2018 ANNUAL REPORT

75 YEARS

STAR

Bank | Insurance | Private Advisory

The year 2018 marked a significant milestone for STAR Bank: we celebrated our 75th year as a family-owned and operated Indiana business. As the banking industry continues to evolve, STAR has remained true to the principles upon which our founders, including my father and uncle, started this legacy. Those principles are a dedication to remaining a privately held institution, a commitment to being progressive and, above all, an unwavering focus on growing the Indiana communities we serve.

STAR Financial Group had a record-breaking year in 2018 thanks to the dedication of STAR's team members. It is my privilege to report these results.

THOMAS M. MARCUCCILLI
Chairman, STAR Financial Group, Inc.

Contents

2018 Economic Review

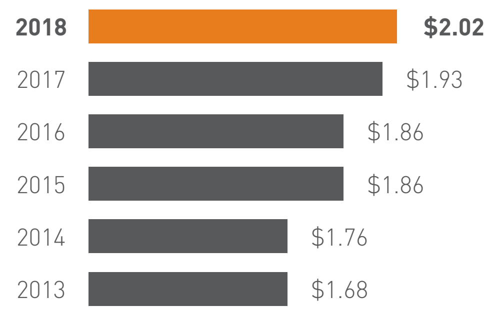
STAR Financial Bank's average assets grew by 3.8% in 2018. At the close of 2018, STAR reported total assets of $2.02 billion, total loans and leases of $1.47 billion and total deposits of $1.71 billion. This accelerated growth is due to record production from multiple lines of business.

- The Commercial Bank achieved a new high watermark for outstanding loans in 2018, with over $1.1 billion.
- The Retail Bank opened nearly 6,000 checking accounts in 2018, representing an increase in new household growth, year-over-year, by 28%.
- Private Banking added 99 nameplates and grew deposits by more than $7 million.
- STAR Wealth Management had record earnings in 2018, in excess of $2 million.
- STAR Insurance Agency generated a record $1.5 million in pre-tax earnings and an annual premium of $42 million.

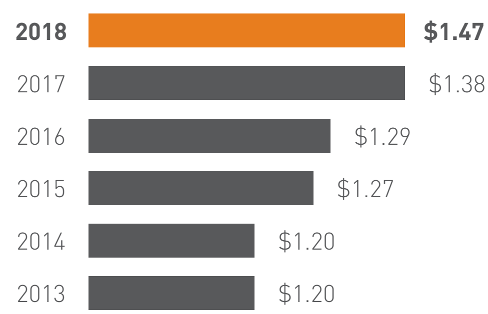
In 2018, STAR Financial Group reported net earnings of $21.6 million, which is a 45% increase of earnings over 2017.

$2.02 BILLION in assets

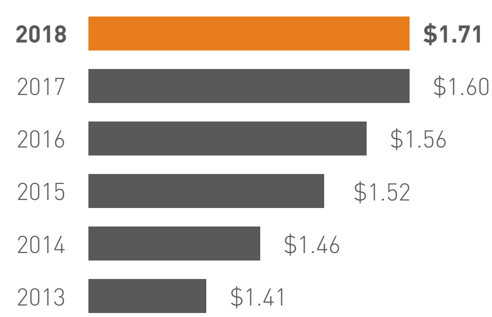
TOTAL ASSETS
(in billions)



TOTAL LOANS & LEASES
(in billions)



DEPOSITS
(in billions)



STAR employees knitted more than 300 red hats to support American Heart Association's Little Hats, Big Hearts.

Invested in the Community

Continuing a tradition of giving back to Indiana communities, STAR donated over $640,000 to more than 100 Indiana nonprofit organizations in 2018. Those donations were focused on STAR's three pillars of philanthropic giving: Education, Arts and Economic Development.

STAR employees gave back to their communities in 2018 as well, recording 3,027 volunteer hours at 175 nonprofit organizations in Indiana. To encourage our employees to continue supporting local nonprofit organizations they care about, STAR offers a matching program that doubles their gifts up to $50.

For more information about STAR's commitment to the community, visit **starfinancial.com/community**.

The Volunteer Time Off program at STAR lets employees explore philanthropic opportunities.

STAR employees joined together to lend a helping hand at United Way's Day of Caring *(above)* and a PBS Pledge Drive *(right)*.

STAR employees presented a check to Hillcroft Services of Muncie.

2018 STAR Giving included more than 100 nonprofits, including:

Amani Family Services
Anderson Arts
Arts United of Greater Fort Wayne
Big Brothers Big Sisters NE IN
Boys & Girls Club of Fort Wayne
Brightpoint
Carey Services Duck Race
Central Indiana Regional Partnership
Community Foundation of Grant County
Community Harvest Food Bank
Downtown Angola Coalition
Early Childhood Alliance
East Central Indiana Regional Partnership
Easterseals Arc of Northeast Indiana
Embassy Theatre
Erin's House for Grieving Children
Fort Wayne Children's Choir
Fort Wayne Museum of Art
Fort Wayne Philharmonic
Fort Wayne Public Television
Fort Wayne Rescue Mission
Global Leadership Summit
Grant County Park Association
Greater Fort Wayne
Hillcroft Services
Junior Achievement of Northern Indiana
Kate's Kart
Mad Anthony Children's Foundation
Madison County Chamber Gala
Mississinewa Battlefield
Muncie-Delaware Advancement Corporation
Northeast Indiana Regional Partnership
St Vincent Hospital
The Literacy Alliance
Troy Center
Turnstone
United Way of Allen County
United Way of Central Indiana
United Way of Delaware County
United Way of Grant County
United Way of Henry County
United Way of Madison County
United Way of Whitley County
University of Saint Francis
YMCA of Greater Fort Wayne
YMCA of Kokomo
YMCA of Muncie
YMCA of Whitley County
YWCA of Northeast Indiana

A 75-Year Legacy and Counting

In 2018, we celebrated 75 years in business with the customers, employees and communities who made the milestone possible. On October 25, 2018 *(our official anniversary)*, Mayor Tom Henry joined STAR team members and executives to proclaim STAR Day in Fort Wayne. To celebrate, bankers at all 43 branches threw parties for customers with cupcakes, gifts and fun.

Our 75th year serves as a reminder that STAR is here to stay. As we celebrate the successes leading to this point, we remain focused on the future and dedicated to our founding principles.

Mayor Tom Henry declared October 25th as STAR Day to celebrate STAR Bank's 75-year legacy in Indiana communities.


75 YEARS
to the

Central Region Leaders gather to celebrate a team member's 35 years of dedication at STAR.

The STAR Experience

In 2018, STAR made significant investments to continue to provide an exemplary workplace culture to over 550 team members in Indiana. As part of that effort, employees at all levels worked together to launch initiatives throughout the year to celebrate and support the STAR team. Career pathing has been expanded to give STAR employees more opportunities to work with supervisors and HR in achieving their goals. Additionally, STAR implemented a paid maternity and paternity leave program – and will continue sending each new parent a baby blanket.

STAR invested in physical infrastructure in 2018, renovating nine branches to our new banking model. The new banking model provides a customer-centric banking experience with digital tools inside the office, through the Tech Bar, as well as outside the office, through video banking. In 2018, STAR's core system was upgraded resulting in a streamlined workflow for employees. As we look to the future, we are excited to continue to launch new digital tools to optimize the STAR experience and maintain focus on STAR's commitment to technology.

Community members and STAR employees gather to officially open STAR's new Muncie Broadway office.

Looking Ahead

We see 2019 as a year of exciting opportunity and growth as we navigate the ever-changing banking industry and concentrate on developing new digital solutions for today while keeping an eye out for disruption on the horizon. Collaboration with industry partners remains a strategic focus for STAR as we discover new ways to continue to deliver the seamless customer experience today's consumers expect. With business optimism remaining strong in Indiana, we look forward to growing alongside the Indiana communities and businesses we serve.

THOMAS M. MARCUCCILLI
Chairman, STAR Financial Group, Inc.

STAR Financial Group, Inc.

Independent Auditor's Report and
Consolidated Financial Statements

December 31, 2018 and 2017

	2018	2017	2016
For the Year			
Net income	$ 21,626	$ 14,921	$ 16,156
Dividends declared	3,903	3,780	3,702
Weighted average shares	3,699,263	3,722,799	3,796,856
Per Basic Common Share			
Net income	$ 5.85	$ 4.01	$ 4.26
Dividends declared	1.06	1.02	0.98
Book value at December 31	60.44	55.60	51.81
At December 31			
Total assets	$ 2,017,490	$ 1,934,531	$ 1,862,858
Earning assets	1,852,393	1,769,920	1,694,961
Loans and leases	1,473,216	1,382,779	1,296,941
Deposits	1,710,115	1,604,008	1,563,713
Stockholders' equity	224,051	206,095	193,713
Capital Ratios (Bank only)			
Risk-based capital ratios			
Tier I	12.21%	11.98%	12.00%
Total (Tier I plus Tier II)	13.32	13.04	13.19
Leverage ratio	10.75	10.47	10.07
Common Equity Tier I	12.21	11.98	12.00

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CPAs & Advisors

200 E. Main Street, Suite 700 | Fort Wayne, IN 46802-1900
260.460.4000 | Fax 260.426.2235 | bkd.com

Independent Auditor's Report

Board of Directors and Stockholders
STAR Financial Group, Inc.
Fort Wayne, Indiana

We have audited the accompanying consolidated financial statements of STAR Financial Group, Inc. (Company) and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 financial statements based on our audits. We conducted our audits 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances. 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 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 STAR Financial Group, Inc. and its subsidiaries as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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200 E. Main Street, Suite 700 | Fort Wayne, IN 46802-1900
260.460.4000 | Fax 260.426.2235 | bkd.com

Report on Internal Control Over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, STAR Financial Group's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 8, 2019, expressed an unmodified opinion on the effectiveness of the Company's internal control over financial reporting.

BKD, LLP

Fort Wayne, Indiana
March 8, 2019

	2018	2017
Assets		
Cash and cash equivalents		
Cash and due from banks	$ 39,762	$ 44,215
Interest-bearing demand deposits	64,333	25,127
Total cash and cash equivalents	104,095	69,342
Investment securities available-for-sale	334,139	379,845
Loans held for sale	197	200
Loans and leases	1,473,216	1,382,779
Less		
Allowance for loan and lease losses	(19,492)	(18,031)
Net loans and leases	1,453,724	1,364,748
Bank owned life insurance	45,314	46,100
Premises and equipment, net	40,017	38,784
Interest receivable	8,358	7,307
Goodwill	5,567	5,567
Other assets	26,079	22,638
Total assets	$ 2,017,490	$ 1,934,531
Liabilities and Stockholders' Equity		
Liabilities		
Deposits		
Demand, noninterest bearing	$ 630,485	$ 615,977
Interest bearing		
Demand	873,656	823,747
Certificates of deposit of $100,000 or more	55,730	42,918
Other time deposits	150,244	121,366
Total deposits	1,710,115	1,604,008
Short-term borrowings	33,906	30,132
Long-term borrowings	20,250	66,402
Subordinated debt	10,310	10,310
Other liabilities	18,858	17,584
Total liabilities	1,793,439	1,728,436
Stockholders' Equity		
Common stock		
No par value, 5,000,000 shares authorized, 4,854,380 shares issued	7,359	7,359
Capital surplus	6,712	6,712
Retained earnings	259,066	241,343
Accumulated other comprehensive loss	(4,210)	(5,203)
Treasury stock at cost, 1,159,108 and 1,147,614 shares	(44,876)	(44,116)
Total stockholders' equity	224,051	206,095
Total liabilities and stockholders' equity	$ 2,017,490	$ 1,934,531

STAR Financial Group, Inc.

