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Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, Joe Henkel
Name of the Holding Company Director and Official

Director / CEO
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and individual consent to public release of all details in the report concerning that individual.

Signature of Holding Company Director and Official

03/28/2017
Date of Signature

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:
- [x] is included with the FR Y-6 report
- [ ] will be sent under separate cover
- [ ] is not prepared

For Federal Reserve Bank Use Only

RSSD ID ____________
C.I. ____________

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2016
Month / Day / Year

N/A
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

Kleberg and Company Bankers, Inc.
Legal Title of Holding Company

P.O. Box 911
(Mailing Address of the Holding Company) Street / P.O. Box

City	State	Zip Code
Kingsville	TX	78363

100 E Kleberg / Kingsville / TX / 78363
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Name	Title
Brad Womack	EVP/COO

361-595-2924
Area Code / Phone Number / Extension

361-593-1519
Area Code / FAX Number

brad.womack@klebergbank.com
E-mail Address

www.klebergbank.com
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? .... 0=No 1=Yes: 1

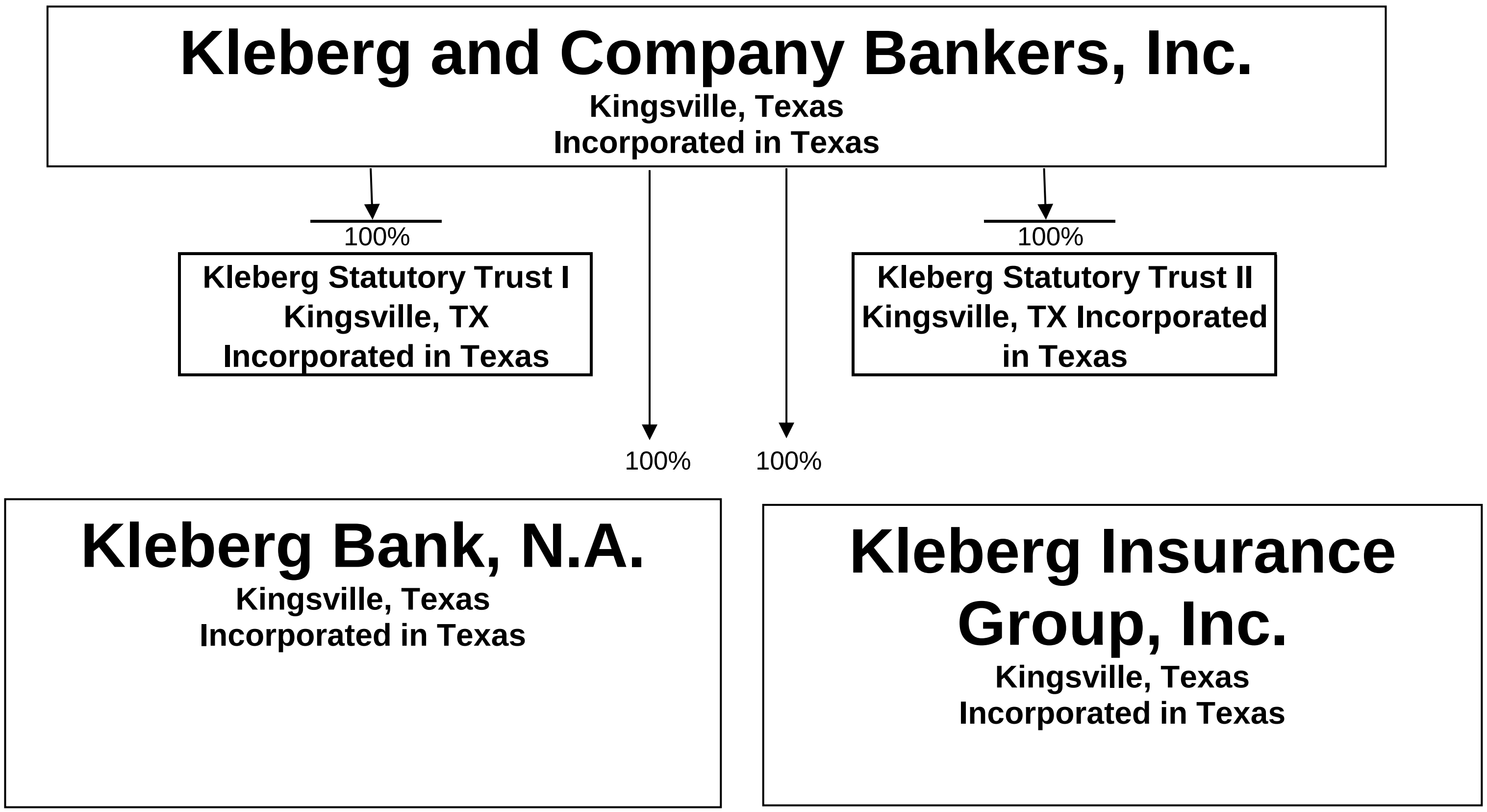
In accordance with the General Instructions for this report (check only one),

1. **a letter justifying this request is being provided along with the report** .... [x]
2. **a letter justifying this request has been provided separately** .... [ ]

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

Public reporting burden for this information collection is estimated to vary from 1.3 to 101 hours per response, with an average of 5.50 hours per response, including time to gather and maintain data in the required form and to review instructions and complete the information collection. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden to: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, DC 20551, and to the Office of Management and Budget, Paperwork Reduction Project (7100-0297), Washington, DC 20503.

Report Item 2a: Organization Chart



No LEI is available for any of the entities in this organizational chart.

Report Item 2b: Branch Verification submitted via secure email 03/28/2017.

Attachment B

Report Item 2b

Results: A list of branches for your holding company: KLEBERG AND COMPANY BANKERS, INC. (1104325) of KINGSVILLE, TX.
The data are as of 12/31/2016. Data reflects information that was received and processed through 01/10/2017.

Reconciliation and Verification Steps
1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions
OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure
When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Office)	556459	KLEBERG BANK, N.A.	100 EAST KLEBERG AVENUE	KINGSVILLE	TX	78363	KLEBERG	UNITED STATES	2125	0	KLEBERG BANK, N.A.	556459	
OK		Full Service	2129259	AIRLINE BRANCH	2037 AIRLINE RD	CORPUS CHRISTI	TX	78412	NUECES	UNITED STATES	225985	9	KLEBERG BANK, N.A.	556459	
OK		Full Service	392358	AYERS BRANCH	4211 AYERS STREET	CORPUS CHRISTI	TX	78415-5331	NUECES	UNITED STATES	459477	11	KLEBERG BANK, N.A.	556459	
OK		Full Service	3543003	BALDWIN BRANCH	4102 BALDWIN BLVD	CORPUS CHRISTI	TX	78405	NUECES	UNITED STATES	362352	8	KLEBERG BANK, N.A.	556459	
OK		Full Service	2381244	MORGAN BRANCH	2611 MORGAN AVE	CORPUS CHRISTI	TX	78405	NUECES	UNITED STATES	225986	10	KLEBERG BANK, N.A.	556459	
OK		Full Service	4986157	SOUTH STAPLES BRANCH	5350 S STAPLES	CORPUS CHRISTI	TX	78411	NUECES	UNITED STATES	Not Required	Not Required	KLEBERG BANK, N.A.	556459	
OK		Full Service	2995119	KLEBERG WALMART BRANCH	1133 E GENERAL CAVAZOS BLVD	KINGSVILLE	TX	78363	KLEBERG	UNITED STATES	196322	2	KLEBERG BANK, N.A.	556459	

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Public Volume

Report Item 3: Shareholders
(1)(a) (1)(b) (1)(C) (2)(a) (2)(b) (2)(C)

Current Shareholder with Ownership, control or holdings of 5% or more with power to vote as of 12-31-16				Shareholders not listed in (3)(1)(a) through 3 (1)(C) that had ownership, control or Holdings of 5% or more with power to vote during the fiscal year ending 12-31-15		
1b. The BHC does prepare an annual report for its shareholders, please see e Name & Address (City, State, Country)	(1)(b) Country of Citizenship or Incorporation	(1)(C) Number and Percentage of Each Class of Voting Securities		(2)(a) Name & Address (City, State, Country)	(2)(b) Country of Citizenship or Incorporation	(2)(C) Number and Percentage of Each Class of Voting Securities
John D. Alexander, Jr San Antonio, Texas, USA	USA	5,296	8.06%	James Higbee Clement, Jr. Dallas, TX, USA	USA	See Confidential Volume
Dorothy Alexander Matz San Antonio, Texas, USA	USA	1,417	2.16%			
Henrietta K Alexander San Antonio, Texas, USA	USA	1,119	1.70%			
Henrietta K. Alexander George 200 Trust No.1 Trustee: Henrietta K Alexander Houston, TX, USA	USA	262	0.40%			
The Helen K Groves Irrevocable Trust Trustee: Helen K Groves San Antonio, Texas, USA	USA	5,057	7.70%			
Stewart Armstrong San Antonio, TX, USA	USA	18,805	28.63%			
Catharine C Whittenburg Testamentary Trust for C.C.W. Armstrong Trustees: C.C. Whittenburg Armstrong Amarillo, TX, USA	USA	880	1.34%			
Catharine Coble Armstrong Jorgensen Houston, TX, USA	USA	171	0.26%			
Jorgensen 2011 Descendants Trust Agreement Trustee: Mia A. Brous Dallas, TX, USA	USA	259	0.39%			
Catharine Larkin Auchincloss Kingsville, TX, USA	USA	2,675	4.07%			
John A Larkin, III	USA	935	1.42%			

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Report Item 3: Shareholders
(1)(a) (1)(b) (1)(C) (2)(a) (2)(b) (2)(C)

