Delmarva Bancshares, Inc. and Subsidiaries

Annual Report 2019

Delmarva Bancshares, Inc. and Subsidiaries

Financial Report
December 31, 2019

To Our Shareholders:

I am pleased to report 2019 net income for Delmarva Bancshares, Inc., parent company for 1880 Bank, was $3.6 million or $0.59 per share compared to $3.4 million or $0.56 per share for the year ending 2018. As of December 31, 2019, total assets were $375 million, 1% lower than yearend 2018. Total deposits were $314 million, 2% less than yearend 2018, and total loans were $251 million, 2% lower than the same time period 2018. Nonperforming assets ("NPAs") decreased by $1.5 million, or 32%, to $3 million from yearend 2018 to 2019, and NPAs to total assets were 0.85% at December 31, 2019 compared to 1.24% at December 31, 2018. Return on average assets and return on average equity were 0.95% and 7.46%, respectively, for the year ended December 31, 2019. Fully diluted tangible book value increased by $0.55, or 8%, to $7.81 from yearend 2018 to 2019.

We paid quarterly cash dividends of $0.05 per share to our shareholders throughout 2019, our first full year of those payments in over a decade. We achieved greater profitability in 2019 compared to 2018 because of our relentless focus on expense management and improving the quality of our earning assets.

Given our quest to enhance efficient operations throughout the company, in May 2019, we implemented Robotic Process Automation ("RPA"). RPA configures computer software for users to integrate human interaction actions in digital systems for business processes. With RPA, robots can capture data and manipulate applications so that other systems can perform repetitive tasks. In other words, we automated routine, repetitive, tedious and daily manual tasks. RPA allows us to redeploy employees to customer facing initiatives to improve service. Thus far, we have automated 73 tasks and realized total time saved of 12.5 hours daily.

Digital banking continues to expand globally and 1880 Bank rolled out several enhancements and updates to our electronic offerings. In early 2019, we unveiled our new website, 1880bank.com. The new website is simple to use with rich features to enable customers quick online access to their accounts, and the vast services we offer. Customers may also open and fund an account online. In April, customers were able to get instant issuance of an 1880 Bank check card at our branch locations. In December, we released a new and improved mobile banking app. Accessing balances, paying bills, transferring funds and paying individuals never has been easier with our new mobile banking app. We trust you take advantage of the great benefits 1880 Bank provides and the hometown service you deserve.

The strength of Delmarva continues to be our team members who train for and work to deliver exceptional service to customers. Our team of professionals are highly involved in volunteer activities to support the communities we serve. It is our team members' commitment to serve customers and their community that makes us successful.

We, the Board and Management, remain focused on increasing shareholder value and are thankful for your ongoing support, and investment in Delmarva Bancshares, Inc.

Kim C. Liddell

President and Chairman of the Board

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Delmarva Bancshares, Inc.
Cambridge, Maryland

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Delmarva Bancshares, Inc. and its subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, 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 consolidated financial statements (collectively, the financial statements).

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

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the 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 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 financial statements referred to above present fairly, in all material respects, the financial position of Delmarva Bancshares, Inc. and its subsidiaries 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.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 13, 2020

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Balance Sheets
December 31, 2019 and 2018

