estimating other than temporary impairment losses, management considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. The Company's consolidated statements of income as of December 31, 2016, 2015, and 2014, do not reflect any such impairment.

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

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

LOANS

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

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

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

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

ALLOWANCE FOR LOAN LOSSES

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

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

The allowance consists of specific and general components. The specific component relates to loans that are specifically reviewed for impairment. For such loans, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers loans not specifically reviewed for impairment and homogeneous loan pools, such as residential real estate and consumer loans. The general component is measured for each loan category separately based on each category's average of historical loss experience over a trailing thirty-six month period, adjusted for qualitative factors. Such qualitative factors may include current economic conditions if different from the three-year historical loss period, trends in underperforming loans, trends in volume and terms of loan categories, concentrations of credit, and trends in loan quality.

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

Loans acquired from a merger are recorded at fair value with no carryover of the acquired entity's previously established allowance for loan losses. The excess of expected cash flows over the estimated fair value of acquired loans is recognized as interest income over the remaining contractual lives of the loans using the level yield method. Subsequent decreases in expected cash flows will require additions to the allowance for loan losses. Subsequent improvements in expected cash flows result in the recognition of additional interest income over the then-remaining contractual lives of the loans.

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

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

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

GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

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

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

Accounting guidance permits, but does not require, companies to measure many financial instruments and certain other items at fair value. The decision to elect the fair value option is made individually for each instrument and is irrevocable once made. Changes in fair value for the selected instruments are recorded in earnings. The Company did not select any financial instruments for the fair value election in 2016 or 2015.

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

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

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

TREASURY STOCK

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

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

INCOME TAXES
Deferred income taxes are determined using the asset and liability method of accounting. Under this method, the net deferred tax asset or liability is determined based on the tax effects of temporary differences between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

Management analyzes material tax positions taken in any income tax return for any tax jurisdiction and determines the likelihood of the positions being sustained in a tax examination. A tax position is recognized as a benefit only if it is “more likely than not” that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded.

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

RECENT ACCOUNTING PRONOUNCEMENTS
From time to time the FASB issues an Accounting Standards Update ("ASU") to communicate changes to Generally Accepted Accounting Principles. The following information provides brief summaries of newly issued but not yet effective ASUs that could have an effect on LCNB’s financial position or results of operations:

ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)"
ASU No. 2014-09 was issued in May 2014 and supersedes most current revenue recognition guidance for contracts to transfer goods or services or other nonfinancial assets. Lease contracts, insurance contracts, and most financial instruments are not included in the scope of this update. ASU No. 2014-09 provides that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance enumerates five steps that entities should follow in achieving this core principle. Additional disclosures providing information about contracts with customers are required.

Guidance in ASU No. 2014-09 has been clarified by the following ASUs:

- ASU No. 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)"
- ASU No. 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing"
- ASU No. 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients"

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

As extended by ASU No. 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," ASU No. 2014-09 and the clarifying ASUs are effective for public companies for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Transitional guidance is included in the updates. Earlier adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. LCNB's revenue is comprised of net interest income, which is explicitly excluded from the scope of ASU No. 2014-09, and non-interest income. The update may require LCNB to change how it recognizes certain recurring revenue streams related to non-interest income. However, it is not expected to have a material impact on LCNB's results of operations or financial position. Management continues to monitor the guidance from the FASB and the Transition Resource Group for Revenue Recognition in determining the impact of ASU No. 2014-09 on various types of non-interest income.

ASU No. 2014-15, "Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity’s Ability to Continue as a Going Concern"
ASU No. 2014-15 was issued in August 2014 and requires management to evaluate for each annual and interim reporting period whether it is probable that the entity will not be able to meet its obligations as they become due within one year after the date that financial statements are issued (or are available to be issued, where applicable). Certain disclosures, as described in the update, are required if management identifies substantial doubt about the entity's ability to continue as a going concern. ASU No. 2014-15 will take effect in the annual periods ending after December 15, 2016, and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. Adoption of ASU No. 2014-15 is not expected to have a material impact on LCNB's results of operations or financial position.

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

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

For public business entities, the new guidance is effective for annual reporting periods, and interim reporting periods within those annual periods, beginning after December 15, 2017. Adoption of ASU No. 2016-01 is not expected to have a material impact on LCNB's results of operations or financial position.

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

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

The amendments in this update are to be applied using a modified retrospective approach, as defined, and are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. Early application is permitted. LCNB estimates that it will recognize discounted right of use assets and and lease liabilities totaling approximately $5 million for the leases disclosed in Note 8 - Leases. This projection is based on various assumptions, including the level of interest rates and no significant increases in leasing activity, that may change between now and the effective date.

ASU No. 2016-05, "Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships (a consensus of the Emerging Issues Task Force)"
ASU No. 2016-05 was issued in March 2016 and applies to reporting entities for which there is a change in a counterparty to a derivative instrument that has been designated a hedging instrument under Topic 815, "Derivatives and Hedging." The amendments in this update clarify that a change in a counterparty to such a derivative instrument does not, in and of itself, require dedesignation of that hedging relationship provided that all other hedge accounting criteria under applicable guidance continue to be met. The amendments in ASU No. 2016-05 are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. LCNB does not currently have any investments in derivative instruments that have been designated as hedging instruments and adoption of ASU No. 2016-05 is not expected to have an impact on LCNB's results of operations or financial position.

ASU No. 2016-06 , "Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments (a consensus of the Emerging Issues Task Force)"
ASU No. 2016-06 was issued in March 2016 and clarifies what steps are required when assessing whether the economic characteristics and risks of call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to the economic characteristics and risks of their debt hosts, which is one of

the criteria for bifurcating an embedded derivative. An entity performing the assessment under the amendments in this update is required to assess the
embedded call (put) options solely in accordance with the four-step decision sequence. The four-step decision sequence requires an entity to consider whether (1) the payoff is adjusted based on changes in an index, (2) the payoff is indexed to an underlying other than interest rates or credit risk, (3) the debt involves a substantial premium or discount, and (4) the call (put) option is contingently exercisable. The amendments in ASU No. 2016-06 are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. LCNB does not currently have any investments in debt instruments containing such call (put) options and adoption of ASU No. 2016-06 is not expected to have an impact on LCNB's results of operations or financial position.

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NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

ASU No. 2016-09, "Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting"
ASU No. 2016-09 was issued in March 2016 and affects all entities that issue share-based payment awards to their employees. The new guidance involves several aspects of the accounting for share-based payment transactions, including income tax
consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Under ASU No. 2016-09, any excess tax benefits or tax deficiencies should be recognized as income tax expense or benefit in the income statement. Excess tax benefits are to be classified as an operating activity in the statement of cash flows. In accruing compensation cost, an entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as required under current guidance, or account for forfeitures when they occur. For an award to qualify for equity classification, an entity cannot partially settle the award in excess of the employer's maximum statutory withholding requirements. Such cash paid by an employer when directly withholding shares for tax withholding purposes should be classified as a financing activity in the statement of cash flows. The amendments in ASU No. 2016-09 are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. Adoption of ASU No. 2016-07 is not expected to have a material impact on LCNB's results of operations or financial position. If the provisions of the ASU had been adopted in 2014, excess tax benefits from the exercise of stock options and the vesting of restricted common stock would have reduced the provision for income taxes for 2016 and 2015 by $61,000 and $13,000, respectively. There were no excess tax benefits during 2014.

