



# TIMELESS VISION.

AMERICAN VALUES *at* WORK.



2016 ANNUAL REPORT

## Corporate Information

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*Owner & Principal, Boyer Financial Group*

**John G. Engleson**

*Executive V.P., Integrity Business Services, LLC  
President, zAxis Corporation*

**Bernard M. Lesavoy, Esquire**

*Member/Partner, Lesavoy Butz & Seitz LLC*

**David M. Lobach, Jr.**

*Chairman of the Board, CEO & President  
Embassy Bancorp, Inc. and  
Embassy Bank for the Lehigh Valley*

**John C. Pittman**

*J.C. Pittman Inc.*

**Patti Gates Smith**

*Owner  
GatesSmith Consulting*

**John T. Yurconic**

*President, John Yurconic Agency  
President, Insurance Premium Financing, Inc.*

### Executive Officers

**David M. Lobach, Jr.**

*Chairman of the Board, CEO & President*

**Judith A. Hunsicker**

*Sr. Executive Vice President, COO, CFO,  
Secretary & Treasurer*

**James R. Bartholomew**

*Executive Vice President & SLO Commercial Lending*

## Officers

### Senior Vice Presidents

**David C. Arner, Electronic Banking & Security**

**Tracy A. Barker, Deposit Operations & Human Resources**

**Desty A. Bonstein, Private Banking**

**Mark A. Casciano, Strategic Initiatives**

**Diane M. Cunningham, Consumer Lending, Commercial Services, Branch Administration & Marketing**

**Lynne M. Neel, Controller-Finance, Loan Operations & Assistant Secretary**

### Vice Presidents

**Michelle L. Barron, Deposit Operations & Electronic Banking**

**Scott A. Karwacki, Credit Analysis**

**Michael N. Lahanas, Commercial Lending**

**Michael B. Macy, Commercial Lending**

**Susan M. McCann, Private Banking**

**Tracy L. McCarthy, Loan Operations**

**Joellen D. Repsher, Commercial Services**

**Bryce E. Ruggieri, Commercial Lending**

**Brian M. Sabol, Commercial Lending**

**Brandi L. Stefanov, Branch Administration**

**Jennifer A. Tropeano, Consumer Lending**

**Kristin A. Wannisky, Marketing**

**Timothy P. Woodbridge, Commercial Lending**

### Assistant Vice Presidents

**Bryan D. Lobach, Commercial Services**

**Cynthia L. Morley, Commercial Lending**

**Mary Beth Mulicka, Branch Administration**

**Christine L. Pierce, Branch Administration**

**Krystal A. Salce, Credit Analysis**

**Debra A. Young, Commercial Services**

**Heather K. Zuito, Private Banking**

### Assistant Treasurers

**Janelle D. Creveling, Branch Administration**

**Antonio A. Dias, Deposit Operations**

**Matthew J. DePatto, Branch Administration**

**Gina P. Franco, Consumer Lending**

**Kara Helfrich, Branch Administration**

**Lori L. Herman, Branch Administration**

**Jessica L. Kalavoda, Consumer Lending**

**Maria P. Nace, Branch Administration**

**Taryn M. Pell, Consumer Lending**

**Lisa A. Rex, Consumer Lending**

**Sara E. Stuber, Branch Administration**

**Laura S. Suplee, Assistant Controller-Finance**

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

**FORM 10-K**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year end 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 000-53528

**Embassy Bancorp, Inc.**

(Exact name of registrant as specified in its charter)

**Pennsylvania**  
(State of incorporation)

**26-3339011**  
(I.R.S. Employer Identification No.)

**One Hundred Gateway Drive, Suite 100**  
**Bethlehem, PA**  
(Address of principal executive offices)

**18017**  
(Zip Code)

**(610) 882-8800**  
(Issuer's Telephone Number)

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

**None**  
(Title of each class)

**None**  
(Name of each exchange on which registered)

Securities registered under section 12(g) of the Exchange Act:

**Common Stock, Par Value \$1.00 per share**

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

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

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 filing requirements for the past 90 days. Yes [ X ] No [ ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 [ X ] No [ ]

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 or the Exchange Act.) Yes  No

The aggregate market value of the registrant’s common stock held by non-affiliates at June 30, 2016, the registrant’s most recently completed second fiscal quarter was \$57,196,552.

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant’s classes of common equity, as of the latest practicable date:

**COMMON STOCK**

**Number of shares outstanding as of March 24, 2017**

**(\$1.00 Par Value)**  
(Title Class)

**7,448,628**  
(Outstanding Shares)

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant’s definitive proxy statement for the 2017 annual meeting of shareholders are incorporated by reference into Part III of this report.



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## PART I

### Item 1. BUSINESS.

#### General

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s principal operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

#### Mission

The Company provides a traditional range of financial products and services to meet the depository and credit needs of individual consumers, small and medium sized businesses and professionals in its market area. As a locally owned and operated community bank, there is a strong focus on service that is highly personalized, efficient and responsive to local needs. It is the intention of the Company to deliver its products and services with the care and professionalism expected of a community bank and with a special dedication to personalized service. To create this environment, the Company employs an experienced, well-trained, highly motivated staff, with interest in building quality client relationships using state-of-the-art delivery systems and client service facilities. The Company’s senior management has extensive banking experience and establishes the Company’s goal to serve the financial needs of its clients and provide a profitable return to its investors, consistent with safe and sound banking practices. The Company focuses on obtaining and retaining customer relationships by offering a broad range of financial services, competitively-priced and delivered in a responsive manner, with emphasis to understand the financial needs of its customers.

Correspondent relationships are utilized where it is cost beneficial. The specific objectives of the Company are: 1) to provide individuals, professionals and local businesses with the highest standard of relationship banking in the local market; 2) to attract deposits and loans by offering state of the art products and services with competitive pricing; 3) to provide a reasonable return to shareholders on capital invested; and 4) to attract, train and retain a happy, motivated and team oriented group of banking professionals dedicated to meeting the Company’s objectives.

#### Market “Niche”

The Company provides the traditional array of commercial banking products and services emphasizing a one-on-one, sit down approach, for the delivery of products and services to consumers and businesses located in Lehigh and Northampton Counties in Pennsylvania. In the Company’s primary market area, which is dominated by offices of large statewide, regional and interstate banking institutions, banking services that are furnished in a friendly and courteous manner with a timely response to customer needs fill a “niche” that arises due to the loss of local institutions through merger and acquisitions.

#### Deposits

The Company offers small business cash management services to help local companies better manage their cash flow, in order for the Company to attract and retain stable deposit relationships. The expertise and experience of the Company’s management coupled with the latest technology accessed through third party providers enables the Company to maximize the growth of business-related deposits.

As for consumers, deposit growth is driven by a variety of factors including, but not limited to, population growth, bank and non-bank competition, local bank mergers and consolidations, increase in household income, interest rates, accessibility of location and the sales efforts of Company personnel. Time deposits can be attracted and/or increased by paying an interest rate higher than that offered by competitors, but they are the most costly type of deposit. The most profitable type of deposits are non-interest bearing demand (checking) accounts which can be attracted by offering free checking. However, both high interest rates and free checking accounts generate certain expenses for a bank and the desire to increase deposits must be balanced with the need to be profitable. The deposit services of the Company are generally comprised of demand deposits, savings deposits, money market deposits, time deposits and Individual Retirement Accounts.

## **Loans**

The loan portfolio of the Company consists primarily of secured fixed-rate and variable-rate loans, with a significant concentration in commercial real estate transactions and consumer residential real estate mortgage and home equity loans. While most credit facilities are appropriately collateralized, major emphasis is placed upon the financial condition of the borrower and evaluating the borrower's cash flow versus debt service requirements. The Company has an experienced lending and private banking team. The Company believes that the familiarity of its experienced management team and members of the Company's Loan Committee with prospective local borrowers enables the Company to better evaluate the character, integrity and creditworthiness of the prospective borrowers.

Loan growth is driven by customer demand, which in turn is influenced by individual and business indebtedness and consumer demand for goods. The Company's loan and private banking officers call upon accountants, financial planners, attorneys, local realtors and others to generate loan referrals. Again, a balance between growth, credit risk and pricing is required to maintain performing loans for the Company, as lending money will always entail some risk. A performing loan is a loan which is being repaid according to its original terms and is the most desirable type of loan that a bank seeks to make. Without loans a bank cannot generate enough earnings to be profitable. The risk involved in each loan must, therefore, be carefully evaluated before the loan is made. The interest rate at which the loan is made should always reflect the risk factors involved, including the term of the loan, the value of collateral, if any, the reliability of the projected source of repayment and the amount of the loan requested. Credit quality will always be the Company's most important factor.

The Company does not sell its mortgages into the secondary market, has not been involved in any "sub-prime" mortgage lending, and has not purchased or invested in any securities backed by or which include sub-prime loans.

## **Business Lending**

The Company generally targets businesses with annual revenues of less than \$10 million, including business owners, legal, and medical professionals. The Company offers responsiveness, flexibility and local decision making for loan applications of small business owners thereby eliminating delays caused by non-local management. The Company participates in local, state and federal loan programs.

## **Consumer Lending**

The Company offers its retail customer base a product line of consumer loan services including mortgage loans, secured home equity loans, lines of credit, auto loans, and to a much lesser extent, unsecured personal loans.

## **Residential Mortgage Loans**

The Company offers a range of specialty home equity and mortgage products at competitive rates, which are retained and serviced by the Company. The Company seeks to capitalize on its policy of closing loans in a time frame that will meet the needs of its borrowers.

### **Commercial Mortgage/Construction Loans**

The Company originates various types of loans secured by real estate, including, to a limited extent, construction loans. Construction loans are generally priced at floating rates tied to current market rates. Upon completion of construction, these loans may be converted into permanent commercial and residential loans. Construction lending is expected to constitute a minor portion of the Company's loan portfolio.

In some cases, the Company originates loans larger than its lending limit and enters into participation arrangements for those loans with other banks.

As an independent community bank, the Company serves the special needs of legal, medical, accounting, financial service providers and other professionals. Commercial mortgages, lines of credit, term loans and demand loans are tailored to meet the needs of the Company's customers in the professional community. In addition to the usual criteria for pricing credit-related products, the Company takes into consideration the overall customer relationship to establish credit pricing. Deposit relationships in demand, savings, money market, and certificate accounts are considered in loan pricing along with the credit worthiness of the borrower.

### **Other Services**

To further attract and retain customer relationships, the Company provides or will provide the standard array of financial services expected of a community bank, which include the following:

Treasurer Checks	Remote Deposit Capture
Certified Checks	Mobile Banking
Gift Cards	Night Depository Services
Wire Transfers	Bond Coupon Redemptions
Savings Bond Redemptions	Bank by Mail
Credit/Debit Card Merchant Processing	Automated Teller Machines
Direct Deposit/ACH Services	On-Line Banking and Bill Pay
Cash Management Services	Commercial Credit Cards
Escrow Management Services	ATM and Debit Cards
Safe Deposit Boxes	Fraud Detection Services

### **Fee Income**

Fee income is non-interest related. The Company earns fee income by charging customers for banking services, credit card and merchant processing, treasurer's checks, overdrafts, wire transfers, bond coupon redemptions, and check orders, as well as other deposit and loan related fees. Unlike many in the industry, the Company does not sell its mortgages on the secondary market, nor does it offer trust or investment/brokerage services to its customers to generate fee income.

### **Community Reinvestment Act**

The Community Reinvestment Act of 1977 ("CRA") is designed to create a system for bank regulatory agencies to evaluate a depository institution's record in meeting the credit needs of its community. The Company had its last CRA examination in 2015 and received a "satisfactory" rating.

The Company's Directors and Officers are committed to reaching out to the community in which they live and work. The personal, business and community rewards for helping local residents and businesses are numerous. The Board is dedicated to recognizing an ongoing commitment and understanding of the Company's responsibility under the CRA. The Company is committed to providing access to credit and deposit products for all members of the communities that it serves.

## **Service/Market Area**

The Company is headquartered in Hanover Township, Northampton County, Pennsylvania and draws its primary deposits and business from areas immediately surrounding its principal office and its branch offices in South Whitehall Township, Lower Macungie Township, the City of Bethlehem, Salisbury Township, Lower Saucon Township, Lower Nazareth Township and Borough of Nazareth, Pennsylvania, as well as the remainder of Lehigh and Northampton Counties in Pennsylvania.

According to FDIC data the Company ranks 6<sup>th</sup> in market share in Northampton County, with four (4) offices, and 7<sup>th</sup> in Lehigh County with four (4) offices, with a combined deposit market share of 5.94% for both counties. The Company believes there is significant room for organic growth in its current market area of Lehigh and Northampton Counties. The Company continually evaluates strategic locations for branch offices within the Lehigh Valley, which are supplemented by convenient access through electronic banking products and services, for both consumer and commercial customers.

## **Bank Premises**

The Company leases each of its bank operations premises, situated at the following locations:

Northampton County:

- Hanover Township (includes administrative offices)
- Lower Saucon Township
- Lower Nazareth Township
- Borough of Nazareth

Lehigh County:

- South Whitehall Township
- Salisbury Township
- Lower Macungie Township
- City of Bethlehem

The Company pays certain additional expenses of occupying these spaces including, but not necessarily limited to, real estate taxes, insurance, utilities and repairs. The Company is obligated under the leases to maintain the premises in good order, condition and repair.

## **Employees**

As of December 31, 2016, the Company had a total of 83 full-time equivalent employees.

## **Competition**

The banking business is highly competitive. The Company competes with local banks as well as numerous regionally based commercial banks, most of which have assets, capital and lending limits far larger than those of the Company. The Company also competes with savings banks, savings and loan associations, money market funds, insurance companies, stock brokerage firms, regulated small loan companies, credit unions and with the issuers of commercial paper and other securities. The industry competes primarily in the area of interest rates, products offered, customer service and convenience.

Among the advantages many of the Company's competitors have over the Company are larger asset and capital bases, the ability to finance wide-ranging advertising campaigns and to allocate their investment assets to regions of highest yield and demand. Larger companies have market presence in the form of more branch offices. The Company's growth in number of offices has improved its ability to compete in the market. The Company believes it is able to compete with the market in terms of interest rate and level of customer service, as reflected in growth in market share. Many competitors offer certain services such as trust services, investment services and international banking that are

not offered directly by the Company and, by virtue of their greater capital, most competitors will have substantially higher lending limits than those of the Company. The recent consolidation of banks in the Company's market, due to mergers and acquisitions, has provided additional opportunities for the Company to build new customer relationships.

## **Segments**

The Company acts as an independent community financial services provider and offers traditional banking and related financial services to individual, business and government customers. The Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer, residential mortgage and home equity loans; and the providing of other financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

## **Seasonality**

Management does not feel that the deposits, loans, or the business of the Company are seasonal in nature. Deposit and loan generation may, however, vary with local and national economic and market conditions which should not have a material effect on planning and policy making.

## **Supervision and Regulation**

The Company is subject to extensive regulation under federal and Pennsylvania banking laws, regulations and policies, including prescribed standards relating to capital, earnings, dividends, the repurchase or redemption of shares, loans or extensions of credit to affiliates and insiders, internal controls, information systems, internal audit systems, loan documentation, credit underwriting, asset growth, impaired assets and loan-to-value ratios. The Bank regulatory framework is intended primarily for the protection of depositors, federal deposit insurance funds and the banking systems as a whole, and not for the protection of security holders.

The following summary sets forth certain of the material elements of the regulatory framework applicable to bank holding companies and their bank subsidiaries and provides certain specific information about the Company and the Bank. It does not describe all of the provisions of the statutes, regulations and policies that are identified. To the extent that the following information describes statutory and regulatory provisions, it is qualified in its entirety by express reference to each of the particular statutory and regulatory provisions. A change in applicable statutes, regulations or regulatory policy may have a material effect on the business of the Company.

### *Dodd-Frank Wall Street Reform and Consumer Protection Act*

As a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which became law on July 21, 2010, there is additional regulatory oversight and supervision of the Company and the Bank. The Dodd-Frank Act significantly changed the regulation of financial institutions and the financial services industry. The Dodd-Frank Act includes, and the regulations being developed thereunder will include, provisions affecting large and small financial institutions alike, including several provisions that affect the regulations of community banks and bank holding companies.

The Dodd-Frank Act, among other things, imposed new capital requirements on bank holding companies; changed the base for FDIC insurance assessments to a bank's average consolidated total assets minus average tangible equity, rather than upon its deposit base; permanently raised the current standard deposit insurance limit to \$250,000; and expanded the FDIC's authority to raise insurance premiums. The legislation also calls for the FDIC to raise its ratio of reserves to deposits from 1.15% to 1.35% for deposit insurance purposes by September 30, 2020 and to "offset the effect" of increased assessments on insured depository institutions with assets of less than \$10 billion.

The Dodd-Frank Act also includes provisions that affect corporate governance and executive compensation at all publicly-traded companies and allows financial institutions to pay interest on business checking accounts. The

legislation also restricts proprietary trading, places restrictions on the owning or sponsoring of hedge and private equity funds, and regulates the derivatives activities of banks and their affiliates. The Dodd-Frank Act also establishes the Financial Stability Oversight Council to identify threats to the financial stability of the U.S., promote market discipline, and respond to emerging threats to the stability of the U.S. financial system.

#### *Consumer Financial Protection Bureau*

The Dodd-Frank Act also establishes the Consumer Financial Protection Bureau (the “CFPB”) as an independent entity within the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”). The CFPB has broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home-equity loans and credit cards. The CFPB’s rules contain provisions on mortgage-related matters such as steering incentives, and determinations as to a borrower’s ability to repay, loan servicing, and prepayment penalties.

On January 10, 2013, the CFPB issued a final regulation defining a “qualified mortgage” for purposes of the Dodd-Frank Act, and setting standards for mortgage lenders to determine whether a consumer has the ability to repay the mortgage. This regulation, which became effective on January 10, 2014, also affords safe harbor legal protections for lenders making qualified loans that are not “higher priced.” On January 17, 2013, the CFPB issued a final regulation containing new mortgage servicing rules applicable to our bank subsidiary, which took effect on January 10, 2014. The announced goal of the CFPB is to bring greater consumer protection to the mortgage servicing market. These changes affect notices to be given to consumers as to delinquency, foreclosure alternatives, modification applications, interest rate adjustments and options for avoiding “force-placed” insurance. Servicers are prohibited from processing foreclosures when a loan modification is pending, and must wait until a loan is more than 120 days delinquent before initiating a foreclosure action.

The servicer must provide direct and ongoing access to its personnel, and provide prompt review of any loss mitigation application. Servicers must maintain accurate and accessible mortgage records for the life of a loan and until one year after the loan is paid off or transferred. We expect these new standards to add to the cost of conducting our mortgage servicing business.

#### *Capital Adequacy*

In July 2013, the FDIC and the Federal Reserve approved a new rule substantially amending the regulatory risk based capital rules applicable to the Bank and the Company. The final rule implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes new minimum risk-based capital and leverage ratios, which became effective for the Bank and the Company on January 1, 2015, and refines the definition of what constitutes “capital” for purposes of calculating these ratios. The new minimum capital requirements are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a “capital conservation buffer” of 2.5%, and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. In January 2016, the new capital conservation buffer requirement started being phased in at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

The capital ratios to be considered “well capitalized” under current capital rules are: common equity of 6.5%, Tier 1 leverage of 5%, Tier 1 risk-based capital of 8%, and Total Risk-Based capital of 10%.

At December 31, 2016, the Company qualified as “well-capitalized” under the foregoing regulatory capital standards. See Note 16 of the Notes to Consolidated Financial Statements included in Item 8 of this Report.

#### *Federal Deposit Insurance (“FDI”) Act and Part 363 of the FDIC Regulations*

Section 36 of the FDI Act and Part 363 of the FDIC's regulations require insured depository institutions with at least \$500 million in total assets to file a Part 363 Annual Report with the applicable bank regulatory agencies, which, among other things, requires that the Company establish and maintain an effective internal control structure over financial reporting and provide an assessment by management of the institution's compliance with the designated laws and regulations pertaining to insider loans and dividend restrictions.

#### *Bank Holding Company Regulation*

As a bank holding company, the Company is subject to regulation and examination by the Pennsylvania Department of Banking and Securities (the “Pennsylvania Department of Banking”) and the Federal Reserve Board. The Company is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The BHC Act requires each bank holding company to obtain the approval of the Federal Reserve Board before it may acquire substantially all the assets of any bank, or before it may acquire ownership or control of any voting shares of any bank if, after such acquisition, it would own or control, directly or indirectly, more than five percent of the voting shares of such bank. Such a transaction may also require approval of the Pennsylvania Department of Banking. Pennsylvania law permits Pennsylvania bank holding companies to control an unlimited number of banks.

Pursuant to provisions of the BHC Act and regulations promulgated by the Federal Reserve Board thereunder, the Company may only engage in or own companies that engage in activities deemed by the Federal Reserve Board to be so closely related to the business of banking or managing or controlling banks as to be a proper incident thereto, and the holding company must obtain permission from the Federal Reserve Board prior to engaging in most new business activities.

A bank holding company and its subsidiaries are subject to certain restrictions imposed by the BHC Act on any extensions of credit to the bank or any of its subsidiaries, investments in the stock or securities thereof, and on the taking of such stock or securities as collateral for loans to any borrower. A bank holding company and its subsidiaries are also prevented from engaging in certain tie-in arrangements in connection with any extension of credit, lease or sale of property or furnishing of services.

Under the Dodd-Frank Act and Federal Reserve Board regulations, a bank holding company is required to serve as a source of financial and managerial strength to its subsidiary banks and may not conduct its operations in an unsafe or unsound manner. In addition, in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary banks will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice or a violation of the Federal Reserve Board regulations or both. This doctrine is commonly known as the “source of strength” doctrine.

#### *Regulation of Embassy Bank for the Lehigh Valley*

Embassy Bank for the Lehigh Valley is a Pennsylvania-chartered banking institution and is subject to regulation, supervision and regular examination by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation (“FDIC”). Federal and state banking laws and regulations govern, among other things, the scope of a bank's business, the investments a bank may make, the reserves against deposits a bank must maintain, the loans a bank makes and collateral it takes, the maximum interest rates a bank may pay on deposits, the activities of

a bank with respect to mergers and consolidations, and the establishment of branches, and management practices and other aspects of banking operations.

