2019
Annual Report

Proudly serving our community for 109 years

Peoples Bancorp, Inc.
and Subsidiary
The Peoples Bank,
Fleetwood, Athey, Macbeth & McCown, Inc.
Chestertown, Maryland

Peoples Bancorp, Inc. and Subsidiary

Consolidated Financial Statements

December 31, 2019

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PEOPLES BANCORP, INC.

DIRECTORS

E. Jean Anthony
Chestertown, Maryland

Robert W. Clark, Jr.
Betterton, Maryland

LaMonte E. Cooke
Chestertown, Maryland

R. Allen Davis
Galena, Maryland

Ralph W. Dowling
Chestertown, MD

Gary B. Fellows
Millington, Maryland

Patricia Joan O. Horsey
Chestertown, Maryland

Myles S. Loller
Worton, Maryland

Stefan R. Skipp
Arnold, Maryland

Elizabeth A. Strong
Chestertown, Maryland

William G. Wheatley
Worton, Maryland

OFFICERS

E. Jean Anthony
Chairperson of Bank Board

William G. Wheatley
Chairman of Bancorp Board

Ralph W. Dowling
President & CEO

Richard C. Fleetwood, Jr.
President of FAM & M, Inc.

H. Lawrence Lyons
Executive Vice President &
Chief Operating Officer

Randall M. Robey
Executive Vice President &
Chief Financial Officer

Stephanie L. Usilton
EVP & HRO & Board Secretary

Nancy L. Greenwood
Senior Vice President & CCO

Terri L. Garvey
Senior Vice President

David A. Bowman
Vice President

Patricia A. Heinefield
Vice President

S. Henrietta Maloney
Vice President

Ina P. Reed
Vice President & Controller

Heather M. Spofford
Vice Pres. of FAM&M, Inc.

Cecil A. Unruh
Vice President

L. Susan Barnhardt
Assistant Vice President

Harriet P. Creighton
Assistant Vice President

Katie E. DiSano
Assistant Vice President

Sheila M. Dwyer
Assistant Vice President

Eva W. Hickman
Assistant Vice President

Mary Chandler Obrecht
Assistant Vice President

Jodi L. Richardson
Assistant Vice President

Jacquelyn V. Shields
Assistant Vice President

Carolyn L. Walls
Assistant Vice President

M. Kay McHenry
Assistant Secretary

Karen A. Burris
Assistant Cashier

Brandi C. Blyman
Assistant Cashier

Donna H. Edwards
Assistant Cashier

Grace M. Eyler
Assistant Cashier

Evetta D. Hopkins
Assistant Cashier

Mary Ann Landa
Assistant Cashier

Jennifer J. Teat
Assistant Cashier

Samantha M. Thompson
Assistant Cashier

OTHER PERSONNEL

Bonnie L. Allen
Kathleen E. Barnhart
Kathleen M. Bigelow
Kathleen F. Bozarth
Richard Scott Bramble
Kimberly Tanya Brilz
Mary L. Burton
Lori A. Goad
Anjanette S. Graves
Bryan C. Greenwood
Margaret K. Hammer
Anita T. Hayes
Deanna P. Herr
Wilhelmina "Diena" Howard
Lisa M. Jefferson
James "Josh" Johnson
Susan M. Joyner
Jamie L. LaFollette
Melissa L. Leonard
Donna M. Lins
Jennifer L. Mancuso
Kathryn A. Mazur
Spencer M. McAllister
Maleena E. "Liz" Meekins
Lorraine Susan Molano
Richard J. Newberry
Lisa C. Nicholas
Brittany A. Patchett-Rue
Marcey G. Peet
Tracy A. Piasecki
Wendy M. Pleasants
Barbara A. Reinhardt
Barbara J. Richardson
Clara M. Ross
Lois L. Serio
Heather L. Simpson
Angela M. Speakman
Sarah S. Sutton
Sharon L. Sutton
Noralene H. Thomas
Roni Lynn Thomas
Stephanie L. Thomas
Emily M. Torrence
Laurel A. Toth
Deborah C. Voshell
Kimberly S. Wood
Daniel Zottarelli

Greetings to Our Shareholders,

As I write to you, the COVID-19 virus remains at the national forefront, resulting in changes to our way of life and how we conduct our affairs. In March, we implemented our Pandemic Plan, resulting in the closure of our lobbies, and took other necessary steps for the safety of our employees and customers. Our Pandemic Plan was designed with the health of the communities we serve, as well as the personal safety and asset protection of our clients, in mind.

The Bank has utilized multiple forms of media including print, online news sources, social media, radio, and email to keep our clients up-to-date on our COVID-19 response and made the recommendation that customers make use of all of the Bank's self-service banking options and 24/7 account access through our online, mobile, telephone, and ATM banking services. The latest information on the Bank's COVID-19 response can be found at www.pbkc.com/news/COVID-19.

While our operations have remained fully functional outside of our lobby closures, we foresee economic hardship for our customers and our communities. We have concerns about those clients who will be challenged to make their loan payments. Our plan is to study each individual case and work with them on developing a plan for survival as this period continues.

Our organizational financial results in 2019 were healthy. Our profits totaled $2,563,150 for the prior year, representing a 21.6 percentage increase in net income. Additionally, a large portion of our recent success relates to our diversification into new markets and products. The expansion in Easton and Talbot County has complemented our Kent County efforts. The acquisition of the Bartlett, Griffin and Vermilye Insurance Agency located in Easton is already contributing to our profitability. On the product front, as previously referenced, the conversion of our core processing has significantly enhanced our technology.

While enhancing shareholder value without compromising asset quality remains our top strategic objective, there are likely challenges on our horizon. While we had achieved a significant reduction in problem assets over the last 60 months, this trend is not likely to continue given the current economic conditions. That said, current earnings remain stable as of this writing and for the immediate future.

A cornerstone of our efforts relate to our involvement in the community. The Peoples Bank was again selected as the "Best Bank" and "Best Mortgage Lender" by Kent County News' readers. Our numerous community service projects including Chester Gras and the United Way Guest Chef program continue to enhance our relationship with our customers and our communities.

I thank you again, both as a shareholder and as a customer. I look forward to our upcoming virtual meeting – a necessity in these new times we are working through. We have provided you with a link and login to join us within this packet. Please be assured that we are doing our very best to protect your interest in these challenging times. Since its conception in 1910, the Bank has survived many cycles of change and hardship. We all look forward to the times when we may cross paths and shake hands again.

Ralph Dowling

Ralph Dowling
President and CEO

Financial Highlights
Five years ended December 31, 2019

	2019	2018	2017	2016	2015
	(dollars in thousands except per share amounts)				
Deposits	**$214,721**	$216,016	$221,166	$216,757	$202,315
Investments, including stock	**15,115**	23,160	29,366	37,576	23,530
Loans (net of the allowance for loan losses)	**185,294**	191,755	181,155	156,306	146,667
Stockholders' equity	**28,672**	26,474	24,527	23,574	24,336
Assets	**249,191**	246,543	250,273	254,661	239,907
Net income (loss)	**2,563**	2,108	1,518	1,317	1,035
Return on average assets	**1.03%**	0.87%	0.62%	0.54%	0.45%
Return on average equity	**9.11%**	8.40%	6.36%	5.47%	4.42%
Earnings (loss) per share	**3.52**	2.89	2.08	1.71	1.33
Dividends per share	**0.70**	0.49	0.47	0.68	-
Book value per share	**39.34**	36.32	33.65	32.34	31.22
Number of shares outstanding	**728,918**	728,918	728,918	728,918	779,512

COMMITTEES

AUDIT COMMITTEE
E. Jean Anthony, Chairperson
Myles S. Loller
Stefan R. Skipp
Elizabeth A. Strong
Randall M. Robey, Advisor

CAPITAL COMMITTEE
Myles S. Loller, Chairperson
Ralph Dowling
Stefan R. Skipp

GOVERNANCE COMMITTEE
Gary B. Fellows, Chairperson
Robert W. Clark, Jr.
LaMonte E. Cooke

NOMINATING COMMITTEE
Robert W. Clark, Jr., Chairperson
LaMonte E. Cooke
Gary G. Fellows
William G. Wheatley

RISK MANAGEMENT COMMITTEE
Robert W. Clark, Jr., Chairperson
Patricia Joan O. Horsey
Elizabeth A. Strong
Randall M. Robey, Advisor

PERSONNEL/COMPENSATION COMMITTEE
R. Allen Davis, Chairperson
E. Jean Anthony
LaMonte E. Cooke

LOAN COMMITTEE
William G. Wheatley, Chairperson
Patricia Joan O. Horsey
Stefan R. Skipp

TRUSTEES OF THE PEOPLES BANK DEFINED BENEFIT PLAN
E. Jean Anthony, Chairperson
Elizabeth A. Strong
H. Lawrence Lyons