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

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

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

ASU No. 2016-13 will take effect for U.S. Securities and Exchange Commission (SEC) filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. While LCNB's Loan Committee expects that the implementation of ASU No. 2016-13 will increase the balance of the allowance for loan losses, it is continuing to evaluate the potential impact on LCNB's results of operations and financial position.

ASU No. 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments"
ASU No. 2016-15 was issued in August 2016 and applies to all entities required to present a statement of cash flows in their financial reports. The guidance in this ASU addresses eight cash flow classification issues that have been creating diversity in practice. One of the issues is the classification of cash payments for debt prepayment or debt extinguishment costs, which are to be classified as cash outflows from financing activities under the new guidance. LCNB incurred a prepayment penalty during January 2016 upon the early payment in full of a FHLB advance and classified such penalty as a cash outflow from operating activities in its consolidated condensed statements of cash flows. Management early adopted ASU No. 2016-15 during the third quarter 2016 and reclassified the penalty as a cash outflow from financing activities.

NOTE 2 – ACQUISITIONS

On December 29, 2014, LCNB and BNB Bancorp, Inc. (“BNB”) entered into an Agreement and Plan of Merger (“Merger Agreement”) pursuant to which BNB was acquired by LCNB on April 30, 2015. Immediately following the merger of BNB into LCNB, Brookville National Bank ("Brookville National"), a wholly-owned subsidiary of BNB, was merged into LCNB National Bank. Brookville National operated a main office and a branch office, both in Brookville, Ohio. These offices became branches of the Bank after the merger.

Under the terms of the Merger Agreement, the shareholders of BNB common stock received, for each share of BNB common stock, (i) $15.75 in cash and (ii) 2.005 LCNB common shares.

On October 28, 2013, LCNB and Colonial Banc Corp. (“Colonial”) entered into a Stock Purchase Agreement (“Purchase Agreement”) pursuant to which LCNB purchased from Colonial on January 24, 2014 all of the issued and outstanding shares of Eaton National Bank & Trust Co. ("Eaton National"). Immediately following the acquisition, Eaton National was merged into the Bank. Eaton National operated five full–service branches with a main office and another facility in Eaton, Ohio and branch offices in each of West Alexandria, Ohio, New Paris, Ohio, and Lewisburg, Ohio. These offices became branches of the Bank after the merger.

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NOTE 2 – ACQUISITIONS (Continued)

The mergers with BNB and Eaton National were accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration paid were recorded at their estimated fair values as of the respective merger dates, as summarized in the following table (in thousands):

	BNB	Eaton National
Consideration Paid:		
Common shares issued	$ 9,063	—
Cash paid to shareholder(s)	4,403	24,750
Total consideration paid	13,466	24,750
Identifiable Assets Acquired:		
Cash and cash equivalents	13,396	15,635
Investment securities	58,239	35,859
Federal Reserve Bank stock	130	41
Federal Home Loan Bank stock	—	784
Loans	34,661	115,944
Premises and equipment	2,311	1,314
Bank owned life insurance	—	3,618
Core deposit intangible	1,418	2,466
Other real estate owned	—	262
Other assets	532	1,624
Total identifiable assets acquired	110,687	177,547
Liabilities Assumed:		
Deposits	99,133	165,335
Short-term borrowings	—	651
Deferred income taxes	576	—
Other liabilities	57	263
Total liabilities assumed	99,766	166,249
Total Identifiable Net Assets Acquired	10,921	11,298
Goodwill resulting from merger	2,545	13,452

The amount of goodwill recorded reflects LCNB's entrance into new markets and related synergies that are expected to result from the acquisitions and represents the excess purchase price over the estimated fair value of the net assets acquired. The goodwill will not be amortizable on LCNB's financial records, but is deductible for tax purposes. The core deposit intangible for BNB and Eaton National is being amortized over nine years and eight years, respectively, using the straight-line method.

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

The results of operations are included in the consolidated statements of income from the dates of the mergers.

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NOTE 3 - INVESTMENT SECURITIES

The amortized cost and fair value of available-for-sale investment securities at December 31 are summarized as follows (in thousands):

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
2016				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$ 28,180	41	76	28,145
U.S. Agency notes	87,098	150	1,848	85,400
U.S. Agency mortgage-backed securities	72,402	89	1,444	71,047
Municipal securities:				
Non-taxable	114,064	574	1,623	113,015
Taxable	19,710	220	85	19,845
Mutual funds	2,527	—	45	2,482
Trust preferred securities	49	—	1	48
Equity securities	632	55	10	677
	$ 324,662	1,129	5,132	320,659
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 31,015	56	352	30,719
Taxable	9,988	—	217	9,771
	$ 41,003	56	569	40,490
2015				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$ 72,672	309	135	72,846
U.S. Agency notes	140,876	164	1,151	139,889
U.S. Agency mortgage-backed securities	29,608	174	404	29,378
Certificates of deposit	248	1	—	249
Municipal securities:				
Non-taxable	103,900	1,713	134	105,479
Taxable	26,738	337	134	26,941
Mutual funds	2,517	—	51	2,466
Trust preferred securities	49	1	—	50
Equity securities	659	40	19	680
	$ 377,267	2,739	2,028	377,978
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$ 22,233	95	97	22,231
Taxable	400	—	1	399
	$ 22,633	95	98	22,630

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NOTE 3 - INVESTMENT SECURITIES (Continued)

Information concerning securities with gross unrealized losses at December 31, 2016 and 2015, aggregated by length of time that individual securities have been in a continuous loss position, is as follows (in thousands):

	Less Than Twelve Months		Twelve Months or More	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
2016				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$16,076	76	—	—
U.S. Agency notes	69,784	1,848	—	—
U.S. Agency mortgage-backed securities	64,564	1,310	3,518	134
Municipal securities:				
Non-taxable	72,867	1,621	451	2
Taxable	9,721	82	450	3
Mutual funds	1,205	37	277	8
Trust preferred securities	49	1	—	—
Equity securities	201	10	—	—
	$234,467	4,985	4,696	147
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$20,429	251	2,564	101
Taxable	8,030	217	—	—
	$28,459	468	2,564	101
2015				
Investment Securities Available-for-Sale:				
U.S. Treasury notes	$32,854	75	4,846	60
U.S. Agency notes	104,053	1,000	9,869	151
U.S. Agency mortgage-backed securities	19,190	256	4,068	148
Municipal securities:				
Non-taxable	13,124	74	7,037	60
Taxable	15,601	114	880	20
Mutual funds	1,215	17	268	34
Trust preferred securities	—	—	—	—
Equity securities	248	12	73	7
	$186,285	1,548	27,041	480
Investment Securities Held-to-Maturity:				
Municipal securities:				
Non-taxable	$832	3	3,426	94
Taxable	399	1	—	—
	$1,231	4	3,426	94

Management has determined that the unrealized losses at December 31, 2016 are primarily due to fluctuations in market interest rates and do not reflect credit quality deterioration of the securities. Because the Company does not have the intent to sell the investments and it is more likely than not that the Company will not be required to sell the investments before recovery of their amortized cost, the Company does not consider these investments to be other-than-temporarily impaired.