	2019	2018
Assets		
Cash and due from banks	$ 2,986,944	$ 2,183,443
Interest-bearing deposits in other banks	48,282,938	49,055,712
Federal funds sold	845,731	583,038
Total cash and cash equivalents	52,115,613	51,822,193
Investment securities available-for-sale, at fair value	37,892,946	41,212,705
Investment securities held-to-maturity, at cost	4,639,747	-
Restricted stock, at cost	1,754,200	1,733,700
Total investment securities	44,286,893	42,946,405
Loans receivable, net of allowance for loan losses of $1,914,999 (2019) and $1,917,677 (2018)	248,606,302	253,993,318
Bank premises and equipment, net	5,112,802	5,167,235
Other real estate owned, net of valuation allowance of $81,345 (2019) and $81,345 (2018)	2,636,999	641,705
Accrued interest receivable	661,314	650,840
Goodwill	1,852,120	1,852,120
Core deposit intangible, net	158,386	342,601
Cash surrender value of life insurance	14,500,925	14,209,783
Deferred income taxes	4,357,900	5,448,767
Other assets	1,156,487	986,825
Total Assets	$ 375,445,741	$ 378,061,792
Liabilities and Stockholders' Equity		
Liabilities:		
Deposits:		
Non-interest-bearing	$ 91,415,665	$ 85,251,328
Interest-bearing	222,170,205	234,261,400
Total deposits	313,585,870	319,512,728
Accrued interest payable	165,272	131,691
Accrued benefit obligations	4,755,094	4,723,646
Junior subordinated debt	2,570,008	2,536,753
Senior subordinated debt	4,100,000	4,100,000
Other liabilities	767,339	1,023,148
Total Liabilities	325,943,583	332,027,966
Commitments and contingent liabilities		
Stockholders' Equity:		
Convertible Perpetual Preferred Stock, Series A, $.01 par value per share - 1,206,826 shares authorized, issued and outstanding	12,068	12,068
Convertible Perpetual Preferred Stock, Series B, $.01 par value per share - 852,887 shares authorized, issued and outstanding	8,529	8,529
Common Stock, $.01 par value per share - 7,940,287 shares authorized, 3,968,043 and 3,945,396 (including 22,534 and 25,295 nonvested restricted shares, respectively) shares issued and outstanding, respectively	39,455	39,201
Additional paid-in capital	44,154,234	43,866,712
Retained earnings	4,875,152	2,502,391
Accumulated other comprehensive income (loss)	412,720	(395,075)
Total Stockholders' Equity	49,502,158	46,033,826
Total Liabilities and Stockholders' Equity	$ 375,445,741	$ 378,061,792

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Income
Years Ended December 31, 2019 and 2018

	2019	2018
Interest and Dividend Income:		
Loans, including fees	$ 11,966,375	$ 12,040,407
Investment securities	1,069,037	882,766
Dividends on restricted stock	105,842	106,305
Interest on deposits in other banks	1,134,511	585,786
Interest on federal funds sold	15,302	6,488
Total interest income	14,291,067	13,621,752
Interest Expense:		
Deposits	1,321,645	960,454
Junior subordinated debt	198,957	188,337
Senior subordinated debt	290,986	290,986
Borrowed funds	21	3
Total interest expense	1,811,609	1,439,780
Net interest income	12,479,458	12,181,972
(Recovery of) Provision for Loan Losses	(8,322)	168,064
Net interest income after (recovery of) provision for loan losses	12,487,780	12,013,908
Noninterest Income:		
Service charges on deposit accounts	701,255	710,227
Other fees and commissions	840,543	666,769
Income on bank owned life insurance	291,143	309,230
Income from recoveries on acquired loans	23,446	303,367
Other income	18,293	40,674
Total noninterest income	1,874,680	2,030,267
Noninterest Expense:		
Salaries and employee benefits	4,231,957	4,426,537
Premises and equipment	1,121,042	1,134,242
Data processing	1,933,350	1,653,973
OREO write-downs, net losses on sales, and operating expenses	220,546	28,542
Professional fees	722,228	848,623
Director fees	240,000	240,000
Core deposit amortization	184,215	254,391
FDIC assessments	50,271	100,244
Regulatory examination assessments	42,600	41,148
Other insurance expense	142,435	121,826
Other expenses	620,457	725,028
Total noninterest expense	9,509,101	9,574,554
Net income before income taxes	4,853,359	4,469,621
Income tax expense	1,275,683	1,091,774
Net income	$ 3,577,676	$ 3,377,847
Net Income per Common Share: Basic and Diluted	$ 0.59	$ 0.56

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Comprehensive Income
Years Ended December 31, 2019 and 2018