ROWLES & Company, LLP
Certified Public Accountants

The Board of Directors and Stockholders
Peoples Bancorp, Inc.
Chestertown, Maryland

Report of Independent Auditors

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Peoples Bancorp, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 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 audits 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 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 financial position of Peoples Bancorp, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

Baltimore, Maryland
March 18, 2020

8100 Sandpiper Circle, Suite 308, Baltimore, Maryland 21236
443-725-5395 Fax 443-725-5074
Website: www.Rowles.com

CONSOLIDATED BALANCE SHEETS

ASSETS

	DECEMBER 31,	
	2019	2018
Cash and due from banks	**$ 35,036,517**	$ 22,453,931
Investment securities available for sale	**14,832,627**	22,874,699
Federal Home Loan Bank and CBB Financial Corp. stock, at cost	**282,000**	285,400
Loans, less allowance for loan losses of **$3,145,185** and $3,406,938	**185,294,172**	191,754,891
Premises and equipment	**7,270,112**	5,872,723
Accrued interest receivable	**458,703**	490,377
Deferred income taxes	**310,878**	590,387
Other real estate owned	**511,829**	743,290
Goodwill	**705,620**	272,932
Intangible assets	**3,130,019**	-
Other assets	**1,358,553**	1,204,447
	$249,191,030	$246,543,077

LIABILITIES AND STOCKHOLDERS' EQUITY

	2019	2018
Deposits		
Noninterest bearing checking	**$ 75,980,111**	$ 72,338,844
Savings and NOW	**71,911,550**	72,139,841
Money market	**17,864,878**	18,838,131
Other time	**48,964,509**	52,698,964
	214,721,048	216,015,780
Securities sold under repurchase agreements	**1,279,631**	1,682,760
Other borrowings	**1,296,000**	-
Accrued interest payable	**83,763**	51,540
Other liabilities	**3,138,090**	2,319,396
	220,518,532	220,069,476
Stockholders' equity		
Common stock, par value $10 per share; authorized 1,000,000 shares; issued and outstanding **728,918** shares	**7,289,180**	7,289,180
Additional paid-in capital	**2,212,550**	2,212,550
Retained earnings	**20,107,542**	18,054,635
Accumulated other comprehensive income		
Unrealized gain (loss) on securities available for sale	**4,471**	(191,908)
Unfunded liability for defined benefit plan	**(941,245)**	(890,856)
	28,672,498	26,473,601
	$249,191,030	$246,543,077

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

CONSOLIDATED STATEMENTS OF INCOME

	YEARS ENDED DECEMBER 31,	
	2019	2018
Interest and dividend revenue		
Loans, including fees	**$ 8,735,767**	$8,623,546
U.S. government agency securities	**300,576**	351,047
Other	**327,969**	153,884
Total interest and dividend revenue	**9,364,312**	9,128,477
Interest expense		
Deposits	**558,777**	483,220
Borrowed funds	**55,176**	3,762
Total interest expense	**613,953**	486,982
Net interest income	**8,750,359**	8,641,495
Provision for loan losses	**(600,000)**	-
Net interest income after provision for loan losses	**9,350,359**	8,641,495
Noninterest revenue		
Service charges on deposit accounts	**655,663**	740,029
Insurance commissions	**3,848,166**	2,062,367
Gain on sale of other real estate owned	**134,979**	162,106
Loss on sale of assets	**(12,144)**	-
Other noninterest revenue	**250,834**	222,995
Total noninterest revenue	**4,877,498**	3,187,497
Noninterest expense		
Salaries	**5,396,350**	4,333,209
Employee benefits	**1,339,814**	1,205,316
Occupancy	**664,548**	546,320
Furniture and equipment	**521,736**	397,295
Data processing and correspondent fees	**836,362**	632,645
Other real estate owned expense	**127,196**	269,843
Professional fees	**461,641**	372,147
Other operating	**1,638,647**	1,268,250
Total noninterest expense	**10,986,294**	9,025,025
Income before income taxes	**3,241,563**	2,803,967
Income tax expense	**678,413**	695,642
Net income	**$ 2,563,150**	$2,108,325
Earnings per common share - basic and diluted	**$ 3.52**	$ 2.89

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	YEARS ENDED DECEMBER 31, 2019	2018
Net income	**$2,563,150**	$2,108,325
Other comprehensive income		
Unrealized gain (loss) on investment securities available for sale	**270,933**	(38,707)
Income tax relating to unrealized gain (loss) on investment securities available for sale	**(74,554)**	10,651
	196,379	(28,056)
Change in underfunded status of defined benefit plan	**(38,164)**	169,496
Income tax relating to change in underfunded status of defined benefit plan	**(12,225)**	54,294
	(50,389)	223,790
Total other comprehensive income	**145,990**	195,734
Total comprehensive income	**$2,709,140**	$2,304,059

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2019 and 2018

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total stockholders' equity
	Shares	Par value				
Balance, December 31, 2017	728,918	$7,289,180	$2,212,550	$16,303,480	$(1,278,498)	$24,526,712
Net income	-	-	-	2,108,325	-	2,108,325
Change in underfunded status of defined benefit plan net of income taxes of $54,294	-	-	-	-	223,790	223,790
Unrealized loss on investment securities available for sale net of income taxes of $10,651	-	-	-	-	(28,056)	(28,056)
Cash dividend, $0.49 per share	-	-	-	(357,170)	-	(357,170)
Balance, December 31, 2018	728,918	7,289,180	2,212,550	18,054,635	(1,082,764)	26,473,601
Net income	**-**	**-**	**-**	**2,563,150**	**-**	**2,563,150**
Change in underfunded status of defined benefit plan net of income taxes of **$12,225**	**-**	**-**	**-**	**-**	**(50,389)**	**(50,389)**
Unrealized gain on investment securities available for sale net of income taxes of **$74,554**	**-**	**-**	**-**	**-**	**196,379**	**196,379**
Cash dividend, **$0.70** per share	**-**	**-**	**-**	**(510,243)**	**-**	**(510,243)**
Balance, December 31, 2019	**728,918**	**$7,289,180**	**$2,212,550**	**$20,107,542**	**$ (936,774)**	**$28,672,498**

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,	
	2019	2018
Cash flows from operating activities		
Interest received	**$ 9,813,444**	$ 9,234,306
Fees and commissions received	**4,754,663**	3,135,767
Interest paid	**(581,730)**	(490,379)
Cash paid to suppliers and employees	**(9,732,028)**	(8,442,970)
Income taxes paid	**(439,598)**	(465,341)
	3,814,751	2,971,383
Cash flows from investing activities		
Proceeds from maturities and calls of investment securities available for sale	**18,620,085**	6,113,450
Purchase of investment securities available for sale	**(10,339,595)**	-
Redemption of Federal Home Loan Bank stock	**3,400**	3,800
Loans made, net of principal collected	**6,046,970**	(10,626,009)
Purchase of premises, equipment, and software	**(1,717,533)**	(298,004)
Proceeds from sale of premises and equipment	**475**	3,118
Proceeds from sale of other real estate owned	**980,515**	1,392,938
Cash paid for acquisition of insurance agency	**(989,378)**	-
	12,604,939	(3,410,707)
Cash flows from financing activities		
Net increase (decrease) in		
Time deposits	**(3,734,455)**	(6,188,620)
Other deposits	**2,439,723**	1,038,329
Securities sold under repurchase agreements	**(403,129)**	(621,736)
Curtailment of note for the acquisition of insurance agency	**(1,629,000)**	-
Dividends paid	**(510,243)**	(357,170)
	(3,837,104)	(6,129,197)
Net increase (decrease) in cash and cash equivalents	**12,582,586**	(6,568,521)
Cash and cash equivalents at beginning of year	**22,453,931**	29,022,452
Cash and cash equivalents at end of year	**$35,036,517**	$22,453,931

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

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	YEARS ENDED DECEMBER 31,	
	2018	2018
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 2,563,150**	$ 2,108,325
Adjustments to reconcile net income to net cash provided by operating activities		
Amortization of premiums and accretion of discounts	**32,516**	49,741
Provision for loan losses	**(600,000)**	-
Depreciation and software amortization	**415,240**	347,170
Amortization of intangible assets	**223,573**	-
Write-down of other real estate owned	**-**	107,200
Gain on sale of other real estate owned	**(134,979)**	(162,106)
Loss on sale and disposal of premises and equipment	**12,144**	3,176
Decrease (increase) in		
Accrued interest receivable	**31,674**	29,493
Deferred income taxes	**238,815**	230,301
Other assets	**(133,083)**	(172,095)
Deferred origination fees and costs, net	**384,942**	26,595
Increase (decrease) in		
Accrued interest payable	**32,223**	(3,397)
Other liabilities	**748,536**	406,980
	$ 3,814,751	$ 2,971,383
Non cash transactions		
Transfer of foreclosed loans to other real estate owned	**$ 614,075**	$ 718,232

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the accompanying financial statements of Peoples Bancorp, Inc. and its subsidiary, The Peoples Bank, a Maryland commercial bank (the "Bank") and its subsidiaries, Fleetwood, Athey, MacBeth & McCown, Inc., an insurance agency (the "Insurance Subsidiary") and PB Land Trust, a trust to maintain foreclosed real estate owned by the company (the "Land Trust"), conform to accounting principles generally accepted in the United States of America ("GAAP") and to general practices within the banking industry. As used in these notes, unless the context requires otherwise, the term "the Company" refers collectively to Peoples Bancorp, Inc., the Bank, the Insurance Subsidiary, and the Land Trust.