Current Shareholder with Ownership, control or holdings of 5% or more with power to vote as of 12-31-16				Shareholders not listed in (3)(1)(a) through 3 (1)(C) that had ownership, control or Holdings of 5% or more with power to vote during the fiscal year ending 12-31-15		
1b. The BHC does prepare an annual report for its shareholders, please see e Name & Address (City, State, Country)	(1)(b) Country of Citizenship or Incorporation	(1)(C) Number and Percentage of Each Class of Voting Securities		(2)(a) Name & Address (City, State, Country)	(2)(b) Country of Citizenship or Incorporation	(2)(C) Number and Percentage of Each Class of Voting Securities
San Antonio, TX, USA						
Louise Larkin Cutler Revocable Trust Trustee: Louise Larkin Cutler Camden, SC, USA	USA	936	1.42%			
Jean L. Dobson Revocable Trust 1-22-2008 Trustee: Jean L. Dobson Atlanta, GA, USA	USA	936	1.42%			
Peter A. Larkin, Jr. Charlotte, NC, USA	USA	2,713	4.13%			
Alice K. Clement Foultz San Antonio, TX, USA	USA	See Confidential Volume				
Martin W. Clement, II Kingsville, TX, USA	USA	See Confidential Volume				
Leslie Clement Family Trust Trustee: Leslie Clement San Antonio, TX, USA	USA	See Confidential Volume				
Henrietta P.C. Hildebrand Trust 2007 Trustee: Henrietta P.C. Hildebrand San Antonio, TX, USA	USA	See Confidential Volume				
Irene Clement Hildebrand Irrevocable Trust 2005 Trustee: Henrietta P.C. Hildebrand San Antonio, TX, USA	USA	See Confidential Volume				
Ida Clement Steen San Antonio, TX, USA	USA	See Confidential Volume				

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Public Volume

Item #4 Insiders

(1) Name, City, State, Country		(2) Principal Occupation, if not Bank Holding Company	(3.a)Title and Position with Bank Holding Company	(3.b) Title and Position with Direct/Indirect Subsidiaries	(3.c) Title & Position with Other Businesses (include names of other business)	(4.a) Percentage of voting securities - Bank Holding Company	(4.b) Percentage of voting securities - Direct / Indirect Subsidiaries	(4.c) List names of other companies (includes partnerships) if 25% or more of voting securities are held (List name of companies and percentage of voting securities held)	
John D. Alexander, Jr San Antonio, Texas	 USA	Investor	Director Principal Securities Holder	Director, Kleberg Bank, N.A. Director, Kleberg Insurance Group	President - Alexander Production company Partner - J.D. Alexander & Sons Investment Partners	8.06%	0.00%	Alexander Production Company J.D. Alexander & Sons Investment Partners JDA, Jr. 1982 YE Venture AK 1982 Venture AK 1983 Venture AK 1985 Venture BC AM Capital Gap, LLC	100% 50% 32% 67% 50% 50% 25%
Dorothy Alexander Matz San Antonio, Texas	 USA	Horse Breeder	Principal Securities Holder	N/A	Owner - Buck and Doe Stable LLC	2.16%	0.00%	Buck and Doe Stable LLC Alexander Groves Matz LLC Buck Run Valley GP LLC	100% 35% 50%
Henrietta K Alexander San Antonio, Texas	 USA	Rancher	Principal Securities Holder	N/A	Owner - Silverbrook Ranches	2.10%	0.00%	N/A	N/A
Helen K Groves San Antonio, Texas	 USA	Rancher	Principal Securities Holder	N/A	See confidential volume	7.70%	0.00%	Silverbrook Ranches Alexander-Groves Thoroughbreds Alexander Groves Matz GA Management, LLC Groves-Alexander Group, LLC JDA, Jr. 1983 YE Venture JDA, Jr 1982 YE Venture	100% 50% 30% 50% 25% 99% 42%
Stewart Armstrong San Antonio, Texas	 USA	Investor	Chairman Principal Securities Holder	Chairman, Kleberg Bank, N.A. Chairman, Kleberg Insurance Group	Owner - Cibolo LLC Owner - Armstrong Thoroughbreds Owner - 105 E Hopkins LLC	28.63%	0.00%	Cibolo LLC Armstrong Thoroughbreds 105 E Hopkins LLC	100% 100% 100%
C.C. Whittenburg Armstrong Amarillo, TX	 USA	Investor	Principal Securities Holder	N/A	N/A	1.34%	0.00%	N/A	N/A
Catharine Coble Armstrong Jorgensen Houston, TX	 USA	Investor	Principal Securities Holder	N/A	Trustee - Catharine Coble Armstrong Jorgensen Descendant's Trust Trustee - Mia Whittenburg Armstrong Brous Descendant's Trust Trustee - Stewart Larkin Armstrong Jr. Descendant's Trust Partner - EJCJ, LLC	0.26%	0.00%	Catharine Coble Armstrong Jorgensen Descendant's Trust Mia Whittenburg Armstrong Brous Descendant's Trust Stewart Larkin Armstrong Jr. Descendant's Trust EJCJ, LLC	33% 33% 33% 50%
Mia A. Brous Dallas, TX	 USA	Interior Designer	Principal Securities Holder	N/A	Trustee - Catharine Coble Armstrong Jorgensen Descendant's Trust Trustee - Mia Whittenburg Armstrong Brous Descendant's Trust Trustee - Stewart Larkin Armstrong Jr. Descendant's Trust Owner - Armstrong Interiors Owner - Neola House, LLA dba Madre	0.39%	0.00%	Catharine Coble Armstrong Jorgensen Descendant's Trust Mia Whittenburg Armstrong Brous Descendant's Trust Stewart Larkin Armstrong Jr. Descendant's Trust Armstrong Interiors Neola House, LLC dba Madre	33% 33% 33% 100$ 33%
Catharine Larkin Auchincloss Kingsville, TX	 USA	Investor	Principal Securities Holder	N/A	N/A	4.07%	0.00%	N/A	N/A
John A Larkin, III San Antonio, TX	 USA	Investor	Principal Securities Holder	N/A	Owner - Lark Guitars LLC	1.42%	0.00%	Lark Guitars LLC	100%
Louise Larkin Cutler Camden, SC	 USA	Investor	Principal Securities Holder	N/A	N/A	1.42%	0.00%	N/A	N/A
Jean L. Dobson Atlanta, GA	 USA	Investor	Principal Securities Holder	N/A	N/A	1.42%	0.00%	N/A	N/A
Peter A. Larkin, Jr. Charlotte, NC	 USA	Investor	Principal Securities Holder	N/A	N/A	4.13%	0.00%	N/A	N/A
Joe Henkel Kingsville, TX	 USA	Banker	Director / CEO	President / CEO, Kleberg Bank, N.A Director, Kleberg Insurance Group Secretary, Kleberg Insurance Group	See confidential volume	See confidential volume	See confidential volume	See confidential volume	
John B Womack Kingsville, TX	 USA	Banker	Secretary	COO/EVP - Kleberg Bank, N.A. President, Kleberg Insurance Group	See confidential volume	See confidential volume	See confidential volume	See confidential volume	

Attachment C

2016 Annual Report

Kleberg and Company Bankers, Inc.

and Subsidiary

Kleberg Bank, National Association

Kingsville, Texas

Kleberg and Company Bankers, Inc.
Board of Directors

Stewart L. Armstrong – *Chairman of the Board*
Investments

John D. Alexander, Jr. – *Director*
President
Alexander Production Company

Joe M. Henkel – *Director*
President & Chief Executive Officer
Kleberg Bank, National Association

Kleberg Bank, National Association
Board of Directors

Stewart L. Armstrong – *Chairman of the Board*
Investments

John D. Alexander, Jr.
President
Alexander Production Company

Gabriel Guerra
Corpus Christi Market President, Executive Officer
Kleberg Bank, National Association

Linda Hahn
Certified Public Accountant
Hahn & Oldham P. C.

Joe M. Henkel – *Director*
President & Chief Executive Officer
Kleberg Bank, National Association

John L. Womack
Certified Public Accountant
John Womack & Co. P. C.

Kleberg Bank, National Association
Advisory Directors

Joyce Bynum
Jay Jay Well Service
Retired

Bill Colston, Jr.
Riviera Telephone Co.
President & General Manager

Ricki Cunningham
Coldwell Banker Homestead Properties, In.
Broker/Owner

David Delaney
King Ranch, Inc.
Vice President & General Manager
Livestock and Ranching Operations