Consolidated Statements of Income
Years Ended December 31, 2018 and 2017
(In Thousands Except Share Data)

	2018	2017
Interest Income		
Interest on loans	$ 66,454	$ 57,468
Interest on investment securities		
Taxable	6,520	6,010
Tax exempt	2,386	2,120
Total interest income	75,360	65,598
Interest Expense		
Interest on deposits	5,042	2,309
Interest on short-term borrowings	78	49
Interest on long-term borrowings	1,343	1,551
Total interest expense	6,463	3,909
Net Interest Income	68,897	61,689
Provision for Loan and Lease Losses	8,000	—
Net Interest Income After Provision for Loan and Lease Losses	60,897	61,689
Noninterest Income		
Service charges and fees	8,623	8,298
Bank card processing	6,907	6,491
Mortgage sales and servicing fees	2,327	2,537
Insurance commissions	6,580	6,331
Trust and brokerage fee income	3,459	2,901
Gain on sale of Insurance book of business	1,871	—
Gain on sale of fixed assets	72	230
Other fees and commissions	1,615	1,846
ATM foreign surcharge income	357	401
Check order income	225	240
Dividend income	163	139
Realized loss on sale of securities	—	(46)
Other	2,066	1,574
Total noninterest income	34,365	30,942
Noninterest Expense		
Salaries and employee benefits	39,966	38,763
Occupancy expense	6,116	6,188
Equipment expense	8,938	8,898
Bank card processing fees	1,865	1,780
Loan and collection expense	1,663	1,937
Deposit insurance premiums	881	721
Advertising and promotional	1,805	2,305
Professional services	1,729	1,892
Other	6,056	5,573
Total noninterest expense	69,019	68,057
Income Before Income Taxes	26,243	24,574
Provision for Income Taxes	4,617	9,653
Net Income	$ 21,626	$ 14,921
Basic and Diluted Earnings Per Share	$ 5.85	$ 4.01
Weighted-Average Shares Outstanding	3,699,263	3,722,799

See Notes to Consolidated Financial Statements

STAR Financial Group, Inc.

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2018 and 2017
(In Thousands)

	2018	2017
Net Income	$ 21,626	$ 14,921
Other Comprehensive Income (Loss)		
Change in fair value of cash flow hedges, net of taxes of $27 and $50, for 2018 and 2017, respectively.	101	94
Unrealized appreciation on available-for-sale securities, net of taxes of $175 and $1,654, for 2018 and 2017, respectively.	997	3,264
Less: reclassification adjustment for realized losses included in net income, net of taxes $(16) for 2017.	—	(30)
Unrealized depreciation on available-for-sale securities for which a portion of an other-than-temporary impairment has been recognized in income, net of taxes of $(28) and $(22), for 2018 and 2017, respectively.	(105)	(40)
	993	3,288
Comprehensive Income	$ 22,619	$ 18,209

See Notes to Consolidated Financial Statements

STAR Financial Group, Inc.

Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2018 and 2017

(In Thousands Except Share Data)

	Common Stock	Capital Surplus	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
Balance, January 1, 2017	$ 7,359	$ 6,712	$ 229,294	$ (7,583)	$ (42,069)	$ 193,713
Net income			14,921			14,921
Other comprehensive income				3,288		3,288
Reclassification of tax rate change on unrealized loss on securities			908	(908)		-
Cash dividends ($1.02 per share)			(3,780)			(3,780)
Purchase of treasury stock (32,106 shares)					(2,047)	(2,047)
Balance, December 31, 2017	7,359	6,712	241,343	(5,203)	(44,116)	206,095
Net income			21,626			21,626
Other comprehensive income				993		993
Cash dividends ($1.06 per share)			(3,903)			(3,903)
Purchase of treasury stock (11,494 shares)					(760)	(760)
Balance, December 31, 2018	$ 7,359	$ 6,712	$ 259,066	$ (4,210)	$ (44,876)	$ 224,051

See Notes to Consolidated Financial Statements

STAR Financial Group, Inc.

Consolidated Statements of Cash Flows
Years Ended December 31, 2018 and 2017
(In Thousands)

	2018	2017
Operating Activities		
Net income	$ 21,626	$ 14,921
Items not requiring (providing) cash		
Net gain from sale of loans	(1,055)	(1,304)
Origination of loans for sale	(35,748)	(34,258)
Proceeds from sale of loans	36,806	36,087
Increase in value of bank-owned life insurance	(1,225)	(1,292)
Depreciation and amortization on premises and equipment	4,733	4,509
Net amortization of securities	3,730	3,722
Provision for deferred taxes	3,531	4,237
Realized loss on sale of securities	—	46
Gain on sale of Insurance book of business	(1,871)	—
(Gain) Loss on sale of premises and equipment	72	(230)
Change in interest receivable	(1,051)	(298)
Change in other assets	(4,570)	1,654
Change in other liabilities	1,274	1,131
Net cash provided by operating activities	26,252	28,925
Investing Activities		
Proceeds from sales of investment securities available-for-sale	—	2,596
Proceeds from maturities and calls of investment securities available-for-sale	47,901	52,971
Proceeds from disposal of premises and equipment	52	672
Proceeds from sale of Insurance book of business	1,871	—
Proceeds from bank-owned life insurance policy	2,011	466
Purchase of premises and equipment	(8,598)	(8,901)
Purchase of investment securities available-for-sale	(4,826)	(67,268)
Net change in loans	(88,976)	(86,946)
Net cash used in investing activities	(50,565)	(106,410)
Financing Activities		
Net change in deposits	106,107	40,295
Net change in short-term borrowings	3,774	(7,118)
Proceeds from long-term borrowings	60,000	67,062
Repayment of long-term borrowings	(106,152)	(42,079)
Cash dividends	(3,903)	(3,780)
Purchase of treasury stock	(760)	(2,047)
Net cash provided by financing activities	59,066	52,333
Net Change in Cash and Cash Equivalents	34,753	(25,152)
Cash and Cash Equivalents, Beginning of Year	69,342	94,494
Cash and Cash Equivalents, End of Year	$ 104,095	$ 69,342
Supplemental Cash Flows Information		
Interest paid	$ 6,393	$ 3,893
Income taxes paid	5,489	3,415
Transfer of loans into other real estate owned	44	94

See Notes to Consolidated Financial Statements

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STAR Financial Group, Inc. (STAR or the Company) is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiaries, STAR Financial Bank (Bank), STAR Insurance Agency (Insurance Agency), and STAR Captive Insurance (Captive). In 2013, the Company formed STAR Captive Insurance as a wholly owned subsidiary to insure members of the consolidated group for potential losses in excess of existing insurance policies. The Bank owned 100% of STAR Insurance Agency (Insurance Agency) until August 2012 when it transferred said investment to STAR Financial Group as a dividend. After this transfer, the Bank has one wholly owned subsidiary, Titan, Inc. (Titan). The Bank is primarily engaged in providing a full range of banking and financial services to individual and corporate customers throughout Central and Northeastern Indiana. The Bank is subject to the regulation of certain federal and state agencies and undergoes periodic examinations by those regulatory authorities. The Bank also provides trust and investment advisory services through a separate division titled STAR Wealth Management (Wealth). STAR Insurance Agency provides various insurance products and services to individuals and corporate customers. Titan is primarily engaged in managing the Bank's investment securities.

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 revenue and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans, loan servicing rights, valuation of deferred tax assets, other-than-temporary impairments (OTTI) and fair values of financial instruments.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents. Cash and cash equivalents are defined to include the Company's cash on hand and demand deposits with other institutions (including money market mutual funds).

At December 31, 2018, the Company's cash accounts exceeded federally insured limits by approximately $19,392,000.

Investment Securities

Available-for-sale securities, which include any security for which the Company has no immediate plan to sell but which may be sold in the future, are carried at fair value. Unrealized gains and losses are recorded, net of related income tax effects, in other comprehensive income (loss). Effective January 1, 2018, changes in the fair value of equity securities is recorded in non-interest income. Amortization of premiums and accretion of discounts are recorded as interest income from securities. Realized gains and losses are recorded as net security gains (losses). Gains and losses on sales of securities are determined on the specific-identification method.

For debt securities with fair value below amortized cost when the Company does not intend to sell a debt security, and it is more likely than not, the Company will not have to sell the security before recovery of its cost basis, it recognizes the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income (loss).

The Company's consolidated statement of income for the year ended December 31, 2018, reflects the full impairment (that is, the difference between the security's amortized cost basis and fair value) on debt securities that the Company intends to sell or would more likely than not be required to sell before the expected recovery of the amortized cost basis. For available-for-sale debt securities that management has no intent to sell and believes that it more likely than not will not be required to sell prior to recovery, only the credit loss component of the impairment is recognized in earnings, while the noncredit loss is recognized in accumulated other comprehensive loss. The credit loss component recognized in earnings is identified as the amount of principal cash flows not expected to be received over the remaining term of the security as projected based on cash flow projections.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of cost or fair value in the aggregate. Net unrealized losses, if any, are recognized through a valuation allowance by charges to noninterest income. Gains and losses on loan sales are recorded in noninterest income, and direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon sale of the loan.

Loans

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 balances adjusted for unearned income, charge-offs, the allowance for loan losses, any unamortized deferred fees or costs on originated loans and unamortized premiums or discounts on purchased loans.

For loans amortized at cost, interest income is accrued based on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, as well as premiums and discounts, are deferred and amortized as a level yield adjustment over the respective term of the loan.

For all loan classes, the accrual of interest is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Past due status is based on contractual terms of the loan. For all loan classes, the entire balance of the loan is considered past due if the minimum payment contractually required to be paid is not received by the contractual due date. For all loan classes, loans are placed on nonaccrual or charged off at an earlier date if collection of principal or interest is considered doubtful.

Management's general practice is to proactively charge down loans individually evaluated for impairment to the fair value of the underlying collateral. Consistent with regulatory guidance, charge-offs on all loan segments are taken when specific loans, or portions thereof, are considered uncollectible. The Company's policy is to promptly charge these loans off in the period the uncollectible loss is reasonably determined.

For all loan portfolio segments except residential and consumer loans, the Company promptly charges-off loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. For impaired loans that are considered to be solely collateral dependent, a partial charge-off is recorded when a loss has been confirmed by an updated appraisal or other appropriate valuation of the collateral.