Principles of consolidation

The consolidated financial statements include the accounts of the Peoples Bancorp, Inc. and the Bank, the Insurance Subsidiary, and the Land Trust. Intercompany balances and transactions have been eliminated.

Nature of business

Peoples Bancorp, Inc. and its subsidiary operate primarily in Kent, Cecil, Queen Anne's and Talbot Counties, Maryland. The Bank, which operates out of a main office and six branches, offers deposit services and loans to individuals, small businesses, associations, and government entities. Other services include direct deposit of payroll and social security checks, automatic drafts from accounts, automated teller machine services, cash management services, safe deposit boxes, money orders and on-line banking with bill payment service.

The Insurance Subsidiary operates from locations in Kent County and Talbot County. They provide a full range of insurance products to businesses and consumers. Product lines include property, casualty, life, marine, long-term care and health insurance.

Use of estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions may affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are sold for one-day periods.

Investment securities

As securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities which management has the intent and ability to hold to maturity are classified as held to maturity and recorded at amortized cost which is cost adjusted for amortization of premiums and accretion of discounts to maturity, or over the expected life in the case of mortgage-backed securities. Amortization and accretion are recorded using the interest method. Securities which may be sold before maturity are classified as available for sale and carried at fair value with unrealized gains and losses excluded from earnings and reported in other comprehensive income.

Gains and losses on the sale of securities are determined using the specific identification method.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (Continued)

Federal Home Loan Bank stock and CBB Financial Corp. stock

Federal Home Loan Bank stock and CBB Financial Corp. stock are carried at cost. As a member of the Federal Home Loan Bank, the Bank is required to purchase stock based on its total assets. Additional stock is purchased and redeemed based on outstanding Federal Home Loan Bank advances to the Bank.

Loans and allowance for loan losses

Loans are stated at their outstanding unpaid principal balance adjusted for deferred origination costs, deferred origination fees, and the allowance for loan losses.

Interest on loans is accrued based on the principal amounts outstanding. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. The accrual of interest is discontinued when it is not reasonable to expect collection of interest under the original terms. As a result of management's ongoing review of the loan portfolio, loans are classified as nonaccrual when it is not reasonable to expect collection of interest under the original terms. These loans are classified as nonaccrual even though the presence of collateral or the borrower's financial strength may be sufficient to provide for ultimate repayment. Interest on nonaccrual loans is recognized only when received. A loan is generally placed in nonaccrual status when it is specifically determined to be impaired or it becomes 90 days or more past due. When a loan is placed in nonaccrual status, all interest that had been accrued on the loan but remains unpaid is reversed and deducted from earnings as a reduction of reported interest revenue. No additional interest is accrued on the loan balance until the collection of both principal and interest becomes reasonably certain. A loan will be returned to accrual status when all of the principal and interest amounts contractually due are brought current and management believes that future principal and interest amounts contractually due are reasonably assured, which belief is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (Continued)

Loans and allowance for loan losses

The allowance consists of specific, general, and unallocated components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, an allowance is established when the collateral value, if the loan is collateral dependent, or the discounted cash flows of the impaired loan is lower than the carrying value of that loan. The general component covers nonclassified loans and is based on historical loss experience adjusted for qualitative factors. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, management believes that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Impairment is measured on a loan-by-loan basis. Reserves are determined using the net present value of cash flows, or if the loan is collateral dependent, the fair value of the collateral less cost to sell.

As a general rule, a loan, or a portion thereof, is deemed uncollectible and is charged-off as and when required by bank regulatory guidelines, which provide that the loan, or portion thereof, should be charged-off when the Company becomes aware of the loss. The Company becomes aware of a loss upon the occurrence of one or more triggering events, including, among other things, the receipt of new information about the borrower's intent and/or ability to repay the loan, the severity of delinquency, the borrower's bankruptcy, the detection of fraud, or the borrower's death.

Premises and equipment

Land is carried at cost. Premises and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over estimated useful lives of three to ten years for furniture and equipment, ten to forty years for premises, and three years for software.

Other real estate owned

Real estate acquired through foreclosure is recorded at the lower of cost or fair value on the date acquired. In general, cost equals the Company's investment in the property at the time of foreclosure. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in other operating expense.

Goodwill and intangible assets

Goodwill represents the excess of the cost of an acquisition over the fair value of the net assets acquired. Other intangible assets represent purchased assets that lack physical substance but can be distinguished from goodwill because of contractual or other legal rights or because the asset is capable of being sold or exchanged either on its own or in combination with a related contract, asset or liability. Goodwill is not ratably amortized into the income statement over an estimated life, but rather is tested at least annually for impairment. The balance of goodwill was $705,620 at December 31, 2019 and $273,932 at December 31, 2018.

Intangible assets that have finite lives are amortized over their estimated useful lives and are also subject to impairment testing. The Company's intangible assets have finite lives and are amortized on a straight-line basis over periods not exceeding 15 years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (Continued)

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred income taxes are provided for the temporary differences between financial and taxable income.

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Per share data

Basic earnings per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding and does not include the effect of any potentially dilutive common stock equivalents. Diluted earnings per share is calculated by dividing net income by the weighted-average number of shares outstanding, adjusted for the dilutive effect of stock-based awards. The weighted average number of shares outstanding were 728,918 for 2019 and 2018. There were no dilutive common stock equivalents outstanding in 2019 or 2018.

Subsequent Events

The Company has evaluated events and transactions occurring subsequent to the balance sheet date of December 31, 2019 through March 18, 2020, the date these financial statements were available to be issued, for items that should potentially be recognized or disclosed in these financial statements. No significant subsequent events were identified that would affect the presentation of the financial statements.

2. Agency Acquisition

On January 2, 2019, the Bank's wholly-owned subsidiary, Fleetwood, Athey, MacBeth, and McCown, Inc. (dba Fleetwood Insurance Group), purchased the assets of Bartlett, Griffin, & Vermilye, an insurance agency with an office located in Easton, Maryland. The operations are included in the operations of Fleetwood, Athey, MacBeth, and McCown, Inc. for the period since the acquisition date. The principals and shareholders of Bartlett, Griffin, & Vermilye, Inc. agreed to employment agreements with noncompete provisions as part of the acquisition. In conjunction with the asset purchase, Fleetwood, Athey, MacBeth, and McCown, Inc. also purchased from a related interest of the principals of Bartlett, Griffin, & Vermilye the real estate utilized in their Easton Office.

The purchase price of $1,045,944 for the real estate was paid in cash at settlement. The purchase price for the operations of $3,900,000 was paid partially with cash at settlement, and notes issued by Fleetwood, Athey, MacBeth, and McCown, Inc. for $2,925,000 collectively. The original terms of the notes call for three annual payments of $975,000 collectively plus interest on the anniversary date of the acquisition. The notes are at a rate of 3%, and are guaranteed by the Bank. The notes were modified on March 29, 2019, to allow for a principal curtailment of $1,629,000, restructuring the $1,296,000 balance to mature June 30, 2020 with accrued interest paid at maturity. The Company recorded $432,688 of goodwill and $3,353,592 of other intangible assets as a result of the acquisition. The goodwill will not be amortized for financial statement purposes but will be reviewed annually for impairment. The intangible assets will be amortized over 15 years for financial statement and income tax purposes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Agency Acquisition (Continued)

	Fair Value
Building improvements	$ 100,000
Furniture and equipment	15,000
Other assets	13,738
Other liabilities	(640)
Note	(2,925,000)
Goodwill	432,688
Intangible assets	3,353,592
Net cash	$ 989,378

3. Cash and Due From Banks

The Bank normally carries balances with other banks that exceed the federally insured limit. The average balances carried in excess of the limit, including unsecured federal funds sold to the same banks, were $7,774,381 for 2019 and $7,857,109 for 2018.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same category. The combined total is insured up to $250,000.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

4. Investment Securities

Investment securities are summarized as follows:

December 31, 2019	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
U.S. government agency	**$ 4,989,559**	**$ 1,890**	**$ 15,066**	**$ 4,976,383**
Mortgage-backed securities	**9,836,899**	**33,635**	**14,290**	**9,856,244**
	$ 14,826,458	**$ 35,525**	**$ 29,356**	**$ 14,832,627**

December 31, 2018	Amortized cost	Unrealized gains	Unrealized losses	Fair value
Available for sale				
U.S. government agency	$ 21,007,479	$ -	$ 245,769	$ 20,761,710
Mortgage-backed securities	2,131,985	3,428	22,424	2,112,989
	$ 23,139,464	$ 3,428	$ 268,193	$ 22,874,699

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Investment Securities (Continued)

Contractual maturities and the amount of pledged securities are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are paid monthly.