Royce Felder
Felder Crop Insurance
Owner

Reynaldo B. Hernandez
Dept. of Homeland Security
Retired

David Hoelscher
Farming & Ranching

David LeMonte
Christus Spohn Kleberg Hospital
Administrator

Dick Messbarger
Greater Kingsville Economic Development Council
Retired

Darrell Nordeen
Celanese Bishop Site Director
Retired

Carol Perez
Kingsville Independent School
Superintendent

O. J. Rodriguez, M.D.
Family Medical Practice

Wesley Rogers
Rogers Landholdings
CEO/Owner

Steven H. Tallant
Texas A&M University-Kingsville
President

Kleberg Bank, National Association
Officers 2017

Stewart L. Armstrong
Chairman

Joe M. Henkel
President & Chief Executive Officer

Gabriel Guerra
Corpus Christi Market President
Executive Officer

Jacqueline Ilse
Executive Vice President
Senior Risk Officer-Compliance

Donald Herrick
Executive Vice President
Chief Credit Officer

Travis Nelson
Executive Vice President
Chief Financial Officer

Fred Wollmann
Executive Vice President
Senior Investment Officer

Brad Womack
Executive Vice President
Chief Operating Officer/Cashier

Pedro Azevedo
Senior Vice President

Michael "Chip" Collins
Senior Vice President
Security Officer

Andy Corbett
Senior Vice President

Thomas Davey
Senior Vice President

Edmundo Garza
Senior Vice President

Tony Gomez
Senior Vice President

Dora Martinez
Senior Vice President

Christopher Medrano
Senior Vice President
Chief Information Officer

Patricia Rangel-Vela
Senior Vice President
Director of Operations

Everett Roy
Senior Vice President
Mortgage Center Manager

Bill Williams
Senior Vice President
Senior Operations Manager

Bryan Grove
Vice President
Kleberg Financial Service Manager

George Livas
Vice President

Brandy Morales
Vice President

Cynthia Ozuna
Vice President
CRA Officer

Wilma Saenz-Grover
Vice President

Elizabeth White
Vice President

Norma Anzaldua
Assistant Vice President

Frank Benvenuto
Assistant Vice President

Leticia Cantu
Assistant Vice President
Red Flag/BSA Officer

Lisa Clore
Assistant Vice President

Kayleigh Deleon
Assistant Vice President

Velma Delgado
Assistant Vice President

Desiree Fernandez
Assistant Vice President
Human Resource Manager

Stephen Flores
Assistant Vice President

JoAnn Garcia
Assistant Vice President

Jennifer Grove
Assistant Vice President

Christina Jenkins
Assistant Vice President

Gregg Knupp
Assistant Vice President

Minnie Leal
Assistant Vice President

Imelda Perez
Assistant Vice President

Tina Puebla
Assistant Vice President

Jenny Rodriguez
Assistant Vice President

Gabriel Rojas
Assistant Vice President

Mark Sheldon
Assistant Vice President

Lois Staff
Assistant Vice President

Gina Ulisse
Assistant Vice President

Bill Zimmerman
Assistant Vice President

Randy Rocha
Banking Officer

Julie Rodriguez
Banking Officer

Reagan Welch White
Banking Officer

Catherine Yaklin
Banking Officer

Jimmie Locklear
Information Technology Officer

Kleberg and Company Bankers, Inc.
Selected Financial Data

(In thousands of dollars, except per share data).	2016	2015	2014	2013	2012
Net Income - Kleberg Bank, National Assocation	$ 5,110	$ 4,580	$ 4,567	$ 3,832	$ 5,732
Kleberg and Company Bankers, Inc.					
Payments and Distributions					
Distributions paid to shareholders	$ 1,313	$ 1,183	$ 923	$ 1,064	$ 1,280
Payments for interest on debt	780	762	783	810	847
Payments for principal on debt	1,000	1,000	1,000	1,000	1,000
Total payments and distributions	3,093	2,945	2,706	2,874	3,127
Summary of Operations					
Interest income	$ 17,470	$ 17,284	$ 17,981	$ 16,193	$ 16,962
Interest expense	1,389	1,510	1,723	1,968	2,207
Net interest income	16,081	15,774	16,258	14,225	14,755
Provision expense for loan losses	877	720	729	566	545
Non-interest income	8,035	7,851	7,573	8,158	8,472
Non-interest expense	18,896	19,339	19,543	19,135	17,886
Net Income - Kleberg Company & Bankers, Inc.	4,343	3,566	3,559	2,682	4,796
Per Share Data					
Net income	$ 66.11	$ 54.28	$ 54.01	$ 40.34	$ 72.13
Distributions paid to shareholders	19.99	18.01	14.00	16.00	19.25
Total payments and distributions	47.08	44.83	41.06	43.22	47.03
Book value	715.84	710.39	689.59	582.36	619.53
Adjusted book value	746.47	698.01	663.62	622.31	597.97
Kleberg Bank, National Association					
Balances at Year End:					
Loans	$282,345	$256,792	$251,322	$234,664	$216,105
Deposits	386,603	394,298	394,081	386,941	383,214
Total assets	491,145	482,434	494,726	494,660	457,183
Credit Quality Ratios:					
Net charge-offs to average loans	0.25 %	0.27 %	0.24 %	0.26 %	0.36 %
Allowance for losses to total loans	1.12	1.15	1.15	1.17	1.29
Non-performing assets to total loans	1.32	0.52	0.61	1.10	1.14
Equity Ratios:					
Shareholders equity	$ 59,966	$ 60,754	$ 60,015	$ 53,722	$ 56,854
Equity to assets	12.21 %	12.59 %	9.18 %	7.83 %	12.44 %
Leverage ratio	9.00	8.67	8.19	7.96	8.23
Operating Ratios:					
Return on average assets	1.03 %	0.93 %	0.91 %	0.83 %	1.31 %
Return on average equity	8.11	7.57	7.96	6.95	9.89
Return on average tangible equity	12.18	11.77	12.95	11.94	16.69
Net interest margin	3.82	3.72	3.78	3.61	4.18
Efficiency ratio	76.78	77.87	76.48	78.96	74.38

Kleberg and Company Bankers, Inc. – April 2017

Dear Shareholder:

Kleberg and Company Bankers, Inc. recorded another successful year despite economic and regulatory challenges. The Bank experienced growth in net income, interest margins and loans. These increases are extraordinary due to the extended low interest rate environment and the marginal price of oil, which has affected the economy in South Texas.

Net income increased to $4.3 million in 2016. Compared to the prior year, per share earnings increased by more than $10 to $66 and book value increased by $5 to $716, including the unrealized loss in the securities portfolio. During the past ten years, book value has increased $381 per share, or 114%, after income taxes. In the past three years, we distributed $51 per share: approximately $14 per share more than the federal income tax liability, assuming a 40% personal tax rate. These points highlight the long-term value of your ownership in the Company. We will continue to focus on our commitments to improve earnings and to ensure the long term sustainability of consistent returns in the future.

For Kleberg Bank, the returns on average assets and tangible equity increased to 1.03% and 11.27%, respectively. The Bank improved by growing high quality loans and cost-reduction efforts to improve efficiency. Income improved even with a regulatory change that reduced a high margin recurring source of revenue by more than $1 million per year. With that, and other challenges, the Bank grew net income primarily from interest income related to loan growth, which resulted in a year end 2016 loan portfolio of more than $282 million: a record increase of more than ten percent. We saw loans grow while our local competitors experienced minimal growth or contractions in their loan portfolios.

We also achieved meaningful progress with the Private Banking, Mortgage, and Wealth Management initiatives. The Private Banking team brought in over $5 million in new deposit relationships and referred almost $2 million in mortgage loans to the Mortgage Center. The Mortgage Center increased loan production, closing $54 million in new loans by growing market share in South Texas and the expansion into the Houston market. Kleberg Wealth Management also experienced significant advances; under the leadership of Bryan Grove, total assets under management grew to more than $82 million. We are continuing to develop new products and services, all focused on gaining new, high value relationships.

Low interest rates and regulatory changes require us to become more efficient. Reducing non-interest expense is a focus point where we made significant progress during 2016. Consolidation of personnel to the new Operations Center in Corpus Christi was completed, allowing efficiency, synergy, and process improvements. By August 2017, the Banking Center in the new Corpus Christi headquarters building at 5350 South Staples will be completed to house the commercial and private banking teams. We are confident that this significant upgrade in location and profile will help us to grow market share in Corpus Christi.

We are very pleased to report implementation of a management succession plan. We are in a unique position for a community bank because we have our next generation of management in place, seasoned and well positioned to grow and prosper.

Gabe Guerra has been selected to become the next Chief Executive Officer of Kleberg Bank. He has very successfully directed our commercial, private and personal banking teams for nearly ten years and is a proven leader for our employees and in the Corpus Christi community. Brad Womack will become the Kingsville Market President and retain his role as Chief Operating Officer; his experience, effective management of operations, experience and Kingsville roots make him a natural for this position. We are working to make these changes as smooth as possible with completion of these transitions before December 2018.

Fred Wollmann, our Chief Financial Officer, will retire in September 2017. Mr. Wollmann has exceeded expectations with his service to the Bank for nearly ten years. He managed the 2007 acquisition of First Commerce Bank, successfully navigated us through an unforgiving low interest rate environment and now has the responsibility of managing major changes and renovations of our facilities. He will be succeeded by Travis Nelson, who has demonstrated the proficiency and capabilities to manage the Bank's capital with soundness and integrity.

Don Herrick came to us early in 2017, as Chief Credit Officer, to oversee the safe and sound growth of the Bank's loan portfolio. He came to us from Houston, with 37 years in banking, where he has worked primarily in portfolio management with a very large bank.

2017 has already proven that the only constant is change. We are confident that the recent rise in interest rates will continue to help improve margins and that the economic outlook will favor small businesses. With a new administration in Washington, we are optimistic that the regulatory environment for community banking will improve and government will recognize the value of community banking to the economy.

Electronic banking will continue to be a focus; we want to continually improve service to retain our existing customers and to grow new relationships efficiently and without geographic boundaries. Our online and mobile banking platforms provide the latest e-banking capabilities for our customers, including mobile check deposit, bill-pay, and Apple, Android, and Samsung Pay.

We are honored to be part of extending the legacy of our founder, Robert Justus Kleberg, who started the Bank to "support those who showed the spirit of cooperation in community building". We are confident he would be proud of how Kleberg Bank continues to be a significant force in building our communities. As always, we appreciate the opportunity to provide financial services for you, your family and friends. Please accept our thanks for all that you do for Kleberg Bank.

Sincerely,

Stewart L Armstrong

Joe Henkel

Stewart L. Armstrong
Chairman

Joe Henkel
President & CEO

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Financial Report
December 31, 2016

THE POWER OF BEING UNDERSTOOD
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RSM

Contents

Independent Auditor's Report

To the Board of Directors and Stockholders
Kleberg and Company Bankers, Inc.
Kingsville, Texas

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Kleberg and Company Bankers, Inc. and Subsidiaries, which comprise the consolidated balance sheet as of December 31, 2016; the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the year then ended; and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kleberg and Company Bankers, Inc. and Subsidiaries as of December 31, 2016, and the results of their operations and their cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter
The consolidated financial statements of Kleberg and Company Bankers, Inc. and Subsidiaries as of and for the year ended December 31, 2015, were audited by other auditors, whose report dated March 8, 2016, expressed an unmodified opinion on those statements.

