COMMUNITY SHORES BANK CORPORATION

2019 ANNUAL REPORT

DECEMBER 31, 2019

Selected Financial Information

As of or For the Year-Ended December 31,	2019		2018		2017	
(dollars in thousands, except per share data)						
Results of Operations:						
Net interest income	$ 6,826		$ 6,695		$ 6,554	
Provision for loan losses	0		0		225	
Non-interest income	1,433		1,341		1,540	
Non-interest expense	7,254		7,052		7,051	
Income before income tax	1,005		984		818	
Income tax expense	242		79		1,801[1]	
Net income (loss)	763		905		(983)[1]	
Financial Condition:						
Total assets	202,168		185,074		184,651	
Loans held for sale	484		80		585	
Loans	153,507		147,229		147,913	
Allowance for loan losses	1,601		1,757		1,914	
Securities available for sale	19,794		14,074		14,931	
Deposits	181,489		165,698		165,334	
Repurchase agreements	0		0		1,128	
Subordinated debentures	4,500		4,500		4,500	
Total shareholders' equity	14,952		13,889		13,021	
Performance Ratios:						
Return (loss) on average assets	0.38	%	0.49	%	(0.50)[1]	%
Return (loss) on average shareholders' equity	5.26		6.74		(6.85)[1]	
Net interest margin	3.70		3.86		3.65	
Per Share Data:						
Earnings (loss) per share - basic	$ 0.19		$ 0.22		$ (0.24)[1]	
Earnings (loss) per share - diluted	0.19		0.22		(0.24)[1]	
Book value per share	3.63		3.38		3.17	
Capital Ratios of Bank:						
Tier 1 risk-based capital	11.47	%	11.29	%	10.56	%
Total risk-based capital	12.48		12.44		11.82	

[1] Includes a $1.4 million adjustment related to the enactment of the Tax Reform Act.

COMMUNITY SHORES BANK CORPORATION
Muskegon, Michigan

2019 ANNUAL REPORT

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
Community Shores Bank Corporation
Muskegon, Michigan

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Community Shores Bank Corporation, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Community Shores Bank Corporation as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Crowe LLP

Crowe LLP
Grand Rapids, Michigan
April 20, 2020

COMMUNITY SHORES BANK CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31, 2019 and 2018

	2019	2018
ASSETS		
Cash and due from financial institutions	$ 2,480,491	$ 4,993,403
Interest-bearing deposits in other financial institutions	15,488,890	7,696,839
Cash and cash equivalents	17,969,381	12,690,242
Term deposit	100,000	100,000
Securities available for sale (at fair value)	19,794,376	14,074,030
Loans held for sale	484,350	80,000
Loans	153,506,865	147,228,956
Less: Allowance for loan losses	1,601,235	1,756,708
Net loans	151,905,630	145,472,248
Federal Home Loan Bank stock (at cost)	300,500	300,500
Premises and equipment, net	8,084,383	8,321,604
Accrued interest receivable	463,299	454,443
Foreclosed assets	394,000	820,457
Other assets	2,672,283	2,760,050
Total assets	$ 202,168,202	$ 185,073,574
LIABILITIES AND SHAREHOLDERS' EQUITY		
Deposits		
Non-interest-bearing	$ 41,339,763	$ 41,826,339
Interest-bearing	140,149,416	123,871,809
Total deposits	181,489,179	165,698,148
Subordinated debentures	4,500,000	4,500,000
Accrued expenses and other liabilities	1,227,231	986,160
Total liabilities	187,216,410	171,184,308
Shareholders' equity		
Preferred stock, no par value: 1,000,000 shares authorized and none issued	0	0
Common stock, no par value: 9,000,000 shares authorized; 4,116,664 issued and outstanding at December 31, 2019 and 4,111,664 issued and outstanding at December 31, 2018	19,663,437	19,648,729
Accumulated deficit	(4,839,293)	(5,602,091)
Accumulated other comprehensive income (loss)	127,648	(157,372)
Total shareholders' equity	14,951,792	13,889,266
Total liabilities and shareholders' equity	$ 202,168,202	$ 185,073,574

See accompanying notes to consolidated financial statements.

COMMUNITY SHORES BANK CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

Years ended December 31, 2019 and 2018

	2019	2018
Interest and dividend income		
Loans, including fees	$ 8,108,111	$ 7,408,235
Securities available for sale (including FHLB dividends)	392,532	254,780
Other	293,891	210,294
Total interest and dividend income	8,794,534	7,873,309
Interest expense		
Deposits	1,731,502	963,834
Subordinated debentures	237,117	213,970
Other	3	870
Total interest expense	1,968,622	1,178,674
Net Interest Income	6,825,912	6,694,635
Provision for loan losses	0	0
Net Interest Income After Provision for Loan Losses	6,825,912	6,694,635
Non-interest income		
Service charges on deposit accounts	440,652	422,548
Debit card interchange	311,093	306,684
Net gain on sale of loans held for sale	144,511	172,888
Rental income	228,315	231,985
Other	308,674	207,391
Total non-interest income	1,433,245	1,341,496
Non-interest expense		
Salaries and employee benefits	4,264,353	4,198,474
Occupancy	645,172	635,452
Furniture and equipment	388,471	335,433
Data processing	515,956	544,621
Professional services	307,705	242,774
FDIC insurance	80,464	149,402
Other	1,052,243	945,655
Total non-interest expense	7,254,364	7,051,811
Income Before Income Tax Expense	1,004,793	984,320
Income tax expense	241,995	79,475
Net Income	$ 762,798	$ 904,845
Basic average shares outstanding	4,111,815	4,106,815
Diluted average shares outstanding	4,116,899	4,112,968
Basic earnings per share	$ 0.19	$ 0.22
Diluted earnings per share	$ 0.19	$ 0.22

See accompanying notes to consolidated financial statements.

COMMUNITY SHORES BANK CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2019 and 2018

	2019	2018
Net income	$ 762,798	$ 904,845
Other comprehensive income (loss):		
Unrealized holding gains (losses) on securities available for sale	$ 364,922	(59,627)
Less reclassification adjustments for realized gains recognized in net income[1]	(4,675)	0
Tax effect[2]	(75,227)	11,979
Total other comprehensive income (loss)	285,020	(47,648)
Comprehensive income	$ 1,047,818	$ 857,197

[1] Presented in non-interest income-other.

[2] Includes Income tax expense related to reclassification adjustments of $982 for 2019 and $0 for 2018.

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
December 31, 2019 and 2018

	Shares	Common Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balance at January 1, 2018	4,106,664	19,637,379	(6,506,936)	(109,724)	13,020,719
Restricted shares issued upon vesting	5,000				
Expense related to share-based compensation		11,350			11,350
Net income			904,845		904,845
Other comprehensive loss				(47,648)	(47,648)
Balance at December 31, 2018	4,111,664	19,648,729	(5,602,091)	(157,372)	13,889,266
Restricted shares issued upon vesting	5,000				
Expense related to share-based compensation		14,708			14,708
Net income			762,798		762,798
Other comprehensive income				285,020	285,020
Balance at December 31, 2019	4,116,664	$ 19,663,437	$ (4,839,293)	$ 127,648	$ 14,951,792

See accompanying notes to consolidated financial statements.

COMMUNITY SHORES BANK CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, 2019 and 2018

	2019	2018
Cash flows from operating activities		
Net income	$ 762,798	$ 904,845
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	0	0
Depreciation and amortization	398,341	330,309
Net amortization of securities	53,390	69,556
Net gain on sale of loans held for sale	(144,511)	(172,888)
Net gain on sale of premises and equipment	(500)	(7,300)
Net loss (gain) on sale of foreclosed assets	(8,916)	18,444
Net gain on sale of securities available for sale	(4,675)	0
Foreclosed asset impairment	113,500	151,080
Originations of loans held for sale	(8,898,800)	(6,525,050)
Proceeds from sales of loans held for sale	8,638,961	7,203,138
Share based compensation	14,708	11,350
Net change in:		
Accrued interest receivable and other assets	227,122	102,361
Accrued expenses and other liabilities	241,071	285,677
Net cash from operating activities	1,392,489	2,371,522
Cash flows (used in) from investing activities		
Activity in securities available for sale:		
Maturities, prepayments and calls	6,359,766	4,230,127
Purchases	(12,774,365)	(3,502,675)
Sales	1,005,785	0
Loan originations and payments, net	(6,656,820)	526,925
Additions to premises and equipment, net	(161,120)	(335,077)
Proceeds from the sale of premises and equipment	500	7,300
Proceeds from the sale of foreclosed assets	321,873	183,823
Net cash (used in) from investing activities	(11,904,381)	1,110,423
Cash flows from (used in) financing activities		
Net change in deposits	15,791,031	364,056
Net change in repurchase agreements	0	(1,127,603)
Net cash from (used in) financing activities	15,791,031	(763,547)
Net change in cash and cash equivalents	5,279,139	2,718,398
Beginning cash and cash equivalents	12,690,242	9,971,844
Ending cash and cash equivalents	$ 17,969,381	$ 12,690,242
Supplemental cash flows information:		
Cash paid during the period for interest	$ 1,709,841	$ 942,973
Transfers from loans to SBA receivable	223,438	0
Transfers from foreclosed assets to SBA receivable	0	10,856
Cash paid during the period for income taxes	10,000	32,000

See accompanying notes to consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of Community Shores Bank Corporation (the "Company") and its wholly-owned subsidiaries, Community Shores Financial Services ("CS Financial Services"), and Community Shores Bank (the "Bank"), and the Bank's wholly-owned subsidiary, Community Shores Mortgage Company (the "Mortgage Company") and the Mortgage Company's wholly-owned subsidiary, Berryfield Development, LLC ("Berryfield"), after elimination of all intercompany transactions and accounts.

