Tri-County Bancorp, Inc.

Tri-County Bank

Years Ended December 31, 2020 and 2019

Consolidated Financial Statements

Rehmann

TRI-COUNTY BANCORP, INC.

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INDEPENDENT AUDITORS' REPORT

March 22, 2021

Stockholders and Board of Directors
Tri-County Bancorp, Inc.
Brown City, Michigan

We have audited the accompanying consolidated financial statements of *Tri-County Bancorp, Inc.* (the Company), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

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

Independent Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of *Tri-County Bancorp, Inc.* as of December 31, 2020 and 2019, and the consolidated 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.

Rehmann Robson LLC

TRI-COUNTY BANCORP, INC.

Consolidated Balance Sheets

	December 31	
	2020	2019
ASSETS		
Cash and due from banks	$ 77,661,454	$ 7,253,181
Federal funds sold	6,342,000	2,377,000
Cash and cash equivalents	**84,003,454**	**9,630,181**
Certificates of deposit	1,980,000	988,000
Investment securities	38,049,565	39,975,113
Restricted investments	839,500	839,500
Loans held for sale	899,700	227,986
Net loans	262,580,110	249,379,129
Accrued interest receivable	2,387,168	2,353,795
Premises and equipment, net	7,420,719	7,648,745
Goodwill, net	273,738	339,783
Bank owned life insurance	10,135,457	6,935,633
Other	1,055,685	1,023,470
Total assets	**$ 409,625,096**	**$ 319,341,335**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	$ 149,667,779	$ 93,184,614
Interest-bearing	208,642,237	181,834,925
Total deposits	**358,310,016**	**275,019,539**
Borrowed funds	3,000,000	3,000,000
Accrued interest payable and other liabilities	1,164,434	1,073,716
Total liabilities	**362,474,450**	**279,093,255**
Commitments and contingencies (Notes 11, 12, 13, 14, 15, and 16)		
Stockholders' equity		
Common stock, no par value: 4,000,000 shares authorized, 1,004,802 shares issued and outstanding (996,677 in 2019)	7,236,281	6,701,213
Unearned ESOP compensation	(171,876)	(343,753)
Retained earnings	39,425,214	33,839,028
Accumulated other comprehensive income	661,027	51,592
Total stockholders' equity	**47,150,646**	**40,248,080**
Total liabilities and stockholders' equity	**$ 409,625,096**	**$ 319,341,335**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Income

	Year Ended December 31	
	2020	**2019**
Interest income		
Loans (including fees)	$ 16,104,772	$ 14,262,740
Investments	778,463	1,033,269
Federal funds sold	15,267	18,466
Total interest income	**16,898,502**	**15,314,475**
Interest expense		
Deposits	1,376,306	1,854,428
Borrowed funds	51,544	5,633
Total interest expense	**1,427,850**	**1,860,061**
Net interest income	**15,470,652**	**13,454,414**
Provision for loan losses	861,835	174,000
Net interest income, after provision for loan losses	**14,608,817**	**13,280,414**
Noninterest income		
Service charges on deposit accounts	1,095,220	1,163,505
Net gain on sale of investment securities	22,633	340
Net gain on sale of loans	1,231,386	291,268
Other	806,060	600,889
Total noninterest income	**3,155,299**	**2,056,002**
Noninterest expenses		
Compensation and benefits	5,818,906	5,480,930
Occupancy and equipment	1,032,798	962,239
Foreclosed assets	50,895	37,632
Data processing	603,921	585,696
Other	2,101,489	2,025,845
Total noninterest expenses	**9,608,009**	**9,092,342**
Income before income taxes	**8,156,107**	**6,244,074**
Income taxes	1,612,000	1,225,000
Net income	**$ 6,544,107**	**$ 5,019,074**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Comprehensive Income

	Year Ended December 31	
	2020	2019
Net income	**$ 6,544,107**	**$ 5,019,074**
Other comprehensive income		
Available-for-sale securities		
Unrealized holding gains arising during the year	794,070	1,257,564
Reclassification adjustment for net realized gains included in net income	(22,633)	(340)
Other comprehensive income before income taxes	**771,437**	**1,257,224**
Income tax expense related to other comprehensive income	(162,002)	(264,017)
Other comprehensive income	**609,435**	**993,207**
Comprehensive income	**$ 7,153,542**	**$ 6,012,281**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Stockholders' Equity

	Common Stock		Unearned ESOP	Retained	Accumulated Other Comprehensive	
	Shares	Amount	Compensation	Earnings	Income (Loss)	Total
Balances, January 1, 2019	**991,874**	**$ 6,536,926**	**$ (515,630)**	**$ 29,570,748**	**$ (941,615)**	**$ 34,650,429**
Comprehensive income	-	-	-	5,019,074	993,207	6,012,281
Dividends ($0.86 per share)	-	-	-	(842,784)	-	(842,784)
Compensation expense related to ESOP	-	-	171,877	91,990	-	263,867
Issuance of common stock	29,359	1,482,622	-	-	-	1,482,622
Issuance of shares upon exercise of common stock options	1,150	60,176	-	-	-	60,176
Redemption of common stock	(25,706)	(1,378,511)	-	-	-	(1,378,511)
Balances, December 31, 2019	**996,677**	**6,701,213**	**(343,753)**	**33,839,028**	**51,592**	**40,248,080**
Comprehensive income	-	-	-	6,544,107	609,435	7,153,542
Dividends ($1.12 per share)	-	-	-	(1,106,558)	-	(1,106,558)
Compensation expense related to ESOP	-	-	171,877	148,637	-	320,514
Issuance of common stock	17,939	1,169,362	-	-	-	1,169,362
Issuance of shares upon exercise of common stock options	100	2,925	-	-	-	2,925
Redemption of common stock	(9,914)	(637,219)	-	-	-	(637,219)
Balances, December 31, 2020	**1,004,802**	**$ 7,236,281**	**$ (171,876)**	**$ 39,425,214**	**$ 661,027**	**$ 47,150,646**

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

TRI-COUNTY BANCORP, INC.