#### *Dividend Restrictions*

The Company is a legal entity separate and distinct from the Bank. Declaration and payment of cash dividends depends upon cash dividend payments to the Company by the Bank, which is the Company's primary source of revenue and cash flow. Accordingly, the right of the Company, and consequently the right of our creditors and shareholders, to participate in any distribution of the assets or earnings of any subsidiary is necessarily subject to the prior claims of creditors of the subsidiary, except to the extent that claims of the Company in its capacity as a creditor may be recognized.

As a Pennsylvania chartered bank, the Bank is subject to regulatory restrictions on the payment and amounts of dividends under the Pennsylvania Banking Code. Further, the ability of banking subsidiaries to pay dividends is also subject to their profitability, financial condition, capital expenditures and other cash flow requirements. See Note 16 to the consolidated financial statements included at Item 8 of this Report.

The payment of dividends by the Bank and the Company may also be affected by other factors, such as the requirement to maintain adequate capital above regulatory guidelines. The federal banking agencies have indicated that paying dividends that deplete a depository institution's capital base to an inadequate level would be an unsafe and unsound banking practice. Under the Federal Deposit Insurance Corporation Improvement Act of 1991, a depository institution may not pay any dividend if payment would cause it to become undercapitalized or if it already is undercapitalized. Moreover, the federal agencies have issued policy statements that provide that bank holding companies and insured banks should generally only pay dividends out of current operating earnings. Federal banking regulators have the authority to prohibit banks and bank holding companies from paying a dividend if the regulators deem such payment to be an unsafe or unsound practice.

#### *Capital Adequacy and Operations*

Enacted in 1991, the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") contains provisions limiting activities and business methods of depository institutions. FDICIA required the primary federal banking regulators to promulgate regulations setting forth standards relating to, among other things, internal controls and audit systems; credit underwriting and loan documentation; interest rate exposure and other off-balance sheet assets and liabilities; and compensation of directors and officers. FDICIA also provided for expanded regulation of depository institutions and their affiliates, including parent holding companies, by such institutions' primary federal banking regulator. Each primary federal banking regulator is required to specify, by regulation, capital standards for measuring the capital adequacy of the depository institutions it supervises and, depending upon the extent to which a depository institution does not meet such capital adequacy measures, the primary federal banking regulator may prohibit such institution from paying dividends or may require such institution to take other steps to become adequately capitalized.

FDICIA established five capital tiers, ranging from "well capitalized" to "critically under-capitalized". A depository institution is well capitalized if it significantly exceeds the minimum level required by regulation for each relevant capital measure. Under FDICIA, an institution that is not well capitalized is generally prohibited from accepting brokered deposits and offering interest rates on deposits higher than the prevailing rate in its market; in addition, "pass through" insurance coverage may not be available for certain employee benefit accounts. FDICIA also requires an undercapitalized depository institution to submit an acceptable capital restoration plan to the appropriate federal bank regulatory agency. One requisite element of such a plan is that the institution's parent holding company must guarantee compliance by the institution with the plan, subject to certain limitations. In the event of the parent holding company's bankruptcy, the guarantee, and any other commitments that the parent holding company has made to federal bank regulators to maintain the capital of its depository institution subsidiaries, would be assumed by the bankruptcy trustee and entitled to priority in payment.

At December 31, 2016, the Bank qualified as "well capitalized" under these regulatory capital standards. See Note 16 of the Notes to Consolidated Financial Statements included at Item 8 of this Report.

*Community Reinvestment Act*

Under the Community Reinvestment Act of 1977 (“CRA”), the FDIC is required to assess the record of all financial institutions regulated by it to determine if these institutions are meeting the credit needs of the community (including low and moderate income neighborhoods) which they serve. CRA performance evaluations are based on a four-tiered rating system: Outstanding, Satisfactory, Needs to Improve and Substantial Noncompliance. CRA performance evaluations are considered in evaluating applications for such things as mergers, acquisitions and applications to open branches. The Bank has a current CRA rating of “Satisfactory.”

*Restrictions on Transactions with Affiliates and Insiders*

The Bank also is subject to the restrictions of Sections 23A, 23B, 22(g) and 22(h) of the Federal Reserve Act and Regulation O adopted by the Federal Reserve Board. Section 23A requires that loans or extensions of credit to an affiliate, purchases of securities issued by an affiliate, purchases of assets from an affiliate (except as may be exempted by order or regulation), the acceptance of securities issued by an affiliate as collateral and the issuance of a guarantee or acceptance of letters of credit on behalf of an affiliate (collectively, “Covered Transactions”) be on terms and conditions consistent with safe and sound banking practices. Section 23A also imposes quantitative restrictions on the amount of and collateralization requirements on such transactions. Section 23B requires that all Covered Transactions and certain other transactions, including the sale of securities or other assets to an affiliate and the payment of money or the furnishing of services to an affiliate, be on terms comparable to those prevailing for similar transactions with non-affiliates.

Section 22(g) and 22(h) of the Federal Reserve Act impose similar limitations on loans and extensions of credit from the bank to its executive officers, directors and principal shareholders and any of their related interests. The limitations restrict the terms and aggregate amount of such transactions. Regulation O implements the provisions of Sections 22(g) and 22(h) and requires maintenance of records of such transactions by the bank and regular reporting of such transactions by insiders. The FDIC also requires the bank, upon request, to disclose publicly loans and extensions of credit to insiders in excess of certain amounts.

*Deposit Insurance and Premiums*

The deposits of the Bank are insured up to applicable limits per insured depositor by the FDIC. In October 2008, the FDIC increased FDIC deposit insurance coverage per separately insured depositor for all account types to \$250,000. This increase was extended permanently through the Dodd-Frank Act.

As a FDIC member institution, the Bank’s deposits are insured to the maximum of \$250,000 per depositor through the Deposit Insurance Fund (“DIF”) that is administered by the FDIC and each institution is required to pay quarterly deposit insurance premium assessments to the FDIC.

The Deposit Insurance Funds Act of 1996 recapitalized the Savings Association Insurance Fund (“SAIF”) and provided that DIF deposits would be subject to one-fifth of the assessment to which SAIF deposits are subject for FICO bond payments. Beginning in 2000, DIF deposits and SAIF deposits were subject to the same assessment for FICO bonds. The FICO assessment for the Bank for 2016 was less than \$0.01 for each \$100 of DIF deposits.

In February 2011, the FDIC adopted final rules to implement changes required by the Dodd-Frank Act with respect to the FDIC assessment rules. In particular, the definition of an institution’s deposit insurance assessment base changed from total deposits to total assets less tangible equity. In addition, the FDIC decreased deposit insurance assessment rates, effective April 1, 2011. The revised initial base assessment rates range from 5 to 9 basis points for Risk Category I banks to 35 basis points for risk category IV banks. Risk Category II and III banks will have an initial base assessment rate of 14 or 23 basis points, respectively. The revised rates and assessment base had a positive effect by lowering the FDIC insurance assessment rate paid by the Bank. However, if the risk category of the Bank changes adversely, FDIC insurance premiums paid by the Bank could increase.

On April 26, 2016, the FDIC adopted a rule amending small institution pricing for the Deposit Insurance Fund Reserve Ratio, (“DIF”), which would be effective the quarter following the date on which the DIF reserve ratio

reaches 1.15%. On June 30, 2016, the DIF rose to 1.17%. FDIC regulations provide for changes in deposit insurance assessments the quarter after the reserve ratio first reaches or surpasses 1.15%, or the third quarter 2016 which will be reflected in the Company's December 2016 assessment payable March 30<sup>th</sup>, 2017.

#### *Other Federal Laws and Regulations*

State usury and credit laws limit the amount of interest and various other charges collected or contracted by a bank on loans. The Bank's loans are also subject to federal laws applicable to credit transactions, such as the following:

- Federal Truth-In-Lending Act, which governs disclosures of credit terms to consumer borrowers;
- Home Mortgage Disclosure Act, requiring financial institutions to provide information to enable public officials to determine whether a financial institution is fulfilling its obligations to meet the housing needs of the community it serves;
- Equal Credit Opportunity Act prohibiting discrimination on the basis of race, creed or other prohibitive factors in extending credit;
- Real Estate Settlement Procedures Act, which requires lenders to disclose certain information regarding the nature and cost of real estate settlements, and prohibits certain lending practices, as well as limits escrow account amounts in real estate transactions;
- Fair Credit Reporting Act governing the manner in which consumer debts may be collected by collection agencies; and
- Various rules and regulations of various federal agencies charged with the implementation of such federal laws.

Additionally, the Company's operations are subject to additional federal laws and regulations applicable to financial institutions, including, without limitation:

- Privacy provisions of the Gramm-Leach-Bliley Act and related regulations, which require the Company to maintain privacy policies intended to safeguard customer financial information, to disclose the policies to the Company's customers and to allow customers to "opt out" of having their financial service providers disclose their confidential financial information to non-affiliated third parties, subject to certain exceptions;
- Right to Financial Privacy Act, which imposes a duty to maintain confidentiality of consumer financial records and prescribes procedures for complying with administrative subpoenas of financial records;
- Consumer protection rules for the sale of insurance products by depository institutions, adopted pursuant to the requirements of the Gramm-Leach-Bliley Act; and
- USA Patriot Act, which requires financial institutions to take certain actions to help prevent, detect and prosecute international money laundering and the financing of terrorism.

Effective July 1, 2010, a federal banking rule under the Electronic Fund Transfer Act prohibited financial institutions from charging consumers fees for paying overdrafts on automated teller machines ("ATM") and one-time debit card transactions, unless a consumer consents, or opts in, to the overdraft service for those type of transactions. If a consumer does not opt in, any ATM transaction or debit that overdraws the consumer's account will be denied. Overdrafts on the payment of checks and regular electronic bill payments are not covered by this new rule. Before opting in, the consumer must be provided a notice that explains the financial institution's overdraft services, including the fees associated with the service, and the consumer's choices. Financial institutions must provide consumers who do not opt in with the same account terms, conditions and features (including pricing) that they provide to consumers who do opt in. The Company did not charge customers for these transactions, nor provide these types of services.

#### *Sarbanes-Oxley Act of 2002*

Enacted in 2002, the Sarbanes-Oxley Act represented a comprehensive revision of laws affecting corporate governance, accounting obligations and corporate reporting. The Sarbanes-Oxley Act is applicable to all companies with equity securities registered or that file reports under the Securities Exchange Act of 1934, including publicly held bank holding companies such as the Company. In particular, the Sarbanes-Oxley Act establishes: (i) requirements for audit committees, including independence, expertise, and responsibilities; (ii) additional responsibilities regarding

financial statements for the Chief Executive Officer and Chief Financial Officer of the reporting company; (iii) standards for auditors and regulation of audits; (iv) increased disclosure and reporting obligations for the reporting company and its directors and executive officers; and (v) new and increased civil and criminal penalties for violations of the securities laws.

#### *Governmental Policies*

The Company's earnings are significantly affected by the monetary and fiscal policies of governmental authorities, including the Federal Reserve Board. Among the instruments of monetary policy used by the Federal Reserve Board to implement these objectives are open-market operations in U.S. Government securities and federal funds, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These instruments of monetary policy are used in varying combinations to influence the overall level of bank loans, investments and deposits, and the interest rates charged on loans and paid for deposits. The Federal Reserve Board frequently uses these instruments of monetary policy, especially its open-market operations and the discount rate, to influence the level of interest rates and to affect the strength of the economy, the level of inflation or the price of the dollar in foreign exchange markets. The monetary policies of the Federal Reserve Board have had a significant effect on the operating results of banking institutions in the past and are expected to continue to do so in the future. It is not possible to predict the nature of future changes in monetary and fiscal policies, or the effect which they may have on the Company's business and earnings.

#### *Other Legislative Initiatives*

Proposals may be introduced in the United States Congress and in the Pennsylvania Legislature and before various bank regulatory authorities which would alter the powers of, and restrictions on, different types of banking organizations and which would restructure part or all of the existing regulatory framework for banks, bank holding companies and other providers of financial services. Moreover, other bills may be introduced in Congress which would further regulate, deregulate or restructure the financial services industry, including proposals to substantially reform the regulatory framework. It is not possible to predict whether these or any other proposals will be enacted into law or, even if enacted, the effect which they may have on the Company's business and earnings.

### **Forward-looking Statements**

This report contains forward-looking statements, including statements of goals, intentions, and expectations as to future trends, plans, events or results of Company operations and policies and regarding general economic conditions. These forward-looking statements are intended to be covered by the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. These statements are based upon current and anticipated economic conditions, nationally and in the Company's market, interest rates and interest rate policy, competitive factors and other conditions that, by their nature, are not susceptible to accurate forecast, and are subject to significant uncertainty.

Such forward-looking statements can be identified by the use of forward-looking terminology such as "believes", "expects", "may", "intends", "will", "should", "anticipates", or the negative of any of the foregoing or other variations thereon or comparable terminology, or by discussion of strategy.

No assurance can be given that the future results covered by forward-looking statements will be achieved. Such statements are subject to risks, uncertainties, and other factors that could cause actual results to differ materially from future results expressed or implied by such forward-looking statements. Important factors that could impact the Company's operating results include, but are not limited to, (i) the effects of changing economic conditions in the Company's market areas and nationally, (ii) credit risks of commercial, real estate, consumer and other lending activities, (iii) significant changes in interest rates, (iv) changes in federal and state banking laws and regulations which could impact the Company's operations, and (v) other external developments which could materially affect the Company's business and operations.

**Item 1A. RISK FACTORS.**

Not required of a smaller reporting company.

**Item 1B. UNRESOLVED STAFF COMMENTS.**

None.

**Item 2. PROPERTIES.**

The Company, through the Bank, occupies eight full-service banking offices in the Lehigh Valley:

Northampton County:

- Hanover Township (includes administrative offices)
- Lower Saucon Township
- Lower Nazareth Township
- Borough of Nazareth

Lehigh County:

- South Whitehall Township
- Salisbury Township
- Lower Macungie Township
- City of Bethlehem

All properties are leased.

**Item 3. LEGAL PROCEEDINGS.**

The Company and the Bank are an occasional party to legal actions arising in the ordinary course of its business. In the opinion of management, the Company has adequate legal defenses and/or insurance coverage respecting any and each of these actions and does not believe that they will materially affect the Company's operations or financial position.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

PART II

**Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

- (a) Shares of Company common stock are traded over-the-counter and in privately negotiated transactions. The Company’s common stock is not listed on any national securities exchange.

Trades in Company common stock made by certain brokerage firms are reported on the OTCQX Market Tier of the OTC Markets under the symbol “EMYB”. The following table reflects high and low bid prices for shares of the Company’s common stock for the periods indicated, based upon information derived from www.otcm Markets.com.

	2016		2015	
	High	Low	High	Low
First	\$ 11.10	\$ 10.15	\$ 10.85	\$ 10.21
Second	\$ 10.70	\$ 10.39	\$ 10.85	\$ 10.30
Third	\$ 10.90	\$ 10.50	\$ 10.92	\$ 10.50
Fourth	\$ 14.05	\$ 10.65	\$ 11.11	\$ 10.45

The above quotations may not reflect inter-dealer prices and should not be considered over-the-counter market quotations as that term is customarily used.

- (b) As of March 24, 2017, there are approximately 952 owners of record of the common stock of the Company.
- (c) On September 30, 2016, the Company paid \$962,584, or \$0.13 per share, in an annual cash dividend on its common stock. On September 30, 2015, the Company paid \$736,687 or \$0.10 per share, in an annual cash dividend on its common stock. As a general matter, cash available for dividend distribution to shareholders of the Company may come from dividends paid to the Company by the Bank, depending upon existing cash levels at the Company. See “Supervision and Regulation – Dividend Restrictions” in Item 1 of this report for a description of restrictions that may limit the Company’s ability to pay dividends on its common stock.
- (d) The following table sets forth information about options outstanding under the Company’s Stock Incentive Plan, as of December 31, 2016:

	Number of Shares to be issued upon exercise of outstanding options	Weighted average exercise price of outstanding options	Number of Shares remaining available for future issuance
Equity Compensation Plans and Individual Employment Agreements	116,243	\$ 7.34	298,778

- (e) Sales of Securities.  
None.
- (f) Repurchase of Equity Securities.  
None.

**Item 6. SELECTED FINANCIAL DATA.**

Not required of a smaller reporting company.

## **Item 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

This discussion and analysis provides an overview of the consolidated financial condition and results of operations of the Company for the years ended December 31, 2016 and 2015. This discussion should be read in conjunction with the consolidated financial statements and notes to consolidated financial statements appearing elsewhere in this report.

### **Critical Accounting Policies**

Note 1 to the Company's consolidated financial statements lists significant accounting policies used in the development and presentation of its financial statements. This discussion and analysis, the significant accounting policies, and other financial statement disclosures identify and address key variables and other qualitative and quantitative factors that are necessary for an understanding and evaluation of the Company and its results of operations.

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, which require the Company to make estimates and assumptions. The Company believes that its determination of the allowance for loan losses and the valuation of deferred tax assets involve a higher degree of judgment and complexity than the Company's other significant accounting policies. Further, these estimates can be materially impacted by changes in market conditions or the actual or perceived financial condition of the Company's borrowers, subjecting the Company to significant volatility of earnings.

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Other than temporary accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an entity does not intend to sell the security, and it is more likely than not the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company recognized no other-than-temporary impairment charges during the years ended December 31, 2016 and 2015.

The allowance for loan losses is established through the provision for loan losses, which is a charge against earnings. Provision for loan losses is made to reserve for estimated probable losses on loans. The allowance for loan losses is a significant estimate and is regularly evaluated by the Company for adequacy by taking into consideration factors such as changes in the nature and volume of the loan portfolio, trends in actual and forecasted credit quality, including delinquency, charge-off and bankruptcy rates, and current economic conditions that may affect a borrower's ability to pay. The use of different estimates of assumptions could produce different provision for loan losses. For additional discussion concerning the Company's allowance for loan losses and related matters, see "Provision for Loan Losses" and "Allowance for Loan Losses."

Real estate acquired through foreclosure, or deed-in-lieu of foreclosure is recorded at fair value less estimated selling costs at the date of acquisition or transfer, and subsequently at the lower of its new cost or fair value less estimated selling costs. Adjustments to the carrying value at the date of acquisition or transfer are charged to the allowance for loan losses. The carrying value of the individual properties is subsequently adjusted to the extent it exceeds estimated fair value less the estimated selling costs, at which time a provision for loan losses on such real estate is charged to operations. Appraisals are critical in determining the value of properties. Overly optimistic assumptions or negative changes to assumptions could significantly affect the valuation of a property. The assumptions supporting such

appraisals are carefully reviewed by management to determine that the resulting values reasonably reflect amounts realizable.

Deferred taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carryforwards and their tax basis. Deferred tax assets are reduced by a valuations allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

## **GENERAL**

The Company is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s primary operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

## **OVERVIEW**

The Company’s assets grew \$120.2 million from \$804.0 million at December 31, 2015 to \$924.2 million at December 31, 2016. The Company’s deposits grew \$173.1 million from \$660.3 million at December 31, 2015 to \$833.4 million at December 31, 2016. The significant growth in the Company’s deposits resulted primarily from market disruption due to recent mergers of two regional banks in the Company’s market area, and customers migrating to local community banks. Additional deposit growth was achieved through a concentrated effort to expand business relationships with local municipalities. During the same period, loans receivable, net of the allowance for loan losses, increased \$108.6 million to \$792.6 million at December 31, 2016 from \$684.0 million at December 31, 2015, with a significant portion of such loans originating in the fourth quarter. The market is very competitive and the Company is committed to maintaining a high quality portfolio that returns a reasonable market rate. The Company expects increased lending activity, as the Company expands its presence in the market and continues to become more widely known. The past and current economic conditions have created lower demand for loans by credit-worthy customers. The lending staff has been active in contacting new prospects and promoting the Company’s name in the community. Management believes that this will translate into continued growth of a portfolio of quality loans and core deposit relationships, although there can be no assurance of this. The Company continues to monitor interest rate exposure of its interest bearing assets and liabilities and believes that it is well positioned for any future market rate adjustments.

The Company reported net income of \$7.1 million for the year ended December 31, 2016 as compared to net income of \$7.4 million for the year ended December 31, 2015, a decrease of \$261 thousand, or 3.5%. Diluted earnings per share decreased to \$0.96 in 2016 from \$1.00 in 2015. The difference in net income for the year ended December 31, 2016 and December 31, 2015 resulted, in part, from the costs associated with opening a new branch in December 2015, an increase in provision for loan losses of \$238 thousand due to loan growth in the year ending December 31, 2016 and a commercial loan recovery of \$169 thousand in interest income during the year ended December 31, 2015. In addition, the Company experienced a 9.2% increase in full-time equivalent employees from seventy-six (76) at December 31, 2015 to eighty-three (83) at December 31, 2016, due to the strategic additions of team members to various rolls within the Company. This increase in the number of employees, together with a full year of salaries attributable to the new branch location and the annual increases in salaries, generally, resulted in an increase in overall salary and benefits costs of \$981 thousand.

## **RESULTS OF OPERATIONS**

### **Net Interest Income and Net Interest Margin**

Net interest income is the difference between income on assets and the cost of funds supporting those assets. Earning assets are composed primarily of loans and investments. Interest-bearing deposits and borrowings make up the cost of funds. Non-interest bearing deposits and capital are other components representing funding sources. Changes in the volume and mix of assets and funding sources, along with the changes in yields earned and rates paid, determine changes in net interest income. The timing of deposit and loan growth also impacted net interest income. Deposit and consumer loan growth occurred each quarter throughout the year, however a significant portion of commercial loan growth occurred in the fourth quarter where interest income will be recognized in these balances moving forward.