NATURE OF OPERATIONS: The Company was incorporated on July 23, 1998 under Michigan law and is a bank holding company owning all of the common stock of the Bank. The Bank began operations on January 18, 1999 and is a Michigan banking corporation with depository accounts insured by the FDIC. The Bank provides a range of commercial and consumer banking services in West Michigan, primarily in Muskegon County, which includes the cities of Muskegon and North Muskegon, and Northern Ottawa County, which includes the cities of Grand Haven and Spring Lake. Those services reflect the Bank's strategy of serving small to medium-sized businesses, and individual customers in its market area. Services for businesses include traditional business accounts and both commercial and commercial real estate loans. At year-end 2019, the loan portfolio was 39% commercial and 47% commercial real estate. The remaining 14% of the portfolio is more retail oriented and consists of residential real estate and consumer loans.

The Mortgage Company was formed on March 1, 2002 by transferring a majority of the Bank's commercial and residential real estate loans at that date in exchange for 100% of the equity capital of the Mortgage Company. On the day of formation, the Mortgage Company commenced operations and became legally able to originate residential real estate loans. The Bank services the entire portfolio of loans held by the Mortgage Company pursuant to a servicing agreement. On December 31, 2019, the Bank dissolved the Mortgage Company after seeking and receiving regulatory approval. The Mortgage Company's assets were transferred to the Bank.

Berryfield is a limited liability company that was created in October 2010. The entity's sole purpose is to oversee the development and sale of vacant lots that have been foreclosed on by the Mortgage Company. Upon dissolution of the Mortgage Company on December 31, 2019, Berryfield became a subsidiary of the Bank.

In 2002, the Company formed CS Financial Services. The primary source of revenue for CS Financial Services is referral fee income from a local insurance agency, Lakeshore Employee Benefits. Lakeshore Employee Benefits offers, among other things, employer-sponsored benefit plans.

Community Shores Capital Trust I, ("the Trust") was formed in December 2004. The Company owns all of the common securities of this special purpose trust. The Trust is not consolidated because it is a variable interest entity and the Company is not the primary beneficiary. It exists solely to issue capital securities.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SUBSEQUENT EVENTS: The Company has evaluated subsequent events for recognition and disclosure through April 20, 2020, which is the date the consolidated financial statements were available to be issued (see Note 16 for further discussion of subsequent events).

USE OF ESTIMATES: To prepare consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the consolidated financial statements and the disclosures provided, and future results could differ.

CASH FLOW REPORTING: Cash and cash equivalents includes cash, demand deposits with other financial institutions, short-term investments (securities with daily put provisions), federal funds sold and interest-bearing time deposits with other financial institutions. Cash flows are reported net for customer loan and deposit transactions and short-term borrowings with maturities of one year or less.

TERM DEPOSITS: Term deposits are carried at cost.

SECURITIES: Securities are classified as held to maturity and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with unrealized holding gains and losses reported in other comprehensive income (loss). Interest income includes amortization or accretion of purchase premium or discount. Premiums and discounts on securities are amortized or accreted on the level yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are expected. Premiums are amortized to the call date when applicable. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Management evaluates securities for other-than-temporary impairment (“OTTI”) at least on a quarterly basis, and more frequently when the economic conditions warrant such evaluation.

In assessing OTTI losses, management considers: the length of time and extent that fair value has been less than cost, the financial condition and near term prospects of the issuer, and whether the Company has the intent to sell or is likely to be required to sell the security before its anticipated recovery (see Note 2).

LOANS HELD FOR SALE: Loans held for sale consisted of residential real estate loans at both year-end 2018 and 2019. Loans held for sale are reported at the lower of cost or fair value, on an aggregated basis. These loans are sold to outside investors with servicing released.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

LOANS: Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the principal balance outstanding, net of deferred loan fees and costs and an allowance for loan losses.

The loan portfolio consists of the following segments:

> Commercial- Loans to businesses that are sole proprietorships, partnerships, limited liability companies and corporations. These loans are for commercial, industrial, or professional purposes. The risk characteristics of these loans vary based on the borrower’s business and industry as repayment is typically dependent on cash flows generated from the underlying business.
>
> Commercial Real Estate- Loans to individuals or businesses that are secured by improved and unimproved vacant land, farmland, commercial real property, 1-4 family and multifamily residential properties, and all other conforming, nonresidential properties. Proceeds may be used for land acquisition, development or construction. These loans typically fall into two general categories: property that is owner occupied and income or investment property. Owner occupied commercial real estate loans typically involve the same risks as commercial and industrial loans, however, the underlying collateral is the real estate which is subject to changes in market value after the loan’s origination. Adverse economic events and changes in real estate market valuations generally describe the risks that accompany commercial real estate loans involving income or investment property. The ability of the borrower to repay tends to depend on the success of the underlying project or the ability of the borrower to sell or lease the property at certain anticipated values.
>
> Consumer- Term loans or lines of credit for the purchase of consumer goods, vehicles, or home improvement. The risk characteristics of the loans in this segment vary depending on the type of collateral but for the most part repayment is expected from an individual continuing to generate a cash flow that supports the calculated payment obligation. Secondary support could involve liquidation of collateral.
>
> Residential- Loans to purchase or refinance single family residences. The risks associated with this segment are similar to the risks for consumer loans as far as individual payment obligations, however, the underlying collateral is the real estate. Real estate is subject to changes in market valuation and can be unstable for a variety of reasons.

For all loan segments, interest income is accrued on the unpaid principal using the interest method assigned to the loan product and includes amortization of net deferred loan fees and costs over the loan term. Interest income is not reported when full loan repayment is in doubt. A loan is moved to non-accrual status when it is past due over 90 days unless the loan is well secured and in the process of collection. If a loan is not past due but deemed to be impaired it may also be moved to non-accrual status.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

These rules apply to loans in all segments. However, certain classes of loans in the consumer segment may be charged-off as opposed to moving to non-accrual status.

All interest accrued but not received for a loan placed on non-accrual is reversed against interest income at the time the loan is assigned non-accrual status. Payments received on such loans are applied to principal when there is doubt about recovering the full principal outstanding. Loans are eligible to return to accrual status after six months of timely payment and future payments are reasonably assured.

ALLOWANCE FOR LOAN LOSSES: The allowance for loan losses is a valuation allowance for probable incurred credit losses, increased by the provision for loan losses and from recoveries of previously charged-off loans and decreased by charge-offs of loans.

The allowance for loan loss analysis is performed monthly. Management's methodology consists of specific, general and unallocated components. The general component covers non-impaired loans and is based on historical loss experience adjusted for current economic 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 20 quarters. The historical loss experience is recalculated at the end of each quarter. This actual loss experience is supplemented with current economic factors based on the risks present for each portfolio segment. These current economic factors are also reassessed at the end of each quarter and 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; quality of loan review system; degree of oversight by the Board of Directors; national and local economic trends and conditions; industry conditions; competition and legal and regulatory requirements; and effects of changes in credit concentrations. There were no significant changes to this methodology in 2019.

For the commercial and commercial real estate portfolio segments, historical loss is tracked by loan grade. The Bank utilizes a numeric grading system for commercial and commercial real estate loans. Grades are assigned to each commercial and commercial real estate loan by assessing information about the specific borrower's situation and the estimated collateral values. The description of the loan grade criteria is included in Note 3.

Within the commercial and commercial real estate portfolios, there are classes of loans with like risk characteristics that are periodically segregated because management has determined that the historical losses or current factors are unique and ought to be considered separately from the entire segment.

For the consumer segment, historical loss experience is based on the actual loss history of the following three classes: general consumer loans, personal lines of credit, and home equity lines of credit. The level

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

of delinquencies and charge-off experienced directly impacts the general allocations to the consumer classes. Similar to the commercial segment, charge-off activity in the consumer segment has been lessening, thus reducing the calculated historical loss factor assigned to the general allocations.

For the residential segment, loss experience is not segregated by grades or classes. The level of delinquencies, charge-off experience, and direction of real estate values directly impacts the general allocations to the residential real estate segment. Similar to the commercial and consumer segments, charge-off activity in the residential segment has been lessening, thus reducing the calculated historical loss factor assigned to the general allocations.

Charge-off activity in each of the loan portfolio segments has been lessening which has been reducing the calculated historical loss factors assigned to the general loan allocation for each loan portfolio segment. Therefore, to maintain an adequate level of reserve, management has established a minimum loss factor unique to each loan portfolio segment. In periods with lower loss factor calculations, the greater of the minimum loss factor or the calculated loss factor will be used.