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2020	2019
Cash flows from operating activities		
Net income	$ 6,544,107	$ 5,019,074
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	401,820	342,652
Amortization of goodwill	66,045	65,864
Net amortization of premiums on investment securities	199,651	350,763
Net gain on sale of investment securities	(22,633)	(340)
Mortgage servicing rights amortization	375,536	232,943
Provision for loan losses	861,835	174,000
Net gain on sale of loans	(1,231,386)	(291,268)
Foreclosed asset losses	26,837	18,828
(Gain) loss on sale and disposal of equipment	(508)	15,271
Increase in cash surrender value of bank owned life insurance	(199,824)	(171,025)
Deferred income tax expense	9,000	37,000
Originations of mortgage loans held for sale	(45,872,514)	(19,700,086)
Proceeds from mortgage loan sales	46,432,186	19,991,354
Changes in operating assets and liabilities which (used) provided cash		
Accrued interest receivable	(33,373)	(279,990)
Other assets	(449,331)	(534,947)
Accrued interest payable and other liabilities	(80,284)	609,564
Net cash provided by operating activities	**7,027,164**	**5,879,657**
Cash flows from investing activities		
Net activity in certificates of deposit	(992,000)	-
Activity in held-to-maturity securities		
Maturities, prepayments and calls	593,039	522,984
Activity in available-for-sale securities		
Purchases	(14,799,044)	(2,394,676)
Sales, maturities, prepayments and calls	16,725,972	12,979,312
Loan principal originations, net	(14,512,679)	(28,627,434)
Purchases of premises and equipment	(174,420)	(3,615,701)
Purchase of bank owned life insurance	(3,000,000)	-
Proceeds from sale of equipment	1,134	381,024
Proceeds from sale of foreclosed assets	464,606	291,947
Net cash used in investing activities	**(15,693,392)**	**(20,462,544)**
Cash flows from financing activities		
Acceptances of deposits, net	83,290,477	12,673,199
Proceeds from borrowed funds	-	3,000,000
ESOP shares earned	320,514	263,867
Proceeds from issuance of common stock	1,169,362	1,482,622
Proceeds from exercise of common stock options, including tax benefit	2,925	60,176
Common stock repurchased and redeemed	(637,219)	(1,378,511)
Cash dividends paid	(1,106,558)	(842,784)
Net cash provided by financing activities	**83,039,501**	**15,258,569**
Net increase in cash and cash equivalents	**74,373,273**	**675,682**
Cash and cash equivalents, beginning of year	9,630,181	8,954,499
Cash and cash equivalents, end of year	**$ 84,003,454**	**$ 9,630,181**

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

Notes to Consolidated Financial Statements

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of ***Tri-County Bancorp, Inc.*** , a registered bank holding company (the “Company”), and its wholly owned subsidiary, Tri-County Bank (the “Bank”). All significant intercompany accounts and transactions have been eliminated in consolidation.

The Company is independently owned and operates a community bank engaged in the business of retail and commercial banking services through its twelve branches located in Sanilac, Lapeer, Macomb, St. Clair, and Tuscola counties in Michigan. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all of the Bank’s primary markets. The Bank’s results of operations can be significantly affected by changes in interest rates or changes in the local economic environment.

The Bank is a state chartered bank and is a member of both the Federal Reserve Bank of Chicago (“FRB”) and the Federal Deposit Insurance Corporation (“FDIC”) Bank Insurance Fund. The Bank is also subject to the regulations and supervision of state regulators and undergoes periodic examinations by these regulatory authorities. The Company is further subject to regulations of the Federal Reserve Bank Board governing bank holding companies.

Economic Uncertainties

The outbreak of a novel coronavirus (COVID-19), which the World Health Organization declared in March 2020 to be a pandemic, continues to spread throughout the United States of America and the globe. In response, many State Governors have issued temporary Executive Orders that, among other stipulations, effectively prohibit in-person work activities for most industries, businesses, and occupations, having the effect of altering the Bank's normal service delivery methods. As a result, the outbreak has disrupted the Bank's customary operating activities. The extent of the ultimate impact of the pandemic on the Bank's operational and financial performance will depend on various developments, including the duration and spread of the outbreak, and its impact on borrowers, customers, employees, vendors, and regulatory actions, all of which cannot be reasonably predicted at this time. While management reasonably expects the COVID-19 outbreak could negatively impact the Bank's financial condition, operating results, and timing and amounts of cash flows, the related financial consequences, including the effects of potential changes in key accounting estimates, are highly uncertain.

Recent Events

On March 22, 2020, the federal banking agencies issued an *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus.* This guidance encouraged financial institutions to work with borrowers that may be unable to meet their contractual obligations because of the effects of COVID-19. The guidance further indicates that in collaboration with FASB the federal banking agencies concluded that short-term modifications made on a good faith basis to borrowers who were current as of the implementation date of a relief program are not Troubled Debt Restructurings (“TDRs”). *The Coronavirus Aid, Relief and Economic Security* (“CARES”) Act was passed by Congress on March 27, 2020. Section 4013 of the CARES Act also addressed COVID-19 related modifications and specified that COVID-19 related modifications on loans that were current as of December 31, 2019 are not TDRs. On December 27, 2020, the 2021 *Consolidated Appropriations Act* was signed into law and included legislation that extended certain relief provisions from the March 2020 CARES Act that were set to expire at the end of 2020. This new legislation extends this relief to the earlier of 60 days after the national emergency termination date or January 1, 2022. Of note, the suspension of consideration of whether a loan modification results in a TDR does not eliminate the assessment of loan collectability.

The CARES Act , as amended, included an allocation of loans to be issued by financial institutions through the federal Small Business Administration (“SBA”) Paycheck Protection Program (“PPP”). PPP loans are forgivable, in whole or in part, if the proceeds are used for payroll and other permitted purposes in accordance with the requirements of the PPP. These loans carry a fixed rate of 1.00% and a term of two years (loans made before June 5, 2020) or five years (loans made on or after June 5, 2020), if not forgiven, in whole or in part. Payments are deferred until either the date that the SBA remits the amount of forgiveness proceeds to the lender or the date that is 10 months after the last day of the covered period if the borrower does not apply for forgiveness within that 10 month period. Through December 31, 2020, the Bank had originated 334 PPP loans totaling $25.8 million in principal. Fees totaling $1.1 million were collected from the SBA for these loans as of December 31, 2020. As of December 31, 2020, the remaining balance of PPP loans was $14,756,303. Loan origination fees associated with PPP loans are deferred and amortized into interest income over the contractual period of 24 months or 60 months, as applicable. Upon SBA forgiveness, any remaining unamortized fees are then recognized into interest income. Participation in the PPP had a significant impact on the Bank’s asset mix and net interest income in 2020. The PPP program under the CARES Act expired on August 8, 2020; however, the *Consolidated Appropriations Act* includes additional funds to be made available in 2021 within the Paycheck Protection Program.

Concentration Risks

The Bank’s primary deposit products are interest and noninterest-bearing checking accounts, savings accounts and time deposits and its primary lending products are real estate mortgages, commercial, agricultural, and consumer loans. The Bank does not have any significant concentrations to any one industry, customer, or depositor.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and the reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses, the fair value of certain investment securities, and the valuation of impaired loans, and other real estate owned.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Company and the Bank are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, and federal funds sold. Generally, federal funds are sold for a one-day period. The Bank maintains deposit accounts in various financial institutions which generally exceed FDIC insured limits or are not insured. Management does not believe the Company is exposed to any significant interest, credit, or other financial risk as a result of these deposits.

Certificates of Deposit

Certificates of deposit held by the Bank are those with original maturities of more than three months. Certificates of deposit are carried at cost. These deposits in other financial institutions may exceed insured limits. Management believes the Bank is not exposed to any significant interest rate or other financial risk on these deposits.

Fair Value Measurements

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2.

Investment Securities

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Debt securities not classified as held-to-maturity or trading are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive income. Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment.

Debt securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other-than-temporary impairment exists, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not the Bank will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Bank must recognize an OTTI charge through earnings for the difference between the debt security's amortized cost basis and its fair value, and such amount is included in noninterest income. For these debt securities, the Bank separates the total impairment into the credit loss component and the amount of the loss related to other factors. In order to determine the amount of the credit loss for a debt security, the Bank calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total OTTI related to credit risk is recognized in earnings and is included in noninterest expenses. The amount of the total OTTI related to other risk factors is recognized as a component of other comprehensive income (loss). For debt securities that have recognized an OTTI through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Restricted Investments

The Bank is a member of the Federal Home Loan Bank System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLB"). The amount of the required investment is based upon the available balance of the Bank's outstanding home mortgage loans or advances from the FHLB and is carried at cost plus the value assigned to stock dividends.