### **2016 Compared to 2015**

Total interest income for the year ended December 31, 2016 was \$30.3 million, compared to \$28.3 million for the year ended December 31, 2015. Total interest expense for the year ended December 31, 2016 was \$3.9 million, compared to \$3.1 million for the year ended December 31, 2015. The increase in interest income is due to the growth in loan balances, offset by lower yields in this interest rate environment. The increase in interest expense is primarily due to growth in savings and certificate of deposits due to the opening of the Nazareth branch, expansion of existing deposit relationships, growth in the number of deposit relationships with municipalities, and significant growth in the number of accounts resulting from customer migration due to recent merger activity in the Company's local marketplace, offset by a decrease in short-term and long-term borrowings. Net interest income increased 5.2% to \$26.4 million for the year ended December 31, 2016 as compared to \$25.1 million for the year ended December 31, 2015.

Generally, changes in net interest income are measured by net interest rate spread and net interest margin. Interest rate spread is the mathematical difference between the average interest earned on earning assets and interest paid on interest bearing liabilities. Interest margin represents the net interest yield on earning assets and is derived by dividing net interest income by average earning assets. The interest margin gives a reader a better indication of asset earning results when compared to peer groups or industry standards.

The Company's net interest margin for the year ended December 31, 2016 was 3.25% compared to 3.48% for the year ended December 31, 2015. The decrease in the margin is due primarily to the decrease in loan and investment rates and increase in certificate of deposit rates associated with the current market conditions, offset by the decrease in short-term and long term borrowings and coupled with the significant growth in the loan, interest bearing deposits, savings and certificate of deposit balances. During this difficult market environment, the Company continued to grow and attract deposits and loans at competitive rates.

The following table includes the average balances, interest income and expense and the average rates earned and paid for assets and liabilities for the periods presented. All average balances are daily average balances.

**Average Balances, Rates and Interest Income and Expense**

	<u>Year Ended December 31, 2016</u>			<u>Year Ended December 31, 2015</u>			<u>Year Ended December 31, 2014</u>		
	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>	<u>Average Balance</u>	<u>Interest</u>	<u>Tax Equivalent Yield</u>
(Dollars in Thousands)									
<b>ASSETS</b>									
Loans - taxable (2)	\$ 722,480	\$ 27,951	3.87%	\$ 643,774	\$ 25,823	4.01%	\$ 579,496	\$ 23,708	4.09%
Loans - non-taxable (1)	9,635	295	4.63%	9,887	315	4.83%	8,353	230	4.17%
Investment securities - taxable (3)	51,853	764	1.47%	49,280	795	1.61%	45,675	753	1.65%
Investment securities - non-taxable (1) (3)	33,031	1,176	5.39%	33,264	1,193	5.43%	34,698	1,269	5.54%
Federal funds sold	708	3	0.47%	680	2	0.29%	955	2	0.22%
Time deposits	-	-	-	185	1	0.54%	1,025	11	1.07%
Interest bearing deposits with banks	18,224	133	0.73%	6,728	124	1.84%	10,738	77	0.72%
<b>TOTAL INTEREST EARNING ASSETS</b>	<b>835,931</b>	<b>30,322</b>	<b>3.72%</b>	<b>743,798</b>	<b>28,253</b>	<b>3.90%</b>	<b>680,940</b>	<b>26,050</b>	<b>3.94%</b>
Less allowance for loan losses	(6,238)			(5,769)			(5,440)		
Other assets	34,451			32,107			28,006		
<b>TOTAL ASSETS</b>	<b>\$ 864,144</b>			<b>\$ 770,136</b>			<b>\$ 703,506</b>		
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>									
Interest bearing demand deposits, NOW and money market	\$ 78,707	\$ 67	0.09%	\$ 60,401	\$ 41	0.07%	\$ 60,603	\$ 32	0.05%
Savings	467,846	2,294	0.49%	406,642	1,978	0.49%	404,196	1,953	0.48%
Certificates of deposit	120,587	1,488	1.23%	83,278	859	1.03%	74,385	721	0.97%
Securities sold under agreements to repurchase and other borrowings	21,221	49	0.23%	72,892	257	0.35%	39,634	293	0.74%
<b>TOTAL INTEREST BEARING LIABILITIES</b>	<b>688,361</b>	<b>3,898</b>	<b>0.57%</b>	<b>623,213</b>	<b>3,135</b>	<b>0.50%</b>	<b>578,818</b>	<b>2,999</b>	<b>0.52%</b>
Non-interest bearing demand deposits	97,555			76,062			62,161		
Other liabilities	6,356			5,730			4,374		
Stockholders' equity	71,872			65,131			58,153		
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 864,144</b>			<b>\$ 770,136</b>			<b>\$ 703,506</b>		
Net interest income		\$ 26,424			\$ 25,118			\$ 23,051	
Net interest spread			3.15%			3.40%			3.42%
Net interest margin			3.25%			3.48%			3.50%

(1) Yields on tax exempt assets have been calculated on a fully tax equivalent basis.

(2) The average balance of taxable loans includes loans in which interest is no longer accruing.

(3) Investment security yields do not give effect to changes in fair value.

The table below demonstrates the relative impact on net interest income of changes in the volume of interest-earning assets and interest-bearing liabilities and changes in rates earned and paid by the Company on such assets and liabilities.

	2016 vs. 2015			2015 vs. 2014		
	Increase (decrease) due to changes in:			Increase (decrease) due to changes in:		
	Volume	Rate	Total	Volume	Rate	Total
(In Thousands)						
Interest-earning assets:						
Loans - taxable	\$ 3,157	\$ (1,029)	\$ 2,128	\$ 2,630	\$ (515)	\$ 2,115
Loans - non-taxable	(8)	(12)	(20)	42	43	85
Investment securities - taxable	42	(73)	(31)	59	(17)	42
Investment securities - non-taxable	(8)	(9)	(17)	(52)	(24)	(76)
Federal funds sold	-	1	1	(1)	1	-
Time deposits	(1)	-	(1)	(9)	(1)	(10)
Interest bearing deposits with banks	212	(203)	9	(29)	76	47
Total net change in income on interest-earning assets	3,394	(1,325)	2,069	2,640	(437)	2,203
Interest-bearing liabilities:						
Interest bearing demand deposits	12	14	26	-	9	9
Savings	298	18	316	12	13	25
Certificates of deposit	385	244	629	86	52	138
Total deposits	695	276	971	98	74	172
Securities sold under agreements to repurchase and other borrowings	(182)	(26)	(208)	246	(282)	(36)
Total net change in expense on interest-bearing liabilities	513	250	763	344	(208)	136
Change in net interest income	\$ 2,881	\$ (1,575)	\$ 1,306	\$ 2,296	\$ (229)	\$ 2,067

**Provision for Loan Losses**

The provision for loan losses represents the expense recognized to fund the allowance for loan losses. This amount is based on many factors that reflect management's assessment of the risk in its loan portfolio. Those factors include economic conditions and trends, the value and adequacy of collateral, volume and mix of the portfolio, performance of the portfolio, and internal loan processes of the Company.

For the year ended December 31, 2016, the provision for loan losses was \$770 thousand, compared to \$532 thousand for the year ended December 31, 2015. The increase in the provision for loan losses was primarily due to the volume of loan growth in 2016 over 2015. Loans grew \$108.6 million in 2016 compared to \$79.0 million in 2015. The allowance for loan losses as of December 31, 2016 was \$6.5 million, which represents 0.82% of outstanding loans, which is comparable to the \$6.1 million as of December 31, 2015, representing 0.88% of outstanding loans. Based principally on current economic conditions, perceived asset quality, and loan-loss experience of comparable institutions in the Company's market area, the allowance is believed to be adequate.

**Non-interest Income**

Non-interest income is derived from the Company's operations and represents primarily credit card processing fees, service fees on deposit and loan relationships and income from bank owned life insurance. Non-interest income also

may include net gains and losses from the sale of available for sale securities. Total non-interest income was \$3.2 million for the year ended December 31, 2016 compared to \$2.8 million for the year ended December 31, 2015. This increase in non-interest income is due to fees from credit card processing services in the amount of \$104 thousand, or 6.2%, over 2015, as well as an increase in deposit service fees in the amount of \$70 thousand, or 10.4%, over 2015, the gain on sales of securities realized of \$350 thousand in 2016 compared to \$165 thousand in 2015, an increase of \$33 thousand in gains on sale of other real estate owned and a decrease of \$24 thousand in impairment of other real estate owned, offset by a \$20 thousand, or 4.9%, decrease in bank owned life insurance from 2015. As the deposit customer account base continues to grow and the Company continues to mature and develop additional sources of fee income, non-interest income is expected to become a more significant contributor to the overall profitability of the Company. Unlike many in the industry, the Company does not sell mortgages in the secondary market, nor does it offer trust or investment/brokerage services to its customers.

### **Non-interest Expense**

Non-interest expenses represent the normal operating expenses of the Company. These expenses include salaries, employee benefits, occupancy, equipment, data processing, advertising and other expenses related to the overall operation of the Company.

Non-interest expenses for the year ended December 31, 2016 was \$18.8 million, compared to \$17.0 million for the year ended December 31, 2015. The increase in non-interest expenses is primarily due to an increase of \$981 thousand, or 14.0%, over 2015, in salaries and employee benefits due to the strategic additions of team members to various rolls within the Company. The Company had eighty-three (83) compared to seventy-six (76) full-time equivalent employees at December 31, 2016 and December 31, 2015, respectively. This increase in the number of employees, together with a full year of salaries attributable to the new branch location and the annual increases in salaries, generally, resulted in an increase in overall salary and benefits costs. Additional increases in non-interest expenses are attributable to: an increase of \$224 thousand, or 9.1%, over 2015, in occupancy and equipment due primarily to the expense associated with a full year in operation of the Nazareth branch; an increase of \$112 thousand, or 8.4%, over 2015 in advertising and promotion expenses due primarily to new advertising campaigns to capitalize on the market merger activity and increased deposit campaigns; an increase of \$78 thousand, or 4.9%, over 2015, in credit card/merchant processing expense due to increased volume; an increase of \$79 thousand, or 5.1%, over 2015, in data processing expense; an increase of \$87 thousand, or 17.3%, over 2015, in professional fees; and an increase of \$156 thousand, or 13.3%, over 2015, in other expenses.

A breakdown of other non-interest expenses is included in the Consolidated Statements of Income in the Consolidated Financial Statements included in Item 8 of this Report.

### **Income Taxes**

The provision for income taxes was \$2.9 million for the years ended December 31, 2016 and 2015. The effective rate on income taxes for the years ended December 31, 2016 and 2015 was 28.5%.

## **FINANCIAL CONDITION**

### **Securities**

The Company's securities portfolio is classified, in its entirety, as "available for sale." Management believes that a portfolio classification of available for sale allows complete flexibility in the investment portfolio. Using this classification, the Company intends to hold these securities for an indefinite amount of time, but not necessarily to maturity. Such securities are carried at fair value with unrealized gains or losses reported as a separate component of stockholders' equity. The portfolio is structured to provide maximum return on investments while providing a consistent source of liquidity and meeting strict risk standards. The Company holds no high-risk securities or derivatives as of December 31, 2016.

The Company's securities portfolio was \$85.6 million at December 31, 2016, a \$8.3 million increase from securities of \$77.3 million at December 31, 2015. The Company's securities have increased primarily due to purchases in the amount of \$29.3 million, offset by a combination of investment principal pay-downs, maturities and sales totaling \$19.0 million and a \$1.9 million decrease in unrealized gains. The carrying value of the securities portfolio as of December 31, 2016 includes a net unrealized loss of \$38 thousand, as compared to a net unrealized gain of \$1.9 million as of December 31, 2015, which is recorded to accumulated other comprehensive income in stockholders' equity. This decrease in the unrealized gain is due primarily to the changes in market conditions from 2015 to 2016. No securities are deemed to be other than temporarily impaired.

The following table sets forth the composition of the securities portfolio at fair value as of December 31, 2016, 2015 and 2014.

	<u>2016</u>	<u>2015</u>	<u>2014</u>
	(In Thousands)		
U.S. Government agency obligations	\$ 32,488	\$ 34,570	\$ 30,076
Municipal securities	38,808	41,204	38,624
U.S. Government sponsored enterprise (GSE)			
- Mortgage-backed securities - residential	14,302	1,479	7,501
Corporate bonds	-	-	996
Total Securities Available for Sale	<u>\$ 85,598</u>	<u>\$ 77,253</u>	<u>\$ 77,197</u>

The following table presents the maturities and average weighted yields of the debt securities portfolio as of December 31, 2016. Maturities of mortgage-backed securities are based on estimated life. Yields are based on amortized cost.

**Securities by Maturities**

	<u>1 year or Less</u>		<u>1-5 Years</u>		<u>5-10 Years</u>		<u>Over 10 Years</u>		<u>Total</u>	
	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>	<u>Amount</u>	<u>Average Yield</u>
(Dollars In Thousands)										
U.S. Government agency obligations	\$ 11,031	0.87%	\$ 21,457	1.29%	\$ -	-	\$ -	-	\$ 32,488	1.15%
Municipal securities	505	4.24%	6,145	4.45%	11,579	5.06%	20,579	5.24%	38,808	5.05%
U.S. GSE - Mortgage-backed securities-residential	72	4.01%	7,144	4.23%	7,086	2.08%	-	-	14,302	2.13%
Total Debt Securities	<u>\$ 11,608</u>	<u>1.03%</u>	<u>\$ 34,746</u>	<u>2.03%</u>	<u>\$ 18,665</u>	<u>3.93%</u>	<u>\$ 20,579</u>	<u>5.24%</u>	<u>\$ 85,598</u>	<u>3.08%</u>

**Loans**

The following table sets forth information on the composition of the loan portfolio by type at December 31, 2016, 2015, 2014, 2013 and 2012. All of the Company's loans are to domestic borrowers.

	<u>December 31, 2016</u>		<u>December 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>
	(Dollars in Thousands)					
Commercial real estate	\$ 321,730	40.27%	\$ 289,304	41.92%	\$ 249,454	40.84%
Commercial construction	28,606	3.58%	17,786	2.58%	23,220	3.80%
Commercial	39,045	4.89%	34,955	5.06%	34,182	5.60%
Residential real estate	408,872	51.17%	347,316	50.33%	302,908	49.60%
Consumer	718	0.09%	745	0.11%	972	0.16%
Gross loans	798,971	100.00%	690,106	100.00%	610,736	100.00%
Unearned origination (fees) costs	144		9		(155)	
Allowance for loan losses	(6,517)		(6,068)		(5,614)	
	<u>\$ 792,598</u>		<u>\$ 684,047</u>		<u>\$ 604,967</u>	
	<u>December 31, 2013</u>		<u>December 31, 2012</u>			
	<u>Balance</u>	<u>Percentage of total Loans</u>	<u>Balance</u>	<u>Percentage of total Loans</u>		
	(Dollars in Thousands)					
Commercial real estate	\$ 235,545	41.40%	\$ 204,904	40.53%		
Commercial construction	21,109	3.71%	19,717	3.90%		
Commercial	28,017	4.92%	28,696	5.68%		
Residential real estate	283,421	49.82%	250,854	49.62%		
Consumer	846	0.15%	1,382	0.27%		
Gross loans	568,938	100.00%	505,553	100.00%		
Unearned origination (fees) costs	(355)		(334)			
Allowance for loan losses	(5,326)		(5,147)			
	<u>\$ 563,257</u>		<u>\$ 500,072</u>			

The following table shows the maturities of the commercial loan portfolio and the sensitivity of such loans to interest rate fluctuations at December 31, 2016.

	<u>One year or Less</u>	<u>After One Year Through Five Years</u>	<u>After Five Years</u>	<u>Total</u>
	(In Thousands)			
Commercial real estate	\$ 44,295	\$ 152,299	\$ 125,136	\$ 321,730
Commercial construction	16,968	6,438	5,200	28,606
Commercial	15,104	17,600	6,341	39,045
	<u>\$ 76,367</u>	<u>\$ 176,337</u>	<u>\$ 136,677</u>	<u>\$ 389,381</u>
Fixed Rates	\$ 40,334	\$ 175,187	\$ 130,536	\$ 346,057
Variable Rates	36,033	1,150	6,141	43,324
	<u>\$ 76,367</u>	<u>\$ 176,337</u>	<u>\$ 136,677</u>	<u>\$ 389,381</u>

### **Credit Risk and Loan Quality**

The allowance for loan losses increased \$449 thousand to \$6.5 million at December 31, 2016 from \$6.1 million at December 31, 2015. At December 31, 2016 and December 31, 2015, the allowance for loan losses represented 0.82% and 0.88%, respectively, of total loans. Based upon current economic conditions, the composition of the loan portfolio, the perceived credit risk in the portfolio and loan-loss experience of comparable institutions in the Bank's market area, management feels the allowance is adequate to absorb reasonably anticipated losses.

At December 31, 2016, aggregate balances on non-performing loans equaled \$6.0 million compared to \$5.5 million at December 31, 2015, representing 0.76% and 0.79% of total loans at December 31, 2016 and December 31, 2015, respectively. In certain circumstances in which the Company has deemed it prudent for reasons related to a borrower's financial condition, the Company has agreed to restructure certain loans (referred to as troubled debt restructurings). Troubled debt restructuring loans, which are considered non-performing loans, outstanding at December 31, 2016 totaled \$4.8 million. Generally, a loan is classified as nonaccrual when it is determined that the collection of all or a portion of interest or principal is doubtful or when a default of interest or principal has existed for 90 days or more, unless the loan is well secured and in the process of collection. A non-performing loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. At December 31, 2016 and December 31, 2015 the Company had \$482 thousand and \$529 thousand, respectively, in recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure.

As of December 31, 2016 the Company had two (2) foreclosed assets totaling \$480 thousand, one in the amount of \$132 thousand acquired in October 2010 and one in the amount of \$348 thousand acquired in August 2014. The details for the non-performing loans and assets are included in the following table:

	<b>December 31,</b>				
	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
	(Dollars In Thousands)				
Non-accrual - commercial	\$ 280	\$ 230	\$ 1,318	\$ 1,824	\$ 2,143
Non-accrual - consumer	874	529	366	481	301
Restructured, accruing interest	4,831	4,723	4,975	7,354	7,841
Loans past due 90 or more days, accruing interest	55	-	-	763	361
<b>Total nonperforming loans</b>	<b>6,040</b>	<b>5,482</b>	<b>6,659</b>	<b>10,422</b>	<b>10,646</b>
Foreclosed assets	480	1,224	1,106	659	3,038
<b>Total nonperforming assets</b>	<b>\$ 6,520</b>	<b>\$ 6,706</b>	<b>\$ 7,765</b>	<b>\$ 11,081</b>	<b>\$ 13,684</b>
Nonperforming loans to total loans	<b>0.76%</b>	0.79%	1.09%	1.83%	2.11%
Nonperforming assets to total assets	<b>0.71%</b>	0.83%	1.08%	1.65%	2.13%

**Allowance for Loan Losses**

Based upon current economic conditions, the composition of the loan portfolio and loan loss experience of comparable institutions in the Company's market areas, an allowance for loan losses has been provided at 0.82% of outstanding loans. Based on its knowledge of the portfolio and current economic conditions, management believes that, as of December 31, 2016, the allowance is adequate to absorb reasonably anticipated losses. As of December 31, 2016, the Company had \$11.2 million of impaired loans (defined as a loan that management feels probable the Company will be unable to collect all amounts according to the contractual terms of the loan agreement or loans considered to be troubled debt restructurings) compared to \$6.4 million at December 31, 2015. Most of the Company's impaired loans required no specific reserves due to adequate collateral. As of December 31, 2016, the Company had impaired loans of \$1.1 million requiring a specific reserve of \$296 thousand. As of December 31, 2015, the Company had impaired loans of \$1.2 million requiring a specific reserve of \$370 thousand.

The activity in the allowance for loan losses is shown in the following table, as well as period end loans receivable and the allowance for loan losses as a percent of the total loan portfolio:

	<b>December 31,</b>				
	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>
	(Dollars In Thousands)				
Loans receivable at end of year	<u>\$ 799,115</u>	<u>\$ 690,115</u>	<u>\$ 610,581</u>	<u>\$ 568,583</u>	<u>\$ 505,219</u>
Allowance for loan losses:					
Balance, beginning	\$ 6,068	\$ 5,614	\$ 5,326	\$ 5,147	\$ 4,215
Provision for loan losses	<u>770</u>	<u>532</u>	<u>250</u>	<u>992</u>	<u>1,183</u>
Loans charged off:					
Commercial real estate	(35)	(60)	(10)	(530)	(231)
Commercial construction	-	-	(50)	(197)	-
Commercial	(75)	-	(38)	(13)	-
Residential real estate	(207)	(28)	(63)	(112)	(39)
Consumer	(4)	-	-	(5)	-
Total charged off	<u>(321)</u>	<u>(88)</u>	<u>(161)</u>	<u>(857)</u>	<u>(270)</u>
Recoveries of loans previously charged-off:					
Commercial real estate	-	10	-	13	1
Commercial construction	-	-	198	-	-
Commercial	-	-	1	3	-
Residential real estate	-	-	-	28	18
Consumer	-	-	-	-	-
Total recoveries	<u>-</u>	<u>10</u>	<u>199</u>	<u>44</u>	<u>19</u>
Net charged off	<u>(321)</u>	<u>(78)</u>	<u>38</u>	<u>(813)</u>	<u>(251)</u>
Balance at end of year	<u>\$ 6,517</u>	<u>\$ 6,068</u>	<u>\$ 5,614</u>	<u>\$ 5,326</u>	<u>\$ 5,147</u>
Allowance for loan losses to loans receivable at end of year	<u>0.82%</u>	<u>0.88%</u>	<u>0.92%</u>	<u>0.94%</u>	<u>1.02%</u>

**Allocation of the Allowance for Loan Losses**

The following table details the allocation of the allowance for loan losses to various loan categories and the related percent of total loans in each category. While allocations have been established for particular loan categories, management considers the entire allowance to be available to absorb losses in any category.