	2019	2018
Net income	**$ 3,577,676**	$ 3,377,847
Other comprehensive income (loss):		
Changes in net unrealized gains (losses) on securities available for sale net of tax of ($329,944) and $67,879, respectively	**807,795**	(178,794)
Total other comprehensive income (loss)	**807,795**	(178,794)
Comprehensive income	**$ 4,385,471**	$ 3,199,053

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Changes in Stockholders' Equity
Years Ended December 31, 2019 and 2018

	Series A Preferred Stock	Series B Preferred Stock	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balances, December 31, 2017	$ 12,068	$ 8,529	$ 38,944	$ 43,651,548	$ (575,117)	$ (216,281)	$ 42,919,691
Stock based compensation, net	-	-	-	281,300	-	-	281,300
Repurchase of common stock (8,069 shares)	-	-	(81)	(65,798)	-	-	(65,879)
Vesting of restricted shares (33,796 shares)	-	-	338	(338)	-	-	-
Net income	-	-	-	-	3,377,847	-	3,377,847
Dividends on common and preferred stock	-	-	-	-	(300,339)	-	(300,339)
Other comprehensive income (loss)	-	-	-	-	-	(178,794)	(178,794)
Balances, December 31, 2018	12,068	8,529	39,201	43,866,712	2,502,391	(395,075)	46,033,826
Stock based compensation, net	**-**	**-**	**-**	**368,659**	**-**	**-**	**368,659**
Repurchase of common stock (9,961 shares)	**-**	**-**	**(99)**	**(80,784)**	**-**	**-**	**(80,883)**
Vesting of restricted shares (35,277 shares)	**-**	**-**	**353**	**(353)**	**-**	**-**	**-**
Net income	**-**	**-**	**-**	**-**	**3,577,676**	**-**	**3,577,676**
Dividends on common and preferred stock	**-**	**-**	**-**	**-**	**(1,204,915)**	**-**	**(1,204,915)**
Other comprehensive income (loss)	**-**	**-**	**-**	**-**	**-**	**807,795**	**807,795**
Balances, December 31, 2019	**$ 12,068**	**$ 8,529**	**$ 39,455**	**$ 44,154,234**	**$ 4,875,152**	**$ 412,720**	**$ 49,502,158**

See Notes to Consolidated Financial Statements.

Delmarva Bancshares, Inc. and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
Cash Flows From Operating Activities:		
Net income	$ 3,577,676	$ 3,377,847
Adjustments to reconcile net income to net		
cash provided by operating activities:		
Depreciation, amortization and accretion, net	622,622	655,888
Net accretion of acquisition accounting adjustments	(364,594)	(635,715)
Stock based compensation, net	368,659	281,300
Deferred income tax expense	760,921	887,935
(Recovery of) provision for loan losses	(8,322)	168,064
Income on investment in life insurance	(291,142)	(309,230)
Income accretion on annuity investments	(39,817)	-
Gain on sale of premises and equipment	-	(17,497)
Losses on other real estate owned write-downs and sales, net	200,695	6,274
Net change in:		
Accrued interest and other assets	(18,330)	(228,661)
Accrued interest and other liabilities	(353,692)	123,897
Net cash provided by operating activities	4,454,676	4,310,102
Cash Flows From Investing Activities:		
Proceeds from sales, maturities, calls and principal paydowns		
of available-for-sale securities	5,317,431	6,198,480
Purchases of available-for-sale securities	(1,059,023)	(14,124,281)
Purchases of held-to-maturity securities	(4,599,930)	-
Purchase of restricted stock, net	(20,500)	(27,100)
Decrease (increase) in loans, net	3,243,202	(6,992,973)
Proceeds from sale of other real estate owned	546,371	212,426
Purchase of premises and equipment	(385,697)	(483,294)
Proceeds from sale of premises and equipment	-	27,500
Net cash provided by (used in) investing activities	3,041,854	(15,189,242)
Cash Flows From Financing Activities:		
Increase in demand, money markets, and savings deposits	1,038,903	13,290,828
(Decrease) increase in time deposits	(6,956,215)	6,537,590
Repurchase of common stock	(80,883)	(65,879)
Dividends on common and preferred stock	(1,204,915)	(300,339)
Net cash (used in) provided by financing activities	(7,203,110)	19,462,200
Increase in cash and cash equivalents	293,420	8,583,060
Cash and Cash Equivalents, Beginning of Year	51,822,193	43,239,133
Cash and Cash Equivalents, End of Year	$ 52,115,613	$ 51,822,193
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for:		
Interest	$ 1,801,737	$ 1,420,406
Taxes	$ 519,756	$ 445,000
Unrealized gain (loss) on securities available for sale	$ 1,137,739	$ (258,033)
Loans transferred to other real estate owned	$ 2,742,360	$ 526,166
Increase in operating lease right-of-use asset upon adoption of ASU 2016-02	$ 161,805	$ -
Increase in operating lease liability upon adoption of ASU 2016-02	$ 161,805	$ -