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NOTE 3 - INVESTMENT SECURITIES (Continued)

Contractual maturities of investment securities at December 31, 2016 were as follows (in thousands). Actual maturities may differ from contractual maturities when issuers have the right to call or prepay obligations.

	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due within one year	$12,364	12,464	3,955	3,959
Due from one to five years	97,171	97,501	4,125	4,068
Due from five to ten years	131,950	129,289	10,081	9,845
Due after ten years	7,567	7,151	22,842	22,618
	249,052	246,405	41,003	40,490
U.S. Agency mortgage-backed securities	72,402	71,047	—	—
Mutual funds	2,527	2,482	—	—
Trust preferred securities	49	48	—	—
Equity securities	632	677	—	—
	$324,662	320,659	41,003	40,490

Investment securities with a market value of $149,990,000 and $215,952,000 at December 31, 2016 and 2015, respectively, were pledged to secure public deposits and for other purposes required or permitted by law.

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

	2016	2015	2014
Proceeds from sales	$92,455	97,981	67,296
Gross realized gains	1,103	627	252
Gross realized losses	21	132	103

NOTE 4 - LOANS

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

	2016	2015
Commercial and industrial	$41,878	45,275
Commercial, secured by real estate	477,275	419,633
Residential real estate	265,788	273,139
Consumer	19,173	18,510
Agricultural	14,802	13,479
Other loans, including deposit overdrafts	633	665
	819,549	770,701
Deferred origination costs, net	254	237
	819,803	770,938
Less allowance for loan losses	3,575	3,129
Loans-net	$816,228	767,809

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LCNB CORP. AND SUBSIDIARY
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NOTE 4 - LOANS (Continued)

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

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

The following table provides certain information at the acquisition date on loans acquired from BNB on April 30, 2015 and from Eaton National on January 24, 2014, not including loans considered to be impaired (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$32,174	102,483
Less fair value adjustment	199	1,347
Fair value of acquired loans	$31,975	101,136
Contractual cash flows not expected to be collected	$195	1,702

The following table provides details on acquired impaired loans obtained through the mergers with BNB and Eaton National that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	BNB	Eaton National
Contractually required principal at acquisition	$3,511	23,414
Contractual cash flows not expected to be collected (nonaccretable difference)	(404)	(6,088)
Expected cash flows at acquisition	3,107	17,326
Interest component of expected cash flows (accretable discount)	(413)	(2,163)
Fair value of acquired impaired loans	$2,694	15,163

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NOTE 4 - LOANS (Continued)

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

	2016	2015
Non-accrual loans:		
Commercial and industrial	$—	—
Commercial, secured by real estate	4,312	876
Agricultural	334	48
Residential real estate	1,079	799
Total non-accrual loans	5,725	1,723
Past-due 90 days or more and still accruing	23	559
Total non-accrual and past-due 90 days or more and still accruing	5,748	2,282
Accruing restructured loans	11,731	13,723
Total	$17,479	16,005
Percentage of total non-accrual and past-due 90 days or more and still accruing to total loans	0.70 %	0.30 %
Percentage of total non-accrual, past-due 90 days or more and still accruing, and accruing restructured loans to total loans	2.13 %	2.08 %

Interest income that would have been recorded during 2016 and 2015 if loans on non-accrual status at December 31, 2016 and 2015 had been current and in accordance with their original terms was approximately $220,000 and $137,000, respectively.

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

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NOTE 4 - LOANS (Continued)

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

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
December 31, 2016							
Allowance for loan losses:							
Balance, beginning of year	$ 244	1,908	854	54	66	3	3,129
Provision charged to expenses	314	358	106	74	(6)	67	913
Losses charged off	(234)	(185)	(127)	(85)	—	(119)	(750)
Recoveries	26	98	52	53	—	54	283
Balance, end of year	$ 350	2,179	885	96	60	5	3,575
Individually evaluated for impairment	$ 9	55	100	13	—	—	177
Collectively evaluated for impairment	341	1,832	785	83	60	5	3,106
Acquired credit impaired loans	—	292	—	—	—	—	292
Balance, end of year	$ 350	2,179	885	96	60	5	3,575
Loans:							
Individually evaluated for impairment	$ 337	12,580	1,518	52	334	—	14,821
Collectively evaluated for impairment	41,466	458,059	262,266	19,192	14,475	178	795,636
Acquired credit impaired loans	98	6,305	2,471	17	—	455	9,346
Balance, end of year	$ 41,901	476,944	266,255	19,261	14,809	633	819,803
December 31, 2015							
Allowance for loan losses:							
Balance, beginning of year	$ 129	1,990	926	63	11	2	3,121
Provision charged to expenses	208	955	125	(17)	55	40	1,366
Losses charged off	(100)	(1,133)	(304)	(52)	(67)	(74)	(1,730)
Recoveries	7	96	107	60	67	35	372
Balance, end of year	$ 244	1,908	854	54	66	3	3,129
Individually evaluated for impairment	$ 9	306	48	—	—	—	363
Collectively evaluated for impairment	235	1,602	806	54	66	3	2,766
Acquired credit impaired loans	—	—	—	—	—	—	—
Balance, end of year	$ 244	1,908	854	54	66	3	3,129
Loans:							
Individually evaluated for impairment	$ 370	12,351	1,541	56	—	—	14,318
Collectively evaluated for impairment	43,726	399,092	269,001	18,516	13,438	179	743,952
Acquired credit impaired loans	1,191	7,877	3,039	27	48	486	12,668
Balance, end of year	$ 45,287	419,320	273,581	18,599	13,486	665	770,938

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(Continued)

NOTE 4 - LOANS (Continued)

	Commercial & Industrial	Commercial, Secured by Real Estate	Residential Real Estate	Consumer	Agricultural	Other	Total
December 31, 2014							
Allowance for loan losses:							
Balance, beginning of year	$ 175	2,520	826	66	—	1	3,588
Provision charged to expenses	173	(20)	712	18	11	36	930
Losses charged off	(261)	(573)	(652)	(129)	—	(79)	(1,694)
Recoveries	42	63	40	108	—	44	297
Balance, end of year	$ 129	1,990	926	63	11	2	3,121
Individually evaluated for impairment	$ 10	415	89	—	—	—	514
Collectively evaluated for impairment	119	1,273	836	63	11	2	2,304
Acquired credit impaired loans	—	302	1	—	—	—	303
Balance, end of year	$ 129	1,990	926	63	11	2	3,121

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

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

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

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

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

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

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NOTE 4 - LOANS (Continued)

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

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

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

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

- Pass – loans categorized in this category are higher quality loans that do not fit any of the other categories described below.
- Other Assets Especially Mentioned (OAEM) - loans in this category are currently protected but are potentially weak. These loans constitute a risk but not to the point of justifying a classification of substandard. The credit risk may be relatively minor yet constitute an undue risk in light of the circumstances surrounding a specific asset.
- Substandard – loans in this category are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the possibility that the Company will sustain some loss if the deficiencies are not corrected.
- Doubtful – loans classified in this category have all the weaknesses inherent in loans classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

NOTE 4 - LOANS (Continued)