The specific component of the allowance for loan losses relates to loans that are individually classified as impaired. A loan is impaired when, based on current information and events, it is probable that the Bank will be unable to collect all amounts due according to the contractual terms of the loan agreement. Loans for which the terms have been modified resulting in a concession, and for which the borrower is experiencing financial difficulties, are considered troubled debt restructurings and are classified as impaired.

Factors considered by management in determining impairment include payment status and 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.

Any loan within a loan portfolio segment can be considered for individual impairment if it meets the above criteria. If a loan is impaired, a portion of the allowance for loan losses is allocated so that the loan is reported, net, at the present value of estimated future cash flows using the loan's existing rate or at the fair value of collateral if repayment is expected solely from the collateral. Troubled debt restructurings are separately identified for impairment disclosures and are measured at the present value of estimated future cash flows using the loan's effective rate at inception. If a troubled debt restructuring is considered to be a collateral dependent loan, the loan is reported, net, at the fair value of the collateral less estimated costs to sell.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Allocations of the allowance for loan losses may be made for specific loans and groups, but the entire allowance for loan losses is available for any loan that, in management's judgment, should be charged-off. Loan balances are generally charged against the allowance for loan losses when management believes the uncollectibility of a loan balance is confirmed. Statutorily, the Bank must charge-off any bad debt that reaches delinquency of 360 days. In the case of an impaired loan, management typically charges off any portion of the debt that is unsecured based on an internal analysis of future cash flows and or collateral.

The unallocated portion of the allowance for loan losses is an additional reserve for the uncertainty involved in the loan portfolio and credit risk factors that are not specific to an individual portfolio segment.

TRANSFERS OF FINANCIAL ASSETS: Transfers of financial assets, which include loan sales, are accounted for as sales when control over the assets has been relinquished. Control over transferred assets is deemed to be surrendered when the assets have been isolated from the Company, 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 the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

FEDERAL HOME LOAN BANK (FHLB) STOCK: The Bank is a member of the FHLB system. Members are required to own a certain amount of stock based on the level of borrowings and other factors. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends received are reported as interest and dividend income in the consolidated statements of income.

PREMISES AND EQUIPMENT: Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 5 to 40 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 3 to 7 years.

FORECLOSED ASSETS: Assets acquired through or instead of loan foreclosure are initially recorded at fair value less estimated selling cost when acquired, establishing a new cost basis. These assets are subsequently accounted for at the lower of cost or fair value less estimated costs to sell. If fair value declines subsequent to foreclosure, a direct write-down is recorded through non-interest expense-other in the consolidated statements of income. Operating costs after acquisition are expensed to non-interest expense-other in the consolidated statements of income.

LONG-LIVED ASSETS: Premises and equipment and other long-term assets are reviewed for impairment when events indicate their carrying amount may not be recoverable from future undiscounted cash flows. If impaired, the assets are written down to fair value.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

SHARE BASED COMPENSATION: Compensation cost is recognized for stock based compensation awards issued to employees, based on the fair value of these awards at the date of grant. A Black-Scholes model is utilized to estimate the fair value of stock options, while the market price of the Company's common stock at the date of grant is used for restricted stock awards. Compensation cost is recognized over the required service period, generally defined as the vesting period. For awards with graded vesting, compensation cost is recognized on a straight-line basis over the requisite service period for the entire award.

INCOME TAXES: Income tax expense is the total of the current year income tax due or refundable and the change in certain deferred tax assets and liabilities. Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between carrying amounts and tax basis of assets, liabilities and net operating loss carry-forwards, computed using enacted tax rates.

Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized.

A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded.

The Company is subject to examinations of federal taxing authorities for years after 2016. The Company recognizes interest and/or penalties related to income tax matters in income tax expense, but did not have any amounts accrued for interest and penalties at either December 31, 2019 or 2018.

OFF-BALANCE SHEET FINANCIAL INSTRUMENTS: Financial instruments include off-balance sheet credit instruments, such as commitments to make loans and standby letters of credit, issued to meet customer financing needs. The face amount for these items represents the exposure to loss, before considering customer collateral or ability to repay. Such financial instruments are recorded when they are funded. Standby letters of credit are considered guarantees and are recorded at fair value at inception.

EARNINGS PER COMMON SHARE: Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share include the dilutive effect of additional potential common shares issuable under share based compensation. On December 20, 2016, the Board granted 30,000 shares of restricted stock. Since that time, 5,000 shares were forfeited and three tranches of 5,000 have vested and been issued. On May 22, 2019, the Board granted 5,000 shares of restricted stock to a senior officer of the Bank. The vesting period varies slightly with 2,000 shares vesting at the first anniversary date and 1,000 shares vesting annually thereafter.

These shares were considered in computing basic earnings per share. The weighted average of the restricted, unvested shares was considered in computing diluted earnings per share.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

COMPREHENSIVE INCOME: Comprehensive income consists of net income and other comprehensive income, net of income taxes. The Company's other comprehensive income includes unrealized gains and losses on securities available for sale, which is also recognized as a separate component of shareholders' equity.

LOSS CONTINGENCIES: Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not currently believe there are such matters outstanding that will have a material effect on the consolidated financial statements.

RESTRICTIONS ON CASH: The Bank was required to have $2,021,000 of cash on hand, or on deposit, with the Federal Reserve Bank to meet regulatory reserve and clearing requirements at year-end 2019 and $1,941,000 at year-end 2018.

DIVIDEND RESTRICTIONS: Holders of the Company's common stock are entitled to receive dividends that the Board of Directors may declare from time to time. The Company may only pay dividends out of funds that are legally available for that purpose. The Company's ability to pay dividends to its shareholders depends primarily on the Bank's ability to pay dividends to the Company. Dividend payments and extensions of credit to the Company from the Bank are subject to legal and regulatory limitations, generally based on capital levels and current and retained earnings.

In addition, under the terms of the subordinated debentures, the Company is precluded from paying dividends on its common stock because the Company exercised its right to defer payments of interest on the subordinated debentures on April 27, 2016. The terms of the subordinated debentures, the trust preferred securities and the agreements under which they were issued, give the Company the right, from time to time, to defer payment of interest for up to 20 consecutive quarters. During the deferral period, the indenture under which the subordinated debentures were issued prohibits the Company from declaring or paying any dividends or distributions on, or redeeming, purchasing, acquiring or making any liquidation payment with respect to, any shares of its common stock.

FAIR VALUE OF FINANCIAL INSTRUMENTS: Fair value of financial instruments is estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates.

ADOPTION OF NEW ACCOUNTING STANDARDS: In February 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-02, *Leases*, to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing essential information about leasing transactions. For public business entities, the new standard was effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Company owns all of its branch locations and does not rent any of its equipment so the impact of the adoption of this ASU on January 1, 2019 did not have a material impact on the Company's consolidated financial position or the results of operations.

In March 2017, the FASB issued ASU No. 2017-08, *Premium Amortization on Purchased Callable Debt Securities*. This ASU requires the premium to be amortized to the earliest call date. The amendments do not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. Previously, entities were required to amortize to the contractual maturity date. For public business entities this ASU is effective for annual reporting periods beginning after December 15, 2018, and early adoption was permitted. The Company adopted this ASU on January 1, 2019 and the adoption of this guidance was not material to the Company's financial position or results of operations.

Other issued accounting standards were reviewed and management has concluded that none apply or are material to the Company's consolidated financial statements.

RECLASSIFICATION: Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or total shareholders' equity.

NOTE 2 – SECURITIES AVAILABLE FOR SALE

The following tables represent the securities held in the Company's portfolio at December 31, 2019 and 2018:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
2019				
US Treasury	$ 0	$ 0	$ 0	$ 0
US Government and federal agency	7,484,882	57,263	(109)	7,542,036
Municipals	810,977	2,022	(2,440)	810,559
Mortgage-backed and collateralized mortgage obligations– residential	8,379,475	52,911	(25,055)	8,407,331
Other	2,958,000	76,450	0	3,034,450
	$ 19,633,334	$ 188,646	$ (27,604)	$ 19,794,376
2018				
US Treasury	$ 1,997,038	$ 0	$ (13,679)	$ 1,983,359
US Government and federal agency	6,509,012	978	(50,997)	6,458,993
Municipals	0	0	0	0
Mortgage-backed and collateralized mortgage obligations– residential	5,767,185	11,516	(147,023)	5,631,678
Other	0	0	0	0
	$ 14,273,235	$ 12,494	$(211,699)	$ 14,074,030

NOTE 2 – SECURITIES AVAILABLE FOR SALE (Continued)

Proceeds from sales of securities in 2019 totaled $1,005,785 resulting in a realized gain of $4,675 and no realized loss. No securities were sold in 2018.