The Company charges-off residential and consumer loans, or portions thereof, when the Company reasonably determines the amount of the loss. The Company adheres to timeframes established by applicable regulatory guidance which provides for the charge-down of 1-4 family first mortgages, junior lien mortgages and other secured consumer loans at 90 days past due. Unsecured retail loans are wholly charged off when the loan is 90 days past due.

For all loan classes, all interest accrued but not collected for loans that are placed on nonaccrual 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. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Nonaccrual loans are returned to accrual status when, in the opinion of management, the financial position of the borrower indicates there is no longer any reasonable doubt as to the timely collection of interest or principal. The Company requires a period of satisfactory performance of not less than six months before returning a nonaccrual loan to accrual status.

When cash payments are received on impaired loans in each loan class, the Company records the payment as interest income unless collection of the remaining recorded principal amount is doubtful, at which time payments are used to reduce the principal balance of the loan. Troubled debt restructured loans recognize interest income on an accrual basis at the renegotiated rate if the loan is in compliance with the modified terms, no principal reduction has been granted and the loan has demonstrated the ability to perform in accordance with the renegotiated terms for a period of at least six months.

Allowance for Loan and Lease Losses

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to income. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical charge-off experience by segment. The historical loss experience is determined by portfolio segment and is based on the actual loss history on a weighted average basis experienced by the Company over the prior three years. Management believes the weighted average three year historical loss experience methodology is appropriate in the current economic environment. Other adjustments (qualitative/environmental considerations) for each segment may be added to the allowance for each loan segment after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

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 based on the loan's current payment status and the borrower's financial condition including available sources of cash flows. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for non-homogenous type loans such as commercial, non-owner residential and construction loans 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. For impaired loans where the Company utilizes the discounted cash flows to determine the level of impairment, the Company includes the entire change in the present value of cash flows as provision for loan losses.

The fair values of collateral dependent impaired loans are based on independent appraisals of the collateral. In general, the Company acquires an updated appraisal upon identification of impairment and annually thereafter for commercial, commercial real estate and multi-family loans. It is the Company's practice to obtain annual appraisals on impaired loans. The Company applies a discount rate to the appraisal based upon the collateral type. In the case of Commercial Real Estate, the discount rate is 25%. After determining the collateral value as described, the fair value is calculated based on the determined collateral value less selling expenses. The potential for outdated appraisal values is considered in our determination of the allowance for loan losses through our analysis of various trends and conditions including the local economy, trends in charge-offs and delinquencies, etc. and the related qualitative adjustments assigned by the Company.

Segments of loans with similar risk characteristics are collectively evaluated for impairment based on the segment's historical loss experience adjusted for changes in trends, conditions and other relevant factors that affect repayment of the loans. Accordingly, the Company does not separately identify individual consumer and residential loans for impairment measurements, unless such loans are the subject of a restructuring agreement due to financial difficulties of the borrower.

In the course of working with borrowers, the Company may choose to restructure the contractual terms of certain loans. In this scenario, the Company attempts to work-out an alternative payment schedule with the borrower in order to optimize collectability of the loan. Any loans that are modified are reviewed by the Company to identify if a troubled debt restructuring (TDR) has occurred, which is when, for economic or legal reasons related to a borrower's financial difficulties, the Company grants a concession to the borrower that it would not otherwise consider. Terms may be modified to fit the ability of the borrower to repay in line with its current financial status and the restructuring of the loan may include the transfer of assets from the borrower to satisfy the debt, a modification of loan terms, or a combination of the two. If such efforts by the Company do not result in a satisfactory arrangement, the loan is referred to legal counsel, at which time foreclosure proceedings are initiated. At any time prior to a sale of the property at foreclosure, the Company may terminate foreclosure proceedings if the borrower is able to work-out a satisfactory payment plan.

It is the Company's policy to have any restructured loans which are on nonaccrual status prior to being restructured remain on nonaccrual status until six months of satisfactory borrower performance at which time management would consider its return to accrual status. If a loan was accruing at the time of restructuring, the Company reviews the loan to determine if it is appropriate to continue the accrual of interest on the restructured loan.

With regard to determination of the amount of the allowance for credit losses, troubled debt restructured loans are considered to be impaired. As a result, the determination of the amount of impaired loans for each portfolio segment within troubled debt restructurings is the same as detailed previously.

Bank Owned Life Insurance

Bank owned life insurance consists of investments in life insurance policies on certain key executives and other members of the Bank's management. The policies are carried at their net cash surrender value. Changes in the policy value are recorded as an adjustment to the carrying value with the corresponding amount recognized as non-interest income or expense. Earnings on these policies are based on the net earnings on the cash surrender value of the policies.

Premises and Equipment

Premises and equipment (including equipment leased to others under operating lease agreements) are recorded at cost less accumulated depreciation. The provision for depreciation is computed on the straight-line method over the estimated useful lives of the assets generally ranging from three to 25 years. Leasehold improvements are capitalized and depreciated using the straight-line method over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Maintenance and repairs are expensed as incurred, while major additions and improvements are capitalized. Gains and losses on disposition are included in the statements of income.

FHLB Stock

Federal Home Loan Bank (FHLB) stock is a required investment for institutions that are members of the Federal Home Loan Bank system. The required investment in the common stock is based on a predetermined formula, carried at cost and evaluated for impairment. Included in other assets on the consolidated balance sheets is FHLB stock totaling $3,156,000 at December 31, 2018 and 2017.

Goodwill

Goodwill is evaluated annually for impairment – or more frequently if impairment indicators are present. If the implied fair value of goodwill is lower than its carrying amount, a goodwill impairment is indicated and goodwill is written down to its implied fair value. Subsequent increases in goodwill value are not recorded in the consolidated financial statements.

Intangible Assets

Intangible assets with finite lives are being amortized on the straight-line basis over periods ranging from five to seven years. Such assets are periodically evaluated as to the recoverability of their carrying values.

Other Real Estate Owned

Other real estate owned represents properties acquired through foreclosures or deeds in lieu of foreclosure or former branches held for sale. The properties are recorded at the lower of the amount of the loan satisfied, or net book value in the case of former branches or fair value. Any excess of the loan amount over the net realizable value of such property when acquired is charged to the allowance for loan and lease losses, establishing a new cost basis. In the case of former branches, any excess of net book value over the net realizable value of such property is charged to impairment of premises and equipment. Subsequent write-downs and gains or losses on sales are recorded in the income statement. Costs of maintaining the properties are recorded in the income statement as incurred. Included in other assets on the consolidated balance sheets is other real estate owned totaling $2,350,000 and $1,093,000 at December 31, 2018 and 2017, respectively.

Mortgage Servicing Rights

Mortgage servicing assets are recognized when rights are acquired through the sale of financial assets. Under the servicing assets and liabilities accounting guidance (ASC 860-50), servicing rights resulting from the sale of loans originated by the Company are initially measured at fair value at the date of transfer. The Company subsequently measures each class of servicing asset using the amortization method. Under the amortization method, servicing rights are amortized in proportion to and over the period of estimated net servicing income. The amortized assets are assessed for impairment based on fair value at each reporting date.

Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income, such as the cost to service, the discount rate, the custodial earnings rate, an inflation rate, ancillary income, prepayment speeds and default rates and losses. These variables change from quarter to quarter as market conditions and projected interest rates change, and may have an adverse impact on the value of the mortgage servicing right and may result in a reduction to noninterest income.

Each class of separately recognized servicing assets subsequently measured using the amortization method are evaluated and measured for impairment. Impairment is determined by stratifying rights into tranches based on predominant characteristics, such as interest rate, loan type and investor type. Impairment is recognized through a valuation allowance for an individual tranche, to the extent that fair value is less than the carrying amount of the servicing assets for that tranche. The valuation allowance is adjusted to reflect changes in the measurement of impairment after the initial measurement of impairment. Changes in valuation allowances are reported with mortgage sales and servicing fees on the income statement. Fair value in excess of the carrying amount of servicing assets for that stratum is not recognized.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

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—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 or the ability to unilaterally cause the holder to return specific assets.

Income Taxes

The Company accounts for income taxes in accordance with income tax accounting guidance (ASC 740, *Income Taxes*). The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenue. The Company determines deferred income taxes using the liability method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

The Company elected to apply the provisions of ASU 2018-02, *Income Statement – Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. As a result, the Company reclassified $908,000 from AOCI to retained earnings in 2017.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. Uncertain tax positions are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50% the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the facts, circumstances and information available at the reporting date and is subject to management's judgment.

The Company files consolidated income tax returns with its subsidiaries.

Treasury Stock

Common stock shares repurchased are recorded at cost. Cost of shares retired or reissued is determined using the first-in, first-out method.

Basic Earnings Per Share

Basic earnings per share are based on the weighted average number of common shares outstanding. STAR had no potentially dilutive common shares outstanding during 2018 or 2017.

Reclassifications

Certain reclassifications have been made to the 2017 consolidated financials to conform to the 2018 consolidated financial statement presentation. These reclassifications had no effect on net income.

Subsequent Events

Subsequent events have been evaluated through March 8, 2019, which is the date the consolidated financial statements were available to be issued.

Note 2: Future Change in Accounting Principle

In February 2016, the FASB issued ASU No. 2016-02 "*Leases (Topic 842).*" ASU 2016-02 establishes a right of use model that requires a lessee to record a right of use asset and a lease liability for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. For lessors, the guidance modifies the classification criteria and the accounting for sales-type and direct financing leases. A lease will be treated as a sale if it transfers all of the risks and rewards, as well as control of the underlying asset, to the lessee. If risks and rewards are conveyed without the transfer of control, the lease is treated as a financing. If the lessor doesn't convey risks and rewards or control, an operating lease results. The amendments are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years for public business entities. Early adoption is permitted.

In July 2018, the FASB issued amendments (ASU No. 2018-11) which provide entities with an additional (and optional) transition method to adopt the new lease standard. Under this new transition method, an entity initially applies the new lease standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current GAAP (Topic 840, Leases). The amendments in ASU 2018-11 also provide lessors with a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component and, instead, to account for those components as a single component if the nonlease components otherwise would be accounted for under the new revenue guidance (Topic 606) and certain criteria are met. For entities that have not adopted Topic 842 before the issuance of ASU No. 2018-11, the effective date and transition requirements for the amendments related to separating components of a contract are the same as the effective date and transition requirements in ASU No. 2016-02. In December 2018, the FASB issued amendments (ASU No. 2018-20) which addresses issues facing lessors when applying the leases standard. The amendments in ASU 2018-20 provide for certain accounting policy elections and changes lessor accounting for sales and similar taxes and certain lessor costs. Entities that have not yet adopted Topic 842 before the issuance of ASU 2018-20 should apply ASU 2018-20 to all new and existing leases when the entity first applies Topic 842 and should apply the same transition method elected for Topic 842.