See Notes to Consolidated Financial Statements.

Note 1. Nature of Operations and Significant Accounting Policies

Principles of Consolidation: The accompanying consolidated financial statements include the accounts of Delmarva Bancshares, Inc. (the "Company"), 1880 Bank (formerly The National Bank of Cambridge), Idlewild Properties, LLC ("Idlewild") and Easton Capital Trust I, all wholly-owned subsidiaries of the Company. All material intercompany accounts and transactions have been eliminated in consolidation, with the exception of Easton Capital Trust, as detailed in Note 8.

Nature of Operations: On October 31, 2014, The National Bank of Cambridge converted from a federal to a state charter and was renamed 1880 Bank (the "Bank"). The 1880 Bank name was inspired by the institution's founding year, reflecting its heritage and 139 years of service to the Delmarva Peninsula community. The name also provides the Company with flexibility to grow and expand geographically. The Bank provides full banking services to individuals and business customers located in Dorchester and Talbot Counties and surrounding areas of the Eastern Shore of Maryland and throughout the Delmarva Peninsula and is subject to competition from other financial institutions. As a state bank, the Bank is subject to regulations of the Office of the Commissioner of Financial Regulation for the State of Maryland and the Federal Reserve Bank of Richmond. The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("US GAAP") and prevailing practices within the banking industry.

On July 15, 2015, the Company completed its acquisition of Easton Bancorp, Inc. ("Easton") pursuant to the terms and conditions of the Agreement and Plan of Merger, dated March 31, 2015 (the "Easton Merger Agreement"), between the Company and Easton. Easton was headquartered in Easton, Maryland, and engaged in banking operations through its subsidiary bank, Easton Bank & Trust. The transaction expanded the Company's footprint in Maryland, adding three branches. Refer to Note 2 for further details on the merger. Idlewild, which was formed to hold the Easton's foreclosed real estate, was acquired as part of the acquisition.

Use of Estimates: In preparing consolidated financial statements in conformity with US GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan losses, acquired loans with specific credit-related deterioration and valuation of other real estate owned.

Cash and Cash Equivalents: For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and due from bank balances, interest-bearing deposits in other banks, and federal funds sold, all of which have original maturities of ninety days or less. Included in cash and due from bank balance on the consolidated balance sheets were restricted funds on deposit with the Federal Reserve Bank totaling $1.7 million and $1.8 million at December 31, 2019 and 2018, respectively.

In addition, the Company maintains cash balances in other correspondent banks that may exceed federally insured limits. The Company has not experienced any losses in such accounts and does not believe it is exposed to any significant credit risk with the associated counterparties.

Investment Securities: Debt securities are classified and carried at amortized cost when management has the positive intent and ability to hold them to maturity. Debt securities are classified as available for sale when they might be sold before maturity. Securities available for sale are carried at fair value, with the unrealized holding gains and losses reported in other comprehensive income, net of tax. Equity securities are carried at fair value, with changes in fair value reported in net income. Equity securities without readily determinable fair value are carried at cost, net of impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Realized gains or losses on the sale of securities are reported in earnings and are determined using the adjusted cost of the specific security sold. Interest income is accrued on the investment's face value. Purchase premium and discounts are recognized in interest income using the interest method over the term of the securities. As of December 31, 2019 and 2018, the Company did not hold any trading securities. As of December 31, 2019 and 2018, the Company held $4.6 million and $0 in held-to-maturity securities.