	<u>December 2016</u>	<u>% of Total Loans</u>	<u>December 2015</u>	<u>% of Total Loans</u>	<u>December 2014</u>	<u>% of Total Loans</u>	<u>December 2013</u>	<u>% of Total Loans</u>	<u>December 2012</u>	<u>% of Total Loans</u>
	(Dollars in Thousands)									
Commercial real estate	\$ 2,349	40.27%	\$ 2,132	41.92%	\$ 1,704	40.84%	\$ 1,791	41.40%	\$ 2,007	40.53%
Commercial construction	516	3.58%	294	2.58%	401	3.80%	495	3.71%	660	3.90%
Commercial	423	4.89%	402	5.06%	407	5.60%	349	4.92%	394	6.71%
Residential real estate	2,937	51.17%	2,529	50.33%	1,955	49.60%	2,068	49.82%	1,677	48.59%
Consumer	15	0.09%	29	0.11%	22	0.16%	24	0.15%	33	0.27%
Unallocated	277		682		1,125		599		376	
Total Allowance for Loan Losses	<u>\$ 6,517</u>	<u>100.00%</u>	<u>\$ 6,068</u>	<u>100.00%</u>	<u>\$ 5,614</u>	<u>100.00%</u>	<u>\$ 5,326</u>	<u>100.00%</u>	<u>\$ 5,147</u>	<u>100.00%</u>

**Deposits**

As growth continues, the Company expects that the principal sources of its funds will be deposits, consisting of demand deposits, NOW accounts, money market accounts, savings accounts, and certificates of deposit from the local market areas surrounding the Company's offices. These accounts provide the Company with a source of fee income and a relatively stable source of funds.

Total deposits at December 31, 2016 were \$833.4 million, an increase of \$173.1 million, or 26.2%, over total deposits of \$660.3 million as of December 31, 2015 due to increases in customer relationships resulting from merger activity in the marketplace and an increase in municipal deposit relationships. The following table reflects the Company's deposits by category for the periods indicated. All deposits are domestic deposits.

	<u>December 31, 2016</u>	<u>December 31, 2015</u>	<u>December 31, 2014</u>
	(In Thousands)		
Demand, non-interest bearing	\$ 117,208	\$ 89,959	\$ 68,467
Demand, NOW and money market, interest bearing	97,687	67,402	63,263
Savings	488,701	406,361	405,964
Time, \$100 and over	89,020	59,533	42,122
Time, other	40,768	37,011	31,852
<b>Total deposits</b>	<b>\$ 833,384</b>	<b>\$ 660,266</b>	<b>\$ 611,668</b>

The following table sets forth the average balance of the Company's deposits and the average rates paid on those deposits for the years ended December 31, 2016, 2015 and 2014:

	<u>December 31, 2016</u>		<u>December 31, 2015</u>		<u>December 31, 2014</u>	
	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>	<u>Average Amount</u>	<u>Average Rate</u>
	(Dollars In Thousands)					
Demand, NOW and money market, interest bearing deposits	\$ 78,707	0.09%	\$ 60,401	0.07%	\$ 60,603	0.05%
Savings	467,846	0.49%	406,642	0.49%	404,196	0.48%
Certificates of deposit	120,587	1.23%	83,278	1.03%	74,385	0.97%
Total interest bearing deposits	667,140	0.58%	550,321	0.52%	539,184	0.50%
Non-interest bearing demand deposits	97,555		76,062		62,161	
<b>Total</b>	<b>\$ 764,695</b>		<b>\$ 626,383</b>		<b>\$ 601,345</b>	

The following table displays the maturities and the amounts of the Company's certificates of deposit of \$100,000 or more as of December 31, 2016:

	<b>December 31, 2016</b>
	(In Thousands)
3 months or less	\$ 8,102
Over 3 through 6 months	22,108
Over 6 through 12 months	21,508
Over 12 months	37,302
Total	<u>\$ 89,020</u>

As a FDIC member institution, the Company's deposits are insured to a maximum of \$250,000 per depositor through the Deposit Insurance Fund ("DIF") that is administered by the FDIC and each institution is required to pay quarterly deposit insurance premium assessments to the FDIC.

### **Liquidity**

Liquidity is a measure of the Company's ability to meet the demands required for the funding of loans and to meet depositors' requirements for use of their funds. The Company's sources of liquidity are cash balances, due from banks, federal funds sold and short-term securities. There are other sources of liquidity that are available to the Company.

The Bank has borrowing capacity with the FHLBank Pittsburgh ("FHLB") of approximately \$445.0 million, which includes a line of credit for \$150.0 million. There were no long-term loans outstanding with the FHLB as of December 31, 2016 and \$3.8 million outstanding as of December 31, 2015. There were no short-term loans outstanding with FHLB as of December 31, 2016 and \$39.3 million outstanding as of December 31, 2015. FHLB deposit letters of credit are standby letters of credit commitments issued by the Bank for the benefit of a third party (the "Beneficiary"), which secure public deposits in the Bank. The Company, through the Bank, had \$3.5 million of FHLB deposit letters of credit outstanding as of December 31, 2016 and none as of December 31, 2015. All FHLB borrowings are secured by qualifying assets of the Bank. The Bank also has a \$10.0 million line of credit with Atlantic Community Bankers Bank, of which none was outstanding at December 31, 2016. Advances from this line are unsecured.

Because of the composition of the Company's balance sheet, its strong capital base, deposit growth, and borrowing capacity, the Company believes that it remains well positioned with respect to liquidity. While it is desirable to be liquid, it has the effect of a lower interest margin. The majority of funds are invested in loans; however, a sizeable portion is invested in investment securities that generally carry a lower yield.

**Contractual Obligations**

The following table represents the Company’s contractual obligations to make future payments as of the year ended December 31, 2016:

	<u>2017</u>	<u>2018-2019</u>	<u>2020-2021</u>	<u>Thereafter</u>	<u>Total</u>
	(In Thousands)				
Time deposits	\$ 70,242	\$ 42,574	\$ 16,972	\$ -	\$ 129,788
Operating Leases	1,307	2,497	1,019	70	4,893
Total	<u>\$ 71,549</u>	<u>\$ 45,071</u>	<u>\$ 17,991</u>	<u>\$ 70</u>	<u>\$ 134,681</u>

**Off-Balance Sheet Arrangements**

The Company’s consolidated financial statements do not reflect various off-balance sheet arrangements that are made in the normal course of business, which may involve some liquidity risk. These commitments consist of unfunded loans and lines of credit and letters of credit made under the same standards as on-balance sheet instruments. These off-balance sheet arrangements at December 31, 2016 and December 31, 2015 totaled \$100.3 million and \$97.4 million, respectively. Because these instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to the Company.

Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

The Company has no investment in or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources.

**Capital Resources and Adequacy**

The Company and the Bank are subject to various regulatory capital requirements administered by banking regulators. Failure to meet minimum capital requirements can initiate certain actions by regulators that could have a material adverse effect on the consolidated financial statements.

The regulations require that banks maintain minimum amounts and ratios of total and Tier 1 capital (as defined in the regulations) to risk weighted assets (as defined), and Tier 1 capital to average assets (as defined). As of December 31, 2016, the Bank met the minimum requirements. In addition, the Bank’s capital ratios exceeded the amounts required to be considered “well capitalized” as defined in the regulations.

The following table provides a comparison of the Bank's risk-based capital ratios and leverage ratios:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
	(Dollars In Thousands)	
Tier 1, common stockholders' equity	\$ 73,061	\$ 66,812
Tier 2, allowable portion of allowance for loan losses	6,517	6,068
Total capital	<u>\$ 79,578</u>	<u>\$ 72,880</u>
Common equity tier 1 capital ratio	11.2%	11.5%
Tier 1 risk based capital ratio	11.2%	11.5%
Total risk based capital ratio	12.2%	12.6%
Tier 1 leverage ratio	8.0%	8.4%

Note: Unrealized gains/losses on securities available for sale are excluded from regulatory capital components of risk-based capital and leverage ratios.

In July 2013, the FDIC and the Federal Reserve approved a new rule that substantially amended the regulatory risk based capital rules applicable to the Bank and the Company. The final rule implements the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act.

The final rule includes new minimum risk-based capital and leverage ratios, which became effective for the Bank and the Company on January 1, 2015, and refines the definition of what constitutes "capital" for purposes of calculating these ratios. The revised minimum capital requirements are: (i) a new common equity Tier 1 capital ratio of 4.5%; (ii) a Tier 1 to risk-based assets capital ratio of 6%; (iii) a total capital ratio of 8%; and (iv) a Tier 1 leverage ratio of 4%. The final rule also establishes a "capital conservation buffer" of 2.5%, and will result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%; (ii) a Tier 1 to risk-based assets capital ratio of 8.5%; and (iii) a total capital ratio of 10.5%. In January 2016, the new capital conservation buffer requirement started being phased in at 0.625% of risk-weighted assets and will increase each year until fully implemented in January 2019. An institution will be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations will establish a maximum percentage of eligible retained income that can be utilized for such actions.

In addition to the risk-based capital guidelines, the federal banking regulators established minimum leverage ratio (Tier 1 capital to total assets) guidelines for bank holding companies. These guidelines provide for a minimum leverage ratio of 3% for those bank holding companies which have the highest regulatory examination ratings and are not contemplating or experiencing significant growth or expansion. All other bank holding companies are required to maintain a leverage ratio of at least 4%.

The capital ratios to be considered "well capitalized" under the new capital rules are: common equity of 6.5%, Tier 1 leverage of 5%, Tier 1 risk-based capital of 8%, and Total Risk-Based capital of 10%.

The following table provides the Company's risk-based capital ratios and leverage ratios:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
	(Dollars In Thousands)	
Tier 1, common stockholders' equity	\$ 73,302	\$ 66,865
Tier 2, allowable portion of allowance for loan losses	<u>6,517</u>	<u>6,068</u>
Total capital	<u>\$ 79,819</u>	<u>\$ 72,933</u>
Common equity tier 1 capital ratio	11.2%	11.5%
Tier 1 risk based capital ratio	11.2%	11.5%
Total risk based capital ratio	12.2%	12.6%
Tier 1 leverage ratio	8.1%	8.3%

### Interest Rate Risk Management

A principal objective of the Company's asset/liability management policy is to minimize the Company's exposure to changes in interest rates by an ongoing review of the maturity and repricing of interest-earning assets and interest-bearing liabilities. The Asset Liability Committee (ALCO), which meets as part of the Board of Directors meeting, oversees this review, which establishes policies to control interest rate sensitivity. Interest rate sensitivity is the volatility of a company's earnings resulting from a movement in market interest rates. The Company monitors rate sensitivity in order to reduce vulnerability to interest rate fluctuations while maintaining adequate capital levels and acceptable levels of liquidity. The Company's asset/liability management policy, monthly and quarterly financial reports, along with simulation modeling, supplies management with guidelines to evaluate and manage rate sensitivity.

GAP, a measure of the difference in volume between interest bearing assets and interest bearing liabilities, is a means of monitoring the sensitivity of a financial institution to changes in interest rates. The chart below provides an indicator of the rate sensitivity of the Company. NOW and savings accounts are categorized by their respective estimated decay rates. The Company is liability sensitive, which means that if interest rates fall, interest income will fall slower than interest expense and net interest income will likely increase. If interest rates rise, interest income will rise slower than interest expense and net interest income will likely decrease. The Company continues to monitor interest rate exposure of its interest bearing assets and liabilities and believes that it is well positioned for any future market rate adjustments.

	0-3 Months	4-12 Months	1-3 Years	4-5 Years	Over 5 Years	Total
(In Thousands)						
<b>Interest-earning assets</b>						
Federal funds sold and interest-bearing deposits	\$ 1,375	\$ -	\$ -	\$ -	\$ -	\$ 1,375
Investment securities	1,974	14,584	39,120	10,566	19,978	86,222
Loans, gross	123,604	132,392	210,901	113,687	218,531	799,115
<b>Total interest-earning assets</b>	<b>126,953</b>	<b>146,976</b>	<b>250,021</b>	<b>124,253</b>	<b>238,509</b>	<b>886,712</b>
<b>Interest-bearing liabilities</b>						
NOW and money market accounts	2,902	94,785	-	-	-	97,687
Savings	432,928	55,773	-	-	-	488,701
Certificates of deposit	13,186	57,056	42,574	16,972	-	129,788
Other borrowed funds	-	-	-	-	-	-
Repurchase agreements and federal funds purchased	11,889	-	-	-	-	11,889
<b>Total interest-bearing liabilities</b>	<b>460,905</b>	<b>207,614</b>	<b>42,574</b>	<b>16,972</b>	<b>-</b>	<b>728,065</b>
<b>GAP</b>	<b>\$ (333,952)</b>	<b>\$ (60,638)</b>	<b>\$ 207,447</b>	<b>\$ 107,281</b>	<b>\$ 238,509</b>	<b>\$ 158,647</b>
<b>CUMULATIVE GAP</b>	<b>\$ (333,952)</b>	<b>\$ (394,590)</b>	<b>\$ (187,143)</b>	<b>\$ (79,862)</b>	<b>\$ 158,647</b>	
<b>GAP TO INTEREST EARNING ASSETS</b>						
	-37.66%	-6.84%	23.40%	12.10%	26.90%	
<b>CUMULATIVE GAP TO INTEREST EARNING ASSETS</b>						
	-37.66%	-44.50%	-21.11%	-9.01%	17.89%	

Based on a twelve-month forecast of the balance sheet, the following table sets forth our interest rate risk profile at December 31, 2016. For income simulation purposes, personal savings accounts are repriced quarterly and NOW and business savings reprice every 4 to 12 months. The impact on net interest income, illustrated in the following table, would vary if different assumptions were used or if actual experience differs from that indicated by the assumptions.

<u>Change in Interest Rates</u>	<u>Percentage Change in Net Interest Income</u>
Down 100 basis points	-1.6%
Down 200 basis points	-8.8%
Up 100 basis points	-0.1%
Up 200 basis points	-0.6%

### **Return on Assets and Equity**

For the year ended December 31, 2016, the return on average assets was 0.83% the return on average equity was 9.95% and the ratio of average shareholders' equity to average total assets was 8.32%.

For the year ended December 31, 2015, the return on average assets was 0.96% the return on average equity was 11.38% and the ratio of average shareholders' equity to average total assets was 8.46%.

### **Dividend Payout Ratio**

For the year ended December 31, 2016 and 2015 the dividend payout ratio was 13.46% and 9.93%, respectively.

### **Effects of Inflation**

The majority of assets and liabilities of the Company are monetary in nature, and therefore, differ greatly from most commercial and industrial companies that have significant investments in fixed assets or inventories. The precise impact of inflation upon the Company is difficult to measure. Inflation may affect the borrowing needs of consumers, thereby impacting the growth rate of the Company's assets. Inflation may also affect the general level of interest rates, which can have a direct bearing on the Company.

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS.**

Not required of a smaller reporting company.

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders  
Embassy Bancorp, Inc.

We have audited the accompanying consolidated balance sheets of Embassy Bancorp, Inc. and its subsidiary, Embassy Bank for the Lehigh Valley (collectively the “Company”), as of December 31, 2016 and 2015, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated 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 consolidated financial position of the Company as of December 31, 2016 and 2015, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania  
March 30, 2017

Consolidated Balance Sheets

<u>ASSETS</u>	<u>December 31,</u> <u>2016</u>	<u>December 31,</u> <u>2015</u>
	(In Thousands, Except Share Data)	
Cash and due from banks	\$ 14,574	\$ 12,459
Interest bearing demand deposits with banks	8,644	6,067
Federal funds sold	1,000	1,000
Cash and Cash Equivalents	24,218	19,526
Securities available for sale	85,598	77,253
Restricted investment in bank stock	624	2,178
Loans receivable, net of allowance for loan losses of \$6,517 in 2016; \$6,068 in 2015	792,598	684,047
Premises and equipment, net of accumulated depreciation	2,109	2,258
Bank owned life insurance	12,728	12,343
Accrued interest receivable	1,749	1,637
Other real estate owned	480	1,224
Other assets	4,129	3,572
<b>Total Assets</b>	<b>\$ 924,233</b>	<b>\$ 804,038</b>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Liabilities:		
Deposits:		
Non-interest bearing	\$ 117,208	\$ 89,959
Interest bearing	716,176	570,307
Total Deposits	833,384	660,266
Securities sold under agreements to repurchase	11,889	27,535
Short-term borrowings	-	39,306
Long-term borrowings	-	3,820
Accrued interest payable	813	462
Other liabilities	4,869	4,548
<b>Total Liabilities</b>	<b>850,955</b>	<b>735,937</b>
Stockholders' Equity:		
Common stock, \$1 par value; authorized 20,000,000 shares;		
2016 issued 7,452,462 shares; outstanding 7,443,472 shares;		
2015 issued 7,407,547 shares; outstanding 7,407,547 shares	7,453	7,408
Surplus	24,603	24,299
Retained earnings	41,344	35,158
Accumulated other comprehensive (loss) income	(24)	1,236
Treasury stock, at cost, 2016; 8,990 shares	(98)	-
<b>Total Stockholders' Equity</b>	<b>73,278</b>	<b>68,101</b>
<b>Total Liabilities and Stockholders' Equity</b>	<b>\$ 924,233</b>	<b>\$ 804,038</b>

See notes to consolidated financial statements.

**Consolidated Statements of Income**

	<b>Year Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
	(In Thousands, Except Per Share Data)	
<b>INTEREST INCOME</b>		
Loans receivable, including fees	\$ 28,246	\$ 26,138
Securities, taxable	764	795
Securities, non-taxable	1,176	1,193
Federal funds sold, and other	136	126
Interest on time deposits	-	1
<b>Total Interest Income</b>	<b>30,322</b>	<b>28,253</b>
<b>INTEREST EXPENSE</b>		
Deposits	3,849	2,878
Securities sold under agreements to repurchase	12	17
Short-term borrowings	32	135
Long-term borrowings	5	105
<b>Total Interest Expense</b>	<b>3,898</b>	<b>3,135</b>
<b>Net Interest Income</b>	<b>26,424</b>	<b>25,118</b>
<b>PROVISION FOR LOAN LOSSES</b>	<b>770</b>	<b>532</b>
<b>Net Interest Income after Provision for Loan Losses</b>	<b>25,654</b>	<b>24,586</b>
<b>OTHER NON-INTEREST INCOME</b>		
Credit card processing fees	1,774	1,670
Other service fees	743	673
Bank owned life insurance	385	405
Gain on sale of securities, net	350	165
Gain (loss) on sale of other real estate owned	21	(12)
Impairment on other real estate owned	(80)	(104)
<b>Total Other Non-interest Income</b>	<b>3,193</b>	<b>2,797</b>
<b>OTHER NON-INTEREST EXPENSES</b>		
Salaries and employee benefits	7,994	7,013
Occupancy and equipment	2,680	2,456
Data processing	1,620	1,541
Credit card processing	1,674	1,596
Advertising and promotion	1,445	1,333
Professional fees	590	503
FDIC insurance	428	374
Insurance	60	54
Loan & real estate	240	250
Charitable contributions	692	636
Other real estate owned expenses	100	100
Other	1,326	1,170
<b>Total Other Non-interest Expenses</b>	<b>18,849</b>	<b>17,026</b>
<b>Income before Income Taxes</b>	<b>9,998</b>	<b>10,357</b>
<b>INCOME TAX EXPENSE</b>	<b>2,850</b>	<b>2,948</b>
<b>Net Income</b>	<b>\$ 7,148</b>	<b>\$ 7,409</b>
<b>BASIC EARNINGS PER SHARE</b>	<b>\$ 0.96</b>	<b>\$ 1.01</b>
<b>DILUTED EARNINGS PER SHARE</b>	<b>\$ 0.96</b>	<b>\$ 1.00</b>
<b>DIVIDENDS PER SHARE</b>	<b>\$ 0.13</b>	<b>\$ 0.10</b>

*See notes to consolidated financial statements.*

**Consolidated Statements of Comprehensive Income**

	<b>Year Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
	(In Thousands)	
<b>Net Income</b>	<b>\$ 7,148</b>	<b>\$ 7,409</b>
<b>Change in Accumulated Other Comprehensive Income:</b>		
Unrealized holding loss on securities available for sale	<b>(1,560)</b>	(182)
Less: reclassification adjustment for realized gains	<b>(350)</b>	(165)
	<b>(1,910)</b>	(347)
Income tax effect	<b>650</b>	118
Net unrealized loss	<b>(1,260)</b>	(229)
<b>Other comprehensive loss, net of tax</b>	<b>(1,260)</b>	(229)
<b>Comprehensive Income</b>	<b>\$ 5,888</b>	<b>\$ 7,180</b>

*See notes to consolidated financial statements.*

Consolidated Statements of Stockholders' Equity

Years Ended December 31, 2016 and 2015

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total
(In Thousands, Except Share and Per Share Data)						
<b>BALANCE - DECEMBER 31, 2014</b>	\$ 7,358	\$ 24,024	\$ 28,485	\$ 1,465	\$ -	\$ 61,332
Net income	-	-	7,409	-	-	7,409
Other comprehensive income	-	-	-	(229)	-	(229)
Dividend declared, \$.10 per share	-	-	(736)	-	-	(736)
Compensation expense recognized on stock options	-	49	-	-	-	49
Common stock grants to directors and officers, 32,875 shares, net of unearned compensation expense of \$260	33	63	-	-	-	96
Shares issued under Dividend Reinvestment and Stock Purchase Plan, 16,920 shares	17	163	-	-	-	180
<b>BALANCE - DECEMBER 31, 2015</b>	<u>\$ 7,408</u>	<u>\$ 24,299</u>	<u>\$ 35,158</u>	<u>\$ 1,236</u>	<u>\$ -</u>	<u>\$ 68,101</u>
<b>BALANCE - DECEMBER 31, 2015</b>	\$ 7,408	\$ 24,299	\$ 35,158	\$ 1,236	\$ -	\$ 68,101
Net income	-	-	7,148	-	-	7,148
Other comprehensive income	-	-	-	(1,260)	-	(1,260)
Dividend declared, \$.13 per share	-	-	(962)	-	-	(962)
Common stock grants to directors and officers, 25,139 shares, net of unearned compensation expense of \$450	25	86	-	-	-	111
Compensation expense recognized on stock options	-	27	-	-	-	27
Purchase treasury stock, 8,990 shares at \$10.85 per share	-	-	-	-	(98)	(98)
Shares issued under Dividend Reinvestment and Stock Purchase Plan, 19,776 shares	20	191	-	-	-	211
<b>BALANCE - DECEMBER 31, 2016</b>	<u>\$ 7,453</u>	<u>\$ 24,603</u>	<u>\$ 41,344</u>	<u>\$ (24)</u>	<u>\$ (98)</u>	<u>\$ 73,278</u>

See notes to consolidated financial statements.