The amortized cost and fair value of the securities portfolio are shown by expected maturity. Expected maturities may differ from contractual maturities if borrowers have the right to call or prepay obligations with or without call or prepayment fees. Below is the schedule of contractual maturities for securities held at December 31, 2019:

2019	Amortized Cost	Fair Value
Due in one year or less	$ 1,500,336	$ 1,500,425
Due from one to five years	9,753,523	9,886,620
Thereafter	0	0
Mortgage-backed and collateralized mortgage obligations – residential	8,379,475	8,407,331
	$ 19,633,334	$ 19,794,376

Below is the table of securities with unrealized losses, aggregated by investment category and length of time such securities were in an unrealized loss position at December 31, 2019 and 2018:

	Less than 12 Months		12 Months or Longer		Total	
2019	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury	$ 0	$ 0	$ 0	$ 0	$ -	$ -
US Government and federal agency	0	0	999,746	(109)	999,746	(109)
Municipals	397,560	(2,440)	0	0	397,560	(2,440)
Mortgage-backed and collateralized mortgage obligations - residential	1,390,561	(6,489)	1,482,618	(18,566)	2,873,179	(25,055)
Other	0	0	0	0	0	0
	$ 1,788,121	$ (8,929)	$ 2,482,364	$ (18,675)	$ 4,270,485	$ (27,604)

NOTE 2 – SECURITIES AVAILABLE FOR SALE (Continued)

	Less than 12 Months		12 Months or Longer		Total	
2018	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury	$ 0	$ 0	$ 1,983,359	$ (13,679)	$ 1,983,359	$ (13,679)
US Government and federal agency	999,979	(886)	2,956,251	(50,111)	3,956,230	(50,997)
Municipals	0	0	0	0	0	0
Mortgage-backed and collateralized mortgage obligations - residential	0	0	4,872,254	(147,023)	4,872,254	(147,023)
Other	0	0	0	0	0	0
	$ 999,979	$ (886)	$ 9,811,864	$(210,813)	$ 10,811,843	$(211,699)

Other-Than-Temporary-Impairment

Management evaluates securities for OTTI at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. In determining OTTI, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the Company has the intent to sell the security or more likely than not will be required to sell the security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment and is based on the information available to management at a point in time.

When OTTI occurs, the amount of the OTTI recognized in earnings depends on whether an entity intends to sell the security or it is more likely than not it will be required to sell the security before recovery of its amortized cost basis, less any current-period credit loss.

The issuers of the Company’s securities are of generally high credit quality and because the Company does not have the intent to sell these securities and it is likely that it will not be required to sell the securities before their anticipated recovery, the Company does not consider these securities to be other-than-temporarily impaired at December 31, 2019 and no unrealized losses have been recognized into income.

At year-end 2019 and 2018, there were no holdings of securities of any one issuer, other than the U.S. Government and its agencies, in an amount greater than 10% of shareholders’ equity.

There were no securities pledged at year-end 2019 or 2018.

NOTE 3 - LOANS

Outstanding loan balances by portfolio segment and class at December 31, 2019 and 2018 were as follows:

	2019	2018
Commercial	$ 59,855,158	$ 54,512,341
Commercial real estate:		
General	70,419,976	64,691,418
Construction	2,260,083	3,896,001
Consumer:		
Lines of credit	5,135,491	5,675,696
Other	1,080,660	1,047,055
Residential	14,801,416	17,474,243
Net deferred loan fees	(45,919)	(67,798)
	153,506,865	147,228,956
Less: Allowance for loan losses	(1,601,235)	(1,756,708)
Net Loans	$ 151,905,630	$ 145,472,248

NOTE 3 - LOANS (Continued)

The following tables present the activity in the allowance for loan losses for the years ending December 31, 2019 and 2018 by portfolio segment:

December 31, 2019	Commercial	Commercial real estate	Consumer	Residential	Unallocated	Total
Allowance for loan losses:						
Beginning balance	$ 579,589	$ 746,943	$ 188,997	$ 133,651	$ 107,528	$ 1,756,708
Charge-offs	(164,464)	0	(24,622)	0	0	(189,086)
Recoveries	3,524	0	30,089	0	0	33,613
Provision for loan losses	46,947	(38,226)	(25,017)	(6,047)	22,343	0
Ending balance	$ 465,596	$ 708,717	$ 169,447	$ 127,604	$ 129,871	$ 1,601,235

December 31, 2018	Commercial	Commercial real estate	Consumer	Residential	Unallocated	Total
Allowance for loan losses:						
Beginning balance	$ 623,445	$ 835,318	$ 190,117	$ 148,448	$ 116,835	$ 1,914,163
Charge-offs	(41,871)	(178,282)	(22,241)	0	0	(242,394)
Recoveries	5,241	56,112	23,586	0	0	84,939
Provision for loan losses	(7,226)	33,795	(2,465)	(14,797)	(9,307)	0
Ending balance	$ 579,589	$ 746,943	$ 188,997	$ 133,651	$ 107,528	$ 1,756,708

NOTE 3 – LOANS (Continued)

The following tables present the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment based on impairment method as of December 31, 2019 and 2018:

2019	Commercial	Commercial real estate	Consumer	Residential	Unallocated	Total
Allowance for loan losses:						
Ending balance attributable to loans:						
Individually evaluated for impairment	$ 22,890	$ 220,851	$ 66,758	$ 18,646	$ 0	$ 329,145
Collectively evaluated for impairment	442,706	487,866	102,689	108,958	0	1,142,219
Unallocated	0	0	0	0	129,871	129,871
Total ending allowance for loan losses balance	$ 465,596	$ 708,717	$ 169,447	$ 127,604	$ 129,871	$ 1,601,235
Loans:						
Individually evaluated for impairment	$ 356,050	$ 5,612,192	$ 88,267	$ 540,452	$ 0	$ 6,596,961
Collectively evaluated for impairment	59,642,639	67,197,510	6,150,040	14,303,213	0	147,293,402
Total ending loans balance	$ 59,998,689	$ 72,809,702	$ 6,238,307	$ 14,843,665	$ 0	$ 153,890,363

2018	Commercial	Commercial real estate	Consumer	Residential	Unallocated	Total
Allowance for loan losses:						
Ending balance attributable to loans:						
Individually evaluated for impairment	$ 197,170	$ 298,462	$ 67,304	$ 0	$ 0	$ 562,936
Collectively evaluated for impairment	382,419	448,481	121,693	133,651	0	1,086,244
Unallocated	0	0	0	0	107,528	107,528
Total ending allowance for loan losses balance	$ 579,589	$ 746,943	$ 188,997	$ 133,651	$ 107,528	$ 1,756,708
Loans:						
Individually evaluated for impairment	$ 766,042	$ 5,983,703	$ 96,881	$ 506,285	$ 0	$ 7,352,911
Collectively evaluated for impairment	53,872,763	62,738,129	6,647,128	17,014,702	0	140,272,722
Total ending loans balance	$ 54,638,805	$ 68,721,832	$ 6,744,009	$ 17,520,987	$ 0	$ 147,625,633

NOTE 3 – LOANS (Continued)

The following tables present loans individually evaluated for impairment by class of loans as of December 31, 2019 and 2018. The recorded investment includes unpaid principal net of interest payments applied to principal (non-accrual loans only) as well as accrued interest receivable and net deferred loan fees. For purposes of this disclosure, the unpaid principal balance is not reduced for partial charge-offs.

2019	Recorded Investment	Unpaid Principal Balance	Related Allowance For Loan Losses	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance for loan losses recorded:						
Commercial	$ 323,780	$ 323,780	$ 0	$ 249,871	$ 0	$ 0
Commercial real estate:						
General	3,295,235	3,279,999	0	3,377,865	162,630	161,130
Construction	0	0	0	0	0	0
Consumer:						
Lines of credit	15,958	15,880	0	17,252	991	991
Other	0	0	0	0	0	0
Residential	435,088	466,185	0	481,202	18,130	18,130
Subtotal	$ 4,070,061	$ 4,085,844	$ 0	$ 4,126,190	$ 181,751	$ 180,251
With an allowance for loan losses recorded:						
Commercial	$ 32,270	$ 46,771	$ 22,890	$ 402,678	$ 1,040	$ 1,040
Commercial real estate:						
General	2,316,957	2,491,257	220,851	2,386,982	40,460	40,460
Construction	0	0	0	0	0	0
Consumer:						
Lines of credit	59,854	59,534	54,365	60,709	4,161	4,154
Other	12,455	12,393	12,393	14,193	968	968
Residential	105,364	114,814	18,646	16,859	0	0
Subtotal	$ 2,526,900	$ 2,724,769	$ 329,145	$ 2,881,421	$ 46,629	$ 46,622
Total	$ 6,596,961	$ 6,810,613	$ 329,145	$ 7,007,611	$ 228,380	$ 226,873

NOTE 3 – LOANS (Continued)