(Table Dollars in Thousands Except Share Data)

The Company adopted ASU 2016-02, 2018-11, and ASU 2018-20 on January 1, 2019. Upon adoption, the Company recognized discounted right of use assets and lease liabilities of $6.38 million and $6.63 million, respectively. The Company chose not to adopt the hindsight practical expedient and instead chose to utilize the transition method of adoption whereby comparative periods shown in the period of adoption will continue to be in accordance with Topic 840. The Company elected to apply the practical expedients where an entity may choose to not reassess: whether expired or existing contracts contain leases under the new definition of a lease; lease classification for expired or existing leases; and whether previously capitalized initial direct costs would qualify for capitalization under Topic 842. Additionally, the Company does not expect to apply the recognition guidance in ASU 2016-02 to any short-term leases. The Company also elected the practical expedient, as an accounting policy election by class of underlying asset, to account for lease and nonlease components together as a single lease component. The Company made an accounting policy election as a lessor to exclude sales taxes and other similar taxes from being reported as lease revenue with an associated expense.

Note 3: Restriction on Cash and Due From Banks

The Bank is required by the Federal Reserve to maintain a portion of its deposits in the form of cash and/or on deposit with the Federal Reserve Bank. The amount of the required reserve balance as of December 31, 2018, was $9,986,000.

Note 4: Investment Securities

The amortized cost and approximate fair values, together with gross unrealized gains and losses, of securities are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2018				
U.S. Treasury and agency securities	$ 12,826	$ —	$ 171	$ 12,655
Obligations of states and political subdivisions	106,926	737	983	103,680
Mortgage-backed Government Sponsored Enterprise (GSE) residential	205,688	68	4,692	201,064
Pooled trust preferred securities	17,158	—	418	16,740
	$ 339,598	$ 805	$ 6,264	$ 334,139
December 31, 2017				
U.S. Treasury and agency securities	$ 17,648	$ 2	$ 90	$ 17,560
Obligations of states and political subdivisions	110,695	1,555	455	111,795
Mortgage-backed Government Sponsored Enterprise (GSE) residential	237,711	191	3,665	234,237
Equity security	94	74	—	168
Pooled trust preferred securities	20,176	—	4,091	16,085
	$ 386,324	$ 1,882	$ 8,301	$ 379,845

Securities with a carrying value of approximately $47,373,000 and $56,464,000 at December 31, 2018 and 2017, respectively, were pledged to secure public and trust deposits, securities sold under agreements to repurchase and for other purposes as required by law.

The amortized cost and fair value of securities at December 31, 2018, by contractual maturity are shown below. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale	
	Amortized Cost	Fair Value
Due within one year	$ 7,904	$ 7,885
Due after one year through five years	31,767	31,701
Due after five years through ten years	57,054	61,202
Due after ten years	37,185	32,287
Total investment securities with a contractual maturity	133,910	133,075
Mortgage-backed GSE residential	205,688	201,064
Total investment securities	$ 339,598	$ 334,139

Gross gains/(losses) of $4,000 and ($46,000) resulting from sales of available-for-sale securities were realized in 2018 and 2017, respectively.

(Table Dollars in Thousands Except Share Data)

Certain investments in debt and equity securities are reported in the financial statements at an amount less than their historical cost. Total fair value of these investments at December 31, 2018 and 2017, was $278,669,000 and $281,154,000 respectively, which is approximately 83% and 74%, respectively, of the available-for-sale investment portfolio. These declines primarily resulted from changes in market interest rates since the securities were purchased and current depressed market conditions.

Based on evaluation of available evidence, including recent changes in market interest rates, discounted cash flow analysis, and credit rating information, management believes the declines in fair value for these securities are temporary, except as discussed below.

The following table shows our investments' gross unrealized losses and fair value, aggregated by investment class and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2018 and 2017.

	December 31, 2018					
	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency securities	$ —	$ —	$ 12,655	$ 171	$ 12,655	$ 171
Obligations of state and political subdivisions	10,188	25	45,384	958	55,572	983
Mortgage-backed GSE residential	4,959	40	188,743	4,652	193,702	4,692
Pooled trust preferred securities	—	—	16,740	418	16,740	418
Total temporarily impaired securities	$ 15,147	$ 65	$ 263,522	$ 6,199	$ 278,669	$ 6,264

	December 31, 2017					
	Less than 12 Months		12 Months or More		Total	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. Treasury and agency securities	$ 10,709	$ 43	$ 4,642	$ 47	$ 15,351	$ 90
Obligations of state and political subdivisions	21,359	122	15,871	333	37,230	455
Mortgage-backed GSE residential	114,422	1,171	98,066	2,494	212,488	3,665
Pooled trust preferred securities	—	—	16,085	4,091	16,085	4,091
Total temporarily impaired securities	$ 146,490	$ 1,366	$ 134,664	$ 6,965	$ 281,154	$ 8,301

U.S. Treasury and Agency Securities

The unrealized losses on the Company's investments in direct obligations of U.S. Treasury and agency securities were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Obligations of State and Political Subdivisions

The unrealized losses on the Company's investments in securities of state and political subdivisions were caused by interest rate changes. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost basis of the investments. Because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Mortgage-backed GSE Residential

The unrealized losses on the Company's investment in mortgage-backed GSE residential securities were caused by interest rate changes. The Company expects to recover the amortized cost basis over the term of the securities. Because the decline in market value is attributable to changes in interest rates and not credit quality, and because the Company does not intend to sell the investments and it is not more likely than not the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at December 31, 2018.

Pooled Trust Preferred Securities

Pooled trust preferred securities within the available-for-sale portfolio include seven securities which are collateralized by trust preferred securities principally issued by banks. As of December 31, 2018, the seven pools include five senior tranche pools and two junior tranche pools. One pool was determined to be fully impaired and was written off against earnings in a prior period. As of December 31, 2018, the remaining six pools were rated below investment grade. The remaining six securities rated below investment grade were evaluated for impairment as discussed below and not deemed to be other-than-temporarily impaired. The Company's unrealized losses on pooled trust preferred securities were primarily caused by deterioration in the financial status of the institutions within the respective pools and sector downgrades by analysts and rating agencies.

(Table Dollars in Thousands Except Share Data)

Other-Than-Temporary Impairment

Upon acquisition of a security, the Company decides whether it is within the scope of the accounting guidance for beneficial interests in securitized financial assets or will be evaluated for impairment under the accounting guidance for investments in debt and equity securities.

The accounting guidance for beneficial interests in securitized financial assets provides incremental impairment guidance for a subset of the debt securities within the scope of the guidance for investments in debt and equity securities. For securities where the security is a beneficial interest in securitized financial assets, the Company uses the beneficial interests in securitized financial asset impairment model.

The Company conducts quarterly reviews to identify and evaluate each investment security to determine whether an other-than-temporary impairment has occurred. Economic models are used to determine whether an other-than-temporary impairment has occurred on these securities. While all securities are considered, the securities primarily impacted by other-than-temporary impairment testing are pooled trust preferred securities. For each trust preferred security in the investment portfolio, an extensive, regular review is conducted to determine if an other-than-temporary impairment has occurred. As part of its impairment analysis, management reviewed the underlying institutions' most recently available financial performance, as well as their participation in the Treasury's TARP program to assist management in applying the appropriate constant default rate to its cash flow projections for each security. To determine the range and likelihood of potential principal and interest losses on these tranches, management evaluated cash flow projections encompassing multiple market assumptions, including default rates, recoveries and severity. Based upon these cash flow projections and all other information available, management projected that all future contractual principal and interest payments will be received and no additional other-than-temporary impairment existed as of December 31, 2018. If economic conditions worsen, it is possible that the securities that are currently performing satisfactorily could suffer impairment and could potentially require write-downs in future periods.

Credit Losses Recognized on Investments

Certain debt securities have experienced fair value deterioration due to credit losses, as well as due to other market factors, but are not otherwise other-than-temporarily impaired.

The following table provides information about debt securities for which only a credit loss was recognized in income.

	Accumulated Credit Losses 2018	2017
Credit losses on debt securities held		
Beginning of year	$ 3,574	$ 3,574
Additions related to other-than-temporary losses not previously recognized	—	—
End of year	$ 3,574	$ 3,574

Note 5: Loans and Allowance for Loan and Lease Losses

STAR's business activity is primarily with customers located in north central and northeast Indiana. The loan portfolio is diversified by type and industry. Collateral requirements for each loan are based upon the credit evaluation of each transaction.

Classes of loans at December 31, include:

	2018	2017
Commercial and industrial	$ 551,245	$ 536,440
Commercial real estate	571,804	487,157
Consumer:		
Consumer, home equity lines of credit	81,587	82,907
Consumer, auto	19,372	20,112
Consumer, other	24,803	26,674
Residential	198,079	198,700
Finance leases	26,326	30,789
Gross loans	1,473,216	1,382,779
Allowance for loan losses	(19,492)	(18,031)
Net loans	$ 1,453,724	$ 1,364,748

The components of the Company's direct financing leases as of December 31 are summarized below:

	2018	2017
Future minimum lease payments	$ 27,090	$ 30,965
Residual interests	1,872	2,190
Initial direct costs	20	28
Unearned income	(2,656)	(2,394)
Contract revenue	-	-
	$ 26,326	$ 30,789

(Table Dollars in Thousands Except Share Data)

Future minimum lease payments are as follows:

2019	$ 9,300
2020	6,145
2021	4,540
2022	3,197
2023	1,373
Thereafter	2,535
	$ 27,090

The risk characteristics of each loan portfolio segment are as follows:

Commercial and Industrial and Commercial Real Estate

Commercial and industrial loans are primarily based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers; however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may include a personal guarantee. Short-term loans may be made on an unsecured basis. In the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers.

Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. The characteristics of properties securing the Company's commercial real estate portfolio are diverse, but with geographic location almost entirely in the Company's market area. Management monitors and evaluates commercial real estate loans based on collateral, geography and risk grade criteria. In general, the Company avoids financing single purpose projects unless other underwriting factors are present to help mitigate risk. In addition, management tracks the level of owner-occupied commercial real estate versus nonowner-occupied loans.