**Consolidated Statements of Cash Flows**

	<b>Year Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
	(In Thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 7,148	\$ 7,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	770	532
Amortization of deferred loan costs	113	50
Depreciation and amortization	730	605
Net amortization of investment security premiums and discounts	306	222
Stock compensation expense	76	49
Net realized (gain) loss on sale of other real estate owned	(21)	12
Impairment on other real estate owned	80	104
Income on bank owned life insurance	(385)	(405)
Deferred income taxes	77	(33)
Net realized gain on sale of securities available for sale	(350)	(165)
Increase in accrued interest receivable	(112)	(38)
Decrease (increase) in other assets	16	(73)
Increase in accrued interest payable	351	113
Increase in other liabilities	404	127
<b>Net Cash Provided by Operating Activities</b>	<b>9,203</b>	<b>8,509</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of securities available for sale	(29,288)	(18,956)
Maturities, calls and principal repayments of securities available for sale	11,326	7,754
Proceeds from sales of securities available for sale	7,751	10,742
Net increase in loans	(108,952)	(80,016)
Net redemption (purchases) of restricted investment in bank stock	1,554	(1,394)
Net maturities of interest bearing time deposits	-	250
Proceeds from sale of other real estate owned	182	96
Purchases of premises and equipment	(581)	(1,348)
<b>Net Cash Used in Investing Activities</b>	<b>(118,008)</b>	<b>(82,872)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Net increase in deposits	173,118	48,598
Net decrease in securities sold under agreements to repurchase	(15,646)	(2,769)
Decrease (increase) in short-term borrowed funds	(39,306)	30,306
Proceeds from long-term borrowed funds	-	6,000
Payment of long-term borrowed funds	(3,820)	(4,080)
Acquisition of treasury stock	(98)	-
Proceeds from Dividend Reinvestment Plan	211	180
Dividends paid	(962)	(736)
<b>Net Cash Provided by Financing Activities</b>	<b>113,497</b>	<b>77,499</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>4,692</b>	<b>3,136</b>
<b>CASH AND CASH EQUIVALENTS - BEGINNING</b>	<b>19,526</b>	<b>16,390</b>
<b>CASH AND CASH EQUIVALENTS - ENDING</b>	<b>\$ 24,218</b>	<b>\$ 19,526</b>
<b>SUPPLEMENTARY CASH FLOWS INFORMATION</b>		
Interest paid	\$ 3,547	\$ 3,022
Income taxes paid	\$ 2,636	\$ 3,262
Other real estate sold through bank financing	\$ 523	\$ 287
Deferral of gain from sale of other real estate sold through bank financing	\$ 21	\$ 24
Other real estate acquired in settlement of loans	\$ 41	\$ 641

*See notes to consolidated financial statements.*

## **Note 1 – Summary of Significant Accounting Policies**

### **Principles of Consolidation and Nature of Operations**

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation organized in 2008 and registered as a bank holding company pursuant to the Bank Holding Company Act of 1956, as amended (the “BHC Act”). The Company was formed for purposes of acquiring Embassy Bank For The Lehigh Valley (the “Bank”) in connection with the reorganization of the Bank into a bank holding company structure, which was consummated on November 11, 2008. Accordingly, the Company owns all of the capital stock of the Bank, giving the organization more flexibility in meeting its capital needs as the Company continues to grow.

The Bank, which is the Company’s principal operating subsidiary, was originally incorporated as a Pennsylvania bank on May 11, 2001 and opened its doors on November 6, 2001. It was formed by a group of local business persons and professionals with significant prior experience in community banking in the Lehigh Valley area of Pennsylvania, the Bank’s primary market area.

### **Estimates**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, the valuation of other real estate owned, and the valuation of deferred tax assets.

### **Concentrations of Credit Risk**

Most of the Company’s activities are with customers located in the Lehigh Valley area of Pennsylvania. Note 2 discusses the types of securities in which the Company invests. The concentrations of credit by type of loan are set forth in Note 3. The Company does not have any significant concentrations to any one specific industry or customer, with the exception of lending activity to a broad range of lessors of residential and non-residential real estate within the Lehigh Valley. Although the Company has a diversified loan portfolio, its debtors’ ability to honor their contracts is influenced by the region’s economy.

### **Presentation of Cash Flows**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing demand deposits with bank, and federal funds sold. Generally, federal funds are purchased or sold for less than one week periods.

### **Securities**

Securities classified as available for sale are those securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Securities available for sale are carried at fair value. Any decision to sell a security classified as available for sale would be based on various factors, including significant movement in interest rates, changes in maturity mix of the Company’s assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Unrealized gains and losses are reported as increases or decreases in other comprehensive income. Realized gains or losses, determined on the basis of the cost of the specific securities sold, are included in earnings. Premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Other than temporary accounting guidance specifies that (a) if a company does not have the intent to sell a debt security prior to recovery and (b) it is more likely than not that it will not have to sell the debt security prior to recovery, the security would not be considered other-than-temporarily impaired unless there is a credit loss. When an

entity does not intend to sell the security, and it is more likely than not the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income. The Company recognized no other-than-temporary impairment charges during the years ended December 31, 2016 and 2015.

### **Restricted Investments in Bank Stock**

Restricted investments in bank stock consist of FHLBank Pittsburgh (“FHLB”) stock and Atlantic Community Bankers Bank (“ACBB”) stock. The restricted stocks have no quoted market value and are carried at cost. Federal law requires a member institution of the FHLB to hold stock of its district FHLB according to a predetermined formula.

During 2014 the FHLB conducted limited excess capital stock repurchases based upon positive quarterly net income. In October 2014, the FHLB amended its Capital Plan and created two subclasses of stock, one required as a member (“membership stock”) and additional stock in the FHLB in relation to the level of outstanding borrowings (“activity-based stock”). Under this new plan the costs of membership decreased. As a result of this decrease, the FHLB began repurchasing excess stock on a regular monthly repurchase date and pay dividends, if conditions warrant, on a quarterly basis. Dividend payments of \$48 thousand and \$113 thousand were received during the years ended December 31, 2016 and 2015, respectively.

Management evaluates the FHLB and ACBB restricted stock for impairment. Management’s determination of whether these investments are impaired is based on their assessment of the ultimate recoverability of their cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of their cost is influenced by criteria such as (1) the significance of the decline in net assets of the issuer as compared to the capital stock amount for the issuer and the length of time this situation has persisted, (2) commitments by the issuer to make payments required by law or regulation and the level of such payments in relation to the operating performance of the issuer, and (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the issuer.

Management believes no impairment charge is necessary related to the FHLB or ACBB restricted stock as of December 31, 2016.

### **Loans Receivable**

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at their outstanding unpaid principal balances, net of any deferred fees or costs. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the yield using the effective interest method. Premiums and discounts on purchased loans are amortized as adjustments to interest income using the effective interest method. Delinquency fees are recognized in income when chargeable, assuming collectability is reasonably assured.

The loans receivable portfolio is segmented into commercial and consumer loans. Commercial loans consist of the following classes: commercial real estate, commercial construction and commercial. Consumer loans consist of the following classes: residential real estate and other consumer loans.

The Company makes commercial loans for real estate development and other business purposes required by the customer base. The Company’s credit policies determine advance rates against the different forms of collateral that can be pledged against commercial loans. Typically, the majority of loans will be limited to a percentage of their underlying collateral values such as real estate values, equipment, eligible accounts receivable and inventory. Individual loan advance rates may be higher or lower depending upon the financial strength of the borrower and/or term of the loan. The assets financed through commercial loans are used within the business for its ongoing operation. Repayment of these kinds of loans generally comes from the cash flow of the business or the ongoing conversion of assets. Commercial real estate loans include long-term loans financing commercial properties. Repayments of these loans are dependent upon either the ongoing cash flow of the borrowing entity or the resale of or

lease of the subject property. Commercial real estate loans typically require a loan to value ratio of not greater than 80% and vary in terms.

Residential mortgages and home equity loans are secured by the borrower's residential real estate in either a first or second lien position. Residential mortgages and home equity loans have varying interest rates (fixed or variable) depending on the financial condition of the borrower and the loan to value ratio. Residential mortgages may have amortizations up to 30 years and home equity loans may have maturities up to 25 years. Other consumer loans include installment loans, car loans, and overdraft lines of credit. Some of these loans may be unsecured.

For all classes of loans receivable, the accrual of interest may be discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. A loan may remain on accrual status if it is in the process of collection and is either guaranteed or well secured. When a loan is placed on nonaccrual status, unpaid interest credited to income in the current year is reversed. Interest received on nonaccrual loans, including impaired loans, generally is applied against principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

### **Allowance for Loan Losses**

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The reserve for unfunded loan commitments represents management's estimate of losses inherent in its unfunded loan commitments and is recorded in other liabilities on the consolidated balance sheet. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans, or portions of loans, determined to be confirmed losses are charged against the allowance account and subsequent recoveries, if any, are credited to the account. A loss is considered confirmed when information available at the balance sheet date indicates the loan, or a portion thereof, is uncollectible.

Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

Management maintains the allowance for loan losses at a level it believes adequate to absorb probable credit losses related to specifically identified loans, as well as probable incurred losses inherent in the remainder of the loan portfolio as of the balance sheet dates. The allowance for loan losses account consists of specific and general reserves. The specific component consists of the specific reserve for impaired loans individually evaluated under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 310, "Receivables," and the general component is utilized for loss contingencies on those loans collectively evaluated under FASB ASC 450, "Contingencies."

For the specific portion of the allowance for loan losses, a loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. All amounts due according to the contractual terms means that both the contractual interest and principal payments of a loan will be collected as scheduled in the loan agreement. Factors considered by management in determining impairment include payment status, ability to pay and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Loans considered impaired under FASB ASC 310 are measured for impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral if the loan is collateral dependent. If the present

value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral dependent, is less than the recorded investment in the loan, including accrued interest and net deferred loan fees or costs, the Company will recognize the impairment by adjusting the allowance for loan losses account through charges to earnings as a provision for loan losses.

For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For commercial and industrial loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable aging or equipment appraisals or invoices. Indications of value from these sources are generally discounted based on the age of the financial information or the quality of the assets.

The general portion of the allowance for loan losses covers pools of loans by major loan class including commercial loans not considered impaired, as well as smaller balance homogeneous loans, such as residential real estate and other consumer loans. Loss contingencies for each of the major loan pools are determined by applying a total loss factor to the current balance outstanding for each individual pool. The total loss factor is comprised of a historical loss factor using the loss migration method plus a qualitative factor, which adjusts the historical loss factor for changes in trends, conditions and other relevant factors that may affect repayment of the loans in these pools as of the evaluation date. Loss migration involves determining the percentage of each pool that is expected to ultimately result in loss based on historical loss experience. Historical loss factors are based on the ratio of net loans charged-off to loans, net, for each of the major groups of loans evaluated and measured for impairment under FASB ASC 450. The historical loss factor for each pool, includes but is not limited to, an average of the Company's historical net charge-off ratio for the most recent rolling twenty-four quarters.

In addition to these historical loss factors, management also uses a qualitative factor that represents a number of environmental risks that may cause estimated credit losses associated with the current portfolio to differ from historical loss experience. These environmental risks include: (i) changes in lending policies and procedures including underwriting standards and collection, charge-off and recovery practices; (ii) changes in the composition and volume of the portfolio; (iii) changes in national, local and industry conditions, including the effects of such changes on the value of underlying collateral for collateral-dependent loans; (iv) changes in the volume and severity of classified loans, including past due, nonaccrual, troubled debt restructures and other loan modifications; (v) changes in the levels of, and trends in, charge-offs and recoveries; (vi) the existence and effect of any concentrations of credit and changes in the level of such concentrations; (vii) changes in the experience, ability and depth of lending management and other relevant staff; (viii) changes in the quality of the loan review system and the degree of oversight by the board of directors; and (ix) the effect of external factors such as competition and regulatory requirements on the level of estimated credit losses in the current loan portfolio. Each environmental risk factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The unallocated component of the general allowance is used to cover inherent losses that exist as of the evaluation date, but which have not been identified as part of the allocated allowance using the above impairment evaluation methodology due to limitations in the process. One such limitation is the imprecision of accurately estimating the impact current economic conditions will have on historical loss rates. Variations in the magnitude of impact may cause estimated credit losses associated with the current portfolio to differ from historical loss experience, resulting in an allowance that is higher or lower than the anticipated level.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payment, for

commercial and consumer loans. Credit quality risk ratings include regulatory classifications of special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weakness may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness and borrowers are highly leveraged. They include loans that are inadequately protected by the current sound net worth and the paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are charged to the allowance for loan losses. Loans not classified are rated pass.

Federal regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

### **Other Real Estate Owned**

Other real estate owned is comprised of properties acquired through foreclosure proceedings or acceptance of a deed-in-lieu of foreclosure and loans classified as in-substance foreclosures. A loan is classified as an in-substance foreclosure when the Company has taken possession of the collateral, regardless of whether formal foreclosure proceedings take place. Other real estate owned is recorded at fair value less cost to sell at the time of acquisition. Any excess of the loan balance over the recorded value is charged to the allowance for loan losses at the time of acquisition. After foreclosure, valuations are periodically performed and the assets are carried at the lower of cost or fair value less cost to sell. Changes in the valuation allowance on foreclosed assets are included in other income. Costs to maintain the assets are included in other expenses. Any gain or loss realized upon disposal of other real estate owned is included in other income.

### **Bank Owned Life Insurance**

The Company invests in bank owned life insurance ("BOLI") as a tax deferred investment and a source of funding for employee benefit expenses. BOLI involves the purchasing of life insurance by the Company on certain of its employees and directors. The Company is the owner and beneficiary of the policies. This life insurance investment is carried at the cash surrender value of the underlying policies. Income from increases in cash surrender value of the policies is included in non-interest income and is not subject to income taxes unless surrendered. The Company does not intend to surrender these policies, and accordingly, no deferred taxes have been recorded on the earnings from these policies.

### **Premises and Equipment**

Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the following estimated useful lives of the related assets: furniture, fixtures and equipment for five to ten years, leasehold improvements for ten to fifteen years, computer equipment and data processing software for three to five years, and automobiles for five years.

### **Transfers of Financial Assets**

Transfers of financial assets, including sales of loan participations, are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

## Advertising Costs

The Company follows the policy of charging the costs of advertising to expense as incurred.

## Income Taxes

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to taxable income. Deferred income taxes are provided on the liability method whereby deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and net operating loss carry forwards and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

## Earnings Per Share

Basic earnings per share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period, as adjusted for stock dividends and splits. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustments to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate solely to outstanding stock options and are determined using the treasury stock method.

	<u>2016</u>	<u>2015</u>
	(Dollars In Thousands, Except Per Share Data)	
Net income	\$ <u>7,148</u>	\$ <u>7,409</u>
Weighted average shares outstanding	7,415,372	7,371,271
Dilutive effect of potential common shares, stock options	<u>49,973</u>	<u>33,950</u>
Diluted weighted average common shares outstanding	<u>7,465,345</u>	<u>7,405,221</u>
Basic earnings per share	\$ <u>0.96</u>	\$ <u>1.01</u>
Diluted earnings per share	\$ <u>0.96</u>	\$ <u>1.00</u>

Stock options of 4,227 were not considered in computing diluted earnings per common share for the year ended December 31, 2016. There were no stock options not considered in computing diluted earnings per common share for the year ended December 31, 2015.

## Employee Benefit Plan

The Company has a 401(k) Plan (the "Plan") for employees. All employees are eligible to participate after they have attained the age of 21 and have also completed 12 consecutive months of service during which at least 1,000 hours of service are completed. The employees may contribute up to the maximum percentage allowable by law of their compensation to the Plan, and the Company provides a match of fifty percent of the first 8% percent to eligible participating employees. Full vesting in the Plan is prorated equally over a four-year period. The Company's contributions to the Plan for the years ended December 31, 2016 and 2015 were \$151 thousand and \$139 thousand, respectively.

### **Off-Balance Sheet Financial Instruments**

In the ordinary course of business, the Company has entered into off-balance sheet financial instruments consisting of commitments to extend credit and letters of credit. Such financial instruments are recorded in the balance sheet when they are funded.

### **Comprehensive Income**

Accounting principles generally accepted in the United States of America require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income. In accordance with Financial Accounting Standards Board (FASB) guidance, the Company has disclosed the components of comprehensive income in the accompanying consolidated statements of comprehensive income.

### **Segment Reporting**

The Company acts as an independent, community, financial services provider, and offers traditional banking and related financial services to individual, business and government customers. The Company offers a full array of commercial and retail financial services, including the taking of time, savings and demand deposits; the making of commercial, consumer and home equity loans; and the provision of other financial services.

Management does not separately allocate expenses, including the cost of funding loan demand, between the commercial and retail operations of the Company. As such, discrete financial information is not available and segment reporting would not be meaningful.

### **Stock-Based Compensation**

The Company applies the fair value recognition provisions of FASB Accounting Standards Codification (ASC) 718, Compensation-Stock Compensation. ASC 718 requires compensation costs related to share-based payment transactions to be recognized in the financial statements over the period that an employee provides service in exchange for the award based on the fair value of the award. The Black-Scholes model is used to estimate the fair value of stock options.

### **Subsequent Events**

The Company follows ASC Topic 855 Subsequent Events. This topic establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before the consolidated financial statements are issued. The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2016 through the date these consolidated financial statements were available for issuance for items that should potentially be recognized or disclosed in these consolidated financial statements.

### **New Accounting Standards**

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which will supersede the current revenue recognition requirements in Topic 605, Revenue Recognition. The ASU is based on the principle that revenue is recognized to depict the transfer of 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 ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued ASU 2015-14 which deferred the effective date of ASU 2014-09 by one year. The new guidance will be effective for public companies for periods beginning after December 15, 2017 with private companies provided a one-year deferral until periods beginning after December 15, 2018. The ASU permits application of the new revenue recognition guidance to be applied using one of two retrospective application methods. The Company has not yet determined which

application method it will use or the potential effects of the new standard on the financial statements, if any. This guidance does not apply to revenue associated with financial instruments, including loans, securities, and derivatives that are accounted for under other U.S. GAAP guidance. For that reason, the Company does not expect it to have a material impact on the consolidated results of operations for elements of the statement of income associated with financial instruments, including securities gains, interest income and interest expense. However, the Company does believe the new standard will result in new disclosure requirements. The Company currently in the process of reviewing contracts to assess the impact of the new guidance on our service offerings that are in the scope of the guidance, included in non-interest income such as service charges and payment processing. The Company is continuing to evaluate the effect of the new guidance on revenue sources other than financial instruments on our financial position and consolidated results of operations.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which will supersede the current lease requirements in Topic 840. The ASU requires lessees to recognize a right of use asset and related lease liability for all leases, with a limited exception for short-term leases. Leases will be classified as either finance or operating, with the classification affecting the pattern of expense recognition in the statement of income. Currently, leases are classified as either capital or operating, with only capital leases recognized on the balance sheet. The reporting of lease related expenses in the statements of operations and cash flows will be generally consistent with the current guidance. The new guidance will be effective for years beginning after December 15, 2018 for public companies and for years beginning after December 15, 2019 for private companies. Once effective, the standard will be applied using a modified retrospective transition method to the beginning of the earliest period presented. The Company is currently assessing the impact this new standard will have on its consolidated financial statements.

In June 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-13, Financial Instruments - Credit Losses. ASU 2016-13 requires entities to report “expected” credit losses on financial instruments and other commitments to extend credit rather than the current “incurred loss” model. These expected credit losses for financial assets held at the reporting date are to be based on historical experience, current conditions, and reasonable and supportable forecasts. This ASU will also require enhanced disclosures to help investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity’s portfolio. These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. For public business entities that are U.S. Securities and Exchange Commission filers, the amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. For all other public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. For all other entities, the amendments in this update are effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021. The Company is currently evaluating the impact the adoption of ASU 2016-13 will have on its consolidated financial statements and results of operations, however due to the significant differences in the revised guidance from existing U.S. GAAP, the implementation of this guidance may result in material changes to the Company’s accounting for credit losses on financial instruments.

### **Reclassification**

Certain amounts in the 2015 consolidated financial statements may have been reclassified to conform to 2016 presentation. These reclassifications had no effect on 2015 net income.

**Note 2 – Securities Available For Sale**

The amortized cost and approximate fair values of securities available-for-sale were as follows:

	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
	(In Thousands)			
<b>December 31, 2016 :</b>				
U.S. Government agency obligations	\$ 32,581	\$ 12	\$ (105)	\$ 32,488
Municipal bonds	38,410	1,161	(763)	38,808
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	14,645	114	(457)	14,302
Total	<u>\$ 85,636</u>	<u>\$ 1,287</u>	<u>\$ (1,325)</u>	<u>\$ 85,598</u>
<b>December 31, 2015 :</b>				
U.S. Government agency obligations	\$ 34,676	\$ 15	\$ (121)	\$ 34,570
Municipal bonds	39,378	1,970	(144)	41,204
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	1,327	152	-	1,479
Total	<u>\$ 75,381</u>	<u>\$ 2,137</u>	<u>\$ (265)</u>	<u>\$ 77,253</u>

The amortized cost and fair value of securities as of December 31, 2016, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without any penalties.

	<u>Amortized Cost</u>	<u>Fair Value</u>
	(In Thousands)	
Due in one year or less	\$ 11,530	\$ 11,536
Due after one year through five years	27,470	27,602
Due after five years through ten years	11,311	11,579
Due after ten years	20,680	20,579
	<u>70,991</u>	<u>71,296</u>
U.S. Government Sponsored Enterprise (GSE) - Mortgage- backed securities - residential	14,645	14,302
	<u>\$ 85,636</u>	<u>\$ 85,598</u>

Gross gains of \$350 thousand and \$165 thousand were realized on sales of securities for the years ended December 31, 2016 and December 31, 2015, respectively. There were no gross losses in 2016 or 2015 on the sale of securities.