2018	Recorded Investment	Unpaid Principal Balance	Related Allowance For Loan Losses	Average Recorded Investment	Interest Income Recognized	Cash Basis Interest Recognized
With no related allowance for loan losses recorded:						
Commercial	$ 188,790	$ 248,597	$ 0	$ 481,419	$ 573	$ 0
Commercial real estate:						
General	3,453,592	3,439,142	0	4,604,777	178,512	176,271
Construction	0	0	0	0	0	0
Consumer:						
Lines of credit	18,782	18,721	0	17,004	1,082	1,074
Other	0	0	0	0	0	0
Residential	506,285	546,831	0	461,212	16,983	16,983
Subtotal	$ 4,167,449	$ 4,253,291	$ 0	$ 5,564,412	$ 197,150	$ 194,328
With an allowance for loan losses recorded:						
Commercial	$ 577,252	$ 591,885	$ 197,170	$ 606,609	$ 398	$ 304
Commercial real estate:						
General	2,530,111	2,705,889	298,462	1,929,942	49,625	49,625
Construction	0	0	0	0	0	0
Consumer:						
Lines of credit	61,595	61,348	50,902	67,862	4,285	4,285
Other	16,504	16,402	16,402	16,594	1,160	1,160
Residential	0	0	0	0	0	0
Subtotal	$ 3,185,462	$ 3,375,524	$ 562,936	$ 2,621,007	$ 55,468	$ 55,374
Total	$ 7,352,911	$ 7,628,815	$ 562,936	$ 8,185,419	$ 252,618	$ 249,702

NOTE 3 – LOANS (Continued)

The following tables present the recorded investment in non-accrual and loans past due greater than 90 days still on accrual by class of loans as of December 31, 2019 and 2018:

	Non-Accrual		Loans Greater Than 90 Days Past Due Still Accruing	
	2019	2018	2019	2018
Commercial	$ 329,357	$ 591,932	$ 0	$ 0
Commercial real estate:				
General	1,423,066	1,346,379	0	0
Construction	0	0	0	0
Consumer:				
Lines of credit	0	0	0	0
Other	0	0	0	11,740
Residential	120,961	81,209	0	0
Total	$ 1,873,384	$ 2,019,520	$ 0	$ 11,740

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2019:

Accruing Loans	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Accruing Past Due Loans	Current Accruing Loans	Total Recorded Investment of Accruing Loans
Commercial	$ 0	$ 21,046	$ 0	$ 21,046	$ 59,648,286	$ 59,669,332
Commercial real estate:						
General	0	0	0	0	69,118,780	69,118,780
Construction	0	0	0	0	2,267,856	2,267,856
Consumer:						
Lines of credit	0	0	0	0	5,153,574	5,153,574
Other	0	822	0	822	1,083,911	1,084,733
Residential	0	0	0	0	14,722,704	14,722,704
Total	$ 0	$ 21,868	$ 0	$ 21,868	$ 151,995,111	$ 152,016,979

NOTE 3 – LOANS (Continued)

The following table presents the aging of the recorded investment in past due loans by class of loans as of December 31, 2018:

Accruing Loans	30-59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days Past Due	Total Accruing Past Due Loans	Current Accruing Loans	Total Recorded Investment of Accruing Loans
Commercial	$ 27,490	$ 0	$ 0	$ 27,490	$ 54,019,383	$ 54,046,873
Commercial real estate:						
General	99,304	0	0	99,304	63,372,078	63,471,382
Construction	0	0	0	0	3,904,071	3,904,071
Consumer:						
Lines of credit	0	8,824	0	8,824	5,684,211	5,693,035
Other	5,110	0	11,740	16,850	1,034,124	1,050,974
Residential	0	0	0	0	17,439,778	17,439,778
Total	$ 131,904	$ 8,824	$ 11,740	$ 152,468	$ 145,453,645	$ 145,606,113

NOTE 3 – LOANS (Continued)

Troubled Debt Restructurings:

The Company has $5,768,679 at December 31, 2019 of unpaid principal balance to customers whose loan terms have been modified in troubled debt restructurings. There are specific reserves of $306,922 allocated on $2,430,505 of the total; the remainder of the troubled debt restructurings has no specific reserve allocation. At December 31, 2018, the Company had $6,670,636 of unpaid principal on troubled debt restructurings. There were specific reserves of $554,267 allocated on $3,146,829 of the total with the remainder having no reserves.

During 2019, there were no new modifications.

During 2018, the terms of certain loans were modified as troubled debt restructurings. The modification of the terms of such loans included one or a combination of the following: a stated rate of interest lower than the current market rate for a new loan with similar risk; interest only payments on an amortizing note; a reduced payment amount which does not fully cover the interest; financing concessions; or a permanent reduction of the recorded investment in the loan.

In 2018, two loans with modifications received a modified payment structure for a range of 3 months to 7 years.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its loan obligations in the foreseeable future without the modification. This evaluation is performed utilizing the Company's internal underwriting policy.

NOTE 3 – LOANS (Continued)

The following table presents loans by class modified as troubled debt restructurings that occurred during the 12 month period ended December 31, 2018:

2018	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Current Balance
Troubled debt restructurings:				
Commercial	2	$ 20,027	$ 20,000	$ 19,798
Total	2	$ 20,027	$ 20,000	$ 19,798

Of the two loans modified during 2018, there were no charge-offs related to the troubled debt restructurings. There was an additional $19,798 of specific reserves established on these balances.

For both the 12 month periods ended December 31, 2019 and 2018, there were no troubled debt restructurings that experienced a payment default within 12 months following the modification.

Generally, a modified loan is considered to be in payment default when the borrower is not performing according to the renegotiated terms.

NOTE 3 – LOANS (Continued)

Credit Quality Indicators:

The Bank utilizes a numeric grading system for commercial and commercial real estate loans to indicate the strength of the credit. At origination, grades are assigned to each commercial and commercial real estate loan by assessing information about the specific borrower's situation including cash flow analysis and the estimated collateral values. The loan grade is reassessed at each renewal or amendment but any credit may receive a review based on lender identification of changes in the situation or behavior of the borrower. All commercial and commercial real estate loans exceeding $500,000 are formally reviewed at least annually. Once a loan is graded a 5M or greater number, and is over $100,000, the loan grade will be reanalyzed once a quarter. In addition to these methods for assigning loan grades, changes may occur through the external loan review or regulatory exam process. The loan grades are as follows:

1. Exceptional. Loans with an exceptional credit rating.
2. Quality. Loans with excellent sources of repayment that conform, in all respects, to Bank policy and regulatory requirements. These are loans for which little repayment risk has been identified.
3. Above Average. Loans with above average sources of repayment and minimal identified credit or collateral exceptions and minimal repayment risk.
4. Average. Loans with average sources of repayment that materially conform to Bank policy and regulatory requirements. Repayment risk is considered average.
5. Acceptable. Loans with acceptable sources of repayment and risk.

5M. Monitor. Loans considered to be below average quality. The loans are often fundamentally sound but require more frequent management review because of an adverse financial event. Risk of non-payment is elevated.

6. Special Mention. Loans that have potential weaknesses and deserve close attention. If uncorrected, further deterioration is likely. Risk of non-payment is above average.
7. Substandard. Loans that are inadequately protected by the borrower's capacity to pay or the collateral pledged. Risk of non-payment is high.
8. Doubtful. Loans in this grade have identified weaknesses that make full repayment highly questionable and improbable.

When a loan is downgraded to a nine, it is considered a loss and is charged-off.

NOTE 3 – LOANS (Continued)

As of December 31, 2019 and 2018, and based on the most recent analysis performed, the recorded investment by risk category and class of loans is as follows:

	Commercial		Commercial Real Estate General		Commercial Real Estate Construction	
	2019	2018	2019	2018	2019	2018
1	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
2	719,251	687,921	1,188,270	1,322,986	0	0
3	5,174,029	8,871,094	3,950,285	4,517,182	196,358	234,721
4	27,858,711	23,332,535	31,972,577	28,475,655	1,955,062	641,217
5	19,517,834	19,260,490	25,339,170	23,698,210	116,436	3,028,133
5M	5,015,350	476,347	2,653,219	1,191,344	0	0
6	1,366,914	1,277,679	2,536,945	2,508,335	0	0
7	17,381	141,226	1,477,795	1,757,151	0	0
8	329,219	591,513	1,423,585	1,346,898	0	0
Total	$ 59,998,689	$ 54,638,805	$ 70,541,846	$ 64,817,761	$ 2,267,856	$ 3,904,071

The Company considers the performance of the loan portfolio and its impact on the allowance for loan losses. For residential and consumer loan classes, the Company evaluates credit quality based on the aging status of the loan, which was previously presented and by payment activity. The following tables present the recorded investment in residential and consumer loans based on payment activity as of December 31, 2019 and 2018:

	Residential	
	2019	2018
Performing	$ 14,303,213	$ 17,014,702
Non-performing	540,452	506,285
Total	$ 14,843,665	$ 17,520,987

	Consumer – Lines of credit		Consumer – Other	
	2019	2018	2019	2018
Performing	$ 5,077,762	$ 5,612,658	$ 1,072,278	$ 1,034,470
Non-performing	75,812	80,377	12,455	16,504
Total	$ 5,153,574	$ 5,693,035	$ 1,084,733	$ 1,050,974

NOTE 4 – FORECLOSED ASSETS

Foreclosed asset activity for the year ended December 31:

	2019	2018
Beginning of year	$ 820,457	$ 1,184,660
Additions	0	0
Reductions from sales	(312,957)	(202,267)
Direct write-downs	(113,500)	(151,080)
Transfer to SBA receivable	0	(10,856)
End of year	$ 394,000	$ 820,457

Expenses related to foreclosed assets include:

	2019	2018
Operating expenses, net of rental income	$ 66,185	$ 49,604

A significant portion of the operating expenses is related to property taxes paid on the foreclosed assets. These amounts can vary from year-to-year depending on the number and types of foreclosed properties as well as the timing of the payments.