	Available for sale	
December 31, 2019	Amortized cost	Fair value
Maturing		
Within one year	**$ 3,004,500**	**$ 3,006,390**
Over one to five years	**1,985,059**	**1,969,993**
	$ 4,989,559	**$ 4,976,383**
Pledged securities	**$ 5,216,664**	**$ 5,217,062**
December 31, 2018		
Maturing		
Within one year	$17,998,280	$17,801,190
Over one to five years	3,009,199	2,960,520
	$21,007,479	$20,761,710
Pledged securities	$ 6,280,100	$ 6,193,344

Investments are pledged to secure the deposits of federal and local governments and as collateral for repurchase agreements.

Securities in a continuous unrealized loss position at December 31, 2019 and 2018, are as follows:

	Less than 12 months		12 months or longer		Total	
December 31, 2019	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value
Available for sale						
U.S. government agency	**$15,066**	**$1,969,993**	**$ -**	**$ -**	**$ 15,066**	**$ 1,969,993**
Mortgage-backed securities	**14,290**	**5,739,881**	**-**	**-**	**14,290**	**5,739,881**
	$29,356	**$7,709,874**	**$ -**	**$ -**	**$ 29,356**	**$ 7,709,874**
December 31, 2018						
Available for sale						
U.S. government agency	$ -	$ -	$245,769	$20,761,710	$245,769	$20,761,710
Mortgage-backed securities	17,449	1,425,870	4,975	362,037	22,424	1,787,907
	$17,449	$1,425,870	$250,744	$21,123,747	$268,193	$22,549,617

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

4. Investment Securities (Continued)

All unrealized losses on securities as of December 31, 2019 and 2018, are considered to be temporary losses. Each security will be redeemed at face value at, or prior to, maturity. In most cases, the temporary impairment in value is caused by market interest rate fluctuations.

There were no sales of securities in 2019 or 2018.

5. Loans and Allowance for Loan Losses

Major classifications of loans as of December 31, are as follows:

	2019	2018
Real estate		
Residential	**$ 87,245,406**	$ 86,714,061
Commercial	**59,875,667**	63,111,187
Other	**24,994,095**	21,487,250
Construction and land development	**5,189,173**	6,990,981
Commercial	**10,726,355**	15,899,198
Consumer	**862,894**	1,028,443
	188,893,590	195,231,120
Deferred (fees) costs, net	**(454,233)**	(69,291)
Allowance for loan losses	**(3,145,185)**	(3,406,938)
	$185,294,172	$191,754,891

Loan Origination/Risk Management

The Company has certain lending policies and procedures in place that are designed to maximize loan income within an acceptable level of risk. Management reviews and approves these policies and procedures on a regular basis. A reporting system supplements the review process by providing management with frequent reports related to loan production, loan quality, loan delinquencies and nonperforming and potential problem loans.

The Company obtains an independent loan review from a third-party vendor that reviews and evaluates the credit risk program on a periodic basis. Results of these reviews are presented to management. The loan review process complements and reinforces the risk identification and assessment decisions made by lenders and credit personnel, as well as the Company's policies and procedures.

Residential real estate loans are underwritten subject to the borrower's ability and willingness to repay, and a loan-to-value ratio of offered collateral of not more than 80% of the appraised value of the collateral.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

Real Estate Loans

Real estate loans are broken into the following categories: Residential; Commercial; Construction and Land Development; and Other Loans.

Commercial real estate loans are subject to underwriting standards and processes similar to commercial loans, in addition to those of real estate loans. These loans are assessed primarily based on cash flow and secondarily on the underlying real estate collateral. Commercial real estate lending typically involves higher loan principal amounts and the repayment of these loans is generally largely dependent on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Commercial real estate loans may be more adversely affected by conditions in the real estate markets or in the general economy. Management monitors and evaluates commercial real estate loans based on collateral and cash flow. With respect to loans to developers and builders that are secured by non-owner occupied properties that the Company may originate from time to time, the Company generally requires the borrower to have had an existing relationship with the Company and have a proven record of success.

Construction, including land development, loans are underwritten based on financial analyses of the developers and property owners, and estimates of costs and value associated with the complete project. These estimates may be inaccurate. Construction loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project. Sources of repayment for these types of loans may be pre-committed permanent loans from approved long-term lenders, sales of developed property or an interim loan commitment from the Company until permanent financing is obtained. These loans are monitored by on-site inspections and are considered to have higher risks than other real estate loans due to their ultimate repayment being sensitive to interest rate changes, governmental regulation of real property, general economic conditions and the availability of long-term financing.

Commercial Loans

Commercial loans are underwritten after evaluating and understanding the borrower's ability to operate profitably and to prudently expand its business. The Company's management examines current and projected cash flows to determine the ability of the borrower to repay its obligations as agreed. Commercial loans are primarily made based on the identified cash flows of the borrower and secondarily on the underlying collateral provided by the borrower. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. Most commercial loans are secured by the assets being financed or other business assets, such as accounts receivable or inventory, and may incorporate a personal guarantee; however, some short-term loans may be made on an unsecured basis.

Consumer Loans

The Company originates consumer loans. To monitor and manage consumer loan risk, underwriting policies and procedures are developed and modified as needed. The Company believes that its monitoring activity, coupled with relatively small loan amounts that are spread across many individual borrowers, minimizes risk.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

The rate repricing and maturity distribution of the loan portfolio at December 31, is as follows:

	2019
Within ninety days	$ 12,220,546
Over ninety days to one year	14,431,518
Over one year to five years	101,136,434
Over five years	61,105,092
	$ 188,893,590
Variable rate loans included in total above	$ 29,055,213

The following table illustrates total impaired loans segmented by those with and without a related allowance as of December 31, 2019 and 2018.

Total Impaired Loans Segmented by With and Without a Related Allowance Recorded
December 31, 2019

Description of Loans	Number of loans	Recorded Investment	Unpaid Contractual Balance	Related Allowance	Interest Income Recognized	Average Recorded Investment
With Related Allowance Recorded						
Residential real estate	4	$ 456,681	$ 482,043	$ 31,484	$ 26,388	$ 484,089
Commercial real estate	2	389,805	495,297	6,950	30,210	500,348
Other real estate	3	435,246	435,246	84	24,284	436,579
Construction and land development	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	9	1,281,732	1,412,586	38,518	80,882	1,421,016
With No Related Allowance Recorded						
Residential real estate	30	2,835,093	3,606,178	-	180,799	3,654,260
Commercial real estate	4	674,712	1,106,387	-	54,674	1,113,166
Other real estate	2	336,732	672,839	-	8,192	672,839
Construction and land development	2	37,866	46,344	-	3,082	46,702
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	38	3,884,403	5,431,748	-	246,747	5,486,967
TOTAL						
Residential real estate	34	3,291,774	4,088,221	31,484	207,187	4,138,349
Commercial real estate	6	1,064,517	1,601,684	6,950	84,884	1,613,514
Other real estate	5	771,978	1,108,085	84	32,476	1,109,418
Construction and land development	2	37,866	46,344	-	3,082	46,702
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
Total impaired loans	47	$5,166,135	$ 6,844,334	$ 38,518	$ 327,629	$ 6,907,983

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

Total Impaired Loans Segmented by With and Without a Related Allowance Recorded
December 31, 2018

Description of Loans	Number of loans	Recorded Investment	Unpaid Contractual Balance	Related Allowance	Interest Income Recognized	Average Recorded Investment
With Related Allowance Recorded						
Residential real estate	4	$ 282,614	$ 306,143	$ 62,472	$ 14,938	$ 308,204
Commercial real estate	3	754,128	866,639	46,690	35,234	866,821
Other real estate	-	-	-	-	-	-
Construction and land development	-	-	-	-	-	-
Commercial loans	-	-	-	-	-	-
Consumer loans	-	-	-	-	-	-
	7	1,036,742	1,172,782	109,162	50,172	1,175,025
With No Related Allowance Recorded						
Residential real estate	32	2,452,754	3,315,568	-	174,439	3,393,986
Commercial real estate	5	755,445	1,141,873	-	56,735	1,140,625
Other real estate	7	1,327,731	1,655,645	-	93,360	1,649,795
Construction and land development	2	42,815	48,211	-	3,082	48,505
Commercial loans	1	212,160	212,160	-	9,334	221,244
Consumer loans	-	-	-	-	-	-
	47	4,790,905	6,373,457	-	336,950	6,454,155
TOTAL						
Residential real estate	36	2,735,368	3,621,711	62,472	189,377	3,702,190
Commercial real estate	8	1,509,573	2,008,512	46,690	91,969	2,007,446
Other real estate	7	1,327,731	1,655,645	-	93,360	1,649,795
Construction and land development	2	42,815	48,211	-	3,082	48,505
Commercial loans	1	212,160	212,160	-	9,334	221,244
Consumer loans	-	-	-	-	-	-
Total impaired loans	54	$5,827,647	$ 7,546,239	$109,162	$ 387,122	$ 7,629,180

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

The following table summarizes activity in the allowance for loan losses and allocations based on loans that are individually evaluated for impairment and loan balances collectively evaluated for impairment.