The following table shows the Company's investments' gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2016 and December 31, 2015, respectively:

	<u>Less Than 12 Months</u>		<u>12 Months or More</u>		<u>Total</u>	
	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>	<u>Fair Value</u>	<u>Unrealized Losses</u>
<b>December 31, 2016 :</b>	(In Thousands)					
U.S. Government agency obligations	\$ 20,388	\$ (105)	\$ -	\$ -	\$ 20,388	\$ (105)
Municipal bonds	8,595	(763)	-	-	8,595	(763)
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	13,206	(457)	-	-	13,206	(457)
Total Temporarily Impaired Securities	<u>\$ 42,189</u>	<u>\$ (1,325)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 42,189</u>	<u>\$ (1,325)</u>
<b>December 31, 2015 :</b>						
U.S. Government agency obligations	\$ 25,525	\$ (121)	\$ -	\$ -	\$ 25,525	\$ (121)
Municipal bonds	6,180	(144)	-	-	6,180	(144)
Total Temporarily Impaired Securities	<u>\$ 31,705</u>	<u>\$ (265)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,705</u>	<u>\$ (265)</u>

The Company had forty-two (42) securities in an unrealized loss position at December 31, 2016. Unrealized losses are due only to market rate fluctuations. As of December 31, 2016, the Company either has the intent and ability to hold the securities until maturity or market price recovery, or believes that it is more likely than not that it will not be required to sell such securities. Management believes that the unrealized loss only represents temporary impairment of the securities. None of the individual losses are significant.

Securities with a carrying value of \$71.8 million and \$64.9 million at December 31, 2016 and December 31, 2015, respectively, were subject to agreements to repurchase, pledged to secure public deposits, or pledged for other purposes required or permitted by law.

**Note 3 – Loans Receivable**

The following table presents the composition of loans receivable at December 31, 2016 and 2015 respectively:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Commercial real estate	\$ 321,730	\$ 289,304
Commercial construction	28,606	17,786
Commercial	39,045	34,955
Residential real estate	408,872	347,316
Consumer	718	745
<b>Total Loans</b>	<b>798,971</b>	<b>690,106</b>
Unearned net loan origination costs (fees)	144	9
Allowance for Loan Losses	<u>(6,517)</u>	<u>(6,068)</u>
	<u>\$ 792,598</u>	<u>\$ 684,047</u>

**Note 4 – Allowance for Loan Losses**

The changes in the allowance for loan losses for the years ended December 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Allowance for loan losses:	(In Thousands)	
Balance, beginning	\$ 6,068	\$ 5,614
Provision for loan losses	770	532
Loans charged off	(321)	(88)
Recoveries	-	10
Balance at end of year	<u>\$ 6,517</u>	<u>\$ 6,068</u>

The following table presents the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention (potential weaknesses), substandard (well defined weaknesses) and doubtful (full collection unlikely) within the Company's internal risk rating system as of December 31, 2016 and December 31, 2015, respectively:

	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
<b>December 31, 2016</b>	(In Thousands)				
Commercial real estate	\$ 315,579	\$ 20	\$ 6,131	\$ -	\$ 321,730
Commercial construction	28,291	-	315	-	28,606
Commercial	38,916	29	100	-	39,045
Residential real estate	407,787	-	1,085	-	408,872
Consumer	718	-	-	-	718
Total	<u>\$ 791,291</u>	<u>\$ 49</u>	<u>\$ 7,631</u>	<u>\$ -</u>	<u>\$ 798,971</u>
<b>December 31, 2015</b>					
Commercial real estate	\$ 287,755	\$ -	\$ 1,549	\$ -	\$ 289,304
Commercial construction	16,971	-	815	-	17,786
Commercial	34,889	66	-	-	34,955
Residential real estate	346,787	-	529	-	347,316
Consumer	745	-	-	-	745
Total	<u>\$ 687,147</u>	<u>\$ 66</u>	<u>\$ 2,893</u>	<u>\$ -</u>	<u>\$ 690,106</u>

The following table summarizes information in regards to impaired loans by loan portfolio class as of December 31, 2016 and 2015, respectively:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Year to Date	
				Average Recorded Investment	Interest Income Recognized
<b>December 31, 2016</b>					
With no related allowance recorded:					
Commercial real estate	\$ 8,159	\$ 8,463		\$ 5,924	\$ 255
Commercial construction	315	315		565	19
Commercial	100	160		50	2
Residential real estate	1,516	1,723		1,050	23
Consumer	-	-		-	-
With an allowance recorded:					
Commercial real estate	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial construction	-	-	-	-	-
Commercial	279	279	64	263	12
Residential real estate	811	811	232	914	5
Consumer	-	-	-	-	-
Total:					
Commercial real estate	\$ 8,159	\$ 8,463	\$ -	\$ 5,924	\$ 255
Commercial construction	315	315	-	565	19
Commercial	379	439	64	313	14
Residential real estate	2,327	2,534	232	1,964	28
Consumer	-	-	-	-	-
	<u>\$ 11,180</u>	<u>\$ 11,751</u>	<u>\$ 296</u>	<u>\$ 8,766</u>	<u>\$ 316</u>
<b>December 31, 2015</b>					
With no related allowance recorded:					
Commercial real estate	\$ 3,644	\$ 3,928		\$ 3,672	\$ 139
Commercial construction	815	815		1,096	38
Commercial	-	-		-	-
Residential real estate	758	758		1,029	10
Consumer	-	-		-	-
With an allowance recorded:					
Commercial real estate	\$ -	\$ -	\$ -	\$ 336	\$ -
Commercial construction	-	-	-	-	-
Commercial	321	321	115	323	10
Residential real estate	834	834	255	878	5
Consumer	-	-	-	-	-
Total:					
Commercial real estate	\$ 3,644	\$ 3,928	\$ -	\$ 4,008	\$ 139
Commercial construction	815	815	-	1,096	38
Commercial	321	321	115	323	10
Residential real estate	1,592	1,592	255	1,907	15
Consumer	-	-	-	-	-
	<u>\$ 6,372</u>	<u>\$ 6,656</u>	<u>\$ 370</u>	<u>\$ 7,334</u>	<u>\$ 202</u>

The following table presents nonaccrual loans by classes of the loan portfolio as of December 31, 2016 and 2015, respectively:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Commercial real estate	\$ 180	\$ 164
Commercial construction	-	-
Commercial	100	66
Residential real estate	874	529
Consumer	-	-
Total	<u>\$ 1,154</u>	<u>\$ 759</u>

The performance and credit quality of the loan portfolio is also monitored by analyzing the age of the loans receivable as determined by the length of time a recorded payment is past due. The following table presents the classes of the loan portfolio summarized by the past due status as of December 31, 2016 and 2015, respectively:

	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days Past Due	Total Past Due	Current	Total Loan Receivables	Loan Receivables > 90 Days and Accruing
	(In Thousands)						
<b>December 31, 2016</b>							
Commercial real estate	\$ 123	\$ -	\$ 180	\$ 303	\$ 321,427	\$ 321,730	\$ -
Commercial construction	-	-	-	-	28,606	28,606	-
Commercial	196	-	100	296	38,749	39,045	-
Residential real estate	595	155	929	1,679	407,193	408,872	55
Consumer	-	-	-	-	718	718	-
Total	<u>\$ 914</u>	<u>\$ 155</u>	<u>\$ 1,209</u>	<u>\$ 2,278</u>	<u>\$ 796,693</u>	<u>\$ 798,971</u>	<u>\$ 55</u>
<b>December 31, 2015</b>							
Commercial real estate	\$ 219	\$ -	\$ 164	\$ 383	\$ 288,921	\$ 289,304	\$ -
Commercial construction	500	-	-	500	17,286	17,786	-
Commercial	-	-	66	66	34,889	34,955	-
Residential real estate	159	76	529	764	346,552	347,316	-
Consumer	-	-	-	-	745	745	-
Total	<u>\$ 878</u>	<u>\$ 76</u>	<u>\$ 759</u>	<u>\$ 1,713</u>	<u>\$ 688,393</u>	<u>\$ 690,106</u>	<u>\$ -</u>

The following table summarizes information in regards to the allowance for loan losses as of December 31, 2016 and 2015, respectively:

	<u>Commercial Real Estate</u>	<u>Commercial Construction</u>	<u>Commercial</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
	(In Thousands)						
<b>Allowance for loan losses</b>							
<b>Year Ending December 31, 2016</b>							
<b>Beginning Balance - December 31, 2015</b>	\$ 2,132	\$ 294	\$ 402	\$ 2,529	\$ 29	\$ 682	\$ 6,068
Charge-offs	(35)	-	(75)	(207)	(4)	-	(321)
Recoveries	-	-	-	-	-	-	-
Provisions	252	222	96	615	(10)	(405)	770
<b>Ending Balance - December 31, 2016</b>	<u>\$ 2,349</u>	<u>\$ 516</u>	<u>\$ 423</u>	<u>\$ 2,937</u>	<u>\$ 15</u>	<u>\$ 277</u>	<u>\$ 6,517</u>
<b>Year Ending December 31, 2015</b>							
<b>Beginning Balance - December 31, 2014</b>	\$ 1,704	\$ 401	\$ 407	\$ 1,955	\$ 22	\$ 1,125	\$ 5,614
Charge-offs	(60)	-	-	(28)	-	-	(88)
Recoveries	10	-	-	-	-	-	10
Provisions	478	(107)	(5)	602	7	(443)	532
<b>Ending Balance - December 31, 2015</b>	<u>\$ 2,132</u>	<u>\$ 294</u>	<u>\$ 402</u>	<u>\$ 2,529</u>	<u>\$ 29</u>	<u>\$ 682</u>	<u>\$ 6,068</u>

The following tables represent the allocation of the allowance for loan losses and the related loan portfolio disaggregated based on impairment methodology at December 31, 2016 and December 31, 2015:

	<u>Commercial Real Estate</u>	<u>Commercial Construction</u>	<u>Commercial</u>	<u>Residential Real Estate</u>	<u>Consumer</u>	<u>Unallocated</u>	<u>Total</u>
(In Thousands)							
<b>December 31, 2016</b>							
<b>Allowance for Loan Losses</b>							
Ending Balance	\$ 2,349	\$ 516	\$ 423	\$ 2,937	\$ 15	\$ 277	\$ 6,517
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ 64	\$ 232	\$ -	\$ -	\$ 296
Ending balance: collectively evaluated for impairment	\$ 2,349	\$ 516	\$ 359	\$ 2,705	\$ 15	\$ 277	\$ 6,221
<b>Loans receivables:</b>							
Ending balance	\$ 321,730	\$ 28,606	\$ 39,045	\$ 408,872	\$ 718		\$ 798,971
Ending balance: individually evaluated for impairment	\$ 8,159	\$ 315	\$ 379	\$ 2,327	\$ -		\$ 11,180
Ending balance: collectively evaluated for impairment	\$ 313,571	\$ 28,291	\$ 38,666	\$ 406,545	\$ 718		\$ 787,791
<b>December 31, 2015</b>							
<b>Allowance for Loan Losses</b>							
Ending Balance	\$ 2,132	\$ 294	\$ 402	\$ 2,529	\$ 29	\$ 682	\$ 6,068
Ending balance: individually evaluated for impairment	\$ -	\$ -	\$ 115	\$ 255	\$ -	\$ -	\$ 370
Ending balance: collectively evaluated for impairment	\$ 2,132	\$ 294	\$ 287	\$ 2,274	\$ 29	\$ 682	\$ 5,698
<b>Loans receivables:</b>							
Ending balance	\$ 289,304	\$ 17,786	\$ 34,955	\$ 347,316	\$ 745		\$ 690,106
Ending balance: individually evaluated for impairment	\$ 3,644	\$ 815	\$ 321	\$ 1,592	\$ -		\$ 6,372
Ending balance: collectively evaluated for impairment	\$ 285,660	\$ 16,971	\$ 34,634	\$ 345,724	\$ 745		\$ 683,734

### **Troubled Debt Restructurings**

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition than it would not otherwise consider, resulting in a modified loan which is then identified as troubled debt restructuring ("TDR"). The Company may modify loans through rate reductions, extensions to maturity, interest only payments, or payment modifications to better coincide the timing of payments due under the modified terms with the expected timing of cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and the evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

The following table presents TDRs outstanding:

	<u>Accrual Loans</u>	<u>Non-Accrual Loans</u>	<u>Total Modifications</u>
	(In Thousands)		
<b>December 31, 2016</b>			
Commercial real estate	\$ 3,078	\$ -	\$ 3,078
Commercial construction	260	-	260
Commercial	250	-	250
Residential real estate	1,243	-	1,243
Consumer	-	-	-
	<u>\$ 4,831</u>	<u>\$ -</u>	<u>\$ 4,831</u>
<b>December 31, 2015</b>			
Commercial real estate	\$ 3,145	\$ -	\$ 3,145
Commercial construction	260	-	260
Commercial	255	-	255
Residential real estate	1,063	-	1,063
Consumer	-	-	-
	<u>\$ 4,723</u>	<u>\$ -</u>	<u>\$ 4,723</u>

The following table presents newly restructured loans that occurred during the years ended December 31, 2016 and 2015:

	<u>Number of Loans</u>	<u>Pre-Modification Outstanding Balance</u>	<u>Post- Modification Outstanding Balance</u>
	(Dollars In Thousands)		
<b>Year Ending December 31, 2016</b>			
Residential real estate	1	\$ 212	\$ 212
	<u>1</u>	<u>\$ 212</u>	<u>\$ 212</u>
<b>Year Ending December 31, 2015</b>			
Residential real estate	1	\$ 142	\$ 142
	<u>1</u>	<u>\$ 142</u>	<u>\$ 142</u>

Of the TDRs listed above, there was not an impairment reserve recorded in the allowance for loan losses for the twelve months ended December 31, 2016 and December 31, 2015. As of the years ended December 31, 2016 and 2015, no available commitments were outstanding on TDRs.

There were no loans that were modified and classified as a TDR within the prior twelve months that experienced a payment default (loans ninety or more days past due) during the twelve months ended December 31, 2016.

**Note 5 - Bank Premises and Equipment**

The components of premises and equipment at December 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Furniture, fixtures and equipment	\$ 2,856	\$ 2,710
Leasehold improvements	3,004	2,715
Computer equipment and data processing software	2,463	2,303
Automobiles	184	182
Construction in progress	40	56
	<u>8,547</u>	<u>7,966</u>
Accumulated depreciation	<u>(6,438)</u>	<u>(5,708)</u>
	<u>\$ 2,109</u>	<u>\$ 2,258</u>

Depreciation expense for the years ended December 31, 2016 and 2015 was \$730 thousand and \$605 thousand, respectively.

**Note 6 – Deposits**

The components of deposits at December 31, 2016 and 2015 are as follows:

	<u>December 31, 2016</u>	<u>December 31, 2015</u>
	(In Thousands)	
Demand, non-interest bearing	\$ 117,208	\$ 89,959
Demand, NOW and money market, interest bearing	97,687	67,402
Savings	488,701	406,361
Time, \$100 and over	89,020	59,533
Time, other	40,768	37,011
Total deposits	<u>\$ 833,384</u>	<u>\$ 660,266</u>

At December 31, 2016, the scheduled maturities of time deposits are as follows (in thousands):

2017	\$ 70,242
2018	30,481
2019	12,093
2020	6,390
2021	10,582
	<u>\$ 129,788</u>

Time deposits with individual balances equal to or greater than \$250,000 (FDIC insurance limit) at December 31, 2016 and 2015 totaled \$45.5 million and \$23.1 million, respectively.

**Note 7 - Securities Sold under Agreements to Repurchase**

Securities sold under agreements to repurchase generally mature within a few days from the transaction date and are reflected at the amount of cash received in connection with the transaction. The securities are retained under the Company's control at its safekeeping agent. The Company adjusts collateral based on the fair value of the underlying securities, on a monthly basis. Information concerning securities sold under agreements to repurchase for the years ended December 31, 2016 and 2015 is summarized as follows:

	<u>2016</u>	<u>2015</u>
	(Dollars In Thousands)	
Balance outstanding at December 31	\$ 11,889	\$ 27,535
Weighted average interest rate at the end of the year	0.070%	0.058%
Average daily balance during the year	\$ 14,500	\$ 32,336
Weighted average interest rate during the year	0.082%	0.054%
Maximum month-end balance during the year	\$ 25,752	\$ 34,156

**Note 8 – Short-term and Long-term Borrowings**

The Bank has borrowing capacity with FHLB of approximately \$445.0 million, which includes a line of credit for \$150.0 million. There were no long-term loans outstanding with the FHLB as of December 31, 2016 and \$3.8 million outstanding as of December 31, 2015. There were no short-term loans outstanding with FHLB as of December 31, 2016 and \$39.3 million outstanding as of December 31, 2015. FHLB deposit letters of credit are standby letters of credit commitments issued by the Bank for the benefit of a third party (the "Beneficiary"), which secure public deposits in the Bank. The Company, through the Bank, had \$3.5 million of FHLB deposit letters of credit outstanding as of December 31, 2016 and none as of December 31, 2015. All FHLB borrowings are secured by qualifying assets of the Bank.

The Bank also has a \$10.0 million line of credit with Atlantic Community Bankers Bank, of which none was outstanding at December 31, 2016 and 2015. Advances from this line are unsecured.

**Note 9 - Lease Commitments**

The Company leases its banking premises under leases which the Company classifies as operating leases. These leases expire at various dates through February 2022. In addition to fixed rentals, the leases require the Company to pay certain additional expenses of occupying these spaces, including real estate taxes, insurance, utilities and repairs. A portion of these leases are with related parties as described below.

Future minimum lease payments by year and in the aggregate, under all lease agreements, are as follows:

	<u>Related Parties</u>	<u>Third Parties</u>	<u>Total</u>
	(In Thousands)		
2017	426	881	1,307
2018	441	902	1,343
2019	450	704	1,154
2020	458	130	588
2021	431	-	431
Thereafter	<u>70</u>	<u>-</u>	<u>70</u>
	<u>\$ 2,276</u>	<u>\$ 2,617</u>	<u>\$ 4,893</u>

Total rent expense was \$1.3 million and \$1.2 million for the years ended December 31, 2016 and 2015, respectively. Rent expense to related parties was \$406 thousand and \$410 thousand for the years ended December 31, 2016 and 2015, respectively (see Note 14).

**Note 10 - Employment Agreements and Supplemental Executive Retirement Plans**

The Company has entered into employment agreements with its Chief Executive Officer, Chief Financial Officer and Executive Vice President of Commercial Lending.

The Company has a non-qualified Supplemental Executive Retirement Plan (“SERP”) for certain executive officers that provides for payments upon retirement, death or disability. As of December 31, 2016 and 2015, respectively, other liabilities include \$3.8 million and \$3.4 million, respectively, accrued under these plans. For the years ended December 31, 2016 and 2015, \$430 thousand and \$377 thousand, respectively, were expensed under these plans.

**Note 11 - Stock Incentive Plan and Employee Stock Purchase Plan**

**Stock Incentive Plan:**

At the Company’s annual meeting on June 16, 2010, the shareholders approved the Embassy Bancorp, Inc. 2010 Stock Incentive Plan (the “SIP”). The SIP authorizes the Board of Directors, or a committee authorized by the Board of Directors, to award a stock based incentive to (i) designated officers (including officers who are directors) and other designated employees at the Company and its subsidiaries, and (ii) non-employee members of the Board of Directors and advisors and consultants to the Company and its subsidiaries. The SIP provides for stock based incentives in the form of incentive stock options as provided in Section 422 of the Internal Revenue Code of 1986, non-qualified stock options, stock appreciation rights, restricted stock and deferred stock awards. The term of the option, the amount of time for the option to vest after grant, if any, and other terms and limitations will be determined

at the time of grant. Options granted under the SIP may not have an exercise period that is more than ten years from the time the option is granted. At inception, the aggregate number of shares available for issuance under the SIP was 500,000. The SIP provides for appropriate adjustments in the number and kind of shares available for grant or subject to outstanding awards under the SIP to avoid dilution in the event of merger, stock splits, stock dividends or other changes in the capitalization of the Company. The SIP expires on June 15, 2020. At December 31, 2016, there were 298,778 shares available for issuance under the SIP.

The Company grants shares of restricted stock, under the SIP, to certain members of its Board of Directors as compensation for their services, in accordance with the Company's Non-employee Directors Compensation program adopted in October 2010. The Company also granted restricted stock to certain officers under individual agreements with these officers. Some of these restricted stock awards vest immediately, while the remainder vest over three to nine service years. Management recognizes compensation expense for the fair value of the restricted stock awards on a straight-line basis over the requisite service period. Since inception of the plan and through the Company's restricted stock grants activity for the year ended December 31, 2016, there have been 84,979 awards granted. During the years ended December 31, 2016 and 2015 there were 25,139 and 32,875 awards granted, respectively. During the years ended December 31, 2016 and 2015 the Company recognized \$111 thousand and \$96 thousand in compensation expense for the restricted stock awards.