The Bank is also a member of the Federal Reserve Bank System ("FRB"). The amount of the required investment is determined by the FRB at the time the Bank becomes a member. The amount of the investment may be adjusted thereafter and is carried at cost.

Loans

Loans that management has the positive intent and ability to hold for the foreseeable future or until maturity or pay-off are generally reported at their outstanding unpaid principal balances adjusted for charge-offs, the allowance for loan losses, and any deferred fees or costs on originated loans. Interest income is accrued on the unpaid principal balance. Except for fees associated with origination of PPP loans in 2020, management estimates that direct costs incurred in originating loans approximate the origination fees generated on these loans. Therefore, net deferred loan origination fees on loans classified as held-to-maturity are not included on the accompanying consolidated balance sheets, and there were no adjustments to the loan yields for loans originated during the years then ended. As noted above, loan origination fees associated with PPP loans are deferred and being amortized over the contractual period of 24 months or 60 months, as applicable.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Personal loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. Loans that become 180 days past due and are not in the process of collection will be foreclosed, the collateral disposed of, and any deficiency charged off. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on nonaccrual or are charged off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest on these loans is accounted for on the cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans are comprised of those loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more as to interest or principal payments and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses

The allowance for loan losses ("allowance") is an estimate of loan losses inherent in the Bank's loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the appropriateness of the total allowance after loan losses and loan growth. Loan losses are charged off against the allowance when the Bank determines the loan balance to be uncollectible. Cash received on previously charged off amounts is recorded as a recovery to the allowance.

The allowance consists of three primary components: general reserves, specific reserves and an unallocated component. For such loans that are classified as impaired, a specific reserve is established when the discounted cash flows or collateral value 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 losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent three years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. PPP loans receive $0 allocation as they are fully guaranteed by the SBA and are subject to forgiveness under the SBA forgiveness criteria.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all 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 commercial and construction loans by either the present value of expected future cash flows discounted at the loan's effective interest rate or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if the repayment is expected to be provided solely by the underlying collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment allowances or disclosures, unless such loans are the subject of a restructuring agreement or in nonaccrual status.

The Bank evaluates the credit quality of loans in the consumer and residential (including construction) loan portfolios, based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans and loans past due as to principal or interest 90 days or more and loans modified under troubled debt restructurings are considered in a nonperforming status for purposes of credit quality evaluation.

Under certain circumstances, the Bank will provide borrowers relief through loan restructurings. A loan restructuring constitutes a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Bank grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Bank's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention (or Watch): Loans classified as special mention (watch) have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date. Special mention (watch) loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Doubtful: Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and are charged off immediately.

The majority of the Bank's consumer and residential loan portfolio is comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolios is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

The Bank maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, commercial real estate, agricultural, residential construction, residential real estate, and consumer and other, with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Commercial Real Estate: Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for the properties to produce sufficient cash flow to service debt obligations.

Agricultural: Agricultural loans generally possess a lower inherent risk of loss than other portfolio segments as crops are insured, in most cases, at a substantial portion of the crop's expected income. Economic and environmental trends determined by commodity prices and crop yields can significantly impact the quality of these loans.

Residential Construction: Residential construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within a specified cost and time line. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Residential Real Estate: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. These loans generally possess a lower inherent risk of loss than other real estate portfolio segments. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer and Other: The consumer and other loan portfolios are usually comprised of a large number of small loans scheduled to be amortized over a specific period. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank’s primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examinations.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commercial letters of credit and standby letters of credit. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

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 of which the provision is accounted for in the consolidated statements of income.

Transfers of Financial Assets

Transfers of financial assets, including mortgage loans held-for-sale, as described above, 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 legally isolated from the Bank, 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 Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity. Other than servicing, as disclosed in Note 5, the Bank has no substantive continuing involvement related to these loans. The Bank sold to an unrelated third party residential mortgage loans with proceeds of $46,432,186 and $19,991,354 in 2020 and 2019, respectively, which resulted in net gains of $1,231,386 and $291,268 in 2020 and 2019, respectively. Servicing fee income earned on such loans was $320,967 and $310,486 for 2020 and 2019, respectively, and is included in other noninterest income in the consolidated statements of income.

Servicing

Servicing assets are recognized as separate assets when rights are acquired through the purchase or sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on relative fair value. 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.

Servicing assets or liabilities are amortized in proportion to and over the period of net servicing income or net servicing loss and are assessed for impairment or increased obligation based on fair value of rights compared to amortized cost at each reporting date. Impairment is determined by stratifying rights into tranches based on predominant risk 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 capitalized amount for the tranche. If the Bank later determines that all or a portion of the impairment no longer exists for a particular tranche, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported in other assets on the consolidated balance sheets.

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

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, on the date of transfer, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in expenses from foreclosed assets in the consolidated statements of income. Foreclosed assets were not significant in 2020 or 2019.

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 2 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management reviews these assets for impairment whenever events or circumstances indicates the related carrying amount may not be recoverable.

Goodwill

Goodwill consists of amounts paid in excess of the fair value of assets acquired and liabilities assumed in connection with a business combination. The Company amortizes goodwill on a straight line basis over 10 years. Goodwill is also tested for impairment when a triggering event occurs that indicates that the fair value of the Company may be below its carrying amount. Goodwill is tested for impairment at the Company level. Goodwill amortization, which is recorded in other noninterest expenses, is insignificant in 2020 and 2019.

Bank-Owned Life Insurance

The Company holds life insurance policies purchased on the lives of key members of management. In the event of death of one of these individuals, the Company, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the consolidated balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in other noninterest income.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred income tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in federal income tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

Common Stock

Shares of common stock are purchased and redeemed in the ordinary course of business. The cost of common shares purchased and redeemed has been charged entirely to common stock.

Share-Based Compensation Plans

Compensation expense relating to share-based compensation plans is based on the fair value of the awards granted and is recognized on a straight-line basis over the requisite service period of each award.

Reclassification

Certain amounts as reported in the 2019 consolidated financial statements have been reclassified to conform with the 2020 presentation.

Subsequent Events

In preparing these consolidated financial statements, the Company has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2020, the most recent consolidated balance sheet presented herein, through March 22, 2021, the date these consolidated financial statements were available to be issued. No such significant events or transactions were identified.

New Accounting Pronouncement

Accounting Standards Update ("ASU") 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, and all subsequent amendments to the ASU, was issued with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions. The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates. The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgements used in estimating credit losses, as well as the credit quality and underwriting standards of an institution's portfolio. In addition, the ASU amends existing guidance on accounting for credit losses on available-for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures. The ASU on credit losses will take effect for fiscal years beginning after December 15, 2022. Management is currently evaluating the provisions of the standard to determine the potential impact on the Company's consolidated financial statements.