December 31, 2019	Residential Real Estate	Commercial Real Estate	Other Real Estate	Construction and land Development	Commercial	Consumer	Overdraft	Unallocated	Total
Allowance for loan losses									
Beginning balance	**$ 1,281,256**	**$ 546,257**	**$ 329,238**	**$ 65,795**	**$ 284,904**	**$ 11,839**	**$ 482**	**$ 887,167**	**$ 3,406,938**
Charge-offs	**(48,371)**	**-**	**-**	**-**	**(87,075)**	**-**	**(2,354)**	**-**	**(137,800)**
Recoveries	**121,338**	**36,276**	**-**	**269,903**	**48,265**	**133**	**132**	**-**	**476,047**
Provision	**548,745**	**99,809**	**(48,290)**	**(267,409)**	**(84,479)**	**(1,806)**	**2,503**	**(849,073)**	**(600,000)**
Ending balance	**$ 1,902,968**	**$ 682,342**	**$ 280,948**	**$ 68,289**	**$ 161,615**	**$ 10,166**	**$ 763**	**$ 38,094**	**$ 3,145,185**
Ending balance allocated to:									
Loans individually evaluated for impairment	**$ 31,484**	**$ 6,950**	**$ 84**	**$ -**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 38,518**
Loans collectively evaluated for impairment	**1,871,484**	**675,392**	**280,864**	**68,289**	**161,615**	**10,166**	**763**	**38,094**	**3,106,667**
	$ 1,902,968	**$ 682,342**	**$ 280,948**	**$ 68,289**	**$ 161,615**	**$ 10,166**	**$ 763**	**$ 38,094**	**$ 3,145,185**
Loans individually evaluated for impairment	**$ 3,291,774**	**$ 1,064,517**	**$ 771,978**	**$ 37,866**	**$ -**	**$ -**	**$ -**	**$ -**	**$ 5,166,135**
Loans collectively evaluated for impairment	**83,953,632**	**58,811,150**	**24,222,117**	**5,151,307**	**10,726,355**	**859,227**	**3,667**	**-**	**183,727,455**
	$87,245,406	**$59,875,667**	**$24,994,095**	**$5,189,173**	**$10,726,355**	**$ 859,227**	**$ 3,667**	**$ -**	**$188,893,590**

December 31, 2018	Residential Real Estate	Commercial Real Estate	Other Real Estate	Construction and land Development	Commercial	Consumer	Overdraft	Unallocated	Total
Allowance for loan losses									
Beginning balance	$ 1,327,389	$ 662,779	$ 124,482	$ 452,082	$ 440,365	$ 4,782	$ 541	$ 382,426	$ 3,394,846
Charge-offs	(98,242)	-	-	-	(40,611)	-	(1,164)	-	(140,017)
Recoveries	78,544	24,000	-	5,615	37,859	5,910	181	-	152,109
Provision	(26,435)	(140,522)	204,756	(391,902)	(152,709)	1,147	924	504,741	-
Ending balance	$ 1,281,256	$ 546,257	$ 329,238	$ 65,795	$ 284,904	$ 11,839	$ 482	$ 887,167	$ 3,406,938
Ending balance allocated to:									
Loans individually evaluated for impairment	$ 62,472	$ 46,690	$ -	$ -	$ -	$ -	$ -	$ -	$ 109,162
Loans collectively evaluated for impairment	1,218,784	499,567	329,238	65,795	284,904	11,839	482	887,167	3,297,776
	$ 1,281,256	$ 546,257	$ 329,238	$ 65,795	$ 284,904	$ 11,839	$ 482	$ 887,167	$ 3,406,938
Loans individually evaluated for impairment	$ 2,735,368	$ 1,509,573	$ 1,327,731	$ 42,815	$ 212,160	$ -	$ -	$ -	$ 5,827,647
Loans collectively evaluated for impairment	83,978,693	61,601,614	20,159,519	6,948,166	15,687,038	1,026,216	2,227	-	189,403,473
	$86,714,061	$63,111,187	$21,487,250	$6,990,981	$15,899,198	$1,026,216	$ 2,227	$ -	$195,231,120

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

As part of the on-going monitoring of the quality of the Bank's loan portfolio, management tracks certain credit quality indicators. The Bank risk rates all loans. Loans are risk rated based on the scale below:

Grade 1 through 4 – Pass. These grades include "pass grade" loans to borrowers of acceptable credit quality and risk.

Grade 5 – Pass/Watch. This grade includes loans that are on Management's "watch list" and is intended to be utilized on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near future.

Grade 6 – Special Mention. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation. This grade may include loans not fully secured where a specific valuation allowance may be necessary.

Grade 7 through 9 – Substandard. This grade includes loans, in accordance with regulatory guidelines, for which accrual of interest may have stopped. This grade includes loans that are past due or not fully secured where a specific valuation allowance may be necessary.

The following table illustrates loans classified by risk grades.

December 31, 2019	Pass	Pass/Watch	Special Mention	Substandard	Total
Residential real estate	**$ 78,778,671**	**$ 3,200,042**	**$ 1,516,540**	**$ 3,750,153**	**$ 87,245,406**
Commercial real estate	**54,580,328**	**3,745,349**	**388,996**	**1,160,994**	**59,875,667**
Other real estate	**22,337,302**	**1,884,814**	**-**	**771,979**	**24,994,095**
Construction and land development	**4,882,143**	**269,164**	**-**	**37,866**	**5,189,173**
Commercial	**10,214,486**	**199,357**	**3,336**	**309,176**	**10,726,355**
Consumer	**862,540**	**354**	**-**	**-**	**862,894**
	$171,655,470	**$ 9,299,080**	**$ 1,908,872**	**$ 6,030,168**	**$188,893,590**

December 31, 2018	Pass	Pass/Watch	Special Mention	Substandard	Total
Residential real estate	$ 79,106,721	$ 5,075,943	$ 848,267	$ 1,683,130	$ 86,714,061
Commercial real estate	53,920,751	5,747,785	415,573	3,027,078	63,111,187
Other real estate	18,386,050	1,773,469	-	1,327,731	21,487,250
Construction and land development	6,622,822	283,773	-	84,386	6,990,981
Commercial	15,105,584	366,487	4,480	422,647	15,899,198
Consumer	1,028,243	200	-	-	1,028,443
	$174,170,171	$13,247,657	$ 1,268,320	$ 6,544,972	$195,231,120

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

The following table analyzes the age of past due loans segregated by class of loans as of December 31, 2019 and 2018.

December 31, 2019	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
Residential real estate	**$ 427,116**	**$ 620,568**	**$ 1,330,009**	**$ 2,377,693**	**$ 84,867,713**	**$ 87,245,406**
Commercial real estate	-	-	-	-	**59,875,667**	**59,875,667**
Other real estate	-	-	**336,732**	**336,732**	**24,657,363**	**24,994,095**
Construction and land development	**33,991**	-	-	**33,991**	**5,155,182**	**5,189,173**
Commercial loans	-	-	-	-	**10,726,355**	**10,726,355**
Consumer loans	-	-	-	-	**862,894**	**862,894**
Total	**$ 461,107**	**$620,568**	**$1,666,741**	**$2,748,416**	**$186,145,174**	**$188,893,590**

December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater than 90 Days	Total Past Due	Current	Total Loans
Residential real estate	$ 590,131	$ -	$ 295,593	$ 885,724	$ 85,828,337	$ 86,714,061
Commercial real estate	-	-	337,099	337,099	62,774,088	63,111,187
Other real estate	64,610	282,924	-	347,534	21,139,716	21,487,250
Construction and land development	-	-	-	-	6,990,981	6,990,981
Commercial loans	5,858	-	-	5,858	15,893,340	15,899,198
Consumer loans	-	-	-	-	1,028,443	1,028,443
Total	$ 660,599	$282,924	$ 632,692	$1,576,215	$193,654,905	$195,231,120

Loans on which the accrual of interest has been discontinued or reduced, and the interest that would have been accrued at December 31, are as follows:

	2019	2018
Residential real estate	**$2,001,454**	$1,470,273
Commercial real estate	**518,926**	927,218
Other real estate	**336,732**	64,610
Construction and land development	**37,866**	42,815
Commercial loans	**-**	-
Consumer loans	**-**	-
Total	**$2,894,978**	$2,504,916
Interest not accrued on nonaccrual loans	**$ 82,722**	$ 139,682

There were no loans over 90 days past due and accruing at December 31, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

A loan will be returned to accrual status when all of the principal and interest amounts contractually due are brought current and management believes that future principal and interest amounts contractually due are reasonably assured, which belief is typically evidenced by a sustained period (at least six months) of repayment performance by the borrower.