Information regarding the Company's restricted stock grants activity for the years ended December 31, 2016 and 2015 are as follows:

	<u>Restricted Stock Awards</u>	<u>Weighted Average Grant Date Fair Value</u>
<b>Non-Vested at December 31, 2014</b>	-	\$ -
Granted	32,875	10.83
Vested	<u>(9,122)</u>	<u>10.55</u>
<b>Non-Vested at December 31, 2015</b>	23,753	\$ 10.94
Granted	25,139	12.14
Vested	<u>(10,488)</u>	<u>10.70</u>
<b>Non-Vested at December 31, 2016</b>	<u>38,404</u>	<u>\$ 11.79</u>

In December 2016, January 2014, February 2013 and 2012, the Company granted stock options to purchase 4,227, 29,663, 29,742 and 52,611 shares of stock to certain executive officers under individual agreements and/or in accordance with their respective employment agreements. No stock options were granted in 2015. Stock compensation expense related to these options was \$27 thousand and \$45 thousand for the year ended December 31, 2016 and 2015, respectively. At December 31, 2016, approximately \$15 thousand unrecognized cost to these stock options granted in 2016 and 2014 will be recognized over the next 2.97 and 0.05 years, respectively. The fair value of the options granted in 2016, 2014, 2013 and 2012 was determined with the following weighted average assumptions: dividend yield of 1.03% in 2016 and 0.00% in 2014, 2013 and 2012, respectively, risk free interest rate of 2.35%, 2.30%, 1.34% and 1.43%, respectively, expected life of 6.0 years, 6.0 years, 6.0 years and 7.5 years, respectively, and expected volatility of 25.58%, 28.93%, 28.79% and 31.10%, respectively. The weighted average fair value of options granted in 2016, 2014, 2013 and 2012 was \$3.28, \$2.46, \$2.14 and \$2.56 per share, respectively.

Activities under the SIP, related to stock options, is summarized as follows:

	<b>Number of Options</b>	<b>Weighted Average Exercise Price</b>
<b>Outstanding, December 31, 2014</b>	112,016	\$ 7.14
Granted	-	-
Exercised	-	-
Forfeited	-	-
<b>Outstanding, December 31, 2015</b>	112,016	\$ 7.14
Granted	4,227	12.64
Exercised	-	-
Forfeited	-	-
<b>Outstanding, December 31, 2016</b>	<b>116,243</b>	<b>\$ 7.34</b>
<b>Exercisable, December 31, 2016</b>	<b>102,128</b>	<b>\$ 7.10</b>

Stock options outstanding at December 31, 2016 are exercisable at prices ranging from \$6.62 to \$13.23 per share. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2016 is 5.06 years and 4.80 years, respectively. The weighted-average remaining contractual life of options outstanding and exercisable at December 31, 2015 was 5.91 years and 5.61 years, respectively. At December 31, 2016, the aggregate intrinsic value of options outstanding and exercisable was \$637 thousand. The intrinsic value was determined by using the latest known sales price of the Company's common stock. For the years ending December 31, 2016 and 2015, the aggregate intrinsic value of options exercised was \$328 thousand.

The following table summarizes information about the range of exercise prices for stock options outstanding at December 31, 2016:

<b>Range of Exercise Price</b>	<b>Weighted Average Exercise Price</b>	<b>Number Outstanding</b>	<b>Weighted Average Remaining Contractual Life (Years)</b>	<b>Number Exercisable</b>
\$6.62 to \$7.94	\$ 7.14	112,016	4.91	102,128
\$11.91 to \$13.23	\$ 12.64	4,227	8.97	-
		<b>116,243</b>	<b>5.06</b>	<b>102,128</b>

#### Employee Stock Purchase Plan:

On January 1, 2017, the Company implemented the Embassy Bancorp, Inc. Employee Stock Purchase Plan, which was approved by the Company's shareholders at the annual meeting held on June 16, 2016. Under the plan, each employee of the Company and its subsidiaries who is employed on an offering date and customarily is scheduled to work at least twenty (20) hours per week and more than five (5) months in a calendar year is eligible to participate. The purchase price for shares purchased under the plan shall initially equal 95% of the fair market value of such shares on the date of purchase. The purchase price may be adjusted from time to time by the Board of Directors;

provided, however, that the discount to fair market value shall not exceed 15%. The Company has authorized 350,000 shares of its common stock for the plan, none of which were issued as of December 31, 2016.

**Note 12 – Other Comprehensive Income (Loss)**

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income (loss).

The components of other comprehensive loss, both before tax and net of tax, are as follows:

	Year Ended December 31,					
	2016			2015		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
(In Thousands)						
Change in accumulated other comprehensive loss:						
Unrealized holding losses on securities available for sale	\$ (1,560)	\$ 531	\$ (1,029)	\$ (182)	\$ 62	\$ (120)
Reclassification adjustments for gains on securities transactions included in net income (A),(B)	(350)	119	(231)	(165)	56	(109)
<b>Total other comprehensive loss</b>	<b>\$ (1,910)</b>	<b>\$ 650</b>	<b>\$ (1,260)</b>	<b>\$ (347)</b>	<b>\$ 118</b>	<b>\$ (229)</b>

(A) Realized gains on securities transactions included in gain on sales of securities, net, in the accompanying Consolidated Statements of Income.

(B) Tax effect included in income tax expense in the accompanying Consolidated Statements of Income.

A summary of the realized gains on securities available for sale, net of tax, is as follows:

	Year Ended December 31,	
	2016	2015
	(In Thousands)	
Securities available for sale:		
Realized gains on securities transactions	\$ (350)	\$ (165)
Income taxes	119	56
<b>Net of tax</b>	<b>\$ (231)</b>	<b>\$ (109)</b>

A summary of the accumulated other comprehensive (loss) income, net of tax, is as follows:

	<b>Securities Available for Sale</b>
	(In Thousands)
<b>Year Ended December 31, 2016 and 2015</b>	
<b>Balance January 1, 2016</b>	<b>\$ 1,236</b>
Other comprehensive loss before reclassifications	(1,029)
Amounts reclassified from accumulated other comprehensive income	(231)
Net other comprehensive loss during the period	(1,260)
<b>Balance December 31, 2016</b>	<b>\$ (24)</b>
<b>Balance January 1, 2015</b>	<b>\$ 1,465</b>
Other comprehensive loss before reclassifications	(120)
Amounts reclassified from accumulated other comprehensive income	(109)
Net other comprehensive loss during the period	(229)
<b>Balance December 31, 2015</b>	<b>\$ 1,236</b>

**Note 13 - Federal Income Taxes**

The components of income tax expense for the years ended December 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Current	\$ 2,773	\$ 2,981
Deferred	77	(33)
	<u>\$ 2,850</u>	<u>\$ 2,948</u>

A reconciliation of the statutory federal income tax at a rate of 34% to the income tax expense included in the statement of income for the years ended December 31, 2016 and 2015 is as follows:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Federal income tax at statutory rate	\$ 3,400	\$ 3,521
Tax free interest	(491)	(518)
CSV Life Insurance	(139)	-
Other	80	(55)
	<u>\$ 2,850</u>	<u>\$ 2,948</u>

The Company follows guidance in ASC Topic 740 regarding accounting for uncertainty in income taxes. The Company has evaluated its tax positions. 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 has a likelihood of being realized on examination of more than 50 percent. For tax positions not meeting the “more likely than not” test, no tax benefit is recorded. Under the

“more likely than not” threshold guidelines, the Company believes no significant uncertain tax positions exist, either individually or in the aggregate, that would give rise to the non-recognition of an existing tax benefit. As of December 31, 2016 and 2015, the Company had no material unrecognized tax benefits or accrued interest and penalties. The Company’s policy is to account for interest as a component of interest expense and penalties as a component of other expense. The Company is subject to U.S. federal income tax.

The components of the net deferred tax asset at December 31, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Deferred tax assets:		
Allowance for loan losses	\$ 2,216	\$ 2,063
Accrued SERP	1,306	1,159
Premises and equipment	36	-
Unrealized loss on securities available for sale	14	-
Other	126	406
<b>Total Deferred Tax Assets</b>	<b>3,698</b>	<b>3,628</b>
Deferred tax liabilities:		
Premises and equipment	-	25
Prepaid assets	359	320
Non-qualified Stock Awards	3	3
Deferred loan costs	600	481
Unrealized gain on securities available for sale	-	636
<b>Total Deferred Tax Liabilities</b>	<b>\$ 962</b>	<b>\$ 1,465</b>
<b>Net Deferred Tax Asset</b>	<b>\$ 2,736</b>	<b>\$ 2,163</b>

Based upon the level of historical taxable income and projections for future taxable income over periods in which the deferred tax assets are deductible, management believes it is more likely than not that the Company will realize the benefits of these deductible differences.

**Note 14 - Transactions with Executive Officers, Directors and Principal Stockholders**

The Company has had, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stockholders, their immediate families and affiliated companies (commonly referred to as related parties).

Related parties were indebted to the Company for loans totaling \$4.1 million and \$4.7 million at December 31, 2016 and 2015, respectively. During 2016, loans totaling \$2.6 million were disbursed and loan repayments totaled \$2.7 million. During 2016, one director retired and the related party loan balance of \$545 thousand, attributed to said director, was removed from the totals.

Deposits with related parties were \$25.8 million and \$20.5 million at December 31, 2016 and 2015, respectively.

Fees paid to related parties for legal services for the years ended December 31, 2016 and 2015 were approximately \$87 thousand and \$104 thousand, respectively. The Company leases its main banking office from an investment group comprised of related parties and its West Broad Street office also from a related party, as described in Note 9.

**Note 15 - Financial Instruments with Off-Balance Sheet Risk**

The Company 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 and letters of credit. Such commitments 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 and letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

At December 31, 2016 and 2015, the following financial instruments were outstanding whose contract amounts represent credit risk:

	<u>2016</u>	<u>2015</u>
	(In Thousands)	
Commitments to grant loans, fixed	\$ 3,507	\$ 5,745
Commitments to grant loans, variable	-	-
Unfunded commitments under lines of credit, fixed	22,636	22,679
Unfunded commitments under lines of credit, variable	69,907	65,142
Standby letters of credit	<u>4,234</u>	<u>3,857</u>
	<u>\$ 100,284</u>	<u>\$ 97,423</u>

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. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. 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 upon extension of credit, is based on management's credit evaluation.

Collateral held varies but may include personal or commercial real estate, accounts receivable, inventory and equipment.

Outstanding letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The majority of these standby letters of credit expire within the next twelve months. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending other loan commitments. The Company requires collateral supporting these letters of credit as deemed necessary. The maximum undiscounted exposure related to these commitments at December 31, 2016 and 2015 was \$4.2 million and \$3.9 million, respectively, and the approximate value of underlying collateral upon liquidation that would be expected to cover this maximum potential exposure was \$3.8 million and \$3.7 million, respectively. The current amount of the liability as of December 31, 2016 and 2015 for guarantees under standby letters of credit issued is not considered material.

**Note 16 - Regulatory Matters**

The Company is required to maintain cash reserve balances in vault cash and with the Federal Reserve Bank. As of December 31, 2016, the Company had a \$8.3 million minimum reserve balance.

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. The final rules implementing BASEL Committee on Banking Supervisor's Capital Guidance for U.S. banks (BASEL III rules) became effective for the Company on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule and fully phased in by January 1, 2019. Under the BASEL III rules the Company and the Bank must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.0% for 2015 to 2.50% by 2019. The capital conservation buffer for 2016 is 0.625%. The net unrealized gain or losses on available-for-sale securities are not included in computing regulatory capital amounts. Failure to meet the minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, both the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Company and the Bank to maintain minimum amounts and ratios (set forth below) of total, Tier 1 common capital, and Tier 1 capital (as defined in the regulations) to risk-weighted assets and of Tier 1 capital to average assets. Management believes, as of December 31, 2016, that the Company and the Bank meet all capital adequacy requirements to which they are subject.

As of December 31, 2016, the most recent notification from the regulatory agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's category.

The Bank's actual capital amounts and ratios at December 31, 2016 and 2015 are presented below:

	Actual		For Capital Adequacy Purposes		To be Well Capitalized under Prompt Corrective Action	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollar Amounts in Thousands)						
<b>December 31, 2016:</b>						
Total capital (to risk-weighted assets)	\$ 79,578	12.2 %	\$ ≥ 52,191	≥ 8.0 %	\$ ≥ 65,238	≥ 10.0 %
Tier 1 common capital (to risk-weighted assets)	73,061	11.2	≥ 29,357	≥ 4.5	≥ 42,405	≥ 6.5
Tier 1 capital (to risk-weighted assets)	73,061	11.2	≥ 39,143	≥ 6.0	≥ 52,191	≥ 8.0
Tier 1 capital (to average assets)	73,061	8.0	≥ 36,376	≥ 4.0	≥ 45,470	≥ 5.0
<b>December 31, 2015:</b>						
Total capital (to risk-weighted assets)	\$ 72,880	12.6 %	\$ ≥ 46,377	≥ 8.0 %	\$ ≥ 57,971	≥ 10.0 %
Tier 1 common capital (to risk-weighted assets)	66,812	11.5	≥ 26,087	≥ 4.5	≥ 37,681	≥ 6.5
Tier 1 capital (to risk-weighted assets)	66,812	11.5	≥ 34,783	≥ 6.0	≥ 46,377	≥ 8.0
Tier 1 capital (to average assets)	66,812	8.4	≥ 31,948	≥ 4.0	≥ 39,935	≥ 5.0

The Company's actual capital amounts and ratios at December 31, 2016 and 2015 are presented below:

	Actual		For Capital Adequacy Purposes	
	Amount	Ratio	Amount	Ratio
(Dollar Amounts in Thousands)				
<b>December 31, 2016:</b>				
Total capital (to risk-weighted assets)	\$ 79,819	12.2 %	\$ ≥ 52,192	≥ 8.0 %
Tier 1 common capital (to risk-weighted assets)	73,302	11.2	≥ 29,358	≥ 4.5
Tier 1 capital (to risk-weighted assets)	73,302	11.2	≥ 39,144	≥ 6.0
Tier 1 capital (to average assets)	73,302	8.1	≥ 36,377	≥ 4.0
<b>December 31, 2015:</b>				
Total capital (to risk-weighted assets)	\$ 72,933	12.6 %	\$ ≥ 46,378	≥ 8.0 %
Tier 1 common capital (to risk-weighted assets)	66,865	11.5	≥ 26,088	≥ 4.5
Tier 1 capital (to risk-weighted assets)	66,865	11.5	≥ 34,784	≥ 6.0
Tier 1 capital (to average assets)	66,865	8.3	≥ 32,231	≥ 4.0

The Bank is subject to certain restrictions on the amount of dividends that it may declare due to regulatory considerations. The Pennsylvania Banking Code provides that cash dividends may be declared and paid only out of accumulated net earnings.

**Note 17 – Offsetting Assets and Liabilities**

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Company in a segregated custodial account under a tri-party agreement.



An asset's or liability's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy utilized at December 31, 2016 and 2015 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
	(In Thousands)			
U.S. Government agency obligations	\$ -	\$ 32,488	\$ -	\$ 32,488
Municipal bonds	-	38,808	-	38,808
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	-	14,302	-	14,302
<b>December 31, 2016 Securities available for sale</b>	<b>\$ -</b>	<b>\$ 85,598</b>	<b>\$ -</b>	<b>\$ 85,598</b>
U.S. Government agency obligations	\$ -	\$ 34,570	\$ -	\$ 34,570
Municipal bonds	-	41,204	-	41,204
U.S. Government Sponsored Enterprise (GSE) - Mortgage-backed securities - residential	-	1,479	-	1,479
<b>December 31, 2015 Securities available for sale</b>	<b>\$ -</b>	<b>\$ 77,253</b>	<b>\$ -</b>	<b>\$ 77,253</b>

For financial assets measured at fair value on a nonrecurring basis, the fair value measurements by level within the fair value hierarchy used at December 31, 2016 and 2015 are as follows:

Description	(Level 1) Quoted Prices in Active Markets for Identical Assets	(Level 2) Significant Other Observable Inputs	(Level 3) Significant Unobservable Inputs	Total
	(In Thousands)			
December 31, 2016 Impaired loans (1)	\$ -	\$ -	\$ 794	\$ 794
December 31, 2016 Other real estate owned (1)	\$ -	\$ -	\$ 480	\$ 480
December 31, 2015 Impaired loans (1)	\$ -	\$ -	\$ 785	\$ 785
December 31, 2015 Other real estate owned (1)	\$ -	\$ -	\$ 1,224	\$ 1,224

(1) Fair Value is generally determined through independent appraisals of the underlying collateral, which generally include Level 3 input which are not identifiable. Fair values may also include qualitative adjustments by management based on conditions and liquidation expenses.

Impaired loans are those that are accounted for under existing FASB guidance, in which the Bank has measured impairment generally based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values, based upon the lowest level of input that is significant to the fair value measurements.

Real estate properties acquired through, or in lieu of, foreclosure are to be sold and are carried at fair value less estimated cost to sell. Fair value is based upon independent market prices or appraised value of the property. These

assets are included in Level 3 fair value based upon the lowest level of input that is significant to the fair value measurement.

At December 31, 2016, of the impaired loans having an aggregate balance of \$11.2 million, \$10.1 million did not require a valuation allowance because the value of the collateral securing the loan was determined to meet or exceed the balance owed on the loan. Of the remaining \$1.1 million in impaired loans, an aggregate valuation allowance of \$296 thousand was required to reflect what was determined to be a shortfall in the value of the collateral as compared to the balance on such loans.

The following table presents additional quantitative information about assets measured at fair value on a nonrecurring basis and for which the Company has utilized Level 3 inputs to determine fair value:

Description	Quantitative Information about Level 3 Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
(Dollars In Thousands)				
<b>December 31, 2016:</b>				
Impaired loans	\$ 794	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -25% (-24.8%)
			Liquidation expenses (3)	0% to -10% (-7.5%)
Other real estate owned	\$ 480	Listings, Letters of Intent & Third Party Evaluations (4)	Liquidation expenses (3)	-5% (-5%)
<b>December 31, 2015:</b>				
Impaired loans	\$ 785	Appraisal of collateral (1)	Appraisal adjustments (2)	0% to -25% (-25.0%)
			Liquidation expenses (3)	0% to -7.5% (-7.5%)
Other real estate owned	\$ 1,224	Listings, Letters of Intent & Third Party Evaluations (4)	Liquidation expenses (3)	-5% (-5%)

- (1) Fair value is generally determined through independent appraisals of the underlying collateral, which generally include various Level 3 inputs which are not identifiable.
- (2) Appraisals may be adjusted by management for qualitative factors including economic conditions and the age of the appraisal. The range and weighted average of appraisal adjustments are presented as a percent of the appraisal.
- (3) Appraisals and pending agreements of sale are adjusted by management for liquidation expenses. The range and weighted average of liquidation expense adjustments are presented as a percent of the appraisal or pending agreement of sale.
- (4) Fair value is determined by listings, letters of intent or third-party evaluations.

The following information should not be interpreted as an estimate of the fair value of the entire Company since a fair value calculation is only provided for a limited portion of the Company's assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between the Company's disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair values of the Company's financial instruments at December 31, 2016 and December 31, 2015:

**Cash and Cash Equivalents (Carried at Cost)**

The carrying amounts reported in the balance sheet for cash and short-term instruments approximate those assets' fair values.

**Interest Bearing Time Deposits (Carried at Cost)**

Fair values for fixed-rate time certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected

monthly maturities on time deposits. The Company generally purchases amounts below the insured limit, limiting the amount of credit risk on these time deposits.

**Securities Available for Sale (Carried at Fair Value)**

The fair value of securities available for sale are determined by matrix pricing (Level 2), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted prices. For these securities, the Company obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information and the security's terms and conditions, among other things.

**Loans Receivable (Carried at Cost)**

The fair values of loans, excluding impaired loans carried at fair value of collateral, are estimated using discounted cash flow analyses, using market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, and projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

**Restricted Investment in Bank Stock (Carried at Cost)**

The carrying amount of restricted investment in bank stock approximates fair value, and considers the limited marketability of such securities.

**Accrued Interest Receivable and Payable (Carried at Cost)**

The carrying amount of accrued interest receivable and accrued interest payable approximates its fair value.

**Deposit Liabilities (Carried at Cost)**

The fair values disclosed for demand deposits (e.g., interest and noninterest checking, passbook savings and money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

**Securities Sold Under Agreements to Repurchase and Short-term Borrowings (Carried at Cost)**

These borrowings are short term and the carrying amount approximates the fair value.