RSM US LLP

San Antonio, Texas
March 23, 2017

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Balance Sheets
December 31, 2016 and 2015
(Dollars in Thousands, Except Share Data)

	2016	2015
Assets		
Cash and due from banks	**$ 19,601**	$ 16,575
Cash and cash equivalents	**19,601**	16,575
Interest-bearing deposits in banks	**792**	555
Securities available for sale	**140,379**	165,067
Restricted investment securities	**3,322**	3,082
Loans held for sale	**3,997**	4,922
Loans, net of allowance for loan losses of $3,163 ($2,958 in 2015)	**275,185**	248,913
Bank premises and equipment, net	**17,907**	13,691
Accrued interest receivable	**1,806**	1,759
Intangible assets, net	**18,034**	18,552
Cash surrender value of life insurance	**8,707**	8,474
Other assets	**2,819**	2,266
Total assets	**$ 492,549**	$ 483,856
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Noninterest-bearing	**$ 102,231**	$ 112,984
Interest-bearing	**284,192**	281,141
Total deposits	**386,423**	394,125
Other borrowed funds	**15,637**	13,970
Federal Home Loan Bank borrowings	**25,000**	10,000
Long-term debt	**580**	1,580
Junior subordinated debentures	**13,919**	13,919
Accrued interest payable	**140**	140
Other liabilities	**3,837**	3,312
Total liabilities	**445,536**	437,046
Commitments and contingencies (Notes 6, 7, 9, 10, 11, 12, 13 and 14)		
Stockholders' equity:		
Common stock, $1 par value; 215,000 shares authorized; 110,229 shares issued; 65,693 shares outstanding in 2016 and 2015	**110**	110
Surplus	**8,425**	8,425
Retained earnings	**48,606**	45,576
Accumulated other comprehensive income (loss)	**(2,011)**	816
Common stock in Treasury—at cost (44,536 shares in 2016 and 2015)	**(8,117)**	(8,117)
Total stockholders' equity	**47,013**	46,810
Total liabilities and stockholders' equity	**$ 492,549**	$ 483,856

See notes to consolidated financial statements.

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Statements of Income
Years Ended December 31, 2016 and 2015
(Dollars in Thousands, Except Share Data)

	2016	2015
Interest income:		
Loans—including fees	$ 13,286	$ 12,853
Investment securities	4,110	4,354
Interest-bearing deposits in banks	46	49
Other	28	28
Total interest income	17,470	17,284
Interest expense:		
Deposits	457	683
Long-term debt and other borrowed funds	208	121
Junior subordinated debentures	724	706
Total interest expense	1,389	1,510
Net interest income	16,081	15,774
Provision for loan losses	877	720
Net interest income after provision for loan losses	15,204	15,054
Noninterest income:		
Service charges and fees	4,332	5,433
Mortgage fees	1,474	1,214
Other	2,229	1,204
Total noninterest income	8,035	7,851
Noninterest expense:		
Salaries and employee benefits	10,284	10,481
Occupancy and equipment expenses	2,133	2,145
Other operating expenses	6,479	6,713
Total noninterest expense	18,896	19,339
Net income	$ 4,343	$ 3,566
Basic income per share of common stock	$ 66.11	$ 54.25
Average common shares outstanding	65,693	65,728

See notes to consolidated financial statements.

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Net income	**$ 4,343**	$ 3,566
Other items of comprehensive income:		
Adjustment for net gain on sale of investment securities	**(959)**	(535)
Change in fair value of derivative used for cash flow hedge	**-**	(1)
Unrealized holding loss on securities available for sale	**(1,868)**	(360)
Total other items of comprehensive income	**(2,827)**	(896)
Comprehensive income	**$ 1,516**	$ 2,670

See notes to consolidated financial statements.

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2016 and 2015
(Dollars in Thousands)

	Common Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock in Treasury	Total
Balance at December 31, 2014	$ 110	$ 8,425	$ 43,193	$ 1,712	$ (8,001)	$ 45,439
Net income—year ended December 31, 2015	-	-	3,566	-	-	3,566
Change in other comprehensive income	-	-	-	(896)		(896)
Purchase of Treasury stock	-	-	-	-	(116)	(116)
Cash dividends declared	-	-	(1,183)	-	-	(1,183)
Balance at December 31, 2015	110	8,425	45,576	816	(8,117)	46,810
Net income—year ended December 31, 2016	-	-	4,343	-	-	4,343
Change in other comprehensive income	-	-	-	(2,827)		(2,827)
Cash dividends declared	-	-	(1,313)	-	-	(1,313)
Balance at December 31, 2016	**$ 110**	**$ 8,425**	**$ 48,606**	**$ (2,011)**	**$ (8,117)**	**$ 47,013**

See notes to consolidated financial statements.

Kleberg and Company Bankers, Inc. and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended December 31, 2016 and 2015
(Dollars in Thousands)

	2016	2015
Cash flows from operating activities:		
Net income	$ 4,343	$ 3,566
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,703	1,524
Net realized gains on sales of investment securities	(959)	(535)
Net realized gains on sales of bank premises and equipment	-	(1)
Net amortization/accretion of investment securities premium/discount	1,449	2,399
Provision for loan losses	877	720
Increase in cash surrender value of life insurance	(233)	(230)
Net change in:		
Loans held for sale	925	(1,355)
Accrued interest receivable	(47)	114
Other assets	(553)	40
Accrued interest payable and other liabilities	525	(68)
Net cash provided by operating activities	8,030	6,174
Cash flows from investing activities:		
Net change in:		
Interest-bearing deposits in banks	(237)	3,940
Loans	(27,594)	(5,216)
Proceeds from sales of investment securities	46,517	53,896
Proceeds from sale of bank premises and equipment	-	21
Proceeds from paydowns of investment securities	19,089	28,933
Purchases of investment securities	(44,475)	(71,430)
Recoveries of loans previously charged off	445	438
Capital expenditures	(5,401)	(8,988)
Net cash provided by (used in) investing activities	(11,656)	1,594
Cash flows from financing activities:		
Net change in:		
Deposits	(7,702)	332
Other borrowed funds	1,667	8,819
Federal Home Loan Bank borrowings	15,000	(22,000)
Repayment of long-term debt	(1,000)	(1,000)
Purchase of Treasury stock	-	(116)
Cash dividends paid on common stock	(1,313)	(1,183)
Net cash provided by (used in) financing activities	6,652	(15,148)
Net increase (decrease) in cash and cash equivalents	3,026	(7,380)
Cash and cash equivalents at beginning of year	16,575	23,955
Cash and cash equivalents at end of year	$ 19,601	$ 16,575
Schedules of other cash flow information:		
Interest paid	$ 1,389	$ 1,529

See notes to consolidated financial statements.

Note 1. Summary of Significant Accounting Policies

Consolidation: The consolidated financial statements include the accounts of Kleberg and Company Bankers, Inc. (the Parent Company) and the accounts of its wholly-owned subsidiaries, Kleberg Bank, N.A. (the Bank) and Kleberg Insurance Group (collectively, the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of operations: The Company provides a variety of financial services to individuals and small businesses through its offices in Kingsville and Corpus Christi, Texas. Its primary deposit products are interest-bearing and noninterest-bearing checking and term certificate accounts, and its primary lending products are consumer, mortgage and small business loans.

Use of estimates: The preparation of 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 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 and the valuation of securities available for sale.

New and recently issued accounting standards: In August 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-14, an amendment to ASU No. 2014-09, *Revenue Recognition—Revenue from Contracts with Customers (Topic 606)*. This ASU provides guidance on when to recognize revenue from contracts with customers. The objective of this ASU is to eliminate diversity in practice related to this topic and to streamline and enhance revenue recognition requirements. The ASU defines five steps to recognize revenue including, identify the contract with a customer, identify the performance obligations in the contract, determine a transaction price, allocate the transaction price to the performance obligations and then recognize the revenue when or as the entity satisfies a performance obligation. This amended update is effective for annual reporting periods beginning after December 15, 2019, and the Company is currently assessing the potential impact to the consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities (Topic 825-10)*. The ASU applies to all entities that hold financial assets or owe financial liabilities and represents the finalization of just one component of the FASB's broader financial instruments project. The most far-reaching ramification of the ASU is the elimination of the available-for-sale classification for equity securities and a new requirement to carry those equity securities with readily determinable fair values at fair value through net income. Other notable changes brought about by the ASU involve: (a) applying a practicability exception from fair value accounting to equity securities that do not have a readily determinable fair value, (b) assessing the need for a valuation allowance related to an available-for-sale debt security, (c) applying the fair value option to liabilities and the treatment of changes in fair value attributable to instrument-specific credit risk and (d) adding disclosures and eliminating certain disclosures. The Company is currently evaluating the effect that the standard will have on the consolidated financial statements.

Note 1. Summary of Significant Accounting Policies (Continued)

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract (i.e. lessees and lessors). The new standard requires lessees to apply a dual approach, classifying leases as either finance or operating leases based on the principle of whether or not the lease is effectively a financed purchase by the lessee. This classification will determine whether lease expense is recognized based on an effective interest method or on a straight-line basis over the term of the lease, respectively. A lessee is also required to record a right-of-use asset and a lease liability for all leases with a term of greater than 12 months regardless of their classification. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. The new standard requires lessors to account for leases using an approach that is substantially equivalent to existing guidance for sales-type leases, direct financing leases and operating leases. The standard is effective on January 1, 2020, with early adoption permitted. The Company is in the process of evaluating the impact of this new guidance on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*, which creates a new credit impairment standard for financial instruments. The existing incurred loss model will be replaced with a current expected credit loss (CECL) model for both originated and acquired financial instruments carried at amortized cost and off-balance sheet credit exposures, including loans, loan commitments, held-to-maturity debt securities, financial guarantees, net investment in leases, and most receivables. Recognized amortized cost financial assets will be presented at the net amount expected to be collected through an allowance for credit losses. Expected credit losses on off-balance sheet credit exposures will be recognized through a liability. Expected credit losses on available-for-sale debt securities will also be recognized through an allowance; however, the allowance for an individual available-for-sale debt security will be limited to the amount by which fair value is below amortized cost. Unlike current guidance, which requires certain favorable changes in expected cash flows to be accreted into interest income, both favorable and unfavorable changes in expected credit losses (and therefore the allowance) will be recognized through credit loss expense as they occur. With the exception of purchased financial assets with a more than insignificant amount of credit deterioration since origination, for which the initial allowance will be added to the purchase price of the assets, the initial allowance on financial assets subject to the scope (whether originated or acquired) will be recognized through credit loss expense.

Expanded disclosures will also be required. Transition will generally be on a modified retrospective basis, with certain prospective application transition provisions for securities for which other-than-temporary impairment had previously been recognized and for assets that had previously been accounted for in accordance with Subtopic 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*. This ASU is effective for the Company in fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

Significant group concentrations of credit risk: Most of the Company's activities are with customers located within South Texas. Note 4 discusses the types of securities in which the Company invests. Note 5 discusses the types of lending in which the Company engages. The Company does not have any significant concentrations in any one industry or customer.