The modification of terms on a loan (restructuring) is considered a "troubled debt restructuring" if it is done to accommodate a borrower who is experiencing financial difficulties. The lender may forgive principal, lower the interest rate or payment amount, or may modify the payment due dates or maturity date of the loan for a troubled borrower. The Company's troubled debt restructurings at December 31, 2019 and 2018, are set forth in the following tables:

TROUBLED DEBT RESTRUCTURINGS

December 31, 2019	Number of Contracts	Recorded Investment	Paying as Agreed Under Modified Terms	Number of Past Due Contracts	Past Due 30 Days or More or Nonaccruing
Troubled debt restructurings					
Residential real estate	**29**	**$2,273,463**	**$ 1,919,955**	**4**	**$ 353,508**
Commercial real estate	**6**	**1,106,467**	**1,106,467**	**-**	**-**
Other real estate	**3**	**435,246**	**435,246**	**-**	**-**
Construction and land development	**2**	**37,866**	**37,866**	**-**	**-**
Commercial loans	**-**	**-**	**-**	**-**	**-**
Consumer loans	**-**	**-**	**-**	**-**	**-**
	40	**$3,853,042**	**$ 3,499,534**	**4**	**$ 353,508**

December 31, 2018	Number of Contracts	Recorded Investment	Paying as Agreed Under Modified Terms	Number of Past Due Contracts	Past Due 30 Days or More or Nonaccruing
Troubled debt restructurings					
Residential real estate	32	$2,564,737	$ 1,557,730	17	$ 1,007,007
Commercial real estate	8	1,509,573	582,355	4	927,218
Other real estate	5	980,196	980,196	-	-
Construction and land development	2	42,815	-	2	42,815
Commercial loans	1	212,160	212,160	-	-
Consumer loans	-	-	-	-	-
	48	$5,309,481	$ 3,332,441	23	$ 1,977,040

There were no new troubled debt restructurings in 2019. There were three new troubled debt restructuring in 2018 to one borrower totaling $595,522. Two loans totaling $336,732 were considered to not be performing at December 31, 2019.

At December 31, 2019, formal foreclosure procedures were in process for four loans totaling $473,642. At December 31, 2018 formal foreclosure procedures were in process for three loans totaling $421,233.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

5. Loans and Allowance for Loan Losses (Continued)

Outstanding loan commitments, unused lines of credit, and letters of credit as of December 31, are as follows:

	2019	2018
Check loan lines of credit	**$ 385,823**	$ 415,851
Mortgage lines of credit and loan commitments	**7,239,995**	8,925,475
Other lines of credit and commitments	**12,926,852**	11,692,277
Undisbursed construction loan commitments	**1,041,114**	3,357,706
	$ 21,593,784	$ 24,391,309
Standby letters of credit	**$ 1,164,947**	$ 1,175,090

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest rates fixed at current market rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank's exposure to credit loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment. Management is not aware of any fact that could cause the Bank to incur an accounting loss as a result of funding these commitments.

The Company lends to customers located primarily in and near Kent County, Queen Anne's County, Cecil County, and Talbot County, Maryland. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

6. Premises and Equipment

A summary of premises and equipment and related depreciation expense as of December 31, is as follows:

	2019	2018
Land	**$ 3,100,510**	$ 2,658,141
Premises	**5,604,431**	4,803,877
Furniture and equipment	**2,567,701**	2,655,109
	11,272,642	10,117,127
Accumulated depreciation	**4,002,530**	4,244,404
Net premises and equipment	**$ 7,270,112**	$ 5,872,723
Depreciation expense	**$ 404,500**	$ 336,737

Computer software included in other assets and the related amortization are as follows:

	2019	2018
Cost	**$ 69,372**	$ 110,553
Accumulated amortization	**51,940**	100,407
Net computer software	**$ 17,432**	$ 10,146
Amortization expense	**$ 10,740**	$ 10,433

7. Goodwill and Intangible Assets

The Company recorded $272,932 in goodwill in connection with the Insurance Subsidiary acquisition in 2007. As a result of the acquisition of Bartlett, Griffin, & Vermilye in 2019, the Company recorded $432,688 of goodwill and $3,353,592 of other intangible assets. The intangible assets will be amortized over 15 years for financial statement and income tax purposes. Goodwill is not amortized, but is annually evaluated for impairment. Total goodwill at December 31, 2019 was $705,620.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

7. Goodwill and Intangible Assets (Continued)

Information relating to intangible assets at December 31, is as follows

	2019	2018
Intangible asset	**$ 3,353,592**	$ 550,000
Accumulated amortization	**(223,573)**	(550,000)
Net intangible asset	**$ 3,130,019**	$ -
Amortization expense	**$ 223,573**	$ -

Estimated amortization expense:	
2020	**$ 223,573**
2021	**223,573**
2022	**223,573**
2023	**223,573**
2024	**223,573**
Thereafter	**2,012,154**

8. Other Time Deposits

Maturities of other time deposits as of December 31, are as follows:

	2019	2018
Within one year	**$11,138,273**	$13,868,751
Over one to two years	**8,840,664**	9,832,008
Over two to three years	**5,889,589**	10,828,764
Over three to four years	**8,428,265**	7,416,855
Over four to five years	**14,164,489**	10,752,586
Over five years	**503,229**	-
	$48,964,509	$52,698,964

Included in other time deposits are certificates of deposit in amounts of $250,000 or more of $5,685,268 and $4,151,691 as of December 31, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

9. Securities Sold Under Repurchase Agreements

Securities sold under repurchase agreements represent borrowings from customers. The government agency securities that are the collateral for these agreements are owned by the Bank and are maintained in the custody of an unaffiliated bank. Additional information is as follows:

	2019	2018
Maximum amount outstanding	**$2,745,965**	$3,555,414
Average amount outstanding	**1,525,841**	1,561,814
Average rate paid during the year	**0.32%**	0.24%
Investment securities underlying agreements at year-end		
Book value	**2,008,494**	2,930,538
Fair value	**2,007,999**	2,894,051

10. Borrowed Funds

Note Payable

With the purchase of Bartlett, Griffin, & Vermilye, a note was issued by Fleetwood, Athey, MacBeth, and McCown, Inc. for $2,925,000 collectively. The original terms of the notes call for three annual payments of $975,000 collectively plus interest on the anniversary date of the acquisition. The notes are at a rate of 3%, and are guaranteed by the Bank. The notes were modified on March 29, 2019, to allow for principal curtailment of $1,629,000, restructuring the $1,296,000 balance to mature June 30, 2020, with accrued interest paid at maturity.

Available Lines of Credit

The Bank may borrow up to 30% of its assets from the Federal Home Loan Bank; however, the amount the Bank could borrow would be limited by the balance of qualified loans it could pledge to the FHLB. As of December 31, 2019, the Bank could borrow up to $73,857,300 from the Federal Home Loan Bank subject to qualifying available collateral. The Bank had pledged loans that provided a borrowing capacity of $21,727,310 as of December 31, 2019.