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

	Pass	OAEM	Substandard	Doubtful	Total
December 31, 2016					
Commercial & industrial	$41,178	304	419	—	41,901
Commercial, secured by real estate	443,781	5,479	27,684	—	476,944
Residential real estate	261,839	442	3,974	—	266,255
Consumer	19,182	—	79	—	19,261
Agricultural	13,311	—	1,498	—	14,809
Other	633	—	—	—	633
Total	$779,924	6,225	33,654	—	819,803
December 31, 2015					
Commercial & industrial	$44,596	—	691	—	45,287
Commercial, secured by real estate	397,938	9,316	12,066	—	419,320
Residential real estate	267,567	1,935	4,079	—	273,581
Consumer	18,528	—	71	—	18,599
Agricultural	12,246	850	390	—	13,486
Other	665	—	—	—	665
Total	$741,540	12,101	17,297	—	770,938

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

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NOTE 4 - LOANS (Continued)

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

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans Receivable	Total Loans Greater Than 90 Days and Accruing
December 31, 2016							
Commercial & industrial	$19	—	—	19	41,882	41,901	—
Commercial, secured by real estate	99	69	127	295	476,649	476,944	—
Residential real estate	686	80	727	1,493	264,762	266,255	20
Consumer	59	16	3	78	19,183	19,261	3
Agricultural	125	—	—	125	14,684	14,809	—
Other	115	—	—	115	518	633	—
Total	$1,103	165	857	2,125	817,678	819,803	23
December 31, 2015							
Commercial & industrial	$—	—	—	—	45,287	45,287	—
Commercial, secured by real estate	73	81	876	1,030	418,290	419,320	—
Residential real estate	777	198	1,124	2,099	271,482	273,581	516
Consumer	62	7	43	112	18,487	18,599	43
Agricultural	—	—	—	—	13,486	13,486	—
Other	109	—	—	109	556	665	—
Total	$1,021	286	2,043	3,350	767,588	770,938	559

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LCNB CORP. AND SUBSIDIARY
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(Continued)

NOTE 4 - LOANS (Continued)

Impaired loans for the years ended December 31 were as follows (in thousands):

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2016					
With no related allowance recorded:					
Commercial & industrial	$ 109	263	—	998	151
Commercial, secured by real estate	14,195	15,522	—	15,274	1,140
Residential real estate	3,238	4,286	—	3,736	369
Consumer	26	27	—	37	29
Agricultural	334	334	—	392	136
Other	455	629	—	481	77
Total	$ 18,357	21,061	—	20,918	1,902
With an allowance recorded:					
Commercial & industrial	$ 326	326	9	341	19
Commercial, secured by real estate	4,690	4,946	347	4,194	257
Residential real estate	751	751	100	651	36
Consumer	43	43	13	43	3
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	$ 5,810	6,066	469	5,229	315
Total:					
Commercial & industrial	$ 435	589	9	1,339	170
Commercial, secured by real estate	18,885	20,468	347	19,468	1,397
Residential real estate	3,989	5,037	100	4,387	405
Consumer	69	70	13	80	32
Agricultural	334	334	—	392	136
Other	455	629	—	481	77
Total	$ 24,167	27,127	469	26,147	2,217

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NOTE 4 - LOANS (Continued)

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
December 31, 2015					
With no related allowance recorded:					
Commercial & industrial	$ 1,205	1,500	—	1,467	206
Commercial, secured by real estate	16,345	18,335	—	18,575	2,229
Residential real estate	3,734	5,055	—	4,092	453
Consumer	81	109	—	106	25
Agricultural	48	151	—	81	487
Other	486	701	—	510	82
Total	$ 21,899	25,851	—	24,831	3,482
With an allowance recorded:					
Commercial & industrial	$ 356	356	9	370	21
Commercial, secured by real estate	3,883	4,014	306	4,007	114
Residential real estate	846	958	48	864	37
Consumer	2	1	—	—	—
Agricultural	—	—	—	—	—
Other	—	—	—	—	—
Total	$ 5,087	5,329	363	5,241	172
Total:					
Commercial & industrial	$ 1,561	1,856	9	1,837	227
Commercial, secured by real estate	20,228	22,349	306	22,582	2,343
Residential real estate	4,580	6,013	48	4,956	490
Consumer	83	110	—	106	25
Agricultural	48	151	—	81	487
Other	486	701	—	510	82
Total	$ 26,986	31,180	363	30,072	3,654

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NOTE 4 - LOANS (Continued)

	Average Recorded Investment	Interest Income Recognized
December 31, 2014		
With no related allowance recorded:		
Commercial & industrial	1,823	161
Commercial, secured by real estate	23,360	1,373
Residential real estate	4,645	379
Consumer	179	14
Agricultural	121	20
Other	550	43
Total	30,678	1,990
With an allowance recorded:		
Commercial & industrial	319	19
Commercial, secured by real estate	4,108	117
Residential real estate	1,026	44
Consumer	18	2
Agricultural	—	—
Other	—	—
Total	5,471	182
Total:		
Commercial & industrial	2,142	180
Commercial, secured by real estate	27,468	1,490
Residential real estate	5,671	423
Consumer	197	16
Agricultural	121	20
Other	550	43
Total	36,149	2,172

Of the interest income recognized on impaired loans during 2016, 2015, and 2014, approximately $51,000, $96,000, and $8,000, respectively, were recognized on a cash basis. The Company continued to accrue interest on certain loans classified as impaired during 2016, 2015, and 2014 because they were restructured or considered well secured and in the process of collection.

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NOTE 4 - LOANS (Continued)

Loan modifications that were classified as troubled debt restructurings during the years ended December 31 were as follows (dollars in thousands):

	2016			2015			2014		
	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
Commercial and industrial	—	$ —	$ —	—	$ —	$ —	8	$ 658	$ 340
Commercial, secured by real estate	4	2,142	2,215	1	75	74	2	896	1,214
Residential real estate	6	139	139	7	217	221	2	82	82
Consumer	3	39	39	2	9	9	3	40	40
	13	$ 2,320	$ 2,393	10	$ 301	$ 304	15	$ 1,676	$ 1,676

The pre-modification and post-modification recorded balances for the commercial and industrial and commercial, secured by real estate categories in 2014 changed because a borrower had multiple loans classified as commercial and industrial and a loan classified as commercial, secured by real estate, which were all modified into a loan classified as commercial, secured by real estate.

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NOTE 4 - LOANS (Continued)

Each restructured loan is separately negotiated with the borrower and includes terms and conditions that reflect the borrower’s ability to pay the debt as modified. Modifications may include interest only payments for a period of time, temporary or permanent reduction of the loan’s interest rate, capitalization of delinquent interest, or extensions of the maturity date. Post-modification balances of newly restructured troubled debt by type of modification for the years ended December 31 were as follows (dollars in thousands):

	Term Modification	Rate Modification	Interest Only	Combination	Total Modifications
December 31, 2016					
Commercial & industrial	—	—	—	—	—
Commercial, secured by real estate	1,539	—	304	372	2,215
Residential real estate	38	47	—	54	139
Consumer	—	28	—	11	39
Total	1,577	75	304	437	2,393
December 31, 2015					
Commercial & industrial	—	—	—	—	—
Commercial, secured by real estate	74	—	—	—	74
Residential real estate	221	—	—	—	221
Consumer	9	—	—	—	9
Total	304	—	—	—	304
December 31, 2014					
Commercial & industrial	340	—	—	—	340
Commercial, secured by real estate	—	1,136	—	78	1,214
Residential real estate	82	—	—	—	82
Consumer	38	—	—	2	40
Total	460	1,136	—	80	1,676

LCNB is not committed to lend additional funds to borrowers whose loan terms were modified in a troubled debt restructuring.