Note 1. Summary of Significant Accounting Policies (Continued)

Interest-bearing deposits in banks: Interest-bearing deposits in banks are carried at cost.

Securities: Debt securities that management has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Securities not classified as held-to-maturity or trading, including equity securities with readily determinable fair values, are classified as available-for-sale and recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. During the years ended December 31, 2016 and 2015, the Company had no securities classified as trading securities and no securities classified as held-to-maturity.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the settlement date and are determined using the specific-identification method.

Declines in the fair value of held-to-maturity and available-for-sale securities are evaluated to determine whether declines in fair value below their amortized cost are other than temporary. In estimating other-than-temporary impairment losses, management considers (1) the length of time and the extent to which the fair value has been less than the amortized cost, (2) the financial condition and near-term prospects of the issuer, (3) the current market conditions and (4) the intent and ability of the Company to not sell the security or whether it is more likely than not the Company will be required to sell the security before its anticipated recovery.

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

Loans held for sale: Certain student loans and mortgage loans are originated for sale in the secondary market. These loans are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. No unrealized losses were recognized during 2016 and 2015.

Loans: The Company grants real estate, commercial and consumer loans to customers. A substantial portion of the loan portfolio is represented by real estate loans throughout Kleberg County, Nueces County and surrounding areas. The ability of the Company’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in these areas.

The Company has lending policies and procedures in place to grant loans to borrowers only after a full evaluation of the credit history and repayment abilities of the borrower. Commercial and residential real estate loans are subject to underwriting standards that evaluate cash flow and fair value of the collateral. The collectibility of real estate loans may be adversely affected by conditions in the real estate markets or the general economy. Management monitors and evaluates real estate loans based on cash flow, collateral, geography and risk criteria.

Note 1. Summary of Significant Accounting Policies (Continued)

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably. Such evaluations involve reviews of historical and cash flow projections and valuations of collateral provided by the borrower. Most commercial loans are secured by the assets being financed or other available business assets, and frequently include a personal guarantee by the principal owners; however, some commercial loans may be made on an unsecured basis. The repayment of commercial loans is substantially dependent on the ability of borrowers to operate their businesses profitably and collect amounts due from their customers.

Consumer loans are originated after evaluation of the credit history and repayment ability of the borrower based on current personal income. The repayment of consumer loans can be adversely affected by economic conditions and other factors that impact the borrower's income.

Loans that management has the intent and ability to hold for the foreseeable future, or until maturity or payoff, are reported at their outstanding principal adjusted for any charge-offs and the allowance for loan losses. Interest income is accrued on the unpaid principal balance.

Loan origination fees are capitalized and direct origination costs are expensed as incurred, as this is a more conservative approach, and as management has determined that capitalization of these costs would be immaterial to the consolidated financial statements.

A loan is considered delinquent when principal and/or interest amounts are not current, in accordance with the contractual loan agreement.

The accrual of interest on real estate and commercial loans is discontinued at the time the loan is 90 days delinquent unless the credit is well secured and in process of collection. Consumer loans are typically charged off no later than 120 days' past due. In all cases, loans are placed on nonaccrual status or charged off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued, but not collected, for loans that are placed on nonaccrual status or charged off is reversed against interest income. The interest on these loans is accounted for on the cash basis or cost-recovery method, until qualifying for return to accrual status. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value 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 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 shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price or the fair value of the collateral, if the loan is collateral-dependent.

Note 1. Summary of Significant Accounting Policies (Continued)

Loans are fully charged off when management determines the asset to be uncollectible, repayment is deemed to be delayed or doubtful beyond reasonable time frames, the borrower has declared bankruptcy or the loan is past due for an unreasonable time period. Such charge-offs are charged against the allowance for loan losses. Recoveries of previous loan charge-offs are credited to the allowance for loan losses only when the Company receives cash or other collateral in repayment of the loan.

In situations related to a borrower's financial difficulties, the Company may grant a concession to the borrower for other than an insignificant period of time that would not otherwise be considered. In such instances, the loan will be classified as a troubled debt restructuring. These concessions may include interest rate reductions, payment forbearance or other actions intended to minimize the economic loss and avoid foreclosure of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, the Company measures an impairment loss on the restructuring, as noted above for impaired loans.

Allowance for loan losses: The Company maintains an allowance for loan losses as a reserve established through a provision for possible loan losses charged to expense, which represents management's best estimate of probable losses that have been incurred within the existing portfolio of loans. The allowance, in the opinion of management, is necessary to reserve for estimated loan losses and risks inherent in the loan portfolio. The Company's methodology for the allowance for loan losses includes allowance allocations calculated in accordance with the *FASB Accounting Standards Codification* (ASC), Receivables, and ASC, Contingencies. Accordingly, the methodology is based on historical loss experience by type of credit and internal risk grade, specific homogeneous risk pools and specific loss allocations, with adjustments for current events and conditions.

The Company's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. Factors that influence the determination include quantifiable aspects, such as loan volume, loan concentrations and loan quality trends, including trends in nonaccrual, past-due and classified loans; current period loan charge-offs; and recoveries. The determination also includes qualitative aspects, such as changes in local, regional or national economies or markets, and other factors. Such qualitative factors are highly judgmental and require constant refinement. The Company has an external loan review function, the objective of which is to identify potential problem loans, properly classify loans by risk grade and assist senior management in maintaining an adequate allowance for loan losses account by reviewing and refining the methodology, as needed, based on changing circumstances.

The Company's allowance for loan losses consists primarily of two elements: (1) a specific valuation allowance determined in accordance with the ASC based on probable losses on specific, individual loans and (2) a general valuation allowance determined in accordance with the ASC based on historical loan loss experience for pools of similar loans, which is then adjusted to reflect the impact of current trends and conditions.

Bank-owned life insurance: The Company owns life insurance policies on certain officers and carries the investment at the policies' cash surrender value. The Company pays the premiums, owns the cash value and is the primary beneficiary on the policies.

Bank premises and equipment: Land is carried at cost. Bank premises and equipment and leasehold improvements are carried at cost, less accumulated depreciation and amortization. Depreciation and amortization are recognized on straight-line and accelerated methods over the estimated useful lives of the assets.

Note 1. Summary of Significant Accounting Policies (Continued)

Long-lived assets: Long-lived assets, including property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss would be recognized when estimated undiscounted future cash flows from operations of the asset are less than the carrying value of the asset. The cash flows used for this analysis are those directly associated with and that are expected to arise as a direct result of the use and eventual disposition of the asset. An impairment loss would be measured by the amount by which the carrying value of the asset exceeds its fair value.

Intangible assets: Included in intangible assets is goodwill of $18 million at December 31, 2016 and 2015, as the result of an acquisition. Goodwill is the excess of the purchase price over the fair value of identifiable net assets in business combinations accounted for as purchases. Under ASC Topic 350, goodwill is not amortized, but instead is analyzed for impairment at least annually. For the years ended December 31, 2016 and 2015, the Company determined that no impairment of goodwill has occurred.

Also included was an intangible related to core deposits, which has been fully amortized as of December 31, 2016. The balance as of December 31, 2015, totaled $518 thousand, net of accumulated amortization of $4.7 million. The core deposit intangible was being amortized on a straight-line basis over a period of 10 years.

Foreclosed assets: Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management, and the assets are carried at the lower of carrying amount or fair value, less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other operating expenses. For the years ended December 31, 2016 and 2015, there were no foreclosed assets included in other assets on the consolidated balance sheets.

Transfers of financial assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (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.

Income taxes: The Company, with the consent of its stockholders, has elected under the Internal Revenue Code to be taxed as an S corporation. The stockholders of an S corporation are taxed on their proportionate share of the entity's taxable income. Therefore, no provision or liability for federal income taxes has been included in the consolidated financial statements. Certain specific deductions and credits flow through the Company to its stockholders.

The Company accounts for uncertainty in income taxes in accordance with the provisions of ASC 740, Accounting for Uncertainty in Income Taxes, which addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under this guidance, the Company may recognize the tax benefit from an uncertain tax position only if it is more-than-likely-than-not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The guidance on accounting for uncertainty in income taxes also addresses de-recognition, classification, interest and penalties on income taxes and accounting in interim periods.

Note 1. Summary of Significant Accounting Policies (Continued)

The Company is subject to the Texas gross margin tax.

Interest rate cap agreement: The Company utilizes a master interest rate cap agreement to limit cash outflows on its variable rate debt (cash flow hedge).

Derivatives that have been designated and qualify as cash flow hedging instruments are reported at fair value. The gain or loss on the effective portion of the hedge (i.e., change in fair value) is initially reported as a component of accumulated other comprehensive income. The remaining gain or loss, if any, is recognized currently in earnings. Amounts in accumulated other comprehensive income are reclassified into net income in the same period in which the hedged transaction affects earnings.

Off-balance-sheet credit-related financial instruments: In the ordinary course of business, the Company has entered into off-balance-sheet financial instruments consisting of commitments to extend credit, unfunded commitments under lines of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded or related fees are incurred or received.

Cash and cash equivalents: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks. The Company maintains cash in deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

Revenue recognition: Interest income and expense are recognized on the accrual method based on the respective outstanding balances. Other revenue is recognized at the time the service is rendered or transactions occur.

Comprehensive income: 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 consolidated balance sheet, such items, along with net income, are components of comprehensive income.

Advertising: Advertising costs are expensed as incurred.

Subsequent events: The Company has evaluated subsequent events that occurred after December 31, 2016, through March 23, 2017, the date the consolidated financial statements were available to be issued.

Note 2. Fair Value Measurements

The Company follows the provisions of the ASC, Fair Value Measurements and Disclosures. The disclosures required about fair value measurements include, among other things, (1) the amounts and reasons for certain significant transfers among the three hierarchy levels of inputs; (2) the gross, rather than net, basis for certain Level 3 rollforward information; (3) use of a class basis rather than a major category basis for assets and liabilities; and (4) valuation techniques and inputs used to estimate Level 2 and Level 3 fair value measurements. The ASC defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

Note 2. Fair Value Measurements (Continued)

The ASC guidance establishes a fair value hierarchy for valuation inputs that prioritizes the inputs used in valuation methodologies into the following three levels:

Level 1: Quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access as of the measurement date.