In addition to the borrowing capacity available from the FHLB, the Bank has a line of credit of $8,000,000 in secured overnight federal funds at December 31, 2019. As of December 31, 2019, the Bank had pledged mortgage loans totaling $10,829,342 to the Federal Reserve Bank of Richmond to provide a borrowing capacity of $6,100,116 under its discount window program.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Income Taxes

The components of income tax expense are as follows:

	2019	2018
Current		
Federal	**$ 375,657**	$ 418,104
State	**63,941**	47,237
	439,598	465,341
Deferred	**238,815**	230,301
	$ 678,413	$ 695,642

The components of the deferred income tax expense (benefit) are as follows:

Allowance for loan losses and bad debts	**$ 165,105**	$ -
Prepaid pension costs	**(33,884)**	(12,658)
Depreciation and amortization	**161,923**	83,108
Nonaccrual interest	**27,482**	(9,949)
Deferred compensation	**(11,159)**	(8,118)
Foreclosed real estate impairment	**8,379**	64,655
Net operating loss (NOL)	**(79,031)**	113,263
	$ 238,815	$ 230,301

The components of the net deferred income tax asset are as follows:

	2019	2018
Deferred income tax assets		
Allowance for loan losses	**$ 174,236**	$ 339,341
Deferred compensation	**87,239**	76,080
Pension liability	**160,474**	92,729
Nonaccrual interest	**10,954**	38,437
Foreclosed real estate impairment	**72,154**	80,533
Unrealized loss on investment securities available for sale	**(1,697)**	72,856
NOL carryovers	**82,803**	3,772
	586,163	703,748
Deferred income tax liabilities		
Depreciation and amortization	**275,285**	113,361
Net deferred income tax asset	**$ 310,878**	$ 590,387

Net pension expense is reported in Salaries and benefits expense for December 31, 2019 and 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

11. Income Taxes (Continued)

A reconciliation of the provisions for income taxes from statutory federal rates to effective rates follows:

	2019	2018
Tax at statutory federal income tax rate	**21.0 %**	21.0 %
Tax effect of		
Tax-exempt income	**(1.0)**	(1.5)
State income taxes, net of federal benefit	**5.2**	5.2
Other, net	**(4.3)**	0.2
	20.9 %	24.8 %

The Company does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Company remains subject to examination of income tax returns for the years ending after December 31, 2015.

12. Profit Sharing Plan

The Company has a profit sharing plan qualifying under section 401(k) of the Internal Revenue Code that covers all of the Company's employees with one year of service who have attained age 21. The Company matches 50% of employee contributions to the Plan, up to a maximum of 6% of pay. The Company may make discretionary contributions to the Plan in amounts approved by its Board of Directors. Plan expenses, included in employee benefits expense for 2019 and 2018, were $98,637 and $89,984, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Pension

The Bank has a defined benefit pension plan that was frozen in 2013. Participant benefits stopped accruing as of the date of the freeze. Prior to freezing the plan, it substantially covered all of the employees of the Bank. Benefits are based on years of service and the employee's highest average rate of earnings for five consecutive years during the final ten full years before retirement. The Bank's funding policy is to contribute annually the maximum amount that can be deducted for income tax purposes, determined using the projected unit credit cost method.

The following table sets forth the financial status of the plan at December 31:

	2019	2018
Change in plan assets		
Fair value of plan assets at beginning of year	**$3,820,460**	$4,101,694
Actual return on plan assets	**389,926**	(18,370)
Settlements	**(468,216)**	(183,190)
Employer contribution	**60,000**	-
Benefits paid	**(79,544)**	(79,674)
Fair value of plan assets at end of year	**3,722,626**	3,820,460
Change in benefit obligation		
Projected benefit obligation at beginning of year	**4,210,977**	4,701,426
Settlements	**(468,216)**	(183,190)
Interest cost	**167,327**	159,950
Benefits paid	**(79,544)**	(79,674)
Actuarial loss (gain)	**475,254**	(387,535)
Accumulated benefit obligation at end of year	**4,305,798**	4,210,977
Funded status	**(583,172)**	(390,517)
Unrecognized net loss	**1,298,582**	1,229,064
Prepaid pension expense included in other assets	**$ 715,410**	$ 838,547

Net pension expense includes the following components:

	2019	2018
Service cost	**$ -**	$ -
Interest cost	**167,327**	159,950
Expected return on assets	**(197,826)**	(218,364)
Recognized actuarial loss (gain) due to settlements	**131,609**	64,784
Amortization of loss	**82,027**	93,165
Net pension expense	**$ 183,137**	$ 99,535

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

13. Pension (Continued)

Net pension expense is included in salaries and benefits in 2019 and 2018. The amount of net pension expense expected to be recognized in 2020 is $93,033.

Assumptions used in the accounting for net pension expense were:

Discount rates	**4.25%**	3.50%
Rate of compensation increase	**N/A**	N/A
Long-term rate of return on assets	**5.50%**	5.50%

Assumptions used in determining the net benefit obligation

Discount rate	**3.25%**	4.50%
Rate of compensation increase	**N/A**	N/A

The Bank has not yet determined the amount of contributions to the plan for 2020.

The plan's assets are allocated as follows at December 31:

	2019	2018
Equity securities	**44 %**	42 %
Fixed income securities	**56 %**	58 %
	100 %	100 %

The fair value of plan assets are considered to be valued using level 1 inputs.

Projected benefits expected to be paid from the plan are as follows:

Year	Amount
2020	$ 1,399,075
2021	134,415
2022	393,033
2023	74,002
2024	580,873
2025 - 2029	1,100,797

The long-term rate of return on assets assumption considers the current earnings on assets of the plan as well as the effects of asset diversification. The plan's investment strategy is to earn a reasonable return while safeguarding the benefits promised to employees. All assets of the plan are maintained in mutual funds with MML Investor services.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

14. Other Operating Expenses

Other operating expenses consist of the following:

	2019	2018
Advertising	**$ 142,850**	$ 82,140
Amortization of intangibles	**223,573**	-
Deposit services	**233,394**	208,805
Directors' fees	**144,347**	142,977
Insurance	**77,694**	68,108
Office supplies and printing	**101,410**	91,737
Postage	**109,526**	91,948
Public relations and contributions	**79,912**	76,863
Regulatory assessments	**49,569**	102,085
Telephone	**92,909**	70,718
Other	**383,463**	332,869
	$ 1,638,647	$ 1,268,250

15. Related-Party Transactions

In the normal course of banking business, loans are made to officers and directors of the Company as well as to companies and individuals affiliated with those officers and directors. The terms of these transactions are substantially the same as the terms provided to other borrowers entering into similar loan transactions. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than normal credit risk.

A summary of these loans is as follows:

	2019	2018
Beginning loan balances	**$ 2,380,463**	$ 2,637,500
Advances	**697,850**	180,414
Repayments	**(895,227)**	(437,451)
Ending loan balances	**$ 2,183,086**	$ 2,380,463

In addition to the outstanding balances listed above, the officers and directors and their related interests had $505,445 and $608,922 in unused loans committed but not funded as of December 31, 2019 and 2018, respectively.

Deposits from officers and directors and their related interests were $2,011,209 and $2,417,381 as of December 31, 2019 and 2018, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Capital Standards

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

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the following table) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital. Common Equity Tier 1 capital for the Bank is reduced by goodwill and other intangible assets, net of associated deferred tax liabilities and subject to transition provisions.

Under the revised prompt corrective action requirements, as of January 1, 2015, insured depository institutions are required to meet the following in order to qualify as "well capitalized:" (1) a common equity Tier 1 risk-based capital ratio of 6.5%; (2) a Tier 1 risk-based capital ratio of 8%; (3) a total risk-based capital ratio of 10%; and (4) a Tier 1 leverage ratio of 5%.

The implementation of the capital conservation buffer began on January 1, 2016, at the 0.625% level and was phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

The following table presents actual and required capital ratios as of December 31, 2019 and 2018, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2019 and 2018, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

16. Capital Standards (Continued)

As of December 31, 2019, the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the Bank's category.

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized under the regulatory framework for prompt corrective action.

	Actual		Minimum capital adequacy		To be well capitalized	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
December 31, 2019						
Tier 1 leverage ratio	**$25,413**	**10.300%**	**$ 9,857**	**4.000%**	**$12,322**	**5.000%**
Tier 1 capital (to risk-weighted assets)	**$25,413**	**15.200%**	**$14,188**	**8.500%**	**$13,353**	**8.000%**
Common equity tier 1 capital ratio (to risk-weighted assets)	**$25,413**	**15.200%**	**$11,684**	**7.000%**	**$10,850**	**6.500%**
Total capital ratio (to risk-weighted assets)	**$27,512**	**16.500%**	**$17,526**	**10.500%**	**$16,692**	**10.000%**
December 31, 2018						
Tier 1 leverage ratio	$26,989	11.100%	$ 9,753	4.000%	$12,191	5.000%
Tier 1 capital (to risk-weighted assets)	$26,989	15.800%	$13,485	7.875%	$13,699	8.000%
Common equity tier 1 capital ratio (to risk-weighted assets)	$26,989	15.800%	$10,916	6.375%	$11,130	6.500%
Total capital ratio (to risk-weighted assets)	$29,145	17.000%	$16,909	9.875%	$17,123	10.000%

Tier 1 capital consists of common stock, additional paid capital, and undivided profits less disallowed deferred tax assets. Total capital includes a limited amount of the allowance for loan losses. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

17. Other Real Estate Owned

Activity in other real estate owned is as follows:

	2019	2018
Beginning of year balance	**$ 743,290**	$ 2,081,322
Additions and improvements	**614,075**	-
Write downs	**-**	(107,200)
Proceeds from sales	**(980,515)**	(1,392,938)
Gain (loss) on sales	**134,979**	162,106
End of year balance	**$ 511,829**	$ 743,290

18. Fair Value Measures

The fair value of an asset or a liability is the price that would be received to sell that asset or paid to transfer that liability in an orderly transaction occurring in the principal market (or most advantageous market in the absence of a principal market) for such asset or liability. In estimating fair value, the Company utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. FASB ASC valuation techniques include the assumptions that market participants would use in pricing an asset or a liability. FASB ASC Topic 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1 inputs – Unadjusted quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs – Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (such as interest rates, volatilities, prepayment speeds, credit risks, etc.) or inputs that are derived principally from or corroborated by market data by correlation or other means.