There were no troubled debt restructurings that subsequently defaulted within twelve months of the restructuring date for the years ended December 31, 2016, 2015, and 2014. Two commercial, secured by real estate loans to the same borrower totaling $1,236,000 that were modified during the fourth quarter 2016 subsequently defaulted in February 2017.

All troubled debt restructurings are considered impaired loans. The allowance for loan loss on such restructured loans is based on the present value of future expected cash flows.

Approximately $881,000 of impaired loans without a valuation allowance and $1,168,000 of impaired loans with a valuation allowance at December 31, 2016 consisted of loans that were modified during 2016 and were determined to be troubled debt restructurings. Approximately $147,000 of impaired loans without a valuation allowance and

$125,000 of impaired loans with a valuation allowance at December 31, 2015 consisted of loans that were modified during 2015 and were determined to be troubled debt restructurings.

Mortgage loans sold to and serviced for the Federal Home Loan Mortgage Corporation and other investors are not included in the accompanying consolidated balance sheets. The unpaid principal balances of those loans at December 31, 2016, 2015 and 2014 were approximately $100,982,000, $111,837,000, and $120,433,000, respectively.

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NOTE 4 - LOANS (Continued)

Mortgage servicing right assets are included in core deposit and other intangibles in the consolidated balance sheets. Amortization of mortgage servicing rights is an adjustment to loan servicing income, which is included with other operating income in the consolidated statements of income. Activity in the mortgage servicing rights portfolio during the years ended December 31 was as follows (in thousands):

	2016	2015	2014
Balance, beginning of year	$488	591	498
Amount capitalized to mortgage servicing rights	109	78	292
Amortization of mortgage servicing rights	(169)	(181)	(199)
Balance, end of year	$428	488	591

NOTE 5 - ACQUIRED CREDIT IMPAIRED LOANS

The following table provides, as of December 31, the major classifications of loans acquired that are accounted for in accordance with FASB ASC 310-30 (in thousands):

	2016	2015
Commercial & industrial	$98	1,191
Commercial, secured by real estate	6,305	7,877
Residential real estate	2,471	3,039
Consumer	17	27
Agricultural	—	48
Other loans, including deposit overdrafts	455	486
	9,346	12,668
Less allowance for loan losses	292	—
Loans, net	$9,054	12,668

The following table provides the outstanding balance and related carrying amount for acquired impaired loans at December 31 (in thousands):

	2016	2015
Outstanding balance	$12,289	16,507
Carrying amount	9,346	12,668

Activity during 2016 and 2015 for the accretable discount related to acquired impaired loans is as follows (in thousands):

	2016	2015
Accretable discount, beginning of year	$1,503	2,674
Accretable discount acquired during period	—	413
Reclass from nonaccretable discount to accretable discount	423	983
Less disposals	(5)	(850)
Less accretion	(841)	(1,717)
Accretable discount, end of year	$1,080	1,503

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NOTE 6 – OTHER REAL ESTATE OWNED

Other real estate owned includes property acquired through foreclosure or deed-in-lieu of foreclosure and are included in other assets in the consolidated balance sheets. Changes in other real estate owned were as follows (in thousands):

	2016	2015
Balance, beginning of year	$846	1,370
Additions	214	99
Reductions due to sales	(484)	(205)
Reductions due to valuation write downs	(576)	(418)
Balance, end of year	$—	846

Other real estate owned at December 31 consisted of (in thousands):

	2016	2015
Commercial real estate	$ —	846

The total recorded investment in residential consumer mortgage loans secured by residential real estate that was in the process of foreclosure at December 31, 2016 was $456,000.

NOTE 7 - PREMISES AND EQUIPMENT

Premises and equipment at December 31 are summarized as follows (in thousands):

	2016	2015
Land	$8,277	6,660
Buildings	21,400	21,463
Equipment	13,065	13,005
Construction in progress	7,362	9
Total	50,104	41,137
Less accumulated depreciation	19,860	19,037
Premises and equipment, net	$30,244	22,100

Depreciation charged to expense was, $1,210,000 in 2016, and $1,427,000 in 2015, and $1,479,000 in 2014.

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NOTE 8 - LEASES

Some of the Bank's branches, telephone equipment, and other equipment are leased under agreements expiring at various dates through 2050. These leases are accounted for as operating leases. The leases generally provide for renewal options and most require periodic changes in rental amounts based on various indices. Minimum annual rentals for each of the years 2017 through 2021 and thereafter for non-cancelable leases having terms in excess of one year were as follows (in thousands):

2017	$448
2018	267
2019	224
2020	193
2021	160
Thereafter	3,493
Total	$4,785

Rental expense for all leased branches and equipment was approximately $545,000 in 2016, $542,000 in 2015, and $537,000 in 2014.

NOTE 9 - GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in goodwill during 2016 and 2015 were as follows (in thousands):

	2016	2015
Balance, beginning of year	$30,183	27,638
Additions from acquisitions	—	2,545
Balance, end of year	$30,183	30,183

Other intangible assets in the consolidated balance sheets at December 31, 2016 and 2015 were as follows (in thousands):

	2016			2015		
	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets	Gross Intangible Assets	Accumulated Amortization	Net Intangible Assets
Core deposit intangibles	$6,458	2,304	4,154	6,458	1,550	4,908
Mortgage servicing rights	1,188	760	428	1,496	1,008	488
Total	$7,646	3,064	4,582	7,954	2,558	5,396

The estimated aggregate future amortization expense for each of the next five years for intangible assets remaining as of December 31, 2016 is as follows (in thousands):

2017	$864
2018	843
2019	825
2020	808
2021	795

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NOTE 10 - AFFORDABLE HOUSING TAX CREDIT LIMITED PARTNERSHIP

LCNB is a limited partner in limited partnerships that sponsor affordable housing projects utilizing the Low Income Housing Tax Credit (LIHTC) pursuant to Section 42 of the Internal Revenue Code. The purpose of the investments is to achieve a satisfactory return on capital, to facilitate the sale of additional affordable housing product offerings, and to assist in achieving goals associated with the Community Reinvestment Act. The primary activities of the limited partnerships include the identification, development, and operation of multi-family housing that is leased to qualifying residential tenants.

The following table presents the balances of LCNB's affordable housing tax credit investment and related unfunded commitment at December 31 (in thousands):

	2016	2015
Affordable housing tax credit investment	$2,000	1,000
Less amortization	93	12
Net affordable housing tax credit investment	$1,907	988
Unfunded commitment	$1,617	907

LCNB expects to fund the unfunded commitment over ten years.

The following table presents other information relating to LCNB's affordable housing tax credit investment for the years indicated (in thousands):

	Year ended December 31,		
	2016	2015	2014
Tax credits and other tax benefits recognized	$103	14	—
Tax credit amortization expense included in provision for income taxes	81	12	—

NOTE 11 - CERTIFICATES OF DEPOSIT

Contractual maturities of time deposits at December 31, 2016 were as follows (in thousands):

2017	$63,188
2018	44,305
2019	24,848
2020	46,499
2021	33,124
Thereafter	2,800
	$214,764

The aggregate amount of time deposits in denominations of $250,000 or more at December 31, 2016 and 2015 was $22,410,000 and $20,987,000, respectively.