2. FAIR VALUE MEASUREMENTS

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. The Company only has securities available-for-sale which are recorded at fair value on a recurring basis. Additionally, from time to time, the Company may be required to record at fair value other assets on a nonrecurring basis, such as investment securities held-to-maturity, impaired loans, loans held for sale, foreclosed assets, mortgage servicing rights, goodwill and certain other assets and liabilities. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

Following is a description of the valuation methodologies and key inputs used to measure financial assets and liabilities recorded at fair value which includes an indication of the level of the fair value hierarchy in which the assets or liabilities are classified.

Investment Securities

Available-for-sale debt securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions.

Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, or that are traded by dealers or brokers in active over-the-counter markets.

Level 2 fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include U.S. Treasury securities, government sponsored enterprises, collateralized mortgage obligations, mortgage-backed securities issued by government-sponsored entities, states and municipal bonds and corporate bonds. For Level 3 securities where quoted prices or market prices of similar securities are not available, fair values are calculated using discounted cash flows or other market indicators. The Company did not have any securities classified as Level 1 or 3 at December 31, 2020 or 2019.

Impaired Loans

The fair value of impaired loans is measured in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value or discounted cash flows. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. At December 31, 2020 and 2019, a majority of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank classifies the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank classifies the impaired loan as nonrecurring Level 3.

Foreclosed Assets

Upon transfer from the loan portfolio, foreclosed assets are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or a current appraised value, the Bank classifies the foreclosed asset as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Bank classifies the foreclosed asset as nonrecurring Level 3.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

Assets Recorded at Fair Value on a Recurring Basis

The following table sets forth by level, within the fair value hierarchy, the recorded amount of investment securities measured at fair value on a recurring basis as of December 31:

	Assets at Fair Value			
2020	**Level 1**	**Level 2**	**Level 3**	**Total**
Debt securities available-for-sale				
U.S. Treasury and federal agency	$ -	$ 3,051,406	$ -	$ 3,051,406
Government sponsored enterprises	-	5,152,635	-	5,152,635
Corporate bonds	-	500,000	-	500,000
Mortgage-backed securities	-	7,687,821	-	7,687,821
Collateralized mortgage obligations	-	3,113,615	-	3,113,615
States and municipal	-	16,508,320	-	16,508,320
Total assets at fair value	**$ -**	**$ 36,013,797**	**$ -**	**$ 36,013,797**

	Assets at Fair Value			
2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale				
U.S. Treasury and federal agency	$ -	$ 11,739,269	$ -	$ 11,739,269
Government sponsored enterprises	-	3,015,781	-	3,015,781
Mortgage-backed securities	-	6,777,336	-	6,777,336
Collateralized mortgage obligations	-	5,012,052	-	5,012,052
States and municipal	-	10,801,867	-	10,801,867
Total assets at fair value	**$ -**	**$ 37,346,305**	**$ -**	**$ 37,346,305**

Assets Recorded at Fair Value on a Nonrecurring Basis

Assets recorded at fair value on a nonrecurring basis for which impairment was recognized in the current period consist only of impaired loans and foreclosed assets.

Impaired loans, which are measured for impairment using the fair value of collateral for collateral dependent loans or discounted cash flow analysis, are classified as Level 3, and had carrying amounts of $1,570,091 and $3,806,710 as of December 31, 2020 and 2019, respectively, resulting in an allowance for loan losses allocation of $27,385 and $136,560 as of December 31, 2020 and 2019, respectively.

Foreclosed assets as of December 31, 2020 and 2019, which is carried at the lower of carrying value of fair value less cost to sell, were written down from cost to $0 and $41,580, respectively, resulting in a charge of $10,000 and $12,000 included in foreclosed assets expense in the consolidated income statements for 2020 and 2019, respectively.

Quantitative information about Level 3 fair value measurements is as follows as of December 31:

2020	Level 3 Instruments			
Instrument	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 87,624	Discounted Cash Flow	Duration of Cash Flows	284 months
	1,482,467	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	0%

2019	Level 3 Instruments			
Instrument	Fair Value	Valuation Technique	Unobservable Input	Weighted Average and/or Range
Impaired Loans	$ 224,262	Discounted Cash Flow	Duration of Cash Flows	90-283 Months
	3,582,448	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	0% - 25%

Notes to Consolidated Financial Statements

3. INVESTMENT SECURITIES

The amortized cost and fair value of debt securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
States and municipal	$ 2,035,768	$ 49,303	$ -	$ 2,085,071
Available-for-Sale				
U.S. Treasury and federal agency	2,995,868	55,538	-	3,051,406
Government sponsored enterprises	5,020,649	132,470	484	5,152,635
Corporate bonds	500,000	-	-	500,000
Mortgage-backed securities	7,497,360	197,096	6,635	7,687,821
Collateralized mortgage obligations	3,043,570	71,765	1,720	3,113,615
States and municipal	16,120,084	388,236	-	16,508,320
Total available-for-sale	**35,177,531**	**845,105**	**8,839**	**36,013,797**
Total	**$ 37,213,299**	**$ 894,408**	**$ 8,839**	**$ 38,098,868**

2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-maturity				
States and municipal	$ 2,628,808	$ 62,850	$ -	$ 2,691,658
Available-for-Sale				
U.S. Treasury and federal agency	11,674,927	64,562	220	11,739,269
Government sponsored enterprises	2,994,978	20,803	-	3,015,781
Mortgage-backed securities	6,829,999	5,934	58,597	6,777,336
Collateralized mortgage obligations	5,040,431	2,812	31,191	5,012,052
States and municipal	10,741,141	61,518	792	10,801,867
Total available-for-sale	**37,281,476**	**155,629**	**90,800**	**37,346,305**
Total	**$ 39,910,284**	**$ 218,479**	**$ 90,800**	**$ 40,037,963**

Investment securities with carrying values of approximately $1,024,000 and $4,167,000 at December 31, 2020 and 2019, respectively, were pledged to secure public deposits or for other purposes as permitted or required by law.

The amortized cost and fair value of held-to-maturity and available-for-sale debt securities grouped by contractual maturity at December 31, 2020, are summarized as follows:

	Maturing					
	Due in One Year or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Due After Ten Years	Securities With Variable Monthly Payments Or No Contractual Maturity	Total
Held-to-maturity						
States and municipal	$ 471,000	$ 1,064,768	$ 500,000	$ -	$ -	$ 2,035,768
Available-for-Sale						
U.S. Treasury and federal agency	1,000,198	1,995,670	-	-	-	2,995,868
Government sponsored enterprises	-	1,003,324	4,017,325	-	-	5,020,649
Corporate bonds	-	-	-	500,000	-	500,000
Mortgage-backed securities	-	-	-	-	7,497,360	7,497,360
Collateralized mortgage obligations	-	-	-	-	3,043,570	3,043,570
States and municipal	2,503,830	5,482,966	8,133,288	-	-	16,120,084
Total available-for-sale	**3,504,028**	**8,481,960**	**12,150,613**	**500,000**	**10,540,930**	**35,177,531**
Total amortized cost	**$ 3,975,028**	**$ 9,546,728**	**$ 12,650,613**	**$ 500,000**	**$ 10,540,930**	**$ 37,213,299**
Total fair value	**$ 4,003,310**	**$ 9,821,420**	**$ 12,972,702**	**$ 500,000**	**$ 10,801,436**	**$ 38,098,868**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, mortgage-backed securities and collateralized mortgage obligations are not reported by a specific maturity group.