Level 2: Observable inputs, other than Level 1, including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data.

Level 3: Unobservable inputs supported by little or no market activity for financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

The Company uses fair value to measure certain assets and liabilities on a recurring basis when fair value is the primary measure of accounting. This is done primarily for available-for-sale securities. Fair value is used on a nonrecurring basis to measure certain assets when applying lower of cost or market accounting or when adjusting carrying values, such as impaired loans, other real estate owned and loans held for sale.

Fair value is also used when evaluating impairment on certain assets, including held-to-maturity and available-for-sale securities, goodwill, core deposits and other intangibles, long-lived assets and for disclosures of certain financial instruments.

There were no transfers among the three hierarchy levels of inputs.

A description of the valuation methodologies used for instruments measured at fair value on a recurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Securities available for sale: Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include actively traded government bonds, such as certain United States Treasury and other United States government and agency securities and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. Level 2 securities generally include certain United States government and agency securities, corporate debt securities and certain derivatives. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

Loans held for sale: Loans held for sale are originated for sale in the secondary market. These loans are reported at fair value using Level 2 inputs and are carried at the lower of cost or estimated fair value in the aggregate. Net unrealized losses are recognized through a valuation allowance by charges to income. These loans are held for relatively short periods of time and, as a result, changes in instrument-specific credit risk are not a significant component of the change in fair value.

Note 2. Fair Value Measurements (Continued)

The following tables summarize assets measured at fair value by class on a recurring basis as reported on the consolidated balance sheets as of December 31, 2016 and 2015, segregated by level within the fair value measurement hierarchy (dollars in thousands):

	Fair Value Measurement at December 31, 2016			
	Total	Level 1	Level 2	Level 3
Assets:				
United States government agency securities	$ 28,483	$ -	$ 28,483	$ -
State and municipal securities	12,636	-	12,636	-
Mortgage-backed securities (government guaranteed)	99,260	-	99,260	-
Loans held for sale	3,997	-	3,997	-
	$ 144,376	$ -	$ 144,376	$ -

	Fair Value Measurement at December 31, 2015			
	Total	Level 1	Level 2	Level 3
Assets:				
United States government agency securities	$ 41,946	$ -	$ 41,946	$ -
State and municipal securities	13,163	-	13,163	-
Mortgage-backed securities (government guaranteed)	109,958	-	109,958	-
Loans held for sale	4,922	-	4,922	-
	$ 169,989	$ -	$ 169,989	$ -

A description of the valuation methodologies used for instruments measured at fair value on a nonrecurring basis, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Impaired loans: The specific reserves for collateral-dependent impaired loans are determined based on the fair value of collateral method in accordance with ASC Topic 310. Under the fair value of collateral method, the specific reserve is equal to the difference between the carrying value of the loan and the fair value of the collateral less estimated selling costs. When a specific reserve is required for an impaired loan, the impaired loan is essentially measured at fair value. The fair value of collateral was determined based on appraisals, with further adjustments made to the appraised values due to various factors, including the age of the appraisal, age of comparables included in the appraisal and known changes in the market and in the collateral. The resulting fair value measurement is disclosed in the nonrecurring hierarchy table. Where significant adjustments made to appraisals are based on assumptions not observable in the marketplace and where estimates of fair values used for other collateral supporting commercial loans are based on assumption not observable in the marketplace, such valuations have been classified as Level 3.

Note 2. Fair Value Measurements (Continued)

The following table summarizes assets as of December 31, 2016 and 2015, that are measured at fair value on a nonrecurring basis (dollars in thousands):

	Fair Value Measurement at December 31, 2016			
	Total	Level 1	Level 2	Level 3
Impaired loans	$ 2,400	$ -	$ -	$ 2,400

	Fair Value Measurement at December 31, 2015			
	Total	Level 1	Level 2	Level 3
Impaired loans	$ 629	$ -	$ -	$ 629

Note 3. Restrictions on Cash and Amounts Due From Banks

The Company is required to maintain average balances on hand or with the Federal Reserve Bank. At December 31, 2016 and 2015, these reserve balances totaled $3.7 million and $5.7 million, respectively.

Note 4. Investment Securities

The amortized cost and fair value of securities, with gross unrealized gains and losses, were as follows (dollars in thousands):

	Securities Available for Sale at December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
United States government agency securities	$ 28,995	$ 20	$ 532	$ 28,483
State and municipal securities	12,984	4	352	12,636
Mortgage-backed securities (government guaranteed)	100,411	537	1,688	99,260
	$ 142,390	$ 561	$ 2,572	$ 140,379

	Securities Available for Sale at December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Approximate Fair Value
United States government agency securities	$ 41,963	$ 180	$ 197	$ 41,946
State and municipal securities	13,089	113	39	13,163
Mortgage-backed securities (government guaranteed)	109,199	1,360	601	109,958
	$ 164,251	$ 1,653	$ 837	$ 165,067

Note 4. Investment Securities (Continued)

At December 31, 2016, the Company had investment securities, carried at approximately $86.7 million ($69.6 million at December 31, 2015), pledged to secure public funds and for other purposes required or permitted by law.

For the year ended December 31, 2016, proceeds from sales of securities available for sale totaled approximately $46.5 million ($53.9 million in 2015). Gross realized gains totaled $1.1 million ($686 thousand in 2015) and gross realized losses totaled $179 thousand ($151 thousand in 2015).

The amortized cost and fair value of available-for-sale securities by contractual maturity at December 31, 2016, were as follows (dollars in thousands):

	Amortized Cost	Fair Value
Securities available for sale:		
After one year through five years	$ 3,544	$ 3,514
After five years through 10 years	29,077	28,572
Over 10 years	9,358	9,033
	41,979	41,119
Mortgage-backed securities	100,411	99,260
	$ 142,390	$ 140,379

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

	Securities Available for Sale at December 31, 2016					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
United States government agency securities	$ 27,448	$ 532	$ -	$ -	$ 27,448	$ 532
State and municipal securities	10,894	302	994	50	11,888	352
Mortgage-backed securities (government guaranteed)	71,821	1,633	2,479	55	74,300	1,688
	$ 110,163	$ 2,467	$ 3,473	$ 105	$ 113,636	$ 2,572

	Securities Available for Sale at December 31, 2015					
	Less Than 12 Months		12 Months or More		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
United States government agency securities	$ 20,547	$ 115	$ 4,962	$ 82	$ 25,509	$ 197
State and municipal securities	1,147	5	1,574	34	2,721	39
Mortgage-backed securities (government guaranteed)	48,500	533	5,549	68	54,049	601
	$ 70,194	$ 653	$ 12,085	$ 184	$ 82,279	$ 837

Note 4. Investment Securities (Continued)

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) the current market conditions and (4) the intent and ability of the Company to not sell the security or whether it is more likely than not the Company will be required to sell the security before its anticipated recovery. Declines in the fair value of available-for-sale securities below their amortized cost basis that are deemed to be other than temporary are carried at fair value. Any portion of a decline in fair value associated with credit loss is recognized in earnings as a realized loss. As of December 31, 2016 and 2015, the Company did not have any securities with other-than-temporary impairment.

As of December 31, 2016, there were 87 securities with current unrealized losses. Based upon an evaluation of the available evidence, including recent changes in market rates and credit rating information, management believes the decline in fair value of these debt securities is temporary. In addition, the Company does not have the intent to sell these debt securities prior to their anticipate recovery.

Note 5. Loans and Allowance for Loan Losses

The components of loans in the consolidated balance sheets were as follows (dollars in thousands):

	December 31	
	2016	2015
Real estate:		
Commercial	$ 76,522	$ 57,612
Residential	70,105	62,046
Construction	19,537	23,156
Commercial	37,517	39,815
Consumer	74,305	68,846
Other	362	396
	278,348	251,871
Allowance for loan losses	(3,163)	(2,958)
	$ 275,185	$ 248,913

Included in other loans are overdraft accounts of $205 thousand and $229 thousand at December 31, 2016 and 2015, respectively.

During the years ended December 31, 2016 and 2015, the Company purchased loans from other nonrelated banks totaling $11.0 million and $2.1 million, respectively. The Company sold no loans to nonrelated banks during the years ended December 31, 2016 and 2015.

As part of its on-going monitoring of the credit quality of the Company's loan portfolio, management assigns risk grades to loans as follows.

Pass: Pass loans are loans to borrowers with acceptable credit quality and risk.

Other assets especially mentioned (OAEM): OAEM loans are loans to borrowers whose credit quality may have deteriorated since origination and are at risk of further decline unless measures are taken to correct the situation.

Note 5. Loans and Allowance for Loan Losses (Continued)

Substandard: Substandard loans are loans to borrowers with well-defined credit quality weaknesses, which make payment default or principal exposure possible, but not yet certain. Such loans are individually evaluated for a specific-valuation allowance.

Doubtful: Doubtful loans are loans to borrowers in which payment default or principal exposure is probable. Such loans are individually evaluated for a specific valuation allowance.