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NOTE 12 - BORROWINGS

Funds borrowed from the FHLB at December 31 by year of maturity were as follows (dollars in thousands):

	Outstanding Balance	Average Rate
December 31, 2016		
2017	$ 295	2.82 %
2018	248	2.82 %
2019	55	2.82 %
Total	$ 598	2.82 %
December 31, 2015		
2016	$ 349	2.82 %
2017	5,295	5.11 %
2018	248	2.82 %
2019	55	2.82 %
Total	$ 5,947	4.86 %

All advances from the FHLB are secured by a blanket pledge of the Company's 1-4 family first lien mortgage loans in the amount of approximately $229 million and $231 million at December 31, 2016 and 2015, respectively. Additionally, the Company was required to hold minimum levels of FHLB stock, based on the outstanding borrowings. Total remaining borrowing capacity, including short-term borrowing arrangements, at December 31, 2016 was approximately $79.5 million. One of the factors limiting remaining borrowing capacity is ownership of FHLB stock. The Company could increase its remaining borrowing capacity by purchasing additional FHLB stock.

Short-term borrowings at December 31 were as follows (dollars in thousands):

	2016		2015	
	Amount	Rate	Amount	Rate
Line of credit	$—	— %	$13,187	1.00%
FHLB short-term advance	25,000	0.63%	10,000	0.35%
Repurchase agreements	17,040	0.10%	14,200	0.10%
	$42,040	0.42%	$37,387	0.48%

At December 31, 2016, the Company had short-term borrowing arrangements with three financial institutions and the Federal Home Loan Bank of Cincinnati. The first arrangement is a short-term line of credit for a maximum amount of $10 million at the interest rate in effect at the time of the borrowing. The second arrangement provides that the Company can borrow up to $10 million in federal funds at the interest rate in effect at the time of the borrowing. The third arrangement is a short-term line of credit for a maximum amount of $20 million at an interest rate equal to the lending institution's federal funds rate plus a spread of 50 basis points.

Under the terms of the Cash Management Advance program with the Federal Home Loan Bank of Cincinnati, the Company can borrow up to $64.0 million in short-term advances, subject to total remaining borrowing capacity limitations. The Company has the option of selecting a variable rate of interest for up to 90 days or a fixed rate of

interest for up to 30 days. The interest rate on the Cash Management Advance program is the published rate in effect at the time of the advance. This agreement expires on August 25, 2017.

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NOTE 12 - BORROWINGS (continued)

Repurchase agreements are an option customers may use in managing their cash positions. The repurchase agreements mature the next business day after issuance. They are fully secured by U.S. Agency notes and such collateral securities are held by the Federal Reserve Bank. The maximum amount of outstanding agreements at any month-end during 2016 and 2015 totaled $18,715,000 and $16,250,000, respectively. The average balance during 2016 and 2015 was $13,891,000 and $12,699,000, respectively.

As of December 31, 2016 and 2015, approximately $3.1 million and $1.6 million, respectively, of the repurchase agreements outstanding were held by a company owned by a member of the Company's Board of Directors.

NOTE 13 - INCOME TAXES

The provision for federal income taxes consists of (in thousands):

	2016	2015	2014
Income taxes currently payable	$3,515	4,280	3,194
Deferred income tax provision (benefit)	928	(58)	192
Provision for income taxes	$4,443	4,222	3,386

A reconciliation between the statutory income tax and the Company's effective tax rate follows:

	2016	2015	2014
Statutory tax rate	34.2 %	34.0 %	34.0 %
Increase (decrease) resulting from -			
Tax exempt interest	(6.3)%	(6.0)%	(6.8)%
Tax exempt income on bank owned life insurance	(1.5)%	(1.4)%	(1.7)%
Other – net	(0.1)%	0.3 %	— %
Effective tax rate	26.3 %	26.9 %	25.5 %

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(Continued)

NOTE 13 - INCOME TAXES (continued)

Deferred tax assets and liabilities, included with Other Assets in the Consolidated Balance Sheets, at December 31 consist of the following (in thousands):

	2016	2015
Deferred tax assets:		
Allowance for loan losses	$1,223	1,064
Net unrealized losses on investment securities available-for-sale	1,369	246
Fair value adjustment on loans acquired from merger with First Capital	592	847
Write-down of other real estate owned	—	338
Pension and deferred compensation	1,157	971
Other	546	440
	4,887	3,906
Deferred tax liabilities:		
Depreciation of premises and equipment	(1,332)	(1,332)
Amortization of intangibles	(1,567)	(840)
Deferred loan fees	(2)	(2)
FHLB stock dividends	(351)	(349)
Fair value adjustment on securities acquired from merger with First Capital	(19)	(70)
	(3,271)	(2,593)
Net deferred tax assets	$1,616	1,313

As of December 31, 2016 and 2015 there were no unrecognized tax benefits and the Company does not anticipate the total amount of unrecognized tax benefits will significantly change within the next twelve months. There were no amounts recognized for interest and penalties in the consolidated statements of income for the three-year period ended December 31, 2016.

The Company is no longer subject to examination by federal tax authorities for years before 2013.

NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES

LCNB is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheets. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit is represented by the contract amount of those instruments.

The Bounce Protection product, a customer deposit overdraft program, is offered as a service and does not constitute a contract between the customer and LCNB.

LCNB uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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NOTE 14 - COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Financial instruments whose contract amounts represent off-balance-sheet credit risk at December 31 were as follows (in thousands):

	2016	2015
Commitments to extend credit:		
Commercial loans	$10,350	8,160
Other loans:		
Fixed rate	4,425	2,293
Adjustable rate	1,044	1,362
Unused lines of credit:		
Fixed rate	9,731	6,378
Adjustable rate	80,222	90,153
Unused overdraft protection amounts on demand and NOW accounts	17,123	10,057
Standby letters of credit	657	457
	$123,552	118,860

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract or agreement. Unused lines of credit include amounts not drawn on line of credit loans. Commitments to extend credit and unused lines of credit generally have fixed expiration dates or other termination clauses.

Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. These guarantees generally are fully secured and have varying maturities.

The Company evaluates each customer’s credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, is based on management’s credit evaluation of the borrower. Collateral held varies, but may include accounts receivable; inventory; property, plant and equipment; residential realty; and income-producing commercial properties.

Capital expenditures include the construction or acquisition of new office buildings, improvements to LCNB's offices, purchases of furniture and equipment, and additions or improvements to LCNB's information technology system. Commitments outstanding for capital expenditures as of December 31, 2016 totaled approximately $4,750,000, which includes estimated remaining costs for a new operations center being built in Lebanon, Ohio.

The Company and its subsidiary are parties to various claims and proceedings arising in the normal course of business. Management, after consultation with legal counsel, believes that the liabilities, if any, arising from such proceedings and claims will not be material to the consolidated financial position or results of operations.

NOTE 15 - REGULATORY MATTERS

The Federal Reserve Act requires depository institutions to maintain cash reserves with the Federal Reserve Bank. In 2016 and 2015, the Bank maintained average reserve balances of $10,903,000 and $11,329,000, respectively. The reserve balances at December 31, 2016 and 2015 were $4,313,000 and $633,000, respectively.