Level 3 inputs – Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Fair Value Measures (Continued)

In general, fair value is based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market-based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the issuer's creditworthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time. The Company's valuation methodologies may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Although management believes the Company's valuation methodologies are appropriate and consistent with those used by other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different estimate of fair value at the reporting date. Furthermore, the reported fair value amounts have not been comprehensively revalued since the presentation dates, and, therefore, estimates of fair value after the balance sheet date may differ significantly from the amounts presented herein. Transfers between levels of the fair value hierarchy are recognized on the actual date of the event or circumstance that caused the transfer, which generally coincides with the Company's monthly and quarterly valuation process.

Fair value measured on a recurring basis

The Company measures securities available for sale at fair value on a recurring basis. The following table summarizes securities available for sale measured at fair value on a recurring basis, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value. If quoted prices are available in an active market for identical securities, securities are classified within Level 1 of the hierarchy. If quoted market prices are not available, the fair values are estimated using pricing models, quoted prices of securities with similar characteristics or discounted cash flows. The Company has categorized its securities available for sale as follows:

December 31, 2019	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Available for sale				
U.S. government agency	**$ -**	**$ 4,976,383**	**$ -**	**$ 4,976,383**
Mortgage-backed securities	**-**	**9,856,244**	**-**	**9,856,244**
	$ -	**$ 14,832,627**	**$ -**	**$ 14,832,627**
December 31, 2018				
Available for sale				
U.S. government agency	$ -	$ 20,761,710	$ -	$ 20,761,710
Mortgage-backed securities	-	2,112,989	-	2,112,989
	$ -	$ 22,874,699	$ -	$ 22,874,699

The fair values of investment securities are determined using market quotations, pricing models, quoted prices of securities with similar characteristics or discounted cash flows.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Fair Value Measures (Continued)

Fair values on a nonrecurring basis

The Company's other real estate owned and impaired loans are measured at fair value on a nonrecurring basis, which means that the assets are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of reduced property value).

Other real estate owned measured at fair value on a nonrecurring basis is reported at the fair value of the property, assuming that the sale prices of the properties will be their current appraised values. Appraised values are estimated using Level 3 inputs based on observable market data and current property tax assessments. Impaired loans were measured at fair value during the same period and are reported at the fair value of the loan's collateral. Fair value is generally determined using Level 3 inputs based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds.

December 31, 2019	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs	Total
Other real estate owned	**$ -**	**$ -**	**$ 511,829**	**$ 511,829**
Impaired loans	**-**	**-**	**5,127,617**	**5,127,617**
	$ -	**$ -**	**$ 5,639,446**	**$ 5,639,446**
December 31, 2018				
Other real estate owned	$ -	$ -	$ 743,290	$ 743,290
Impaired loans	-	-	5,718,485	5,718,485
	$ -	$ -	$ 6,461,775	$ 6,461,775

FASB ASC Topic 825 requires disclosure of the fair value of financial assets and financial liabilities, including those financial assets and financial liabilities that are not measured and reported at fair value on a recurring basis or nonrecurring basis.

The estimated fair values of the Company's financial assets and liabilities that are not measured and reported at fair value on a recurring or non-recurring basis are summarized in the table below. The fair values of these financial instruments as of December 31, 2019 and 2018, are based on the exit price notion which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between willing parties under current market conditions. Quoted market prices, where available, are shown as estimates of fair market value. The calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values. Most financial instruments do not have quoted market prices and thus the fair value has been determined based on the amount and timing of future cash flows and estimated discount rates based on observable inputs ("Level 2") or unobservable inputs ("Level 3"). The fair values of cash and cash equivalents, accrued interest receivable, and accrued interest payable approximately equals their carrying values and thus are excluded from the table. The carrying amount and estimated fair values of financial instruments reported at amortized cost, segregated by level of valuation inputs within the fair value hierarchy utilized to measure fair value are presented in the following table.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

18. Fair Value Measures (Continued)

	December 31, 2019				
	Carrying amount	Level 1	Level 2	Level 3	Total fair value
Financial assets					
Federal Home Loan Bank and CBB Financial Corp. stock	**$ 282,000**	**$ -**	**$ -**	**$ -**	**N/A**
Loans, net	**185,294,172**	**-**	**186,608,093**	**-**	**186,608,093**
Financial liabilities					
Non term deposits	**$165,756,539**	**$165,756,539**	**$ -**	**$ -**	**$165,756,539**
Time deposits	**48,964,509**	**-**	**48,180,509**	**-**	**48,180,509**
Short-term borrowings	**1,279,631**	**1,279,631**	**-**	**-**	**1,279,631**
Other borrowings	**1,296,000**	**1,296,000**	**-**	**-**	**1,296,000**

	December 31, 2018				
	Carrying amount	Level 1	Level 2	Level 3	Total fair value
Financial assets					
Federal Home Loan Bank and CBB Financial Corp. stock	$ 285,400	$ -	$ -	$ -	N/A
Loans, net	191,754,891	-	190,865,000	-	190,865,000
Financial liabilities					
Non term deposits	$163,316,816	$163,316,316	$ -	$ -	$163,316,316
Time deposits	52,698,964	-	51,546,000	-	51,546,000
Short-term borrowings	1,682,760	1,682,780	-	-	1,682,780

Federal Home Loan Bank and CBB Financial Corp. stock carried at cost are included in the table above because they are considered to be financial instruments not measured and reported at fair value. The Company has not observed any price change from orderly transactions for these or similar investments that would require an adjustment to the carrying value and therefore a fair value cannot be determined.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. Parent Company Financial Information

The balance sheets, statements of income, and statements of cash flows for Peoples Bancorp, Inc. (Parent Only) follow:

Balance Sheets	December 31, 2019	December 31, 2018
Assets		
Cash	**$ 278,707**	$ 292,998
Investment in Bank Subsidiary	**28,395,002**	26,182,845
Other assets	**2,397**	2,665
Total assets	**$ 28,676,106**	$ 26,478,508
Liabilities and Stockholders' Equity		
Other liabilities	**$ 3,608**	$ 4,907
Total liabilities	**3,608**	4,907
Stockholders' equity		
Common stock	**7,289,180**	7,289,180
Additional paid-in capital	**2,212,550**	2,212,550
Retained earnings	**20,107,542**	18,054,635
Accumulated other comprehensive (loss)	**(936,774)**	(1,082,764)
Total stockholders' equity	**28,672,498**	26,473,601
Total liabilities and stockholders' equity	**$ 28,676,106**	$ 26,478,508

Statements of Income	Years Ended December 31, 2019	Years Ended December 31, 2018
Interest revenue	**$ 834**	$ 427
Dividends from Bank Subsidiary	**506,000**	360,000
Equity in undistributed income of Bank Subsidiary	**2,066,166**	1,758,350
	2,573,000	2,118,777
Expenses		
Other	**12,247**	13,117
	12,247	13,117
Income before income tax benefit	**2,560,753**	2,105,660
Income tax (benefit)	**(2,397)**	(2,665)
Net income	**$ 2,563,150**	$ 2,108,325

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

19. Parent Company Financial Information (Continued)

Statements of Cash Flows	Years Ended December 31, **2019**	2018
Cash flows from operating activities		
Interest and dividends received	**$ 506,834**	$ 360,427
Cash paid for operating expenses	**(10,881)**	(10,749)
	495,953	349,678
Cash flows from financing activities		
Dividends paid	**(510,243)**	(357,170)
	(510,243)	(357,170)
Net increase (decrease) in cash	**(14,291)**	(7,492)
Cash at beginning of year	**292,998**	300,490
Cash at end of year	**$ 278,707**	$ 292,998
Reconciliation of net income to net cash provided by operating activities		
Net income	**$ 2,563,150**	$ 2,108,325
Adjustments to reconcile net income to net cash provided by operating activities		
Undistributed net income of subsidiary	**(2,066,166)**	(1,758,350)
(Increase) decrease in other assets	**268**	1,103
Increase (decrease) in other liabilities	**(1,299)**	(1,400)
	$ 495,953	$ 349,678

Established 1910

109 YEARS OF INDEPENDENT COMMUNITY BANKING

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