At December 31, 2016 and 2015, the Company's loan portfolio risk grades by loan segment were as follows (dollars in thousands):

	December 31, 2016				
	Pass	OAEM	Substandard	Doubtful	Total Loans
Real estate:					
Commercial	$ 74,853	$ 307	$ 1,362	$ -	$ 76,522
Residential	67,646	1,337	1,122	-	70,105
Construction	16,018	486	3,033	-	19,537
Commercial	31,095	2,769	3,653	-	37,517
Consumer	73,407	311	587	-	74,305
Other	362	-	-	-	362
	$ 263,381	$ 5,210	$ 9,757	$ -	$ 278,348

	December 31, 2015				
	Pass	OAEM	Substandard	Doubtful	Total Loans
Real estate:					
Commercial	$ 55,855	$ 341	$ 1,416	$ -	$ 57,612
Residential	59,991	887	1,168	-	62,046
Construction	20,445	-	2,711	-	23,156
Commercial	37,516	782	1,517	-	39,815
Consumer	67,794	663	389	-	68,846
Other	396	-	-	-	396
	$ 241,997	$ 2,673	$ 7,201	$ -	$ 251,871

Note 5. Loans and Allowance for Loan Losses (Continued)

An aged analysis of past-due loans, segregated by class of loans, as of December 31, 2016 and 2015, was as follows (dollars in thousands):

	December 31, 2016					
	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past-Due Loans	Current Loans	Total Loans	Accruing Loans 90 Days or More Past Due
Real estate:						
Commercial	$ 48	$ 34	$ 82	$ 76,440	$ 76,522	$ -
Residential	339	177	516	69,589	70,105	-
Construction	-	-	-	19,537	19,537	-
Commercial	-	46	46	37,471	37,517	-
Consumer	1,257	409	1,666	72,639	74,305	-
Other	-	-	-	362	362	-
	$ 1,644	$ 666	$ 2,310	$ 276,038	$ 278,348	$ -

	December 31, 2015					
	Loans 30-89 Days Past Due	Loans 90 or More Days Past Due	Total Past-Due Loans	Current Loans	Total Loans	Accruing Loans 90 Days or More Past Due
Real estate:						
Commercial	$ -	$ 51	$ 51	$ 57,561	$ 57,612	$ -
Residential	530	151	681	61,365	62,046	-
Construction	-	-	-	23,156	23,156	-
Commercial	244	-	244	39,571	39,815	-
Consumer	1,205	127	1,332	67,514	68,846	-
Other	-	-	-	396	396	-
	$ 1,979	$ 329	$ 2,308	$ 249,563	$ 251,871	$ -

Note 5. Loans and Allowance for Loan Losses (Continued)

Loans are considered impaired and placed on nonaccrual status when, based on current information and events, it is probable the Company will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement. Loans may be placed on impaired and nonaccrual status regardless of whether or not such loans are considered past due. An analysis of impaired and nonaccrual loans, segregated by class of loans, as of December 31, 2016 and 2015, is as follows (dollars in thousands):

	December 31, 2016				
	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment and Unpaid Balance	Related Allowance	Average Recorded Investment
Real estate:					
Commercial	$ 34	$ -	$ 34	$ -	$ 43
Residential	445	-	445	-	383
Construction	1,081	-	1,081	-	541
Commercial	146	196	342	27	172
Consumer	449	114	563	38	440
	$ 2,155	$ 310	$ 2,465	$ 65	$ 1,579

	December 31, 2015				
	Recorded Investment With No Allowance	Recorded Investment With Allowance	Total Recorded Investment and Unpaid Balance	Related Allowance	Average Recorded Investment
Real estate:					
Commercial	$ 51	$ -	$ 51	$ -	$ 101
Residential	212	109	321	61	354
Construction	-	-	-	-	9
Commercial	2	-	2	-	1
Consumer	316	-	316	-	300
	$ 581	$ 109	$ 690	$ 61	$ 765

During the years ended December 31, 2016 and 2015, the Company did not recognize any significant interest income on impaired and nonaccrual loans.

Note 5. Loans and Allowance for Loan Losses (Continued)

Impaired loans also include loans modified in a troubled debt restructuring. Such modifications generally allow the borrower concessions that delay the payment of principal and interest beyond contractual requirements, but not the forgiveness of either principal or interest. The Company has evaluated any possible impairment loss on these loans consistent with its accounting for impaired loans and, any such loss, would be recognized through a charge-off to the allowance for loan loss account.

The following is a summary of the Company's modified loans classified as troubled debt restructuring during 2016 and 2015 (dollars in thousands):

	December 31, 2016		
	Number of Loans	Outstanding Recorded Investment Before Specific Allowance	Outstanding Recorded Investment After Specific Allowance
Real estate:			
Commercial	1	$ 570	$ 570
Residential	1	152	152
Construction	1	1,067	1,067
Commercial	6	386	359
	9	$ 2,175	$ 2,148

	December 31, 2015		
	Number of Loans	Outstanding Recorded Investment Before Specific Allowance	Outstanding Recorded Investment After Specific Allowance
Real estate:			
Commercial	1	$ 600	$ 600
Residential	-	-	-
Construction	-	-	-
Commercial	2	58	58
	3	$ 658	$ 658

As of December 31, 2016, no loans that had been modified within the previous year defaulted in the current year.

Note 5. Loans and Allowance for Loan Losses (Continued)

Changes in the allowance for loan losses, by portfolio segment, for the years ended December 31, 2016 and 2015, were as follows (dollars in thousands):

	Year Ended December 31, 2016						
	Commercial Real Estate	Residential Real Estate	Construction Real Estate	Commercial	Consumer	Other	Total
Balance at beginning of year	$ 604	$ 939	$ 99	$ 191	$ 469	$ 656	$ 2,958
Provision (credit) for loan losses	79	(314)	8	170	1,611	(677)	877
Charge-offs	(8)	(8)	-	(1)	(949)	(151)	(1,117)
Recoveries	5	21	-	31	209	179	445
Net (charge-offs) recoveries	(3)	13	-	30	(740)	28	(672)
Balance at end of year	$ 680	$ 638	$ 107	$ 391	$ 1,340	$ 7	$ 3,163
Allocation:							
Individually evaluated for impairment	$ -	$ -	$ -	$ 27	$ 38	$ -	$ 65
Collectively evaluated for impairment	680	638	107	364	1,302	7	3,098

	Year Ended December 31, 2015						
	Commercial Real Estate	Residential Real Estate	Construction Real Estate	Commercial	Consumer	Other	Total
Balance at beginning of year	$ 604	$ 919	$ 99	$ 173	$ 642	$ 463	$ 2,900
Provision for loan losses	-	-	-	-	366	354	720
Charge-offs	-	(4)	-	-	(722)	(374)	(1,100)
Recoveries	-	24	-	18	183	213	438
Net (charge-offs) recoveries	-	20	-	18	(539)	(161)	(662)
Balance at end of year	$ 604	$ 939	$ 99	$ 191	$ 469	$ 656	$ 2,958
Allocation:							
Individually evaluated for impairment	$ -	$ 61	$ -	$ -	$ -	$ -	$ 61
Collectively evaluated for impairment	604	878	99	191	469	656	2,897

During the year ended December 31, 2016, the Company did not implement any significant changes to its allowance for loan loss methodology.

Note 5. Loans and Allowance for Loan Losses (Continued)

The Company's recorded investment in loans as of December 31, 2016 and 2015, related to each balance in the allowance for loan losses by portfolio segment and disaggregated on the basis of the Company's impairment methodology was as follows:

	Year Ended December 31, 2016						
	Commercial Real Estate	Residential Real Estate	Construction Real Estate	Commercial	Consumer	Other	Total
Loans individually evaluated for impairment	$ -	$ -	$ -	$ 196	$ 114	$ -	$ 310
Loans collectively evaluated for impairment	76,522	70,105	19,537	37,321	74,191	362	278,038
Ending balance	$ 76,522	$ 70,105	$ 19,537	$ 37,517	$ 74,305	$ 362	$ 278,348

	Year Ended December 31, 2015						
	Commercial Real Estate	Residential Real Estate	Construction Real Estate	Commercial	Consumer	Other	Total
Loans individually evaluated for impairment	$ -	$ 109	$ -	$ -	$ -	$ -	$ 109
Loans collectively evaluated for impairment	57,612	61,937	23,156	39,815	68,846	396	251,762
Ending balance	$ 57,612	$ 62,046	$ 23,156	$ 39,815	$ 68,846	$ 396	$ 251,871

Note 6. Bank Premises and Equipment

Components of bank premises and equipment included in the consolidated balance sheets were as follows (dollars in thousands):

	December 31	
	2016	2015
Land	$ 3,068	$ 3,052
Buildings and improvements	12,746	12,438
Leasehold improvements	618	1,144
Equipment and furniture	5,735	5,136
Automobiles	435	420
Fixed assets in progress	4,120	94
	26,722	22,284
Less accumulated depreciation and amortization	8,815	8,593
	$ 17,907	$ 13,691

Depreciation and amortization expense for the years ended December 31, 2016 and 2015, totaled $1.1 million and $1.0 million, respectively.

During 2016, the Company entered into a construction contract to build-out office space at a location owned by the Company. As of December 31, 2016, the Company has approximately $4.5 million remaining in contractual commitments related to the construction and capitalized approximately $3.7 million during 2016.

Note 6. Bank Premises and Equipment (Continued)

The Company has several operating leases for branches and for equipment that terminate in 2017 through 2020.

Pursuant to the terms of noncancelable lease agreements in effect at December 31, 2016, pertaining to bank premises, future rent commitments under the operating leases are as follows (dollars in thousands):

Years ending December 31:		
2017	$	192
2018		147
2019		105
2020		7
	$	451

Each lease contains an option to extend for one consecutive term of five years. The costs of such rentals are not included above. Total rent expense for the year ended December 31, 2016, totaled $290 thousand ($364 thousand for the year ended December 31, 2015).

Note 7. Derivative Financial Instrument

The Company has a cash flow hedge, which resulted in a net loss of $-0- and $1 thousand, respectively, for the years ended December 31, 2016 and 2015. The loss was included in accumulated other comprehensive income, and the related asset had a balance of $-0- as of December 31, 2016 and 2015.

Note 8. Deposits

The aggregate amount of certificates of deposit (CDs) in denominations exceeding $250 thousand was approximately $32.6 million at December 31, 2016 ($28.6 million in 2015).

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

Years ending December 31:		
2017	$	16,983
2018		29,491
2019		4,415
2020		3,917
2021		11,951
	$	66,757

Note 9. Federal Home Loan Bank Borrowings

During 2013, the Bank executed fixed-rate fixed-term borrowings with the FHLB of Dallas. Advances are received pursuant to a collateral pledge and security agreements giving FHLB a lien in certain of the Bank’s loans, including mortgage loans (as defined); all FHLB stock, and all deposit accounts of the Bank held at FHLB. The collateral has a carrying value of approximately $105.3 million at December 31, 2016 ($86.7 million in 2015).