The principal source of income and funds for LCNB Corp. is dividends paid by the Bank. The payment of dividends is subject to restriction by regulatory authorities. For 2017, the restrictions generally limit dividends to the aggregate of net income for the year 2017 plus the net earnings retained for 2016 and 2015. In addition, dividend payments may not reduce capital levels below minimum regulatory guidelines. At December 31, 2016, approximately $14,147,000 of the Bank's earnings retained was available for dividends in 2017 under this guideline. Dividends in excess of these limitations would require the prior approval of the Comptroller of the Currency.

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NOTE 15 - REGULATORY MATTERS (continued)

The Company (consolidated) and the Bank must meet certain minimum capital requirements set by federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possible additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's and Bank's financial statements. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

A new rule requiring a Capital Conservation Buffer began phase-in on January 1, 2016 and will be fully implemented in 2019. Under the fully-implemented rule, a financial institution will need to maintain a Capital Conservation Buffer composed of Common Equity Tier 1 Capital of at least 2.5% above its minimum risk-weighted capital requirements to avoid limitations on its ability to make capital distributions, including dividend payments to shareholders and certain discretionary bonus payments to executive officers. A financial institution with a buffer below 2.5% will be subject to increasingly stringent limitations on capital distributions as the buffer approaches zero.

For various regulatory purposes, financial institutions are classified into categories based upon capital adequacy:

	Minimum Requirement		Minimum Requirement with Capital Conservation Buffer		To Be Considered Well-Capitalized	
Ratio of Common Equity Tier 1 Capital to risk-weighted assets	4.5	%	5.125	%	6.5	%
Ratio of tier 1 capital to risk-weighted assets	6.0	%	6.625	%	8.0	%
Ratio of total capital (tier 1 capital plus tier 2 capital) to risk-weighted assets	8.0	%	8.625	%	10.0	%
Leverage ratio (tier 1 capital to adjusted quarterly average total assets)	4.0	%	N/A		5.0	%

As of the most recent notification from their regulators, the Company and Bank were categorized as "well-capitalized" under the regulatory framework for prompt corrective action. Management believes that no conditions or events have occurred since the last notification that would change the Bank's category.

A summary of the regulatory capital of the Consolidated Company and Bank at December 31 follows (dollars in thousands):

	2016 Consolidated Company	2016 Bank	2015 Consolidated Company	2015 Bank
Regulatory Capital:				
Shareholders' equity	$142,944	141,325	140,108	138,396
Goodwill and other intangible assets	(32,676)	(32,676)	(32,146)	(32,146)
Accumulated other comprehensive (income) loss	2,617	2,605	(256)	(261)
Tier 1 risk-based capital	112,885	111,254	107,706	105,989
Eligible allowance for loan losses	3,575	3,575	3,129	3,129
Total risk-based capital	$116,460	114,829	110,835	109,118
Capital Ratios:				

Common Equity Tier 1 Capital to risk-weighted assets	13.00	%	12.82	%	13.46	%	13.26	%
Tier 1 capital to risk-weighted assets	13.00	%	12.82	%	13.46	%	13.26	%
Total capital (tier 1 capital plus tier 2 capital) to risk-weighted assets	13.41	%	13.24	%	13.85	%	13.65	%
Leverage ratio (tier 1 capital to adjusted quarterly average total assets)	8.81	%	8.69	%	8.62	%	8.49	%

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NOTE 15 - REGULATORY MATTERS (continued)

LCNB Corp. filed a Registration Statement on Form S-3 with the SEC on July 27, 2011 to register 400,000 shares for use in its Amended and Restated Dividend Reinvestment and Stock Purchase Plan (the "Amended Plan"). Formerly LCNB purchased the shares needed for its Dividend and Stock Purchase Plan in the secondary market. Under the Amended Plan, LCNB has the option of purchasing shares in the secondary market, using treasury shares, or issuing new shares.

Two warrants for the purchase of an aggregate total of 217,063 common shares of LCNB stock at an exercise price of $9.26 per share were outstanding at December 31, 2015. The warrants carried a ten year term and were 100% vested at the date of grant, which was January 9, 2009. During March 2016, LCNB repurchased both warrants for $1,545,000, which was accounted for as a reduction to common shares in the shareholders' equity section of the consolidated balance sheets.

NOTE 16 - ACCUMULATED OTHER COMPREHENSIVE INCOME

Changes in accumulated other comprehensive income (loss) for 2016 and 2015 were as follows (in thousands):

	2016			2015		
	Unrealized Gains and Losses on Available-for-Sale Securities	Changes in Pension Plan Assets and Benefit Obligations	Total	Unrealized Gains and Losses on Available-for-Sale Securities	Changes in Pension Plan Assets and Benefit Obligations	Total
Balance at beginning of year	$469	(233)	236	1,126	(341)	785
Before reclassifications	(2,390)	249	(2,141)	(330)	108	(222)
Reclassifications	(712)	—	(712)	(327)	—	(327)
Balance at end of year	$(2,633)	16	(2,617)	469	(233)	236

Reclassifications out of accumulated other comprehensive income (loss) during 2016 and 2015 and the affected line items in the consolidated statements of income were as follows (in thousands):

	2016	2015	Affected Line Item in the Consolidated Statements of Income
Realized gain on sales of securities	$1,082	495	Net gain on sale of securities
Less provision for income taxes	370	168	Provision for income taxes
Reclassification adjustment, net of taxes	$712	327	

NOTE 17 - RETIREMENT PLANS

Prior to January 1, 2009, the Company had a single-employer qualified noncontributory defined benefit retirement plan that covered substantially all regular full-time employees. Effective January 1, 2009, the Company redesigned the plan and merged it into a multiple-employer plan, which is accounted for as a multi-employer plan because assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees

of that employer. Employees hired on or after January 1, 2009 are not eligible to participate in this plan.

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(Continued)

NOTE 17 - RETIREMENT PLANS (continued)

Effective February 1, 2009, the Company amended the plan to reduce benefits for those whose age plus vesting service equaled less than 65 at that date. Also effective February 1, 2009, an enhanced 401(k) plan was made available to those hired on or after January 1, 2009 and to those who received benefit reductions from the amendments to the noncontributory defined benefit retirement plan. Employees hired on or after January 1, 2009 receive a 50% employer match on their contributions into the 401(k) plan, up to a maximum company contribution of 3% of each individual employee's annual compensation. Employees who received a benefit reduction under the retirement plan amendments receive an automatic contribution of 5% or 7% of annual compensation, depending on the sum of an employee's age and vesting service, into the 401(k) plan, regardless of the contributions made by the employees. This contribution is made annually and these employees will not receive any employer matches to their 401(k) contributions.

Certain information pertaining to the qualified noncontributory defined benefit retirement plan is as follows:

Legal name	Pentegra Defined Benefit Plan for Financial Institutions
Plan's employer identification number	13-5645888
Plan number	333

The plan is at least 80% funded as of July 1, 2016 and 2015. A funding improvement or rehabilitation plan has not been implemented, nor has a surcharge been paid to the plan.

Funding and administrative costs of the qualified noncontributory defined benefit retirement plan and 401(k) plan charged to salaries and employee benefits in the consolidated statements of income for the years ended December 31 were as follows (in thousands):

	2016	2015	2014
Qualified noncontributory defined benefit retirement plan	$969	984	967
401(k) plan	359	346	326

The Company expects a minimum contribution of $189,000 to the qualified noncontributory defined benefit retirement plan in 2017. The Company expects to contribute $250,000 to the 401(k) plan in 2017. The Company's contributions to the qualified noncontributory defined benefit retirement plan do not represent more than 5% of total contributions to the plan.