Real Estate, Consumer, Leases and Other

Real estate, consumer, leases and other loans consist of four segments - residential mortgage loans, personal loans, direct financing leases and other loans. For residential mortgage loans that are secured by 1-4 family residences and are generally owner-occupied, the Company generally establishes a maximum loan-to-value ratio and requires private mortgage insurance if that ratio is exceeded. Home equity loans are typically secured by a subordinate interest in 1-4 family residences. Consumer personal, leases and other loans are secured by consumer personal assets, such as automobiles or recreational vehicles. Some consumer personal loans are unsecured, such as small installment loans and certain lines of credit. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas, such as unemployment levels. Repayment can also be impacted by changes in property values on residential properties. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

The following tables present the balance in the allowance for loan losses and the recorded investment in loans based on portfolio segment and impairment method as of December 31, 2018 and 2017:

	2018					
	Commercial and Industrial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses						
Balance, beginning of year	$ 9,278	$ 6,447	$ 1,030	$ 971	$ 305	$ 18,031
Provision charged (credited) to expense	8,075	(193)	144	139	(165)	8,000
Losses charged off	(6,330)	(184)	(497)	(19)	—	(7,030)
Recoveries	298	26	152	—	15	491
Balance, end of year	$ 11,321	$ 6,096	$ 829	$ 1,091	$ 155	$ 19,492
Ending balance, individually evaluated for impairment	$ 6,914	$ 1,001	$ —	$ —	$ —	$ 7,915
Ending balance, collectively evaluated for impairment	$ 4,407	$ 5,095	$ 829	$ 1,091	$ 155	$ 11,577
Loans						
Ending balance	$ 551,245	$ 571,804	$ 125,762	$ 198,079	$ 26,326	$ 1,473,216
Ending balance, individually evaluated for impairment	$ 11,390	$ 7,742	$ —	$ —	$ —	$ 19,132

(Table Dollars in Thousands Except Share Data)

Ending balance, collectively evaluated for impairment	$ 539,855	$ 564,062	$ 125,762	$ 198,079	$ 26,326	$ 1,454,084

	2017					
	Commercial and Industrial	Commercial Real Estate	Consumer	Residential	Finance Leases	Total
Allowance for loan losses						
Balance, beginning of year	$ 8,153	$ 6,263	$ 2,010	$ 2,359	$ 354	$ 19,139
Provision charged (credited) to expense	2,340	(227)	(773)	(1,356)	16	—
Losses charged off	(1,908)	(386)	(466)	(33)	(74)	(2,867)
Recoveries	693	797	259	1	9	1,759
Balance, end of year	$ 9,278	$ 6,447	$ 1,030	$ 971	$ 305	$ 18,031
Ending balance, individually evaluated for impairment	$ 2,568	$ 1,212	$ —	$ —	$ —	$ 3,780
Ending balance, collectively evaluated for impairment	$ 6,710	$ 5,235	$ 1,030	$ 971	$ 305	$ 14,251
Loans						
Ending balance	$ 536,440	$ 487,157	$ 129,693	$ 198,700	$ 30,789	$ 1,382,779
Ending balance, individually evaluated for impairment	$ 11,236	$ 12,364	$ —	$ —	$ —	$ 23,600
Ending balance, collectively evaluated for impairment	$ 525,204	$ 474,793	$ 129,693	$ 198,700	$ 38,789	$ 1,359,179

Internal Risk Categories

Loan grades are numbered 1 through 10. Grades 1 through 6 are considered satisfactory grades. The grade of 7, or Watch, represents loans of lower quality and is considered criticized. The grades of 8, or Substandard, and 9, or Special Mention, and 10, or Loss, refer to assets that are classified. The use and application of these grades by the Bank conform to the Bank's policy.

Prime (1) loans have exceptional credit fundamentals, including stable and predictable income and balance sheet performance; highly regarded with excellent management and management depth.

Good (2) loans have very good credit fundamentals but less predictable income and balance sheet performance than a prime graded credit. Loans have regional exposure in stable industry with seasoned management.

Satisfactory (3) loans are medium size or a local company in a good industry with predictable income and balance sheet performance over time.

Pass (4) all loans with acceptable credit risk but of a moderate to small size for local markets. Credit compares equally or favorably to peers and competitors with a solid balance sheet and profitability with some volatility.

Pass Minus (5) loans are credits where overall risk associated with creditworthiness criteria is considered higher than normal and warrant attention. Startup or less seasoned company within cyclical industry with moderate levels of volatility and deterioration of credit fundamentals.

Risk rated with caution (6) loans are credits where overall risk associated with creditworthiness criteria are less desirable but with potential. High or increasing risk dependence upon collateral or guarantor for protection with weaker or deteriorating financial trends.

Watch (7) all credits where overall credit fundamentals need continued review. Considered higher risk with unfavorable characteristics present. Risk, however, remains reasonable. Borrowings would usually be on a fully secured basis.

Substandard (8) credits have well-defined weaknesses where payment default is possible but not yet probable. Deficiencies are not corrected quickly and financing alternatives are limited. Reliance on collateral and guarantors is increased.

Doubtful (9) loans are credits where the possibility of loss is high, repayment is erratic or nonexistent, and loan is collateral dependent or firm in bankruptcy.

Loss (10) loans are no longer considered bankable assets.

(Table Dollars in Thousands Except Share Data)

Nonperforming mortgage, home equity and consumer loans on non-accrual or greater than 90 days past due and are internally monitored monthly by management.

Performing all other mortgage, home equity and consumer loans.

The following table presents the credit risk profile of the Company's commercial, commercial real estate, and finance leases loan portfolios based on internal rating category as of December 31, 2018 and 2017:

	Commercial and Industrial 2018	Commercial and Industrial 2017	Commercial Real Estate 2018	Commercial Real Estate 2017	Finance Leases 2018	Finance Leases 2017
Grade						
Pass (1-6)	$ 464,944	$ 444,733	$ 534,788	$ 455,649	$ 23,930	$ 27,168
Watch (7)	29,286	58,373	13,179	20,523	2,094	3,082
Substandard (8)	52,509	32,276	23,407	10,565	302	539
Doubtful (9)	4,506	1,058	430	420	—	—
Loss (10)	—	—	—	—	—	—
Total	$ 551,245	$ 536,440	$ 571,804	$ 487,157	$ 26,326	$ 30,789

The following table presents the credit risk profile of the Company's residential real estate, home equity lines of credit, and consumer loan portfolios based on internal rating category as of December 31, 2018 and 2017:

	Consumer - Home Equity Lines of Credit 2018	Consumer - Home Equity Lines of Credit 2017	Consumer - Auto 2018	Consumer - Auto 2017	Consumer - Other 2018	Consumer - Other 2017	Residential 2018	Residential 2017
Performing	$ 81,396	$ 82,690	$ 19,351	$ 20,070	$ 24,644	$ 26,507	$ 197,634	$ 198,130
Nonperforming	191	217	21	42	159	167	445	570
Total	$ 81,587	$ 82,907	$ 19,372	$ 20,112	$ 24,803	$ 26,674	$ 198,079	$ 198,700

The following tables present the Company's loan portfolio aging analysis of the recorded investment in loans as of December 31, 2018 and 2017:

2018

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Total Loans > 90 Days and Accruing
Commercial and industrial	$ 3,811	$ 4,624	$ 4,664	$ 13,099	$ 538,146	$ 551,245	$ 440
Commercial real estate	5,089	—	9,726	14,815	556,989	571,804	9,205
Consumer							
Consumer, home equity lines of credit	53	—	190	243	81,344	81,587	—
Consumer, auto	19	—	7	26	19,346	19,372	—
Consumer, other	109	11	143	263	24,540	24,803	1
Residential	869	19	20	908	197,171	198,079	—
Finance leases	—	—	—	—	26,326	26,326	—
Total	$ 9,950	$ 4,654	$ 14,750	$ 29,354	$ 1,443,862	$ 1,473,216	$ 9,646

2017

	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Total Loans > 90 Days and Accruing
Commercial and industrial	$ 3,327	$ 525	$ 7,966	$ 11,818	$ 524,622	$ 536,440	$ 197
Commercial real estate	1,099	—	2,147	3,246	483,911	487,157	145
Consumer							
Consumer, home equity lines of credit	458	10	213	681	82,226	82,907	7
Consumer, auto	94	—	29	123	19,989	20,112	16
Consumer, other	191	124	42	357	26,317	26,674	41
Residential	359	263	261	883	197,817	198,700	119
Finance leases	—	236	—	236	30,553	30,789	—
Total	$ 5,528	$ 1,158	$ 10,658,	$ 17,344	$ 1,365,435	$ 1,382,779	$ 525

(Table Dollars in Thousands Except Share Data)

A loan is considered impaired, in accordance with the impairment accounting guidance (ASC 310-10-35-16), when based on current information and events, it is probable the Company will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Impaired loans include nonperforming commercial loans but also include loans modified in troubled debt restructurings.

The following tables present impaired loans as of and for the years ended December 31, 2018 and 2017:

2018	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized	Interest Income Recognized on Cash Basis
Loans without a specific valuation allowance:						
Commercial and industrial	$ 4,093	$ 4,892	$ —	$ 5,446	$ 36	$ 36
Commercial real estate	1,246	1,246	—	1,295	64	64
Loans with a specific valuation allowance:						
Commercial and industrial	7,297	13,848	6,914	12,143	164	164
Commercial real estate	6,496	6,535	1,001	6,583	189	186
Total impaired loans	$ 19,132	$ 26,521	$ 7,915	$ 25,467	$ 453	$ 450

2017	Recorded Balance	Unpaid Principal Balance	Specific Allowance	Average Investment in Impaired Loans	Interest Income Recognized	Interest Income Recognized on Cash Basis
Loans without a specific valuation allowance:						
Commercial and industrial	$ 3,753	$ 3,753	$ —	$ 4,021	$ 200	$ 200
Commercial real estate	5,630	5,803	—	5,818	234	85
Loans with a specific valuation allowance:						
Commercial and industrial	7,483	8,271	2,568	8,075	16	16
Commercial real estate	6,734	6,737	1,212	6,805	220	220
Total impaired loans	$ 23,600	$ 24,564	$ 3,780	$ 24,719	$ 670	$ 521

The following table presents the Company's nonaccrual loans at December 31, 2018 and 2017. This table excludes purchased impaired loans and performing troubled debt restructurings.

	2018	2017
Commercial and industrial	$ 11,000	$ 8,678
Commercial real estate	695	2,224
Consumer		
Consumer, home equity lines of credit	191	210
Consumer, auto	21	26
Consumer, other	158	125
Residential	445	452
Finance leases	—	6
Total	$ 12,510	$ 11,721

The Company identified as troubled debt restructurings certain receivables for which the allowance for credit losses had previously been measured under a general allowance for credit losses methodology. Upon identifying those receivables as troubled debt restructurings, the Company identified them as impaired under the guidance in Accounting Standards Codification (ASC) 310-10-35. The ASU requires prospective application of the impairment measurement guidance in ASC 310-10-35 for those receivables newly identified as impaired.

At December 31, 2018 and 2017, the Company had a number of loans that were modified in troubled debt restructurings and impaired. The modification of terms of such loans included one or a combination of the following: an extension of maturity, a reduction of the stated interest rate or a permanent reduction of the recorded investment in the loan.

The following tables present information regarding troubled debt restructurings by class for the year ended December 31, 2018 and 2017.

(Table Dollars in Thousands Except Share Data)

Newly restructured loans:

	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
December 31, 2018			
Commercial and industrial	18	$ 2,058	$ 2,058
Commercial real estate	2	862	862
Consumer			
Consumer, Residential	1	53	53
	21	$ 2,973	$ 2,973

	Number of Loans	Pre-Modification Recorded Balance	Post-Modification Recorded Balance
December 31, 2017			
Commercial and industrial	6	$ 4,183	$ 4,183
Commercial real estate	2	1,181	1,181
Consumer			
Consumer, Residential	—	—	—
	8	$ 5,364	$ 5,364

The troubled debt restructurings described above did not materially increase the allowance for loan losses for the years ended December 31, 2018 and 2017. The troubled debt restructurings described above resulted in $0 charge offs during the years ended December 31, 2018 and 2017.