Note 9. Federal Home Loan Bank (FHLB) Borrowings (Continued)

At December 31, 2016, FHLB borrowings totaled $25 million, with daily interest rates of 0.43 percent and maturity dates in January 2017. FHLB borrowings totaled $10 million at December 31, 2015, with a daily interest rate of 0.31 percent and a maturity date of January 4, 2016.

Note 10. Other Borrowed Funds

Other borrowed funds consist of securities sold under agreements to repurchase and generally mature within one year. The Company has pledged securities against these funds and may be required to provide additional collateral based on the fair value of the underlying securities.

Note 11. Long-Term Debt

The Company has a promissory note with an unrelated bank for the purpose of a prior acquisition and related acquisition expenses. The note bears interest of 1.85 percent over daily one-month LIBOR and is secured by all outstanding shares of common stock of the Bank. The promissory note requires quarterly payments of approximately $233 thousand plus interest and is scheduled to mature on December 31, 2017. As part of the debt agreement, the Company is required to comply with certain financial covenants primarily relating to the Bank. The balance as of December 31, 2016, totaled $580 thousand ($1.6 million in 2015).

Note 12. Junior Subordinated Debt

On September 13, 2006, the Company established the Kleberg Statutory Trust I (the Trust I) with capital of $140 thousand. The Trust issued $4.5 million in pooled Trust Preferred Securities to outside investors. The Trust Preferred Securities bear interest at a floating rate based on the three-month LIBOR plus 1.6 percent. The Trust Preferred Securities mature and are payable on December 15, 2036.

On December 14, 2006, the Company established the Kleberg Statutory Trust II (the Trust II) with capital of $279 thousand. The Trust II issued $9.0 million in pooled Trust Preferred Securities to outside investors. The Trust Preferred Securities bear interest at 6.65 percent fixed rate until December 2016 and a floating rate based on the three-month LIBOR plus 1.75 percent. The Trust Preferred Securities mature and are payable on December 15, 2036.

The Company issued the Trust Preferred Securities as a method of increasing regulatory capital for an acquisition. Trust Preferred Securities are includable in regulatory capital, with certain limitations.

In connection with the transactions, the Company issued Floating Rate Junior Subordinated Deferrable Interest Debentures (the Debentures) to the Trust I for $4.64 million and Trust II for $9.28 million with interest and maturity terms identical to the Trust Preferred Securities. In accordance with the ACS, the Trusts are not consolidated in the accompanying consolidated financial statements. Instead, the investment in the Trusts is shown in other assets and the debentures in junior subordinated debentures on the consolidated balance sheets. Interest expense on the debentures is reported in the consolidated statements of income.

The Company entered into a guarantee agreement to pay the investors in the Trust Preferred Securities.

Note 13. Legal Contingencies

The Company may be party to litigation arising in the normal course of business. Management, after consultation with legal counsel, believes the liabilities, if any, that would arise from such litigation and claims would not be material to the Company's consolidated financial position.

Note 14. Off-Balance-Sheet Activities

Credit-related financial instruments: The Company is a party to credit-related 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, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets.

The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments.

The following financial instruments, whose contract amounts represent credit risk, were outstanding (dollars in thousands):

	Contract Amount	
	December 31	
	2016	2015
Unfunded commitments under lines of credit	$ 73,220	$ 68,730
Commercial and standby letters of credit	80	178

Unfunded commitments under lines of credit include commitments to extend credit on term loans, revolving lines of credit, advancing lines of credit and interim construction loans. These commitments may not be drawn to the total extent to which the Company is committed.

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained are based on the Company's credit evaluation of the customer. Collateral held varies, but may include cash; securities; accounts receivable; inventory; property, plant, and equipment; and real estate.

Commercial and standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially, all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

Note 15. Related-Party Transactions

In the ordinary course of business, the Company has granted loans to principal officers and directors and their affiliates. The aggregate of loans to related parties at December 31, 2016, totaled $312 thousand ($451 thousand in 2015).

Deposits from related parties held by the Bank at December 31, 2016, totaled $6.0 million ($7.3 million at December 31, 2015).

Note 16. Federal Income Taxes

Taxable income is reported on the federal tax returns of the Company's stockholders. Accordingly, no provision has been made for federal income tax in the accompanying consolidated financial statements.

The Company files a United States federal income tax return, as well as a state return in Texas. With few exceptions, the Company is no longer subject to United States federal or Texas state tax examinations by tax authorities for years before 2013.

Note 17. Employee Benefits

At December 31, 2016 and 2015, the Company has an incentive compensation plan, an executive supplemental income plan, a 401(k) plan and a salary continuation plan. Total expense recognized by the Company relating to such benefit plans totaled $979 thousand and $975 thousand for the years ended December 31, 2016 and 2015, respectively.

Incentive compensation plan: Officers and employees of the Bank participate in a discretionary bonus plan. Bonus amounts expected to be paid are based on the performance of the Bank and on the performance of the respective officer or employee. These amounts have been recorded as an expense in the consolidated statements of income.

Executive supplemental income plan: The executive supplemental income plan is a nonqualified deferred compensation plan for designated officers. Upon the participant's retirement, death or disability, the amount of benefits, as defined by the plan document, will be paid to the participant or the beneficiary.

The present value of benefits expected to be provided is expensed over the remaining estimated years of service of the participant. Vesting occurs at the retirement age of 65 or upon the participant's death.

The plan is funded by the Company through annual deposits with insurance companies to provide a tax-deferred investment for future benefit payments, along with life and disability insurance coverage for the participants. The Company had deposit contracts with insurance companies totaling $1.2 million in 2016 and 2015. An accrued benefit liability of $109 thousand is included in other liabilities as of December 31, 2016 ($89 thousand in 2015).

401(k) plan: Under the Company's 401(k) plan, adopted in September 1998, participants are permitted to contribute the maximum allowed by law to the plan, which is matched by the Company 100 percent up to 6 percent of the participant's compensation for the year. All participant contributions are 100 percent vested at all times. The Company's matching contributions vest 25 percent with each year of service beginning the second year of service. Total employer contributions amounted to $348 thousand for 2016 ($327 thousand in 2015).

Salary continuation plan: The Company has a nonqualified deferred compensation plan for six designated officers. Upon the designated officers' disability, retirement or death, the amount of benefits, as defined by the continuation plan document, will be paid out to the participant or the beneficiary. The present value of benefits expected to be provided is expensed over the remaining estimated years of service of the participants. Each designated officer vests over varying years.

Note 17. Employee Benefits (Continued)

The salary continuation plan is funded by the Company through the Bank's purchase of life insurance policies to provide a tax-deferred investment for future benefit payments, along with life insurance coverage for the participants. The designated officer is the insured person under the policy, and the Bank is the owner and beneficiary. The Company had policies with insurance companies with cash surrender values totaling $7.5 million and $7.3 million in 2016 and 2015, respectively. An accrued benefit liability of $2.3 million and $2.2 million is included in other liabilities as of December 31, 2016 and 2015, respectively.

Note 18. Restrictions of Dividends

The Bank, as a National Bank, is subject to the dividend restrictions set forth by the Comptroller of the Currency. Under such restrictions, the Bank may not, without prior approval of the Comptroller of the Currency, declare dividends in excess of the sum of the current year's earnings (as defined) plus the retained earnings (as defined) from the prior two years. As of December 31, 2016 and 2015, the Bank could declare dividends of $5.6 million and $4.5 million without the approval of the Comptroller of the Currency.

Note 19. Capital and Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. Capital adequacy and prompt corrective action regulations involve quantitative measures of assets, liabilities and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators about component classification, risk weighting and other factors.

The Basel III capital rules became effective for the Bank on January 1, 2015, subject to a four-year phase-in period. Quantitative measures established by the Basel III capital rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 Capital, Tier 1 Capital, Total Capital to Risk-Weighted Assets and of Tier 1 Capital to Average Assets. In connection with the adoption of the Basel III capital rules, the Bank elected to opt-out of the requirement to include most components of accumulated other comprehensive income in Common Equity Tier 1 Capital.

Management believes, as of December 31, 2016 and 2015, that the Bank met all capital adequacy requirements to which it is subject. As of December 31, 2016, the most recent notification from the regulators categorized the Bank as well capitalized under the regulatory framework for prompt corrective action.

Note 19. Capital and Regulatory Matters (Continued)

The following table presents actual and required capital ratios as of December 31, 2016, for the Bank under the Basel III capital rules. The minimum required capital amounts present the minimum required levels as of December 31, 2016, based on the phase-in of the Basel III capital rules and the minimum required as of January 1, 2019, when the phase-in is complete. Capital levels to be considered well capitalized under prompt corrective action regulations are also presented.

	December 31, 2016							
	Actual		Minimum Required Basel III Current Phase-In		Minimum Required Basel III Full Phase-In		Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 capital to risk-weighted assets	$ 43,944	14.2%	$ 15,836	5.1%	$ 21,735	7.0%	$ 20,183	6.5%
Tier 1 capital to risk-weighted assets	$ 43,944	14.2%	$ 20,493	6.6%	$ 26,393	8.5%	$ 24,840	8.0%
Total capital to risk-weighted assets	$ 47,107	15.2%	$ 26,703	8.6%	$ 32,603	10.5%	$ 31,050	10.0%
Tier 1 capital to average assets	$ 43,944	9.0%	$ 19,522	4.0%	$ 19,522	4.0%	$ 24,403	5.0%

	December 31, 2015							
	Actual		Minimum Required Basel III Current Phase-In		Minimum Required Basel III Full Phase-In		Minimum Required to be Well Capitalized Under Prompt Corrective Action Provisions	
(Dollars in Thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity Tier 1 capital to risk-weighted assets	$ 41,905	14.9%	$ 12,673	4.5%	$ 19,713	7.0%	$ 18,305	6.5%
Tier 1 capital to risk-weighted assets	$ 41,905	14.9%	$ 16,897	6.0%	$ 23,938	8.5%	$ 22,530	8.0%
Total capital to risk-weighted assets	$ 44,863	15.9%	$ 22,530	8.0%	$ 29,570	10.5%	$ 28,162	10.0%
Tier 1 capital to average assets	$ 41,905	8.7%	$ 19,249	4.0%	$ 19,249	4.0%	$ 24,062	5.0%

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