Citizens National had a qualified noncontributory defined benefit pension plan which covered employees hired before May 1, 2005. The Company assumed this plan at the time of the merger. At December 31, 2016, the amount of the asset for this plan was $30,000, representing the funded status of the plan.

The Bank has a benefit plan which permits eligible officers to defer a portion of their compensation. The deferred compensation balance, which accrues interest at 8% annually, is distributable in cash after retirement or termination of employment. The amount of such deferred compensation liability at December 31, 2016 and 2015 was $3,407,000 and $3,199,000, respectively.

The Bank also has supplemental income plans which provide certain employees an amount based on a percentage of average compensation, payable in accordance with individually defined schedules upon retirement. The projected benefit obligation included in other liabilities for the supplemental income plans at December 31, 2016 and 2015 is $1,284,000 and $1,295,000, respectively. The average discount rate used to determine the present value of the obligations was approximately 5.2% in 2016 and 5.0% in 2015. The service cost associated with the plans was $0 for 2016, $183,000 for 2015, and $43,000 for 2014. Interest costs were $63,000, $56,000, and $56,000 for 2016, 2015, and 2014, respectively.

The deferred compensation plan and supplemental income plans are nonqualified and unfunded. Participation in each plan is limited to a select group of management.

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NOTE 17 - RETIREMENT PLANS (continued)

Effective February 1, 2009, the Company established a nonqualified defined benefit retirement plan, which is also unfunded, for certain highly compensated employees. The nonqualified plan ensures that participants receive the full amount of benefits to which they would have been entitled under the noncontributory defined benefit retirement plan in the absence of limits on benefit levels imposed by certain sections of the Internal Revenue Code.

The components of net periodic pension cost of the nonqualified defined benefit retirement plan for the years ended December 31 are summarized as follows (in thousands):

	2016	2015	2014
Service cost	$41	38	68
Interest cost	78	68	60
Amortization of unrecognized (gain) loss	168	171	—
Amortization of unrecognized prior service cost	—	—	15
Net periodic pension cost	$287	277	143

A reconciliation of changes in the projected benefit obligation of the nonqualified defined benefit retirement plan at December 31 follows (in thousands):

	2016	2015	2014
Projected benefit obligation at beginning of year	$1,843	1,741	1,213
Service cost	41	38	68
Interest cost	78	68	60
Actuarial (gain) or loss	(209)	10	407
Benefits paid	(26)	(14)	(7)
Projected benefit obligation at end of year	$1,727	1,843	1,741

Amounts recognized in other liabilities in the consolidated balance sheets for the nonqualified defined benefit retirement plan at December 31, 2016 and 2015 were $1,727,000 and $1,843,000, respectively.

The accumulated benefit obligation for the nonqualified defined benefit retirement plan at December 31, 2016 and 2015 was $1,727,000 and $1,752,000, respectively.

Amounts recognized in accumulated other comprehensive income, net of tax, at December 31 for the nonqualified defined benefit retirement plan consists of (in thousands):

	2016	2015	2014
Net actuarial (gain)/loss	$(16)	233	339
Past service cost	—	—	—
	$(16)	233	339

The estimated unrecognized net actuarial gain that will be amortized from accumulated other comprehensive income into net periodic benefit cost during 2017 for the nonqualified defined benefit retirement plan is $0.

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NOTE 17 - RETIREMENT PLANS (continued)

Key weighted-average assumptions used to determine the benefit obligation and net periodic pension costs for the nonqualified defined benefit retirement plan for the years ended December 31 were as follows:

	2016	2015	2014
Benefit obligation:			
Discount rate	4.14%	4.34%	3.95%
Salary increase rate	2.00%	2.00%	2.00%
Net periodic pension cost:			
Discount rate	4.34%	3.95%	4.95%
Salary increase rate	2.00%	2.00%	3.00%
Amortization period in years	1.00	1.98	3.95

The nonqualified defined benefit retirement plan is not funded. Therefore no contributions will be made in 2017. Estimated future benefit payments reflecting expected future service for the years ended after December 31, 2016 are (in thousands):

2017	$105
2018	122
2019	122
2020	122
2021	122
2022-2026	600

NOTE 18 - STOCK-BASED COMPENSATION

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

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

Stock-based awards may be in the form of treasury shares or new shares.

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NOTE 18 - STOCK-BASED COMPENSATION (continued)

LCNB has not granted stock options since 2012. Option awards granted to date under the 2002 Plan vest ratably over a five year period and expire ten years after the date of grant. Stock options outstanding at December 31, 2016 were as follows:

	Outstanding Stock Options			Exercisable Stock Options		
Exercise Price Range	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Number	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)
$9.00 - 10.99	4,356	$ 9.00	2.1	4,356	$ 9.00	2.1
$11.00 - 12.99	17,797	12.13	3.8	16,052	12.08	3.7
$17.00 - 18.99	2,516	17.88	0.1	2,516	17.88	0.1
	24,669	12.17	3.1	22,924	12.13	3.0

The following table summarizes stock option activity for the years indicated:

	2016		2015		2014	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
Outstanding at January 1,	83,861	12.39	99,810	$ 12.16	104,966	$ 12.43
Granted	—	—	—	—	—	—
Exercised	(51,390)	11.53	(13,449)	11.31	—	—
Expired	(7,802)	18.76	(2,500)	9.00	(5,156)	17.66
Outstanding at December 31,	24,669	12.17	83,861	12.39	99,810	12.16
Exercisable at December 31,	22,924	12.13	75,072	12.40	79,909	12.18

The following table provides information related to stock options exercised during the years indicated (in thousands):

	2016	2015	2014
Intrinsic value of options exercised	$ 288	67	—
Cash received from options exercised	592	152	—
Tax benefit realized from options exercised	59	13	—

The aggregate intrinsic value (the amount by which the current market value of the underlying stock exceeds the exercise price of the option) for options outstanding at December 31, 2016 that were "in the money" (market price greater than exercise price) was $273,000. The aggregate intrinsic value at that date for only the options that were exercisable was $255,000. The aggregate intrinsic value for options outstanding at December 31, 2015 that were in the money was $360,000 and the aggregate intrinsic value at that date for only the options that were exercisable was $324,000. The intrinsic value changes based on changes in the market value of the Company's stock.

Total expense related to options included in salaries and wages in the consolidated statements of income for the years ended December 31, 2016, 2015, and 2014 was $5,000, $19,000, and $24,000, respectively. The related tax benefit for 2016, 2015, and 2014 was $2,000, $6,000, and $8,000, respectively. Total compensation cost related to option awards to be recognized through the first quarter of 2017 is approximately $1,000.

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NOTE 18 - STOCK-BASED COMPENSATION (continued)

Restricted stock awards granted under the 2015 Plan were as follows:

	2016		2015	
	Shares	Weighted Average Grant Date Fair Value	Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1,	16,038	$ 15.47	—	$ —
Granted	—	—	16,038	15.47
Vested	(7,414)	15.47	—	—
Forfeited	—	—	—	—
Outstanding at December 31,	8,624	$ 15.47	16,038	$