Newly restructured loans by type of modification:

	2018			
	Interest Only	Term	Combination	Total Modification
Commercial and industrial	$ —	$ 1,027	$ 1,031	$ 2,058
Commercial real estate	—	—	862	862
Consumer				
Consumer, Residential	—	—	53	53
	$ —	$ 1,027	$ 1,946	$ 2,973

	2017			
	Interest Only	Term	Combination	Total Modification
Commercial and industrial	$ —	$ —	$ 4,183	$ 4,183
Commercial real estate	227	—	954	1,181
Consumer				
Consumer, Residential	—	—	—	—
	$ 227	$ —	$ 5,137	$ 5,364

There were no troubled debt restructurings modified in the past 12 months that subsequently defaulted.

As of December 31, 2018, there were $1,442,000 of loans designated as TDRs that met the criteria for placement back on accrual status. This criteria is a minimum of six months of payment performance under existing modified terms.

The Company had $44,000 and $197,000 of foreclosed residential real estate property obtained by physical possession as of December 31, 2018 and 2017, respectively. The Company had no consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings are in process according to local jurisdictions as of December 31, 2018 and 2017.

Note 6: Premises and Equipment

Premises and equipment as of December 31 are summarized as follows:

	2018	2017
Land	$ 14,859	$ 15,995
Buildings and improvements	33,530	34,776
Equipment leased to others	4,828	4,828
Furniture and equipment	32,365	30,614
	85,582	86,213

(Table Dollars in Thousands Except Share Data)

Less accumulated depreciation	(45,565)	(47,429)
Net premises and equipment	$ 40,017	$ 38,784

At December 31, 2018 and 2017, STAR and its subsidiary were obligated under a number of operating leases for land and buildings. Rental expense under these leases for the years ended December 31, 2018 and 2017, was $1,879,000 and $2,122,000, respectively. At December 31, 2018, minimum annual rental expense for commitments under leases having remaining non-cancellable lease terms in excess of one year was as follows: 2019 - $1,566,000; 2020 - $1,533,000; 2021 - $1,507,000; 2022 - $1,519,000; 2023 - $932,000 and - $1,878,000 thereafter.

Note 7: Loan Servicing

Mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of mortgage loans serviced for others were approximately $371,604,000 and $390,874,000 at December 31, 2018 and 2017, respectively.

Custodial escrow balances maintained in connection with the foregoing loan servicing, and included in other liabilities, were approximately $2,310,000 and $2,548,000 at December 31, 2018 and 2017, respectively.

Mortgage servicing rights are included in other assets in the accompanying consolidated balance sheets. Comparable market values and a valuation model that calculates the present value of future cash flows were used to estimate fair value.

Activity in the balance of servicing assets was as follows:

	2018	2017
Carrying amount, beginning of year	$ 2,207	$ 2,436
Servicing obligations that result from transfers of financial assets	421	358
Amortization	(503)	(587)
Change in valuation allowance	(7)	—
Carrying amount, end of year	$ 2,118	$ 2,207
Valuation allowance, beginning of year	$ (1)	$ (1)
Valuation allowance recorded	(7)	—
Valuation allowance, end of year	$ (8)	$ (1)
Fair value, beginning of year	$ 4,109	$ 4,271
Fair value, beginning of year	$ 4,011	$ 4,109

Note 8: Time Deposits

At December 31, the scheduled maturities of time deposits are as follows:

2019	$ 131,248
2020	53,509
2021	6,931
2022	3,233
2023	9,440
Thereafter	1,613
	$ 205,974

Time deposits with balances of $250,000 or greater were approximately $30,068,000 and $19,382,000 at December 31, 2018 and 2017, respectively.

Note 9: Short-Term Borrowings

Short-term borrowings at December 31 included the following:

	2018	2017
Securities sold under repurchase agreements	$ 33,906	$ 30,132

(Table Dollars in Thousands Except Share Data)

Securities sold under agreements to repurchase consist of obligations of the Company to other parties. The obligations are secured primarily by municipal and U.S. Government securities and such collateral is held in safekeeping by third parties. Agreements with a maturity of one year or less are included in short-term borrowings, while those with a maturity of more than one year are included in long-term debt. The maximum amount outstanding for all agreements at any month end during 2018 and 2017 totaled $34,103,000 and $36,864,000 and the daily average of such agreements totaled $26,198,000 and $26,922,000.

The Company had $33,906,000 in Securities Sold Under Agreements to Repurchase as of December 31, 2018. These securities were comprised of U.S. Treasuries and government agency securities. The table below shows the remaining contractual maturity in the repurchase agreements.

	December 31, 2018				
	Remaining Contractual Maturity of the Agreements				
	Overnight & Continuous	Up to 30 days	30-90 days	Greater than 90 days	Total
Repurchase Agreements Mortgage-backed GSE residential	$ 33,906	$ —	$ —	$ —	$ 33,906

The Company transfers various securities to customers in exchange for cash at the end of each business day and agrees to acquire the securities at the end of the next business day for the cash exchanged plus interest. The process is repeated at the end of each business day until the agreement is terminated. The securities underlying the agreement remained under the Bank's control.

Note 10: Long-Term Borrowings

As of December 31, 2018 and 2017, STAR had Federal Home Loan Bank of Indianapolis advances (advances) outstanding totaling $20,208,000 and $66,340,000, respectively. The advances bear interest at rates ranging from 1.86% to 5.99% and mature at various dates through November 15, 2023.

None of the advances contained put options at the end of 2018 and 2017, whereby FHLB might require the Company to pay the advance.

Interest is paid monthly and the weighted average interest rate on the advances was 2.15% and 1.82% as of December 31, 2018 and 2017, respectively. The advances at December 31, 2018, are secured by first-mortgage loans totaling $173,261,000 and are subject to restrictions or penalties in the event of prepayment.

The Bank also has an automobile note payable of $42,000 and $62,000 outstanding as of December 31, 2018 and 2017, respectively. The note is interest free and requires monthly principal payments.

Maturities of long-term debt are as follows: 2019 - $10,038,000; 2020 - $39,000; 2021 - $10,147,000; 2022 - $13,000; 2023 - $13,000 and $0 thereafter.

The Company has established borrowing capacity of $335,000,000 and $320,000,000 as of December 31, 2018 and 2017, respectively, with the Federal Home Loan Bank and other financial institutions, of which $20,208,000 and $66,340,000 was outstanding at December 31, 2018 and 2017, respectively. In addition to the other borrowings, the Company also had $1,520,000 and $1,811,000 letters of credit available as of December 31, 2018 and 2017, respectively.

Note 11: Subordinated Debentures

In March 2006, the Company formed STAR Capital Trust I (Trust I) and STAR Capital Trust II (Trust II) which are both statutory business trusts. Trust I issued $5,155,000 of trust preferred capital securities as a participant in a pooled trust preferred securities offering. The Company issued subordinated debentures aggregating $5,155,000 to Trust I. The subordinated debentures are the sole assets of Trust I. The subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The subordinated debentures and trust preferred capital securities bear interest at a rate of three-month LIBOR (2.80%) plus 1.40% (4.20%) and mature on June 30, 2036, and are non-callable for five years after issuance. The securities may be called at any quarterly interest date at par.

Trust II issued $5,155,000 of trust preferred capital securities as a participant in a pooled trust preferred securities offering. The Company issued subordinated debentures aggregating $5,155,000 to Trust II. The subordinated debentures are the sole assets of Trust II. The subordinated debentures and the trust preferred securities pay interest and dividends, respectively, on a quarterly basis. The subordinated debentures and trust preferred capital securities bear interest at a rate of three-month LIBOR (2.80%) plus 1.40% (4.20%) and mature on June 30, 2036. The securities may be called at any quarterly interest date at par.

The trust preferred capital securities, subject to certain limitations, are included in Tier I Capital for regulatory purposes. Trust I and Trust II are not consolidated into the Company and as a result, the Company accounts for the investment in Trust I and Trust II as assets, the subordinated debentures as debt, and the interest paid/received thereon as interest expense/income.

Note 12: Common Stock

The Company has 5,000,000 special shares which may be issued and would have such voting, dividend, liquidation and other rights and preferences, as may be specified by the Board of Directors.

STAR declared $3,903,000 ($1.06 per common share) of cash dividends during the year ended December 31, 2018 and $3,780,000 ($1.02 per common share) during the year ended December 31, 2017.

(Table Dollars in Thousands Except Share Data)

Note 13: Income Tax Expense

The Company files income tax returns in the U.S. federal jurisdiction and various states and local jurisdictions. With a few exceptions, the Company is no longer subject to U.S. federal, state and local or income tax examinations by tax authorities for years before 2014.

Income tax provision is summarized as follows:

	2018	2017
Current		
Federal	$ 2,880	$ 4,555
State	672	861
Deferred	1,605	4,237
Total tax expense	$ 4,617	$ 9,653

A net deferred tax asset is included in other assets and is comprised of the following temporary differences at December 31:

	2018	2017
Deferred tax assets		
Allowance for loan and lease losses	$ 5,296	$ 4,946
Other nondeductible accruals	1,651	1,928
Unrealized loss on available-for-sale securities	1,525	1,759
Other	522	667
	8,994	9,300
Deferred tax liabilities		
Mortgage servicing rights	(564)	(592)
Premises and equipment, including equipment leased to others	(3,609)	(2,483)
Installment sale	(380)	—
Other	(841)	(1,331)
	(5,394)	(4,406)
Total net deferred taxes	$ 3,600	$ 4,894

A reconciliation of income tax expense at the statutory rate to the Company's actual income tax expense is as follows:

	2018	2017
Income taxes at statutory rate	21.0%	35.0%
Write down of net deferred assets to 21%	.0	9.9
State income taxes, net of federal benefit	2.2	2.9
Tax-exempt interest	(3.1)	(5.3)
Bank owned life insurance	(1.1)	(1.5)
Captive insurance income	(1.0)	(1.2)
Tax credits	(0.2)	(1.0)
Other, net	(0.2)	.5
Effective tax rate	17.6%	39.3%

At December 31, 2018, the Company had no general income tax credit carryovers.

On December 22, 2017, The United States enacted tax reform legislation through the *Tax Cuts and Jobs Act*, which significantly changes the existing U.S. tax laws, including a reduction in the corporate tax rate from 35% to 21%, as well as other changes. As a result of enactment of the legislation, the Company incurred a one-time income tax expense of $2,443,000 during the fourth quarter of 2017, primarily the re-measurement of certain deferred tax assets and liabilities.