**Long-Term Borrowings (Carried at Cost)**

Fair values of FHLB and Uninvest advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB and Uninvest advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

**Off-Balance Sheet Financial Instruments (Disclosed at Cost)**

Fair values for the Company's off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

The estimated fair values of the Company's financial instruments were as follows at December 31, 2016 and 2015:

	<u>Carrying Amount</u>	<u>Fair Value Estimate</u>	<u>(Level 1) Quoted Prices in Active Markets for Identical Assets</u>	<u>(Level 2) Significant Other Observable Inputs</u>	<u>(Level 3) Significant Unobservable Inputs</u>
	(In Thousands)				
<b>December 31, 2016:</b>					
Financial assets:					
Cash and cash equivalents	\$ 24,218	\$ 24,218	\$ 24,218	\$ -	\$ -
Interest bearing time deposits	-	-	-	-	-
Securities available-for-sale	85,598	85,598	-	85,598	-
Loans receivable, net of allowance	792,598	790,326	-	-	790,326
Restricted investments in bank stock	624	624	-	624	-
Accrued interest receivable	1,749	1,749	-	1,749	-
Financial liabilities:					
Deposits	833,384	833,627	-	833,627	-
Securities sold under agreements to repurchase and federal funds purchased	11,889	11,886	-	11,886	-
Short-term borrowings	-	-	-	-	-
Long-term borrowings	-	-	-	-	-
Accrued interest payable	813	813	-	813	-
Off-balance sheet financial instruments:					
Commitments to grant loans	-	-	-	-	-
Unfunded commitments under lines of credit	-	-	-	-	-
Standby letters of credit	-	-	-	-	-
<b>December 31, 2015:</b>					
Financial assets:					
Cash and cash equivalents	\$ 19,526	\$ 19,527	\$ 19,527	\$ -	\$ -
Interest bearing time deposits	-	-	-	-	-
Securities available-for-sale	77,253	77,253	-	77,253	-
Loans receivable, net of allowance	684,047	688,645	-	-	688,645
Restricted investments in bank stock	2,178	2,178	-	2,178	-
Accrued interest receivable	1,637	1,637	-	1,637	-
Financial liabilities:					
Deposits	660,266	660,503	-	660,503	-
Securities sold under agreements to repurchase and federal funds purchased	27,535	27,529	-	27,529	-
Short-term borrowings	39,306	39,273	-	39,273	-
Long-term borrowings	3,820	3,740	-	-	3,740
Accrued interest payable	462	462	-	462	-
Off-balance sheet financial instruments:					
Commitments to grant loans	-	-	-	-	-
Unfunded commitments under lines of credit	-	-	-	-	-
Standby letters of credit	-	-	-	-	-

**Note 19 – Parent Company Only Financial**

Condensed financial information pertaining only to the parent company, Embassy Bancorp, Inc., is as follows:

**BALANCE SHEETS**

	As of December 31,	
	2016	2015
(In Thousands)		
<b><u>ASSETS</u></b>		
Cash	\$ 363	\$ 209
Other assets	24	19
Investment in subsidiary	73,036	68,046
Total Assets	<u>\$ 73,423</u>	<u>\$ 68,274</u>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Long-term borrowings	\$ -	\$ -
Other liabilities	145	174
Stockholders' equity	73,278	68,100
Total Liabilities and Stockholders' Equity	<u>\$ 73,423</u>	<u>\$ 68,274</u>

**STATEMENTS OF INCOME AND COMPREHENSIVE INCOME**

	Years Ending December 31,	
	2016	2015
(In Thousands)		
Interest expense on borrowings	\$ -	\$ (83)
Other expenses	(297)	(291)
Equity in net income of banking subsidiary	7,354	7,665
Income before income taxes	7,057	7,291
Income tax benefit	91	118
Net income	<u>\$ 7,148</u>	<u>\$ 7,409</u>
Equity in other comprehensive loss of banking subsidiary	(1,260)	(229)
Comprehensive income	<u>\$ 5,888</u>	<u>\$ 7,180</u>

STATEMENT OF CASH FLOWS

	Years Ending December 31,	
	2016	2015
	(In Thousands)	
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 7,148	\$ 7,409
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock compensation expense	27	49
Net change in other assets and liabilities	(33)	3
Equity in net income of banking subsidiary	(7,354)	(7,665)
<b>Net Cash Used in Operating Activities</b>	<b>(212)</b>	<b>(204)</b>
<b>Cash Flows from Investing Activities:</b>		
Dividend from banking subsidiary	1,104	2,363
<b>Net Cash Provided by Investing Activities</b>	<b>1,104</b>	<b>2,363</b>
<b>Cash Flows from Financing Activities:</b>		
Repayment of long-term borrowings	-	(1,900)
Exercise of stock options, net of payment stock tendered and proceeds from DRIP	322	276
Purchase of treasury stock	(98)	-
Dividends Paid	(962)	(736)
<b>Net Cash Used in Financing Activities</b>	<b>(738)</b>	<b>(2,360)</b>
<b>Net Decrease in Cash</b>	<b>154</b>	<b>(201)</b>
<b>Cash – Beginning</b>	<b>209</b>	<b>410</b>
<b>Cash - Ending</b>	<b>\$ 363</b>	<b>\$ 209</b>

**Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**Item 9A. CONTROLS AND PROCEDURES.**

(a) Disclosure Controls and Procedures.

The Company maintains controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based upon their evaluation of those controls and procedures as of December 31, 2016, the Chief Executive and Chief Financial Officers of the Company concluded that the Company's disclosure controls and procedures were effective.

(b) Management's Report on Internal Control Over Financial Reporting.

Management is responsible for establishing and maintaining effective internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f) under the Securities Exchange Act of 1934. Under the supervision and with the participation of the principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the Internal Control- Integrated Framework (updated 2013 framework version) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on our evaluation under the framework, management has concluded that our internal control over financial reporting was effective as of December 31, 2016.

/s/ David M. Lobach, Jr.

David M. Lobach, Jr.

Chairman, President and Chief Executive Officer

/s/ Judith A. Hunsicker

Judith A. Hunsicker

Senior Executive Vice President, Chief Operating Officer, Secretary and Chief Financial Officer

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to provisions of the Dodd-Frank Act, which exempt smaller reporting companies from this requirement, thus permitting the Company to provide only management's report in this annual report.

(c) Changes in Internal Controls Over Financial Reporting.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the final fiscal quarter of the year to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Item 9B. OTHER INFORMATION.**

None.

### **PART III**

#### **Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information required by Part III, Item 10, is incorporated herein by reference to the information under the captions “Board of Directors,” “Information as to Nominees and Directors,” “Executive Officers,” “Nominating Process,” “Code of Conduct (Ethics),” “Committees of the Board of Directors” and “Section 16(a) Beneficial Ownership Reporting Compliance” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2017 annual meeting of shareholders.

#### **Item 11. EXECUTIVE COMPENSATION.**

The information required by Part III, Item 11, is incorporated herein by reference to the information under the captions “Director Compensation,” “Executive Compensation” and “Agreements with Executive Officers” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2017 annual meeting of shareholders.

#### **Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information required by Part III, Item 12, is incorporated herein by reference to the information under Item 5 of this report and the information under the caption “Information Concerning Share Ownership” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2017 annual meeting of shareholders.

#### **Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information required by Part III, Item 13, is incorporated herein by reference to the information under the captions “Certain Relationships and Related Transactions” and “Director Independence” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2017 annual meeting of shareholders.

#### **Item 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.**

The information required by Part III, Item 14, is incorporated herein by reference to the information under the captions “Independent Registered Public Accounting Firm,” “Fees of Independent Accountants” and “Report of Audit Committee” in the Company’s definitive proxy statement to be filed with the SEC in connection with the Company’s 2017 annual meeting of shareholders.

**PART IV**

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.**

- (a) Financial Statement Schedules can be found under Item 8 of this report.
- (b) Exhibits required by Item 601 of Regulation S-K:

Exhibit

Number

Description

<u>Exhibit Number</u>	<u>Description</u>
3.1	Articles of Incorporation, as amended (conformed) (Incorporated by reference to Exhibit 3.1 of Registrant's Form 10-Q filed on August 12, 2016).
3.2	By-Laws (Incorporated by reference to Exhibit 3.2 of Registrant's Form 10-Q filed on August 12, 2016).
10.1	Embassy Bancorp, Inc. Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to Exhibit 99.1 of Registrant's Registration Statement on Form S-3 filed on June 18, 2012).
10.2	Embassy Bancorp, Inc. 2010 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 of Registrant's Form 10-K filed on March 30, 2016).
10.3	Form of Stock Option Grant Agreement – Directors (Incorporated by reference to Exhibit 10.3 of Registrant's Form 10-K filed on March 30, 2016).
10.4	Form of Stock Option Grant Agreement – Executive Officers (Incorporated by reference to Exhibit 10.4 of Registrant's Form 10-K filed on March 30, 2016).
10.5	Lease Agreement dated June 11, 2001 for the Rte. 512 Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.5 of Registrant's Form 10-K filed on March 30, 2015).
10.6	Lease Agreement dated October 21, 2005 for Hamilton Blvd. and Mill Creek Rd., Lower Macungie Township, PA (Incorporated by reference to Exhibit 10.6 of Registrant's Form 10-K filed on March 30, 2015).
10.7	Lease Addendum dated January 1, 2005 for additional space in the Rte. 512, Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.7 of Registrant's Form 10-K filed on March 30, 2015).
10.8	Lease Agreement dated March 11, 2009 for Cedar Crest Blvd., Allentown, PA (Incorporated by reference to Exhibit 10.8 of Registrant's Form 10-K filed on March 30, 2015).
10.9	Lease Agreement dated March 21, 2003 for Tilghman Street, Allentown, PA (Incorporated by reference to Exhibit 10.9 of Registrant's Form 10-K filed on March 30, 2015).
10.10	Lease Agreement dated March 17, 2006 for 925 West Broad St, Bethlehem PA (Incorporated by reference to Exhibit 10.10 of Registrant's Form 10-K filed on March 30, 2015).
10.11	Lease Agreement dated June 17, 2008 for 5828 Old Bethlehem Pike, Center Valley, PA (Incorporated by reference to Exhibit 10.11 of Registrant's Form 10-K filed on March 30, 2015).
10.12	Lease Agreement dated March 13, 2009 for Corriere Road and Route 248 in Lower Nazareth Township, PA (Incorporated by reference to Exhibit 10.12 of Registrant's Form 10-K filed on March 30, 2015).
10.13	Second Lease Expansion Addendum dated October 21, 2011 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates, LLC.
10.14	Lease Renewal and Modification Agreement dated May 4, 2012 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on May 7, 2012).
10.15	Lease dated September 1, 2015 by and between Embassy Bank for the Lehigh Valley and Orwig Property Management Center Square, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on September 3, 2015).
10.16	Employment Agreement – D. Lobach, dated January 1, 2006 (Incorporated by reference to Exhibit 10.15 of Registrant's Form 10-K filed on March 30, 2015).
10.17	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.17 of Registrant's Form 10-K filed on March 30, 2016).

**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES. (Continued)**

<u>Exhibit Number</u>	<u>Description</u>
10.18	Employment Agreement – J. Hunsicker, dated January 1, 2006 (Incorporated by reference to Exhibit 10.17 of Registrant’s Form 10-K filed on March 30, 2015).
10.19	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated November 19, 2010 (Incorporated by reference to Exhibit 10.19 of Registrant’s Form 10-K filed on March 30, 2016).
10.20	Employment Agreement – J. Bartholomew, dated February 20, 2009 (Incorporated by reference to Exhibit 10.19 of Registrant’s Form 10-K filed on March 30, 2015).
10.21	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated November 19, 2010 (Incorporated by reference to Exhibit 10.21 of Registrant’s Form 10-K filed on March 30, 2016).
10.22	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.22 of Registrant’s Form 10-K filed on March 30, 2016).
10.23	Amendment No. 1 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 21, 2011.
10.24	Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.24 of Registrant’s Form 10-K filed on March 30, 2016).
10.25	Amendment No. 2 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated January 1, 2013 (Incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed on January 2, 2013).
10.26	Amendment No. 3 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated January 23, 2014 (Incorporated by reference to Exhibit 10.1 of Registrant’s Form 8-K filed on January 24, 2014).
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10.28	Amendment No. 2 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated January 1, 2013 (Incorporated by reference to Exhibit 10.3 of Registrant’s Form 8-K filed on January 2, 2013).
10.29	Amendment No. 3 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated January 23, 2014 (Incorporated by reference to Exhibit 10.2 of Registrant’s Form 8-K filed on January 24, 2014).
10.30	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated November 19, 2010 (Incorporated by reference to Exhibit 10.30 of Registrant’s Form 10-K filed on March 30, 2016).
10.31	Amendment No. 2 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated January 1, 2013 (Incorporated by reference to Exhibit 10.4 of Registrant’s Form 8-K filed on January 2, 2013).
10.32	Amendment No. 3 to Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated January 23, 2014 (Incorporated by reference to Exhibit 10.3 of Registrant’s Form 8-K filed on January 24, 2014).
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**Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES. (Continued)**

<u>Exhibit Number</u>	<u>Description</u>
10.35	Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 23, 2015 (Incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed on December 29, 2015).
10.36	Amendment No. 1 to Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated December 21, 2016 (Incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed on December 27, 2016).
10.37	Loan Agreement, dated as of December 22, 2009, by and between Embassy Bancorp, Inc. and Univest National Bank and Trust Co. (Incorporated by reference to Exhibit 10.32 of Registrant's Form 10-K filed on March 30, 2015).
10.38	Subordinated Term Loan Note, dated as of December 22, 2009, by Embassy Bancorp, Inc. in favor of Univest National Bank and Trust Co. (Incorporated by reference to Exhibit 10.33 of Registrant's Form 10-K filed on March 30, 2015).
10.39	Stock Pledge Agreement, dated as of December 22, 2009, by and between Embassy Bancorp, Inc. and Univest National Bank and Trust Co. (Incorporated by reference to Exhibit 10.34 of Registrant's Form 10-K filed on March 30, 2015).
10.40	Embassy Bancorp, Inc. Employee Stock Purchase Plan (Incorporated by reference to Appendix A of Registrant's definitive proxy statement filed on April 21, 2016).
11.1	The statement regarding computation of per share earnings required by this exhibit is contained in Note 1 to the financial statements captions "Earnings Per Share."
21.1	Subsidiaries of the Registrant.
23.1	Consent of Baker Tilly Virchow Krause LLP.
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a)/15d-14(a).
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a)/15d-14(a).
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 1350 of the Sarbanes-Oxley Act of 2002.
101.1	XBRL - Related Documents
	No. Description
101. INS	XBRL Instance Document.
101. SCH	XBRL Taxonomy Extension Schema Document.
101. CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101. LAB	XBRL Taxonomy Extension Label Linkbase Document.
101. PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101. DEF	XBRL Taxonomy Extension Definitions Linkbase Document.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed in its behalf by the undersigned, thereunto duly authorized.

EMBASSY BANCORP, INC.

Dated: March 30, 2017

By: /s/ David M. Lobach, Jr.  
David M. Lobach, Jr.  
Chairman, President and Chief Executive Officer

Dated: March 30, 2017

By: /s/ Judith A. Hunsicker  
Judith A. Hunsicker  
Senior Executive Vice President, Chief Operating  
Officer, Secretary and Chief Financial Officer



**EXHIBIT INDEX**

<u>Exhibit</u> <u>Number</u>	<u>Description</u>
3.1	Articles of Incorporation, as amended (conformed) (Incorporated by reference to Exhibit 3.1 of Registrant's Form 10-Q filed on August 12, 2016).
3.2	By-Laws (Incorporated by reference to Exhibit 3.2 of Registrant's Form 10-Q filed on August 12, 2016).
10.1	Embassy Bancorp, Inc. Dividend Reinvestment and Stock Purchase Plan (Incorporated by reference to Exhibit 99.1 of Registrant's Registration Statement on Form S-3 filed on June 18, 2012).
10.2	Embassy Bancorp, Inc. 2010 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 of Registrant's Form 10-K filed on March 30, 2016).
10.3	Form of Stock Option Grant Agreement – Directors (Incorporated by reference to Exhibit 10.3 of Registrant's Form 10-K filed on March 30, 2016).
10.4	Form of Stock Option Grant Agreement – Executive Officers (Incorporated by reference to Exhibit 10.4 of Registrant's Form 10-K filed on March 30, 2016).
10.5	Lease Agreement dated June 11, 2001 for the Rte. 512 Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.5 of Registrant's Form 10-K filed on March 30, 2015).
10.6	Lease Agreement dated October 21, 2005 for Hamilton Blvd. and Mill Creek Rd., Lower Macungie Township, PA (Incorporated by reference to Exhibit 10.6 of Registrant's Form 10-K filed on March 30, 2015).
10.7	Lease Addendum dated January 1, 2005 for additional space in the Rte. 512, Bethlehem office, Bethlehem, PA (Incorporated by reference to Exhibit 10.7 of Registrant's Form 10-K filed on March 30, 2015).
10.8	Lease Agreement dated March 11, 2009 for Cedar Crest Blvd., Allentown, PA (Incorporated by reference to Exhibit 10.8 of Registrant's Form 10-K filed on March 30, 2015).
10.9	Lease Agreement dated March 21, 2003 for Tilghman Street, Allentown, PA (Incorporated by reference to Exhibit 10.9 of Registrant's Form 10-K filed on March 30, 2015).
10.10	Lease Agreement dated March 17, 2006 for 925 West Broad St, Bethlehem PA (Incorporated by reference to Exhibit 10.10 of Registrant's Form 10-K filed on March 30, 2015).
10.11	Lease Agreement dated June 17, 2008 for 5828 Old Bethlehem Pike, Center Valley, PA (Incorporated by reference to Exhibit 10.11 of Registrant's Form 10-K filed on March 30, 2015).
10.12	Lease Agreement dated March 13, 2009 for Corriere Road and Route 248 in Lower Nazareth Township, PA (Incorporated by reference to Exhibit 10.12 of Registrant's Form 10-K filed on March 30, 2015).
10.13	Second Lease Expansion Addendum dated October 21, 2011 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates, LLC.
10.14	Lease Renewal and Modification Agreement dated May 4, 2012 by and between Embassy Bank for the Lehigh Valley and Red Bird Associates LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on May 7, 2012).
10.15	Lease dated September 1, 2015 by and between Embassy Bank for the Lehigh Valley and Orwig Property Management Center Square, LLC (Incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K filed on September 3, 2015).
10.16	Employment Agreement – D. Lobach, dated January 1, 2006 (Incorporated by reference to Exhibit 10.15 of Registrant's Form 10-K filed on March 30, 2015).
10.17	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.17 of Registrant's Form 10-K filed on March 30, 2016).

**EXHIBIT INDEX (Continued)**

<u>Exhibit Number</u>	<u>Description</u>
10.18	Employment Agreement – J. Hunsicker, dated January 1, 2006 (Incorporated by reference to Exhibit 10.17 of Registrant’s Form 10-K filed on March 30, 2015).
10.19	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and Judith A. Hunsicker, dated November 19, 2010 (Incorporated by reference to Exhibit 10.19 of Registrant’s Form 10-K filed on March 30, 2016).
10.20	Employment Agreement – J. Bartholomew, dated February 20, 2009 (Incorporated by reference to Exhibit 10.19 of Registrant’s Form 10-K filed on March 30, 2015).
10.21	Amendment to Employment Agreement between Embassy Bank for the Lehigh Valley and James R. Bartholomew, dated November 19, 2010 (Incorporated by reference to Exhibit 10.21 of Registrant’s Form 10-K filed on March 30, 2016).
10.22	Amended and Restated Supplemental Executive Retirement Plan Agreement between Embassy Bank for the Lehigh Valley and David M. Lobach, Jr., dated November 19, 2010 (Incorporated by reference to Exhibit 10.22 of Registrant’s Form 10-K filed on March 30, 2016).
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101. PRE	XBRL Taxonomy Extension Presentation Linkbase Document.
101. DEF	XBRL Taxonomy Extension Definitions Linkbase Document.

**Exhibit 21.1**

**SUBSIDIARIES OF THE REGISTRANT**

1. Embassy Bank for the Lehigh Valley, Bethlehem, Pennsylvania; a state-chartered bank organized under Pennsylvania Banking Code of 1965.

**Exhibit 23.1**

**CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

We hereby consent to the incorporation by reference in the Registration Statements on Forms S-8 (Nos. 333-165015 and 333-169018) and S-3 (No. 333-182189) of Embassy Bancorp, Inc. of our report dated March 30, 2017, relating to the consolidated financial statements, which appears in this Annual Report on Form 10-K.

/s/ Baker Tilly Virchow Krause, LLP

Allentown, Pennsylvania  
March 30, 2017





**EXHIBIT 32.1**

**Certification Pursuant to 18 U.S.C. 1350 and  
Section 906 of Sarbanes-Oxley Act of 2002**

We hereby certify that the foregoing Form 10-K of Embassy Bancorp, Inc. for the year ended December 31, 2016 complies in all respects with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Embassy Bancorp, Inc.

/s/ David M. Lobach, Jr.

David M. Lobach, Jr.

Chairman, President and Chief Executive Officer

/s/ Judith A. Hunsicker

Judith A. Hunsicker

Senior Executive Vice President, Chief Operating  
Officer, Secretary and Chief Financial Officer

DATED: March 30, 2017

Embassy Bancorp, Inc. (the “Company”) is a Pennsylvania corporation and registered bank holding company. It is the parent company of Embassy Bank For The Lehigh Valley (the “Bank”), a full service bank providing personal and business lending and deposit service through seven branch offices in the Lehigh Valley area of Pennsylvania.

### Transfer Agent

Computershare  
P.O. Box 30170  
College Station, TX 77842  
Phone: 1-800-368-5948

### Corporate Headquarters

100 Gateway Drive, Suite 100  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405  
610-882-8800 Fax: 610-691-5600  
www.embassybank.com

### Annual Meeting

The Annual Meeting of Embassy Bancorp, Inc. is scheduled for 5:30 PM, June 15, 2017 at the Best Western Lehigh Valley Hotel and Conference Center at 300 Gateway Drive, Bethlehem, Pennsylvania. All shareholders are invited to join us for a reception immediately following the meeting.

### Form 10-K Request

The Company’s Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, is available without charge at the Company’s website at [www.embassybank.com](http://www.embassybank.com) or by contacting:

Judith Hunsicker, Chief Operating Officer  
Embassy Bancorp, Inc.  
P.O. Box 20405  
Lehigh Valley, PA 18002-0405

Embassy Bancorp, Inc. common stock is quoted on the OTCQX under the symbol EMYB and is traded over-the-counter and in privately negotiated transactions. The common stock is not listed on any national securities exchange. OTC Markets ([www.otcm Markets.com](http://www.otcm Markets.com)) maintains a list of market makers of Company common stock. You may also obtain this list by contacting Lynne Neel at 610-882-8805.

On June 16, 2016, the Company declared an annual cash dividend of \$0.13 per share.

### Dividend Reinvestment and Stock Purchase Plan

The Company provides shareholders of record the opportunity to purchase shares of Company common stock through our Dividend Reinvestment and Stock Purchase Plan. Under the Plan, shareholders have the opportunity to use their cash dividends on some or all of their shares of Company common stock, as well as optional cash payments, to purchase additional shares of Company common stock. Eligibility to participate in the plan may be limited to certain jurisdictions, as determined in the discretion of the Company.

To request a prospectus describing the plan, please contact the plan agent:

Computershare  
P.O. Box 30170  
College Station, TX 77842  
Phone: 1-800-368-5948  
Internet: [www.computershare.com](http://www.computershare.com)

**ALLENTOWN**  
1142 S Cedar Crest Blvd.  
(484) 223-0018

**ALLENTOWN**  
4148 W Tilghman St.  
(484) 223-1782

**BETHLEHEM**  
100 Gateway Dr.  
(610) 882-8800

**BETHLEHEM**  
925 West Broad St.  
(484) 821-1210

**EASTON**  
Easton-Nazareth Hwy.  
& Corriere Rd.  
(484) 536-1870

**NAZARETH**  
10 N. Main St.  
(610) 614-3251

**SAUCON VALLEY**  
Route 378 & Colesville Rd.  
(610) 332-2981

**TREXLERTOWN**  
6379 Hamilton Blvd.  
(610) 336-8034