NOTE 5 - PREMISES AND EQUIPMENT, NET

Period end premises and equipment, net were as follows at December 31:

	2019	2018
Land & land improvements	$ 4,763,024	$ 4,763,024
Buildings & building improvements	6,391,400	6,355,744
Furniture, fixtures and equipment	3,359,826	3,253,324
	14,514,250	14,372,092
Less: accumulated depreciation	6,429,867	6,050,488
	$ 8,084,383	$ 8,321,604

Depreciation expense was $398,341 for 2019 and $330,309 for 2018.

In 2019, there were no premises or equipment that were subject to a lease agreement.

NOTE 6 - DEPOSITS

The components of the outstanding deposit balances at December 31, 2019 and 2018 were as follows:

	2019	2018
Non-interest-bearing DDA	$ 41,339,763	$ 41,826,339
Interest-bearing DDA	43,732,644	40,097,611
Money market	14,492,905	17,556,798
Savings	35,462,984	41,832,625
Certificates of deposit	46,460,883	24,384,775
	$ 181,489,179	$ 165,698,148

Time deposits of $250,000 or more were $10,860,409 at year-end 2019 and $1,667,558 at year-end 2018.

Scheduled maturities of certificates of deposits, as of December 31, 2019, were as follows:

2020	26,727,860
2021	15,843,433
2022	3,869,712
2023	1,105
Thereafter	18,773
	$ 46,460,883

NOTE 7 – FEDERAL HOME LOAN BANK AND OTHER BORROWINGS

The Bank had no borrowings outstanding at either year-end 2018 or 2019.

The Bank has borrowing resources through the Federal Home Loan Bank of Indianapolis (FHLB) and the Federal Reserve Discount Window

Through the Bank's membership with the FHLB and based on its current FHLB stock holdings and collateral, there was the capacity to borrow $3,010,629 at December 31, 2019. Each borrowing requires a direct pledge of securities and/or loans. To support potential borrowings with the FHLB, the Bank had residential real estate loans with a carrying value of $6,318,326 pledged at December 31, 2019 and $6,527,157 of residential real estate loans pledged at year-end 2018. The Bank uses a portion of these loans as collateral for the Bank's $2,000,000 overdraft line of credit. The remaining pledged loans are available to collateralize longer term FHLB borrowings. In 2019, the Company utilized its overdraft line of credit with the FHLB once. The FHLB line of credit was used three times during 2018.

At December 31, 2019, collateral pledged for Discount Window borrowings consisted of $5,480,988 of home equity and USDA commercial real estate loans. This collateral provides the Bank the ability to borrow $4,511,589 from this resource. There have been no borrowings from the Discount Window since January 2010.

NOTE 7 – FEDERAL HOME LOAN BANK AND OTHER BORROWINGS (Continued)

The Bank has overnight fed funds lines from two of its correspondent banks totaling $10 million but neither are collateralized.

NOTE 8 – SUBORDINATED DEBENTURES

The Trust, as discussed in Note 1, sold 4,500 Cumulative Preferred Securities ("trust preferred securities") at $1,000 per security in a December 2004 offering. The proceeds from the sale of the trust preferred securities were used by the Trust to purchase an equivalent amount of subordinated debentures from the Company. The trust preferred securities and subordinated debentures carry a floating rate of 2.05% over the 3-month LIBOR and was 4.01% at December 31, 2019 and 4.85% at December 31, 2018. The stated maturity is December 30, 2034. The trust preferred securities are redeemable at par value on any interest payment date and are, in effect, guaranteed by the Company. Interest on the subordinated debentures is payable quarterly on March 30th, June 30th, September 30th and December 30th. The Company is not considered the primary beneficiary of the Trust (under the variable interest entity rules), therefore the Trust is not consolidated in the Company's consolidated financial statements, rather the subordinated debentures are shown as a liability, and the interest expense is recorded on the Company's consolidated statement of income.

The terms of the subordinated debentures, the trust preferred securities and the agreements under which they were issued, give the Company the right, from time to time, to defer payment of interest for up to 20 consecutive quarters, unless certain specified events of default have occurred and are continuing. The deferral of interest payments on the subordinated debentures results in the deferral of distributions on the trust preferred securities.

On April 27, 2016, the Company's Board of Directors voted to again defer interest payments in order to preserve its cash for general operations and potential capital support for the Bank as it grows. The deferral of interest does not constitute an event of default. The Company exercised its option to defer regularly scheduled quarterly interest payments beginning with the quarterly interest payment that was scheduled to be paid on June 30, 2016. As of December 31, 2019, the accrued and unpaid interest owed on the subordinated debentures was $708,034. Accrued and unpaid interest owed on the subordinated debentures at December 31, 2018 was $470,918.

NOTE 9 - BENEFIT PLANS

The Company's 401(k) benefit plan allows employee contributions up to the dollar limit set by law which was $19,000 for 2019 and $18,500 for 2018. The Company may, at its discretion, make a matching contribution. The matching formula is 100% of the first 3% of compensation contributed and 50% of the next 3%. In 2019, the Company's matching expense resulted in a contribution of approximately $109,000. In 2018, the Company's matching expense resulted in a contribution of approximately $97,000.

NOTE 10- INCOME TAXES

The income tax expense was as follows:

	2019	2018
Current expense (benefit)	$ (19,008)	$ (61,159)
Deferred expense	261,003	140,634
Income tax expense	$ 241,995	$ 79,475

A reconciliation of the difference between income tax expense and the amount computed by applying the statutory rate of 21% is as follows:

	2019	2018
Income tax expense at statutory rate	$ 211,007	$ 206,707
Other	30,988	(127,232)
Income tax expense	$ 241,995	$ 79,475

The net deferred tax asset includes the following amounts of deferred tax assets and liabilities as of December 31, 2019 and 2018:

	2019	2018
Deferred tax asset		
Allowance for loan losses	90,611	90,611
Non-accrual loans	4,768	5,969
Deferred loan costs, net	9,643	14,238
Unrealized loss on securities available for sale	0	41,833
AMT credit carryforward	27,509	55,019
Accrued expenses (461h)	172,860	136,764
Foreclosed assets	299,065	540,721
Other	4,153	2,708
Net operating loss carryforward	1,365,429	1,387,278
	1,974,038	2,275,141
Deferred tax liabilities		
Depreciation	$ (109,700)	$ (109,851)
FHLB stock dividends	(4,181)	(4,181)
Prepaid expenses	(21,856)	(20,131)
Unrealized gain on securities available for sale	(33,819)	-
Other	(2,181)	(2,022)
	(171,737)	(136,185)
Net deferred tax asset	$ 1,802,301	$ 2,138,956

NOTE 10- INCOME TAXES (Continued)

The Company's net operating loss carryforward was $6.5 million at December 31, 2019 and $6.6 million at December 31, 2018. The net operating loss carryforward expires 2030-2036 and is expected to be fully utilized against future taxable income.

The realization of deferred tax assets is largely dependent upon future taxable income and future reversals of existing taxable temporary differences. In assessing the need for a valuation allowance, management considered the reduced tax rate, expected future taxable income and other positive and negative factors. Management concluded that no valuation allowance on the Company's net deferred tax asset was necessary at December 31, 2019 and 2018, respectively. At December 31, 2019, deferred tax assets include Alternative Minimum Tax (AMT) credits of $27,509, which under the new federal law, the Company expects to recover by 2022 via reduction of regular tax liability or refund.

There were no unrecognized tax benefits at December 31, 2019 or 2018 and the Company does not expect the total amount of unrecognized tax benefits to significantly increase or decrease in the next 12 months. The Company is no longer subject to examination by taxing authorities for years before 2016.

NOTE 11 – RELATED PARTY TRANSACTIONS

Loans and commitments to principal officers, directors and their affiliates at December 31 were as follows:

	2019	2018
Beginning balance	$ 3,459,910	$ 4,581,667
New loans and line advances	715,368	560,572
Net repayments	(119,099)	(1,682,329)
Ending balance	$ 4,056,179	$ 3,459,910

Deposits from principal officers, directors and their affiliates were $9,338,782 at year-end 2019 and $11,219,764 at year-end 2018.

NOTE 12 – SHARE-BASED COMPENSATION

The Company has one share-based compensation plan as described below. Total compensation cost that has been expensed for that plan was $14,708 for 2019 and $11,350 for 2018.

Stock Incentive Plan of 2016

Under the Stock Incentive Plan of 2016, incentive awards may include, but are not limited to stock options, restricted stock, restricted stock unit, stock appreciation rights and other stock-related awards.