During 2020, there were sales of two available-for-sale securities. Net realized gains amounted to $22,633 during 2020. During 2019, there were seven available-for-securities sold. Net realized gains amounted to $340 during 2019.

Information pertaining to securities with unrealized losses aggregated by investment category and the length of time that individual securities have been in a continuous loss position at December 31 is as follows:

	Less Than 12 Months		Over 12 Months			Total
2020	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Losses
Securities available-for-sale						
Government sponsored enterprises	$ 998,290	$ 484	$ -	$ -	$ 998,290	$ 484
Mortgage-backed securities	2,336,283	6,635	-	-	2,336,283	6,635
Collateralized mortgage obligations	712,775	1,720	-	-	712,775	1,720
Total securities available-for-sale	**$ 4,047,348**	**$ 8,839**	**$ -**	**$ -**	**$ 4,047,348**	**$ 8,839**

Notes to Consolidated Financial Statements

2019	Less Than 12 Months Fair Value	Less Than 12 Months Gross Unrealized Loss	Over 12 Months Fair Value	Over 12 Months Gross Unrealized Loss	Total Fair Value	Total Gross Unrealized Losses
Securities available-for-sale						
U.S. Treasury and federal agency	$ -	$ -	$ 1,499,725	$ 220	$ 1,499,725	$ 220
Mortgage-backed securities	-	-	5,465,420	58,597	5,465,420	58,597
Collateralized mortgage obligations	3,309,840	24,644	676,286	6,547	3,986,126	31,191
States and municipal	594,892	495	259,704	297	854,596	792
Total securities available-for-sale	**$ 3,904,732**	**$ 25,139**	**$ 7,901,135**	**$ 65,661**	**$ 11,805,867**	**$ 90,800**

At December 31, 2020 and 2019, management conducted an analysis to determine whether all securities currently in an unrealized loss position should be considered other-than-temporarily-impaired ("OTTI"). Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Company will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

As of December 31, 2020, the Company's investment security portfolio consisted of 4 securities in an unrealized loss position. Because the decline in the market value is attributable to changes in interest rates, and not credit quality, and because management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Company will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2020.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial and industrial, commercial real estate, agricultural, residential construction, residential real estate and consumer and other loans to customers located primarily in the Sanilac, Lapeer, Macomb, St. Clair, and Tuscola counties of Michigan. The ability of the Bank's debtors to honor their contracts is dependent upon the real estate values and general economic conditions in this region. Substantially all of the consumer, agricultural, commercial real estate, and residential loans are secured by various items of property, while commercial and industrial loans are secured primarily by business assets and personal guarantees; a portion of loans are unsecured.

Loans are summarized by portfolio segment as follows at December 31:

	2020	2019
Commercial and industrial	$ 32,133,550	$ 18,551,483
Commercial real estate	133,024,274	124,018,036
Agricultural	72,527,871	75,162,700
Residential construction	5,798,046	7,075,558
Residential real estate	17,628,578	22,244,832
Consumer and other	3,881,218	4,344,905
Total loans	264,993,537	251,397,514
Allowance for loan losses	(2,413,427)	(2,018,385)
Loans, net	**$ 262,580,110**	**$ 249,379,129**

The changes in the allowance for loan losses and recorded investment in loans are as follows for the year ended December 31, 2020:

	Commercial and Industrial	Commercial Real Estate	Agricultural	Residential Construction	Residential Real Estate	Consumer and Others	Unallocated	Total
Allowance for loan losses:								
Balance at beginning of year	$ 212,243	$ 1,063,498	$ 468,299	$ 48,553	$ 166,223	$ 41,997	$ 17,572	$ 2,018,385
Provision for loan losses	139,812	305,785	249,113	184,960	(536)	273	(17,572)	861,835
Loans charged off	(98,565)	(155,063)	(105,498)	(123,290)	-	(433)	-	(482,849)
Recoveries	-	690	-	-	15,366	-	-	16,056
Balance at end of year	$ 253,490	$ 1,214,910	$ 611,914	$ 110,223	$ 181,053	$ 41,837	$ -	$ 2,413,427
Allowance for loan losses attributable to:								
Individually evaluated for impairment	$ -	$ -	$ -	$ 14,350	$ 13,035	$ -	$ -	$ 27,385
Collectively evaluated for impairment	253,490	1,214,910	611,914	95,873	168,018	41,837	-	2,386,042
Total allowance for loan losses	$ 253,490	$ 1,214,910	$ 611,914	$ 110,223	$ 181,053	$ 41,837	$ -	$ 2,413,427
Recorded investment in loans:								
Individually evaluated for impairment	$ 378,942	$ 545,367	$ 184,475	$ 282,665	$ 178,642	$ -		$ 1,570,091
Collectively evaluated for impairment	31,754,608	132,478,907	72,343,396	5,515,381	17,449,936	3,881,218		263,423,446
Total loans ending balance	32,133,550	133,024,274	72,527,871	5,798,046	17,628,578	3,881,218		264,993,537
Accrued interest receivable	141,222	571,640	1,430,207	13,660	62,329	16,145		2,235,203
Total recorded investment in loans	$ 32,274,772	$ 133,595,914	$ 73,958,078	$ 5,811,706	$ 17,690,907	$ 3,897,363		$ 267,228,740

The changes in the allowance for loan losses and recorded investment in loans are as follows for the year ended December 31, 2019:

	Commercial and Industrial	Commercial Real Estate	Agricultural	Residential Construction	Residential Real Estate	Consumer and Others	Unallocated	Total
Allowance for loan losses:								
Balance at beginning of year	$ 169,640	$ 842,484	$ 460,331	$ 52,413	$ 314,606	$ 41,274	$ 1,561	$ 1,882,309
Provision for loan losses	42,603	221,014	7,968	30,142	(150,834)	7,096	16,011	174,000
Loans charged off	-	-	(5,030)	(34,002)	-	(6,373)	-	(45,405)
Recoveries	-	-	5,030	-	2,451	-	-	7,481
Balance at end of year	$ 212,243	$ 1,063,498	$ 468,299	$ 48,553	$ 166,223	$ 41,997	$ 17,572	$ 2,018,385
Allowance for loan losses attributable to:								
Individually evaluated for impairment	$ -	$ 119,013	$ 4,905	$ -	$ 12,642	$ -	$ -	$ 136,560
Collectively evaluated for impairment	212,243	944,485	463,394	48,553	153,581	41,997	17,572	1,881,825
Total allowance for loan losses	$ 212,243	$ 1,063,498	$ 468,299	$ 48,553	$ 166,223	$ 41,997	$ 17,572	$ 2,018,385
Recorded investment in loans:								
Individually evaluated for impairment	$ 73,243	$ 1,071,686	$ 1,878,913	$ -	$ 782,868	$ -		$ 3,806,710
Collectively evaluated for impairment	18,478,240	122,946,350	73,283,787	7,075,558	21,461,964	4,344,905		247,590,804
Total loans ending balance	18,551,483	124,018,036	75,162,700	7,075,558	22,244,832	4,344,905		251,397,514
Accrued interest receivable	12,507	543,168	1,498,072	19,669	86,659	19,410		2,179,485
Total recorded investment in loans	$ 18,563,990	$ 124,561,204	$ 76,660,772	$ 7,095,227	$ 22,331,491	$ 4,364,315		$ 253,576,999