Note 14: Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, included in stockholders' equity, are as follows:

	2018	2017
Net unrealized losses on available-for-sale securities	$ (5,380)	$ (6,419)
Net unrealized gain (loss) on derivatives used for cash flow hedges	48	(80)
Tax effect	1,122	1,296
Net-of-tax amount	$ (4,210)	$ (5,203)

(Table Dollars in Thousands Except Share Data)

Note 15: Employee Retirement and Savings Plans

STAR has an Employee Stock Ownership Plan (ESOP). As of December 31, 2018 and 2017, there were 307,119 and 335,773 shares in the ESOP, all of which have been allocated to participant's accounts. The fair value of the allocated shares was approximately $21,805,000 and $24,511,000 at December 31, 2018 and 2017, respectively. Upon termination, retirement or disability an employee has the option to receive his/her shares or require the ESOP to purchase such shares at a predetermined value to the ESOP, as defined in the ESOP Agreement. The ESOP has the option to purchase the shares over a five-year period. The amount of payment is based upon the value at the time of payment. In the event that the ESOP does not have sufficient cash available, STAR is required to purchase such shares at the same value.

STAR also has a Section 401(k) savings plan for substantially all employees. The savings plan provides that STAR may contribute up to 50% of the amount of compensation deferred by the employee, up to 5%. STAR contributed $992,000 and $953,000 to the plans in 2018 and 2017, respectively.

Note 16: Derivative Financial Instruments

Cash Flow Hedges

As a strategy to maintain acceptable levels of exposure to the risk of changes in future cash flow due to interest rate fluctuations, the Company entered into interest rate swap agreements for a portion of its floating rate debt. The agreements provide for the Company to receive interest from the counterparty at three month LIBOR (2.80%) and to pay interest to the counterparty at a fixed rate of 2.38% on a notional amount of $10,000,000 at December 31, 2018 and 2017. Settlement is made quarterly.

Management has designated the interest rate swap agreement as a cash flow hedging instrument. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings. At December 31, 2018 and 2017, the Company's cash flow hedge was effective and is not expected to have a significant impact on the Company's net income over the next 12 months.

The Company offers interest rate derivative products (*e.g.* interest rate swaps) to certain of its high-quality commercial borrowers. This product allows customers to enter into an agreement with the Company to swap their variable rate loan to a fixed rate. These derivative products are designed to reduce, eliminate or modify the risk of changes in the borrower's interest rate or market price risk. The extension of credit incurred through the execution of these derivative products is subject to the same approvals and underwriting standards as the related traditional credit product. The Company limits its risk exposure to these products by entering into a mirror-image, offsetting swap agreement with a separate, well-capitalized and rated counterparty previously approved by the Company's Asset Liability Committee. By using these interest rate swap arrangements, the Company is also better insulated from the interest rate risk associated with underwriting fixed-rate loans. These derivative contracts are not designated against specific assets or liabilities under FASB ASC 815-10 and, therefore, do not qualify for hedge accounting. The derivatives are recorded on the balance sheet at fair value and changes in fair value of both the customer and the offsetting swap agreements are recorded (and essentially offset) in non-interest income. The fair value of the derivative instruments incorporates a consideration of credit risk (in accordance with FASB ASC 820-10), resulting in some insignificant volatility in earnings each period. The notional amounts of the interest rate swaps were approximately $22,129,000 and $35,161,000 at December 31, 2018 and 2017, respectively.

The following table presents the fair value of derivative instruments as of December 31, 2018 and 2017.

	2018			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Interest rate contracts	Other Assets	$ 48	Other Liabilities	$ —
Derivatives not designated as hedging instruments				
Interest rate contracts	Other Assets	282	Other Liabilities	282
Total derivatives		$ 330		$ 282

	2017			
	Asset Derivatives		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments				
Interest rate contracts	Other Assets	$ —	Other Liabilities	$ 80

(Table Dollars in Thousands Except Share Data)

Derivatives not designated as hedging instruments				
Interest rate contracts	Other Assets	242	Other Liabilities	242
Total derivatives		$ 242		$ 322

Cash Flow Hedges	Location of Gain (Loss) Reclassified from AOCI into Income	Amount of Gain (Loss) Reclassified from AOCI into Income 2018	2017	Amount of Gain (Loss) Recognized in OCI 2018	2017
Interest rate contracts	Noninterest income – Other	$ —	$ —	$ 128	$ 144

Derivatives Not Designated as Hedging Instruments	Location of Gain (Loss) Recognized in Income	Amount of Gain (Loss) Recognized in Income 2018	2017
Interest rate contracts	Interest on loans	$ (93)	$ (401)

Note 17: Goodwill

The changes in the carrying amount of goodwill for the years ended December 31, 2018 and 2017, were:

	2018	2017
Balance as of January 1	$ 5,567	$ 5,567
Goodwill acquired during the year	—	—
Impairment losses	—	—
Balance as of December 31	$ 5,567	$ 5,567

Note 18: Related Party Transactions

The Bank has loan, deposit and other transactions with its directors and officers, and with organizations and individuals with which they are associated. In management's opinion, such loans and other extensions of credit were made in the ordinary course of business and were made on substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. Further, in management's opinion, these loans did not involve more than normal risk of collectability or present other unfavorable features. The aggregate dollar amount of loans to directors and executive officers who held office at the end of the year, and organizations and individuals with which they are associated, amounted to $16,142,000 and $13,533,000 at December 31, 2018 and 2017, respectively.

Note 19: Commitments and Contingencies

The Bank, in the normal course of business, is a party to various financial instruments with off-balance sheet risk to meet the financing needs of customers. These instruments involve elements of credit risk in excess of amounts recognized in the financial statements. The contract amounts of those instruments reflect the extent of involvement STAR has in financial instruments.

Financial instruments whose contract amounts represent credit risk at December 31:

	2018	2017
Commitments to extend credit	$ 474,725	$ 523,418
Standby letters of credit	13,498	13,729
Forward sale commitments	960	1,150

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

Commitments to extend credit are agreements to loan funds to customers providing there is compliance with terms of the commitment. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Bank upon extension of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, plant and equipment and real estate.

(Table Dollars in Thousands Except Share Data)

Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank holds collateral supporting those commitments when deemed necessary.

Forward sale commitments are commitments to sell groups of residential mortgage loans that the Bank originates or purchases as part of its mortgage banking activities. The Bank commits to sell the loans at specified prices in a future period, typically within 90 days. These commitments are acquired to reduce market risk on mortgage loans in the process of origination and mortgage loans held for sale since the Bank is exposed to interest rate risk during the period between issuing a loan commitment and the sale of the loan into the secondary market.

Management does not expect any material losses to result from these financial instruments.

The Company and Bank are also subject to claims and lawsuits which arise primarily in the ordinary course of business. It is the opinion of management that the disposition or ultimate resolution of such claims and lawsuits will not have a material adverse effect on the consolidated financial position of the Company.

Note 20: Regulatory Matters

The Company and Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and Bank must meet specific capital guidelines that involve quantitative measures of the Company's and Bank's assets, liabilities and certain off-balance sheet items as calculated under U.S. GAAP, regulatory reporting requirements and regulatory capital standards. The Company's and Bank's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

The capital adequacy requirements were heightened by the Basel III Rules, which went into effect on January 1, 2015 with a phase-in period for certain aspects of the rule through 2019. Under the Basel III rules, the Company must hold a capital conservation buffer above the adequately capitalized risk-based capital ratios. The capital conservation buffer is being phased in from 0.000% for 2015 to 2.50% by 2019. The below minimum capital requirements exclude the capital conservation buffer required to avoid limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The capital conservation buffer for 2018 is 1.875%. The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital. The quantitative measures established by regulation to ensure capital adequacy that were in effect on December 31, 2018 and 2017, require the Company and the Bank to maintain minimum capital amounts and ratios (set forth in the following table) of Total, Tier I and Common Equity Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined in the regulation), and of Tier I capital (as defined in the regulation) to average assets (as defined). Management believes, as of the years ended December 31, 2018 and 2017, that the Company and the Bank met all capital adequacy requirements to which they are subject.

Quantitative measures established by regulatory capital standards to ensure capital adequacy require the Company and Bank to maintain minimum amounts and ratios (set forth in the following table) of Total and Tier 1 capital (as defined) to risk-weighted assets (as defined), common equity Tier I capital (as defined) to total risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined).

On May 24, 2018, S.2155 – Economic Growth, Regulatory Relief, and Consumer Protection Act was signed into law which provides regulatory relief for Bank Holding Companies with less than $3 billion in assets. Effective in the third quarter, the Company is not required to file Form FRY-9C, therefore the consolidated capital ratios are not disclosed for the year ended December 31, 2018.

As of December 31, 2018, the most recent notification received from federal banking agencies categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based capital, Tier I risk-based capital, common equity Tier I risk-based capital and Tier I leverage ratios as set forth in the following table. There are no conditions or events since that notification that management believes have changed the Company or Bank's category.

STAR's consolidated and the Bank's capital amounts and ratios are presented in the following table:

	Actual		Minimum Capital Requirement		Minimum to Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018						
Total capital (to risk weighted assets)						
STAR Financial Bank	234,400	13.32	140,779	8.00	$ 175,974	10.00%
Tier I capital (to risk weighted assets)						
STAR Financial Bank	214,908	12.21	105,584	6.00	140,779	8.00
Tier I capital (to average assets)						
STAR Financial Bank	214,908	10.75	79,966	4.00	99,958	5.00
Common equity Tier I capital						
STAR Financial Bank	214,908	12.21	79,188	4.50	114,383	6.50

(Table Dollars in Thousands Except Share Data)

As of December 31, 2017						
Total capital (to risk weighted assets)						
Consolidated	$ 223,687	13.17%	$ 135,855	8.00%	N/A	N/A
STAR Financial Bank	220,654	13.04	135,344	8.00	$ 169,179	10.00%
Tier I capital (to risk weighted assets)						
Consolidated	205,656	12.11	101,891	6.00	N/A	N/A
STAR Financial Bank	202,623	11.98	101,508	6.00	135,344	8.00
Tier I capital (to average assets)						
Consolidated	205,656	10.50	78,345	4.00	N/A	N/A
STAR Financial Bank	202,623	10.47	77,389	4.00	96,736	5.00
Common equity Tier I capital						
Consolidated	205,656	12.11	76,418	4.50	N/A	N/A
STAR Financial Bank	202,623	11.98	76,131	4.50	109,967	6.50

Banking regulations limit the amount that the Bank may pay the Company without prior approval of bank regulatory authorities. At December 31, 2018, retained earnings available for dividends to the Company without such approval totaled approximately $27,756,000.