NOTE 12 – SHARE-BASED COMPENSATION (Continued)

Incentive awards that are stock options or stock appreciation rights are granted with an exercise price not less than the closing price of our common stock on the date of grant. Price, vesting and expiration date parameters are determined by the Board or a committee of the Board on a grant by grant basis. There were 500,000 shares available for incentive awards upon adoption of the plan.

On December 20, 2016, the Board granted 30,000 shares of restricted stock. The restricted stock will vest over five years. In 2019, the Board granted 5,000 shares of restricted stock. There were no grants made in 2018. At year-end 2019, there were 465,000 shares available for future rewards.

A summary of the restricted stock activity in the plan for 2019 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Non-vested at beginning of year	15,000	$ 2.27
Granted	5,000	2.75
Vested/Issued	(5,000)	(2.27)
Forfeited	0	0.00
Non-vested at end of year	15,000	$ 2.43

NOTE 13 - CAPITAL REQUIREMENTS AND RESTRICTIONS ON RETAINED EARNINGS

Banks are subject to regulatory capital requirements administered by the federal banking agencies. Since the Company is a one-bank holding company with consolidated assets of less $500 million, regulatory minimum capital ratios are applied only to the Bank. Capital adequacy guidelines and prompt corrective action regulations involve quantitative measures of assets, liabilities, and certain off-balance-sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet various capital requirements can initiate regulatory action.

The five prompt corrective action classifications are well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. For instance, if a bank is not well capitalized, regulatory approval is required to accept brokered deposits. And generally, a bank may not make a capital distribution if, after making the distribution, it would be undercapitalized. If a bank is undercapitalized, it is subject to being closely monitored by its principal federal regulator, its asset growth and expansion are restricted, acquisitions, new activities, new branches, payment of dividends or management fees are prohibited and plans for capital restoration are required. In addition, further specific types of restrictions may be imposed on the Bank at the discretion of the federal regulator.

NOTE 13 - CAPITAL REQUIREMENTS AND RESTRICTIONS ON RETAINED EARNINGS (Continued)

Under final Basel III capital rules that became effective on January 1, 2015, there was a requirement for a capital conservation buffer of 2.5% of risk-weighted assets that was fully phased in on January 1, 2019. Including the capital conservation buffer, this will result in a minimum CET1 ratio of 7%, a minimum total capital to risk-weighted asset ratio of 10.5%, and a minimum Tier 1 capital to risk-weighted asset ratio of 8.5%. Banks that do not maintain this required capital conservation buffer will become subject to progressively more stringent limitations on the percentage of earnings that can be paid out in dividends or used for stock repurchases, and on the payment of discretionary bonuses to senior executive management. As of December 31, 2019, the capital conservation buffer was 2.50%.

At both year-end periods in 2019 and 2018, the Bank was considered well-capitalized according to prompt corrective action guidance.

Included in the tables below are the actual capital amounts and ratios for the Bank, excluding the capital conservation buffer and the required capital amounts and ratios for the Bank at both December 31, 2019 and 2018.

	Actual			Minimum Required For Capital Adequacy Purposes			Minimum Required to Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
2019									
Common Equity Tier 1 (CET1) to risk-weighted assets of the Bank	$ 18,336,850	11.47	%	$ 7,191,328	4.50	%	$ 10,387,474	6.50	%
Total Capital (Tier 1 and Tier 2) to risk-weighted assets of the Bank	19,938,085	12.48		12,784,584	8.00		15,980,730	10.00	
Tier 1 (Core) Capital to risk-weighted assets of the Bank	18,336,850	11.47		9,588,438	6.00		12,784,584	8.00	
Tier 1 (Core) Capital to average assets of the Bank	18,336,850	9.18		7,994,236	4.00		9,992,795	5.00	

NOTE 13 - CAPITAL REQUIREMENTS AND RESTRICTIONS ON RETAINED EARNINGS (Continued)

	Actual			Minimum Required For Capital Adequacy Purposes			Minimum Required to Be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount	Ratio		Amount	Ratio		Amount	Ratio	
2018									
Common Equity Tier 1 (CET1) to risk-weighted assets of the Bank	$ 17,159,597	11.29	%	$ 6,840,523	4.50	%	$ 9,880,756	6.50	%
Total Capital (Tier 1 and Tier 2) to risk-weighted assets of the Bank	18,916,305	12.44		12,160,931	8.00		15,201,163	10.00	
Tier 1 (Core) Capital to risk-weighted assets of the Bank	17,159,597	11.29		9,120,698	6.00		12,160,931	8.00	
Tier 1 (Core) Capital to average assets of the Bank	17,159,597	9.48		7,240,037	4.00		9,050,046	5.00	

In determining capital for the regulatory ratio calculations, FRB guidelines limit the amount of allowance for loan losses that can be included in Tier 2 capital. In general, only 1.25% of net risk-weighted assets are allowed to be included. At December 31, 2019, $1,601,235 was counted as Tier 2 capital and none was disallowed. Similarly, at December 31, 2018, $1,756,708 was counted as Tier 2 capital and none was disallowed.

NOTE 14 – OFF-BALANCE SHEET ACTIVITIES

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Risk of credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amount of unfunded financial instruments with off-balance sheet risk was as follows at December 31, 2019 and 2018:

	2019		2018	
	Fixed Rate	Variable Rate	Fixed Rate	Variable Rate
Unused lines of credit	$ 4,502,949	$ 24,744,380	$ 5,047,073	$ 23,436,883
Unused standby letters of credit	0	824,942	0	1,075,942
Commitments to make loans	0	255,000	8,452	415,000

Commitments to make loans are generally made for periods of 60 days or less.

NOTE 15 - FAIR VALUE MEASUREMENTS

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. There are three levels of inputs that may be used to measure fair value:

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

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate fair value:

Securities Available for Sale: The fair values of securities are obtained from a third party who utilizes quoted prices on nationally recognized securities exchanges (Level 1 inputs) or matrix pricing (Level 2 inputs), which is a mathematical technique used widely in the industry to value securities without relying exclusively on quoted prices for the specific securities but rather by relying on the securities’ relationship to other benchmark quoted securities. The Company did not have any securities with Level 3 inputs at either December 31, 2019 or 2018.

Impaired Loans: The method used to determine the valuation of impaired loans depends on the anticipated source of repayment. Collateral dependent impaired loans with specific allocations of the allowance for loan losses are measured using the fair value of the collateral which is generally based on recent real estate appraisals or internal evaluations. Management may add discounts to third party appraisals. The appraisals are generally obtained annually and are performed by qualified licensed appraisers approved by the Board of Directors. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. The comparable sales approach evaluates the sales price of similar properties in the same market area. This approach is inherently subjective due to the wide range of comparable sale dates. The income approach considers net operating income generated by the property and the investor’s required return. This approach utilizes various inputs including lease rates and cap rates which are subject to judgment. Such adjustments can be significant and result in a Level 3 classification of the inputs for determining fair value.

NOTE 15 - FAIR VALUE MEASUREMENTS (Continued)

Non-real estate collateral may be valued using appraisals, independent valuation tools or aging reports. To determine the fair value, these values are adjusted or discounted based on several factors, including but not limited to: the Bank's historical losses within that particular asset category; knowledge of the collateral, including age and condition; and changes in market conditions from the time of the valuation, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

Foreclosed Assets: Commercial and residential real estate properties classified as foreclosed assets are measured at fair value, less estimated costs to sell. Fair values are generally based on recent real estate appraisals or internal evaluations. Management may add discounts to third party appraisals. The appraisals are generally obtained annually and are performed by qualified licensed appraisers approved by the Board of Directors. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach. The comparable sales approach evaluates the sales price of similar properties in the same market area. This approach is inherently subjective due to the wide range of comparable sale dates. The income approach considers net operating income generated by the property and the investor's required return. This approach utilizes various inputs including lease rates and cap rates which are subject to judgment. Adjustments of the carrying amount utilizing this process result in a Level 3 classification.

NOTE 15 - FAIR VALUE MEASUREMENTS (Continued)

Assets measured at fair value on a recurring basis are summarized below for the years ended December 31, 2019 and 2018:

		Fair Value Measurements Using		
December 31, 2019	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Securities available for sale:				
US Treasury	$ 0	$ 0	$ 0	$ 0
US Government and federal agency	7,542,036	0	7,542,036	0
Municipals	810,559	0	810,559	0
Mortgage-backed and collateralized mortgage obligations– residential	8,407,331	0	8,407,331	0
Other	3,034,450	0	3,034,450	0
Total	$ 19,794,376	$ 0	$ 19,794,376	$ 0

December 31, 2018	Total	(Level 1)	(Level 2)	(Level 3)
Securities available for sale:				
US Treasury	$ 1,983,359	$ 1,983,359	$ 0	$ 0
US Government and federal agency	6,458,993	0	6,458,993	0
Mortgage-backed and collateralized mortgage obligations– residential	5,631,678	0	5,631,678	0
Total	$ 14,074,030	$ 1,983,359	$ 12,090,671	$ 0

There were no transfers between Level 1 and Level 2 securities during 2019 or 2018.