Notes to Consolidated Financial Statements

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2020:

	Risk Rating				
	Pass	Special Mention (or Watch)	Substandard	Doubtful	Total
Commercial credit risk profile by risk rating					
Commercial and industrial	$ 31,582,016	$ -	$ 551,534	$ -	$ 32,133,550
Commercial real estate	132,000,070	395,267	628,937	-	133,024,274
Agricultural	70,827,684	1,096,319	603,868	-	72,527,871
Total	**$ 234,409,770**	**$ 1,491,586**	**$ 1,784,339**	**$ -**	**$ 237,685,695**

The following table shows the loans allocated by management's internal risk ratings as of December 31, 2019:

	Risk Rating				
	Pass	Special Mention (or Watch)	Substandard	Doubtful	Total
Commercial credit risk profile by risk rating					
Commercial and industrial	$ 18,478,240	$ -	$ 73,243	$ -	$ 18,551,483
Commercial real estate	122,550,987	395,363	1,071,686	-	124,018,036
Agricultural	72,751,519	1,071,969	1,339,212	-	75,162,700
Total	**$ 213,780,746**	**$ 1,467,332**	**$ 2,484,141**	**$ -**	**$ 217,732,219**

The following table shows homogeneous loans allocated by payment activity as of December 31, 2020:

	Consumer Credit Risk Profile by Payment Activity			
	Residential Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 5,515,381	$ 17,537,560	$ 3,881,218	$ 26,934,159
Non-performing	282,665	91,018	-	373,683
Total	**$ 5,798,046**	**$ 17,628,578**	**$ 3,881,218**	**$ 27,307,842**

Notes to Consolidated Financial Statements

The following table shows homogeneous loans allocated by payment activity as of December 31, 2019:

	Consumer Credit Risk Profile by Payment Activity			
	Residential Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 7,075,558	$ 21,686,226	$ 4,344,905	$ 33,106,689
Non-performing	-	558,606	-	558,606
Total	**$ 7,075,558**	**$ 22,244,832**	**$ 4,344,905**	**$ 33,665,295**

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2020:

		Accruing Interest			
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 31,800,662	$ 20,059	$ -	$ 312,829	$ 32,133,550
Commercial real estate	132,478,907	-	-	545,367	133,024,274
Agricultural	72,343,396	-	-	184,475	72,527,871
Residential construction	5,515,381	-	-	282,665	5,798,046
Residential real estate	17,287,415	250,145	-	91,018	17,628,578
Consumer and other	3,872,019	9,199	-	-	3,881,218
Total	**$ 263,297,780**	**$ 279,403**	**$ -**	**$ 1,416,354**	**$ 264,993,537**

The following table shows an aging analysis of the loan portfolio by time past due as of December 31, 2019:

		Accruing Interest			
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 18,133,233	$ 418,250	$ -	$ -	$ 18,551,483
Commercial real estate	123,033,433	-	-	984,603	124,018,036
Agricultural	75,030,004	73,046	-	59,650	75,162,700
Residential construction	7,075,558	-	-	-	7,075,558
Residential real estate	21,500,242	185,984	-	558,606	22,244,832
Consumer and other	4,335,909	8,996	-	-	4,344,905
Total	**$ 249,108,379**	**$ 686,276**	**$ -**	**$ 1,602,859**	**$ 251,397,514**

The following table presents information related to impaired loans as of December 31, 2020:

	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 378,942	$ 379,170	$ -	$ 381,448	$ 34,378
Commercial real estate	545,367	545,367	-	497,682	17,577
Agricultural	184,475	184,475	-	184,476	-
Residential construction	164,665	164,665	-	164,430	-
Residential real estate	91,018	139,337	-	115,851	5,121
Total	**1,364,467**	**1,413,014**	**-**	**1,343,887**	**57,076**
Loans with an allowance recorded					
Residential construction	118,000	118,000	14,350	118,000	-
Residential real estate	87,624	87,624	13,035	87,533	6,936
Total	**205,624**	**205,624**	**27,385**	**205,533**	**6,936**
Total impaired loans					
Commercial and industrial	378,942	379,170	-	381,448	34,378
Commercial real estate	545,367	545,367	-	497,682	17,577
Agricultural	184,475	184,475	-	184,476	-
Residential construction	282,665	282,665	14,350	282,430	-
Residential real estate	178,642	226,961	13,035	203,384	12,057
Total	**$ 1,570,091**	**$ 1,618,638**	**$ 27,385**	**$ 1,549,420**	**$ 64,012**

The following table presents information related to impaired loans as of December 31, 2019:

	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial and industrial	$ 73,243	$ 187,312	$ -	$ 75,692	$ 4,715
Commercial real estate	449,996	449,996	-	449,996	-
Agricultural	1,010,760	1,010,760	-	1,007,754	40,095
Residential real estate	577,427	577,427	-	578,829	7,163
Total	**2,111,426**	**2,225,495**	**-**	**2,112,271**	**51,973**
Loans with an allowance recorded					
Commercial real estate	621,690	621,690	119,013	620,493	6,537
Agricultural	868,153	868,153	4,905	868,173	33,942
Residential real estate	205,441	205,441	12,642	222,464	1,734
Total	**1,695,284**	**1,695,284**	**136,560**	**1,711,130**	**42,213**
Total impaired loans					
Commercial and industrial	73,243	187,312	-	75,692	4,715
Commercial real estate	1,071,686	1,071,686	119,013	1,070,489	6,537
Agricultural	1,878,913	1,878,913	4,905	1,875,927	74,037
Residential real estate	782,868	782,868	12,642	801,293	8,897
Total	**$ 3,806,710**	**$ 3,920,779**	**$ 136,560**	**$ 3,823,401**	**$ 94,186**

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

There were no loans modified in troubled debt restructurings during 2020 or 2019.

The Bank had one commercial real estate loan with a loan balance of $534,607 and a specific reserve of $106,744 that was a troubled debt restructure that defaulted during 2019. There were no TDRs that had payment defaults during 2020.

In late March 2020, the federal banking regulators issued guidance that modifications made to a borrower affected by the COVID-19 pandemic and governmental shutdown orders do not need to be identified as a TDR if the loan was current at the time a modification plan was implemented. Section 4013 of the CARES Act also addressed COVID-19 related modifications and specified that such modifications made on loans that were current as of December 31, 2019 are not TDRs. At December 31, 2020, there were no such loans still in their modification period. The Bank continues to follow the guidance issued by the banking regulators in making any TDR determinations.

5. SERVICING

The Bank services loans for others which generally consists of collecting mortgage payments, maintaining escrow accounts, disbursing payments to investors and taxing authorities, and processing foreclosures. Loans serviced as of December 31, 2020 and 2019, approximated $132,065,631 and $127,033,000, respectively; such loans are not included on the accompanying consolidated balance sheets.

The fair value of mortgage servicing rights was $1,207,816 and $1,315,477 at December 31, 2020 and 2019, respectively. The fair value of servicing rights was determined using discount rates of 2.32% and 5.50% at December 31, 2020 and 2019, respectively, and average prepayment speeds ranging from 11.2% to 32.9% and 10.6% to 16.6% at December 31, 2020 and 2019, respectively.