Note 21: Disclosures About Fair Value of Assets and Liabilities

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements must maximize the use of observable inputs and minimize the use of unobservable inputs. There is a hierarchy of three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities

Level 3 Unobservable inputs supported by little or no market activity and are significant to the fair value of the assets or liabilities

Recurring Measurements

The following tables present the fair value measurements of assets and liabilities recognized in the accompanying balance sheets measured at fair value on a recurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2018 and 2017:

		2018 Fair Value Measurements Using		
	Fair Value	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Cash Equivalents				
Money market mutual funds	$ 4,932	$ 4,932	$ —	$ —
Available-for-Sale Securities				
U.S. Treasury and agency securities	12,655	—	12,655	—
Obligations of states and political subdivisions	103,680	—	103,680	—
Mortgage-backed GSE residential	201,064	—	201,064	—
Pooled trust preferred securities	16,740	—	—	16,740
Interest Rate Swap Assets	330	—	330	—
Interest Rate Swap Liability	(282)	—	(282)	—

(Table Dollars in Thousands Except Share Data)

		2017 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash Equivalents				
Money market mutual funds	$ 588	$ 588	$ —	$ —
Available-for-Sale Securities				
U.S. Treasury and agency securities	17,560	—	17,560	—
Obligations of states and political subdivisions	111,795	—	111,795	—
Mortgage-backed GSE residential	234,237	—	234,237	—
Equity security	168	168	—	—
Pooled trust preferred securities	16,085	—	—	16,085
Interest Rate Swap Assets	242	—	242	—
Interest Rate Swap Liability	(322)	—	(322)	—

Following is a description of the valuation methodologies used for assets and liabilities measured at fair value on a recurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets and liabilities pursuant to the valuation hierarchy. There have been no significant changes in the valuation techniques during the year ended December 31, 2018. For assets and liabilities classified within Level 3 of the fair value hierarchy, the process used to develop the reported fair value is described below.

Cash Equivalents

Where quoted market prices are available in an active market, cash equivalents are classified within Level 1 of the valuation hierarchy and include only money market mutual funds. The Company has no cash equivalents classified as Level 2 or Level 3.

Available-for-Sale Securities

Where quoted market prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities include an insurance industry equity security. If quoted market prices are not available, then fair values are estimated by a third-party pricing service using pricing models, quoted market prices of securities with similar characteristics or discounted cash flows. The inputs used by the pricing service to determine fair value may include one, or a combination of, observable inputs such as benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data market research publications and are classified within Level 2 of the valuation hierarchy. These level 2 securities include U.S. Treasury and agency securities, obligations of state and political subdivisions, and mortgage-backed GSE residential securities. In certain cases where Level 1 or Level 2 inputs are not available, securities are classified within Level 3 of the hierarchy and include pooled trust preferred securities. Based on the lack of observable market data, the Company estimated fair values based on the observable data available and reasonable unobservable market data. The estimated fair value is based on a discounted cash flow model which used appropriately adjusted discount rates reflecting credit and liquidity risks and is further described in the other-than-temporary impairment section of Note 3.

Fair value determinations for Level 3 measurements of securities are the responsibility of the Finance department. The Finance department contracts with a pricing specialist to generate fair value estimates on a monthly or quarterly basis. The Finance department challenges the reasonableness of the assumptions used and reviews the methodology to ensure the estimated fair value complies with accounting standards generally accepted in the United States.

Interest Rate Swap Agreements

Derivative instruments consist of interest rate swaps and interest rate caps. The Company obtained fair values from financial institutions that use internal models with observable market inputs to estimate the values of these instruments (Level 2).

The following is a reconciliation of the beginning and ending balances of recurring fair value measurements recognized in the accompanying consolidated balance sheets using significant unobservable (Level 3) inputs:

	Pooled Trust Preferred Securities
Balance, January 1, 2017	$ 14,365
Total realized and unrealized gains and (losses)	
Included in net income	$ —
Included in other comprehensive income	1,720
Balance, December 31, 2017	$ 16,085
Total realized and unrealized gains and (losses)	
Included in net income	$ —
Included in other comprehensive income	655

(Table Dollars in Thousands Except Share Data)

	Pooled Trust Preferred Securities
Balance, December 31, 2018	$ 16,740
Total gains or (losses) for 2018 included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$ —
Total gains or (losses) for 2017 included in net income attributable to the change in unrealized gains or losses related to assets and liabilities still held at the reporting date	$ —

Nonrecurring Measurements

The following table presents the fair value measurement of assets measured at fair value on a nonrecurring basis and the level within the fair value hierarchy in which the fair value measurements fall at December 31, 2018 and 2017.

		2018 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	$ 5,878	—	—	$ 5,878
Other real estate owned	1,743	—	—	1,743

		2017 Fair Value Measurements Using		
	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Impaired loans (collateral dependent)	$ 10,437	—	—	$ 10,437
Other real estate owned	190	—	—	190

Following is a description of the valuation methodologies used for assets measured at fair value on a nonrecurring basis and recognized in the accompanying consolidated balance sheets, as well as the general classification of such assets pursuant to the valuation hierarchy. The Company has no liabilities measured at fair value on a nonrecurring basis.

Impaired Loans (Collateral Dependent)

Loans for which it is probable that the Company will not collect all principal and interest due according to contractual terms are measured for impairment. An allowable method for determining the amount of impairment includes estimating fair value using the fair value of the collateral for collateral dependent loans. If the impaired loan is identified as collateral dependent, then the fair value method of measuring the amount of impairment is utilized. This method requires obtaining a current independent appraisal of the collateral and applying a discount factor to the value. Impaired loans that are collateral dependent are classified within Level 3 of the fair value hierarchy when impairment is determined using the fair value method.

The Company considers the appraisal or evaluation as the starting point for determining fair value and then considers other factors and events in the environment that may affect the fair value. Appraisals of the collateral underlying collateral-dependent loans are obtained when the loan is determined to be collateral-dependent and subsequently as deemed necessary by the Managed Assets department and Asset Quality Committee. Appraisals are reviewed for accuracy and consistency by the Loan Review department. Appraisers are selected from the list of approved appraisers maintained by management. The appraised values are reduced by discounts to consider lack of marketability and estimated cost to sell if repayment or satisfaction of the loan is dependent on the sale of the collateral. These discounts and estimates are developed by the Loan Review department by comparison to historical results.

Other Real Estate Owned

The fair value of real estate is generally determined based on appraisals by qualified licensed appraisers. The appraisers typically determine the value of the real estate by utilizing an income or market valuation approach, and therefore, are classified within Level 3 of the valuation hierarchy.

Appraisals of OREO are obtained when the real estate is acquired and subsequently as deemed necessary by the Asset Management department and Asset Quality Committee. Appraisals are reviewed for accuracy and consistency by the Loan Review department. Appraisers are selected from the list of approved appraisers maintained by management.

(Table Dollars in Thousands Except Share Data)

Unobservable (Level 3) Inputs

The following tables present quantitative information about unobservable inputs used in recurring and nonrecurring Level 3 fair value measurements as of December 31, 2018 and 2017.

	Fair Value at December 31, 2018	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans (collateral dependent)	$ 5,878	Market comparable properties	Marketability discount	0% – 100% (57%)
Other real estate owned	1,743	Market comparable properties	Comparability adjustments (%)	Not available
Pooled trust preferred securities	16,740	Discounted cash flows	Market yield adjustments	2.49% – 2.75% (2.75%)

	Fair Value at December 31, 2017	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans (collateral dependent)	$ 10,437	Market comparable properties	Marketability discount	0% – 100% (27%)
Other real estate owned	190	Market comparable properties	Comparability adjustments (%)	Not available
Pooled trust preferred securities	16,085	Discounted cash flows	Market yield adjustments	1.51% – 1.80% (1.78%)

Sensitivity of Significant Unobservable Inputs

The following is a discussion of the sensitivity of significant unobservable inputs, the interrelationship between those inputs and other unobservable inputs used in recurring fair value measurement and of how those inputs might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement.

Pooled Trust Preferred Securities

The significant unobservable inputs used in the fair value measurement of the Company's pooled trust preferred securities are premiums and discounts for underlying institutions. Significant increases (decreases) in either of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, changes in either of those inputs will not affect the other input.

Fair Value of Financial Instruments

The following table presents estimated fair values of the Company's financial instruments at December 31, 2018 and 2017.

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
December 31, 2018					
Financial assets					
Cash and cash equivalents	$ 104,095	$ 104,095	$ 104,095	$ —	$ —
Loans held for sale	197	202	—	202	—
Loans and leases, net	1,453,724	1,430,640	—	—	1,430,640
Interest receivable	8,358	8,358	—	8,358	—
Federal Home Loan Bank stock	3,156	3,156	—	3,156	—
Financial liabilities					
Demand deposits	$ 1,504,141	$ 1,504,141	$ 1,501,141	$ —	$ —
Time deposits	205,974	185,142	—	185,142	—
Short-term borrowings	33,906	33,850	—	33,850	—
Long-term borrowings	20,250	19,259	—	19,259	—
Subordinated debt	10,310	5,614	—	5,614	—
Interest payable	186	186	—	116	—
December 31, 2017					
Financial assets					
Cash and cash equivalents	$ 69,342	$ 69,342	$ 69,342	$ —	$ —
Loans held for sale	200	203	—	203	—
Loans and leases, net	1,364,748	1,380,395	—	—	1,380,395
Interest receivable	7,307	7,307	—	7,307	—
Federal Home Loan Bank stock	3,156	3,156	—	3,156	—

(Table Dollars in Thousands Except Share Data)

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial liabilities					
Demand deposits	$ 1,439,724	$ 1,439,724	$ 1,439,724	$ —	$ —
Time deposits	164,284	156,535	—	156,353	—
Short-term borrowings	30,132	30,040	—	30,040	—
Long-term borrowings	66,402	65,799	—	65,799	—
Subordinated debt	10,310	5,614	—	5,614	—
Interest payable	116	116	—	116	—

The following methods were used to estimate the fair value of all other financial instruments recognized in the accompanying consolidated balance sheets at amounts other than fair value.

Cash and Cash Equivalents, Federal Home Loan Bank Stock and Interest Receivable

The carrying amounts approximate fair value.

Loans Held for Sale

For homogeneous categories of loans, such as mortgage loans held for sale, fair value is estimated using the quoted market prices for securities backed by similar loans, adjusted for differences in loan characteristics.

Loans and Leases, net

For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value for all other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality.

Deposit Liabilities

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

Short-Term Borrowings and Interest Payable

Fair values for short-term borrowing and interest payable are estimated using a discounted cash flow calculation that applies interest rates currently being offered for similar maturities.

Long-Term Borrowings

Fair values for Federal Home Loan Bank and other borrowings are estimated using a discounted cash flow calculation that applies interest rates currently being offered for similar maturities.

Subordinated Debt

The fair value for subordinated debt is estimated using a discounted cash flow calculation that applies interest rates currently being offered for similar maturities.

Commitments to Originate Loans, Forward Sale Commitments, Letters of Credit and Lines of Credit

The fair value of commitments to originate loans is estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of forward sale commitments is estimated based on current market prices for loans of similar terms and credit quality. The fair values of letters of credit and lines of credit are based on fees currently charged for similar agreements or on the estimated cost to terminate or otherwise settle the obligations with the counterparties at the reporting date. The fair value of these items is not material.

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2019 Annual Meeting

The 2019 Annual Meeting of the Shareholders of STAR Financial Group occurs on Wednesday, May 22, 2019 at 10 a.m. at STAR Financial Group's Corporate Office at 127 West Berry Street, 2nd floor, Fort Wayne, Indiana.

STAR Financial Bank

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CORPORATE OFFICE

127 W. Berry Street | Fort Wayne, Indiana 46802 | (260) 428-7000

starfinancial.com

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