NOTE 15- FAIR VALUE MEASUREMENTS (Continued)

Assets measured at fair value on a non-recurring basis are summarized below for the period ended December 31, 2019 and 2018.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Impaired loans[1]:	$ 76,220	$ 0	$ 0	$ 76,220
Foreclosed assets:	252,000	0	0	252,000
Total	$ 328,220	$ 0	$ 0	$ 328,220

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2018				
Impaired loans[1]:	$ -	$ 0	$ 0	$ -
Foreclosed assets:	394,957	0	0	394,957
Total	$ 394,957	$ 0	$ 0	$ 394,957

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount of $94,866 at year end 2019, prior to a valuation allowance of $18,646 during the year-ending December 31, 2019. The valuation allowance did not cause additional loan loss in the year. In 2018, there were no collateral dependent loans that received a valuation allowance.

[1] Collateral dependent

NOTE 15 - FAIR VALUE MEASUREMENTS (Continued)

Foreclosed assets measured at fair value less estimated costs to sell still outstanding at December 31, 2019, had a net carrying amount of $252,000 after write-downs of $31,500 recorded during the year ended December 31, 2019. Foreclosed assets measured at fair value less estimated costs to sell still outstanding at December 31, 2018, had a net carrying amount of $394,957 after write-downs of $23,000 recorded during the year ended December 31, 2018.

The following table presents information as of December 31, 2019 about significant unobservable inputs related to the Bank's Level 3 financial assets measured on a non-recurring basis:

	Valuation Technique	Significant Unobservable Inputs	Range of Inputs	
December 31, 2019				
Impaired loans	Sales comparison approach	Adjustments for differences between comparable sales	(30)-25	%
	Income approach	Capitalization rate	9-10	%
Foreclosed assets	Sales comparison approach	Adjustments for differences between comparable sales	(35)-5	%

	Valuation Technique	Significant Unobservable Inputs	Range of Inputs	
December 31, 2018				
Foreclosed assets	Sales comparison approach	comparable sales	(50)-5	%

NOTE 15 - FAIR VALUE MEASUREMENTS (Continued)

The carrying amounts and estimated fair values of financial instruments, not previously presented above, were as follows at year-end:

	Carrying Amount	Fair Value Measurements at December 31, 2019 Using Level 1	Level 2	Level 3	Total
		(in thousands)			
Financial assets					
Cash and cash equivalents	$ 17,969	$ 17,969	$ 0	$ 0	$ 17,969
Term Deposit	100	0	100	0	100
Loans held for sale	484	0	493	0	493
Loans, net (including impaired)	151,906	0	0	152,644	152,644
FHLB stock	301	N/A	N/A	N/A	N/A
Accrued interest receivable	463	0	80	383	463
Financial liabilities					
Non-time deposits	$135,028	$135,028	$ 0	$ 0	$135,028
Time deposits	46,461	0	46,762	0	46,762
Subordinated debentures	4,500	0	0	4,699	4,699
Accrued interest payable	775	0	67	708	775

	Carrying Amount	Fair Value Measurements at December 31, 2018 Using Level 1	Level 2	Level 3	Total
		(in thousands)			
Financial assets					
Cash and cash equivalents	$ 12,690	$ 12,690	$ 0	$ 0	$ 12,690
Term Deposit	100	0	100	0	100
Loans held for sale	80	0	82	0	82
Loans, net (including impaired)	145,472	0	0	144,109	144,109
FHLB stock	301	N/A	N/A	N/A	N/A
Accrued interest receivable	454	5	53	396	454
Financial liabilities					
Non-time deposits	$141,313	$141,313	$ 0	$ 0	$141,313
Time deposits	24,385	0	24,211	0	24,211
Subordinated debentures	4,500	0	0	4,389	4,389
Accrued interest payable	516	0	45	471	516

NOTE 16 – SUBSEQUENT EVENTS (UNAUDITED)

ChoiceOne Financial Services, the parent company of ChoiceOne Bank, and Community Shores Bank Corporation, the parent company of Community Shores Bank, jointly announced on January 6, 2020, the signing of a definitive merger agreement pursuant to which Community Shores Bank Corporation will combine with ChoiceOne Financial Services in a merger. The agreement was approved by the board of directors of both companies.

Under the terms of the merger agreement, each share of Community Shores Bank Corporation common stock outstanding immediately prior to completion of the merger, at the election of each Community Shores shareholder, is an amount of cash equal to $5.00 or 0.17162 shares of ChoiceOne common stock, plus cash in lieu of any fractional share, in each case subject to the limitation that the total number of shares of Community Shores common stock to be converted into shares of ChoiceOne common stock will equal not less than 50% and not more than 75% of the total outstanding shares of Community Shores common stock as of the effective time of the merger. The transaction is valued at approximately $4.64 per share of Community Shores Bank Corporation common stock, or approximately $19 million in the aggregate, based on the closing price of ChoiceOne Financial Service's common stock of $24.99 per share on April 17, 2020.

Consummation of the proposed merger will require regulatory and shareholder approval and the merger is currently expected to be completed in July 2020.

In December 2019, a novel strain of coronavirus surfaced in Wuhan, China, and has spread around the world, with resulting business and social disruption. The coronavirus was declared a Public Health Emergency of International Concern by the World Health Organization on January 30, 2020. The operations and business results of the Company could be materially adversely affected. The extent to which the coronavirus may impact business activity or investment results will depend on future developments, which are highly uncertain and cannot be predicted, including new information which may emerge concerning the severity of the coronavirus and the actions required to contain the coronavirus or treat its impact, among others.

As a result of the Coronavirus, many government programs were instituted under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to support consumers and businesses. One program offered by the Small Business Association (SBA) is the Paycheck Protection Program (PPP). This program is a lending program designed to provide a direct incentive for small businesses to keep their workers on the payroll. Financial institutions across the country have been assisting their customers in applying for these funds. As of April 16, 2020, the Bank was able to get SBA approval for an estimated $23 million of these PPP loans for its customers. The PPP loans will be funded by the end of April 2020 utilizing a combination of the Bank's existing liquidity and its borrowing resources available under the CARES Act. Under this lending program, the SBA will forgive some or all of these PPP loan balances for business that follow specific program guidelines.

DIRECTORS AND OFFICERS

Community Shores Bank Corporation Board of Directors

Gary F. Bogner (Chairman, non-officer)	Real Estate Developer
Stanley L. Boelkins	Associate Broker, Capstone Real Estate LLC
Heather D. Brolick	President and Chief Executive Officer
Robert L. Chandonnet (Vice Chairman, non-officer)	Owner and President, The Nugent Sand Company, Inc.
Garth D. Deur	Former President and CEO, Lake Michigan Financial Corporation
Bruce J. Essex	Former Chairman, Port City Die Cast
Julie K. Greene	Chief Executive Officer, Muskegon Surgery Center

Executive Officers

Heather D. Brolick	President and Chief Executive Officer
Tracey A. Welsh	Senior Vice President / Chief Financial Officer, Secretary and Treasurer

DIRECTORS AND OFFICERS

Community Shores Bank Board of Directors

Gary F. Bogner (Chairman, non-officer)	Real Estate Developer
Stanley L. Boelkins	Associate Broker, Capstone Real Estate LLC
Heather D. Brolick	President and Chief Executive Officer
Robert L. Chandonnet (Vice Chairman, non-officer)	Owner and President, The Nugent Sand Company, Inc.
Garth D. Deur	Former President and CEO, Lake Michigan Financial Corporation
Bruce J. Essex	Former Chairman, Port City Die Cast
Julie K. Greene	Chief Executive Officer, Muskegon Surgery Center

Management Team

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Sherri S. Campbell	Vice President / Credit and Compliance Manager
Sharon L. Gary	Vice President / Human Resources Manager
Brent A. McCarthy	Senior Vice President / Chief Lending Officer
Amy L. Schultz	Senior Vice President /Technology / Operations Manager
Tracy L. Straight	Vice President / Mortgage Originator / Mortgage Operations Manager
Lori E. Versalle	Senior Vice President / Branch Administrator
Tracey A. Welsh	Senior Vice President / Chief Financial Officer, Secretary and Treasurer

DIRECTORS AND OFFICERS

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Brenda S. Carlson	Electronic Banking Manager
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Jennifer L. Egeler	Assistant Vice President / Senior Accountant
Jordan K. Elam	Operations Specialist Coordinator
Jon M. Huizenga	Vice President / Commercial Lending Officer
Alan W. Kowalski	Assistant Vice President / Loss Mitigation Manager
Mari K. Larson	Loan Operations Supervisor
Kip A. Miller	Network Administrator
Renee L. Nyblade	Vice President / Mortgage Loan Originator III / Secondary Market Specialist
Jennifer K. Pallasch	Assistant Vice President / Senior Accountant
Jamie J. Sheffer	Vice President / North Muskegon Branch Manager
Clinton A. Todd	Vice President / Retail Lending Officer
Catherine M. VanPelt	Assistant Vice President / Security and Processing Manager
Patrick R. Wittkopp	Vice President / Commercial Lending Officer
Bretta D. Young	Main Office Branch Manager