The following summarizes the carrying value and the changes therein of mortgage servicing rights included in other assets on the accompanying consolidated balance sheets at December 31:

	2020	2019
Mortgage servicing rights		
Balance at beginning of year	$ 694,808	$ 700,432
Mortgage servicing rights originated	494,281	227,319
Mortgage servicing rights amortized	(375,536)	(232,943)
Balance at end of year	**$ 813,553**	**$ 694,808**

There were no valuation allowances related to mortgage servicing rights as of December 31, 2020 and 2019.

6. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following components at December 31:

	2020	2019
Land	$ 2,006,858	$ 2,003,158
Buildings and improvements	6,521,568	6,467,768
Furniture and equipment	5,179,450	5,066,306
Total	13,707,876	13,537,232
Less accumulated depreciation	6,287,157	5,888,487
Premises and equipment, net	**$ 7,420,719**	**$ 7,648,745**

Depreciation expense was $401,820 and $342,652 for 2020 and 2019, respectively.

7. DEPOSITS

The following is a summary of the distribution of deposits at December 31:

	2020	2019
Interest-bearing		
Money market and NOW accounts	$ 80,731,719	$ 61,466,092
Savings	84,907,977	66,776,488
Time, $250,000 and over	4,424,586	3,157,929
Other time	38,577,955	50,434,416
Total interest-bearing	208,642,237	181,834,925
Noninterest-bearing demand	149,667,779	93,184,614
Total deposits	**$ 358,310,016**	**$ 275,019,539**

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2020, are summarized as follows:

Year	Amount
2021	$ 22,420,642
2022	7,578,739
2023	3,546,586
2024	3,837,205
2025	5,619,369
Total	**$ 43,002,541**

8. BORROWED FUNDS

At December 31, 2020, the Bank has approximately $9,700,000 available under a long-term line of credit with the Federal Home Loan Bank. Under the terms of this agreement, the Bank may borrow at a mutually agreed-upon interest rate at the time of borrowing. Outstanding borrowings amounted to $3,000,000 at a rate of 1.69%, due on November 22, 2021, at December 31, 2020 and 2019.

The Bank also has a $5,000,000 line-of-credit available from another financial institution. Under the terms of this agreement, the Bank may borrow at a mutually agreed upon interest rate at the time of the borrowing. No such borrowings were outstanding at December 31, 2020 and 2019.

9. FEDERAL INCOME TAXES

The provision for federal income taxes consists of the following components for the years ended December 31:

	2020	2019
Currently payable	$ 1,603,000	$ 1,188,000
Deferred expense	9,000	37,000
Income taxes	**$ 1,612,000**	**$ 1,225,000**

A reconciliation between income tax expense reported and the amount computed by applying the statutory federal income tax rate of 21% to income before income taxes is as follows for the years ended December 31:

	2020	2019
Income tax provision at statutory rate	$ 1,713,000	$ 1,311,000
Effect of tax-exempt interest income	(55,000)	(50,000)
Other - net	(46,000)	(36,000)
Income tax expense	**$ 1,612,000**	**$ 1,225,000**

Significant components of the Company's deferred income tax liability, included in accrued interest payable and other liabilities in the accompanying consolidated balance sheets, are comprised of the following amounts at December 31:

	2020	2019
Deferred tax assets		
Allowance for loan losses	$ 379,000	$ 198,000
Accrued vacation	20,000	14,000
Other	29,000	29,000
Total deferred tax assets	**428,000**	**241,000**
Deferred tax liabilities		
Premises and equipment	444,000	255,000
Mortgage servicing rights	171,000	146,000
Unrealized gain on available-for-sale securities	176,000	14,000
Intangible assets	57,000	71,000
Other	16,000	20,000
Total deferred tax liabilities	864,000	506,000
Net deferred tax liability	**$ (436,000)**	**$ (265,000)**

The Company concluded that there are no significant uncertain tax positions requiring recognition in these consolidated financial statements based on the evaluation performed for 2017 through 2020, the years which remain subject to examination by major tax jurisdictions as of December 31, 2020. The Company does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly change in the next 12 months. The Company does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2020 and 2019, and it is not aware of any claims for such amounts by federal or state income tax authorities.

10. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated approximately $1,798,000 and $2,164,000 at December 31, 2020 and 2019, respectively.

Deposits

Deposits of Company directors, executive officers and their affiliates were approximately $3,074,000 and $2,238,000 at December 31, 2020 and 2019, respectively.

11. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making commitments, including requirements for collateral, as it does for on-balance sheet instruments; no significant losses are anticipated as a result of these commitments.

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

	Contract Amount	
	2020	**2019**
Unfunded commitments under lines of credit	$ 33,246,000	$ 24,381,000
Commitments to grant loans	2,493,000	5,329,000
Commercial and standby letters of credit	218,000	191,500

Unfunded commitments under commercial lines of credit, revolving lines and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit may be uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2020 and 2019.

12. DERIVATIVE FINANCIAL INSTRUMENTS

Interest Rate Risk Management – Derivative Instruments Not Designated As Hedging Instruments

Certain derivative instruments do not meet the criteria for hedging requirements. These derivative instruments are generally recognized on the consolidated balance sheets at fair value, with changes in fair value recorded in other noninterest income.

Derivative Loan Commitments

Mortgage loan commitments are referred to as derivative loan commitments if the loan that will result from exercise of the commitment will be held for sale upon funding. The Bank enters into commitments to fund residential mortgage loans at specified times in the future, with the intention that these loans will subsequently be sold in the secondary market. A mortgage loan commitment binds the Bank to lend funds to a potential borrower at a specified interest rate and within a specified period of time, generally up to 60 days after inception of the rate lock.

Outstanding derivative loan commitments expose the Company to the risk that the price of the loans arising from exercise of the loan commitment might decline from inception of the rate lock to funding of the loan due to increases in mortgage interest rates. If interest rates increase, the value of these loan commitments decreases. Conversely, if interest rates decrease, the value of these loan commitments increases. The notional amount of mortgage loan commitments was overall insignificant at December 31, 2020 and 2019.

Forward Loan Sale Commitments

To protect against the price risk inherent in derivative loan commitments and mortgage loan held for sale, the Bank utilizes “best efforts” forward loan sale commitments to mitigate the risk of potential decreases in the values of loans that would result from the exercise of the derivative loan commitments.

With a “best efforts” contract, the Bank commits to deliver an individual mortgage loan of a specified principal amount and quality to an investor if the loan to the underlying borrower closes. Generally, the price the investor will pay the seller for an individual loan is specified prior to the loan being funded (e.g., on the same day the lender commits to lend funds to a potential borrower).

The Bank expects that these forward loan sale commitments will experience changes in fair value opposite to the change in fair value of derivative loan commitments. The notional amount of forward loan sale commitments was overall insignificant at December 31, 2020 and 2019.

The fair value of the rate lock loan commitments related to the origination of mortgage loans that will be held for sale and the forward loan sale commitments are deemed insignificant by management and, accordingly, are not recorded in these consolidated financial statements.

13. REGULATORY REQUIREMENTS

Capital Requirements

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

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (CBLR framework), for qualifying community banking organizations, consistent with Section 201 of the *Economic Growth, Regulatory Relief, and Consumer Protection Act* . The final rule became effective on January 1, 2020 and was elected by the Bank as of December 31 , 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the *Coronavirus Aid, Relief, and Economic Security (CARES) Act* , and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the community bank leverage ratio framework and that maintain a leverage ratio of greater than required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the *Federal Deposit Insurance Act* . Under the interim final rules the community bank leverage ratio minimum requirement is 8% as of December 31 , 2020, 8.5% for calendar year 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the bank maintains a leverage ratio of 7% as of December 31 , 2020, 7.5% for calendar year 2021 , and 8% for calendar year 2022 and beyond.

Under the final rule, an eligible banking organization can opt out of the CBLR framework and revert back to the risk-weighting framework without restriction. As of December 31, 2020, the Bank was a qualifying community banking organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

Notes to Consolidated Financial Statements

Actual and required capital amounts (in thousands) and ratios are presented below at year end.

December 31, 2020	Actual		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio
(Dollars in thousands)				
Tier 1 (Core) Capital to Average Assets				
Tri-County Bank	$ 45,870	11.77%	$ 31,188	8.00%

December 31, 2019	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total Capital to Risk Weighted Assets	$ 41,705	16.48%	$ 26,572	10.50%	$ 25,307	10.00%
Tier 1 (Core) Capital to Risk Weighted Assets	39,687	15.68	21,511	8.50	20,245	8.00
Common Tier 1 (CET1)	39,687	15.68	17,715	7.00	16,449	6.50
Tier 1 Capital to Average Assets	39,687	12.41	12,795	4.00	15,994	5.00

Restrictions on Cash and Amounts Due from Banks

The Bank is required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2020 or 2019.

Restrictions on Dividends, Loans and Advances

Federal and state banking regulations place certain restrictions on the amount of loans or advances that can be extended to the Company by the Bank and dividends that can be paid to the Company by the Bank. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10% of the Bank's capital stock and surplus on a secured basis. In addition, dividends paid by the Bank to the Company would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements.

14. CONTINGENCIES

Litigation

The Company is party to litigation arising during the normal course of business. In the opinion of management, based on consultation with legal counsel, the resolution of such litigation is not expected to have a material effect on the consolidated financial statements.

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Company is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2020.

15. EMPLOYEE BENEFIT PLANS

ESOP Plan

The Company has a noncontributory, internally leveraged employee stock ownership plan (“ESOP”) covering substantially all of its employees. It is the Company’s intent for the ESOP to invest in Tri-County Bancorp, Inc. common stock. The ESOP owned 141,484 shares of Tri-County Bancorp, Inc. common stock at both December 31, 2020 and 2019. Discretionary cash contributions to the Plan are recorded as compensation expense and was approximately $606,000 and $549,000 in 2020 and 2019, respectively. Distributions from the Plan may be in the form of whole shares of stock, cash, or a combination of both, based on the estimated fair value of the stock on the date of distribution. The employer contribution is allocated to each participant based on the adjusted compensation of each participant, defined as the total taxable salary or wages plus the amount of any salary reduction contributions to the 401(k) plan and any deferrals made to an Internal Revenue Code Section 125 Cafeteria Plan. The aggregate fair value of the shares allocated to the Plan as of December 31, 2020 and 2019, was approximately $9,202,000 and $8,725,000, respectively; such shares were included in the computation of dividends in each of the respective years.

On September 30, 2016, the Company loaned the ESOP $859,384 in order for the ESOP to repurchase 24,208 shares. This repurchase was funded with cash from an employer loan made by the Company to the ESOP. Unreleased shares are reported as unearned ESOP compensation in the accompanying consolidated balance sheets. As repayments are made, shares are released and allocated pro-rata to employees based on eligible compensation. As shares are committed to be released, the Company reports compensation expense equal to the average fair value of the shares as determined by an independent valuation.

The ESOP shares are as follows at December 31:

	2020	2019
Allocated shares	136,642	131,801
Unreleased shares	4,842	9,683
Total ESOP shares	**141,484**	**141,484**
Fair value of unreleased shares	**$ 326,088**	**$ 641,028**

401(k) Plan

The Bank sponsors a defined contribution savings plan qualified under Section 401(k) of the Internal Revenue Code. Substantially all full-time employees of the Bank are covered under the Plan. The Bank matches the employee contributions equally up to 5% of the participant's compensation. Contributions to the Plan were $100,823 and $74,519, respectively in 2020 and 2019.

16. SHARE-BASED COMPENSATION

Share-based compensation expense related to employee stock options is measured on the grant date, based on the fair value of the award calculated at that date, and is recognized over the employee's requisite service period, which generally is the options' vesting period. Fair value is calculated using the Black-Scholes option pricing model.

Under the Company's Employee Stock Option Plan, the Company may grant options to its directors, officers and employees for the purchase of up to a maximum lifetime limit of 10,000 shares of common stock per participant, and up to a maximum of 150,000 shares under this plan. The exercise of each option equals the market price of the Company's stock on the date of grant and an option's maximum term is ten years. The options are immediately vested upon grant date.

The expected volatility is based on the historical volatility of American Community Bankers' Association Index. The risk-free interest rates for periods within the contractual life of the awards are based on the U.S. Treasury yield curve in effect at the time of the grant. The expected term is based on historical exercise experience.

Prior to 2018, the Company's policy was to issue new shares upon performance of the Bank's return on average assets as defined in the Plan; during 2018 the Board of Directors elected to cease issuance of options in the future, therefore, no options were granted during 2019 or 2020. A summary of the changes in the status of the Company's stock option plan is presented below.

	Common Shares Subject to Option	Weighted Average Exercise Price	Average Remaining Contractual Term (years)
Outstanding at January 1, 2019	**4,650**	**$ 27.66**	**6.42**
Exercised	(1,900)	26.64	
Outstanding at December 31, 2019	2,750	28.36	5.73
Exercised	(800)	29.25	
Outstanding at December 31, 2020	**1,950**	**$ 28.00**	**4.62**

Of the options exercised in 2020, 100 shares of common stock were issued with the remaining 700 options exercised under a cashless option. As of December 31, 2020, 1,950 options under the plan are outstanding at a weighted average exercise price of $28.00 (range of $26.00 – $29.25), all of which are exercisable.

Of the options exercised in 2019, 1,150 shares of common stock were issued with the remaining 750 options exercised under a cashless option. As of December 31, 2019, 2,750 options under the plan were outstanding at a weighted average exercise price of $28.36 (range of $26.00 - $29.25), all of which were exercisable.

17. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flows Information

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	2020	2019
Interest	$ 1,457,242	$ 1,856,364
Income taxes	$ 1,998,500	$ 879,824

Non-Cash Investing Activities

Collateral repossessed on loans having carrying values in the amount of $449,863 and $233,669 on the date of transfer was transferred to foreclosed assets in 2020 and 2019, respectively.

18. REVENUE FROM CONTRACTS WITH CUSTOMERS

A description of the Company's revenue streams accounted for under ASC 606 follows:

The Company earns fees from its deposit customers for transaction-based fees, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance. The Company also earns interchange fees from debit and credit cardholder transactions conducted through merchant payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

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