Investment securities are impaired when fair value is less than cost. An impairment is considered "other than temporary" if any of the following conditions are met: the Company intends to sell the security, it is more likely than not that the Company will be required to sell the security before the recovery of its amortized cost basis, or the Company does not expect to recover the security's entire amortized cost basis (even if the Company does not intend to sell). The Company does not have any securities impairment that is considered "other-than-temporary" at December 31, 2019 and 2018.

Loans: Loans are reported at their recorded investment, which is the principal amount outstanding, as adjusted for partial charge-offs, payments received on nonaccrual loans, and net deferred fees or cost of loan originations. The balance of the allowance for loan losses is netted against the recorded investment in loans on the consolidated balance sheets. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the yield on the related loans using the interest method. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on all classes of loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal in accordance with the loan's contractual terms, or when a loan becomes contractually past due by ninety days or more with respect to principal or interest. All interest accrued, but not collected, for loans placed on nonaccrual or charged-off is reversed against interest income.

Income on nonaccrual loans is recognized using the cost recovery method. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest. Loans are considered past due when the borrower is not current with their payments in accordance with the contractual terms of their loan agreement.

Troubled Debt Restructurings: In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify a borrower in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance, and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the underlying collateral. In cases where a borrower is granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans.

Allowance for Loan Losses: The allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent losses that are probable and can be reasonably estimated within the loan portfolio. The allowance for loan losses is based upon management's continuing assessment of various factors affecting the collectibility of loans, including current economic conditions, past credit experience, the value of the underlying collateral, and such other factors as in management's judgment deserve current recognition in estimating probable credit losses. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Loans deemed uncollectible are charged off and deducted from the allowance for loan losses while subsequent recoveries are credited to the allowance for loan losses.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

All classes of loans are charged off against the allowance for loan losses when the loan or a portion of the loan is deemed uncollectible. A loan or portion of the loan may be deemed uncollectible, when, for example, pending legal action, such as foreclosure, is expected to result in a collateral shortfall. Any loan or portion of a loan with an internally assigned grade of "loss" is charged off in the month such grade was assigned.

The allowance for loan losses consists of specific, general, and unallocated components. For loans that are classified as impaired, a specific allowance for loan losses is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. For collateral dependent loans, an updated appraisal will be ordered if a current one is not on file. Appraisals are performed by independent third-party appraisers with relevant industry experience. Adjustments to the appraised value may be made based on recent sales of like properties or general market conditions when appropriate. The general component covers non-classified, or performing, loans and those loans classified as substandard or special mention that are not impaired. The general component is based on historical loss experience adjusted for qualitative factors. Non-impaired classified loans are assigned a higher allowance factor than non-classified loans, which increases with the severity of classification. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance for loan losses reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Management has an established, internally-developed methodology to determine the adequacy of the allowance for loan losses that assesses the risks inherent in the loan portfolio. For purposes of determining the allowance for loan losses, management has segmented certain loans in the portfolio by product type. Loans are grouped into the following segments: Residential Real Estate, Commercial Real Estate, Real Estate Development, Commercial and Consumer. As the first step in determining the general component of the allowance for loan losses, management uses the average of the last three years of net charge-off experience for each segment of the portfolio. The historical loss percentage calculated is applied to the quarter end balance of each portfolio segment. The historical component is further adjusted by management's evaluation of various conditions per segment including changes in loan policy and underwriting standards, changes in national and local economic conditions, changes in the nature or volume of the loan portfolio, changes in the ability of lending management and staff, changes in the levels of past dues, nonaccruals and risk rated loans, changes in the quality of the loan review system, changes in the value of underlying collateral for secured loans, effects of concentrations and changes in their levels, changes in value and severity of past due loans and adversely classified loans, changes in collateral value of real estate loans, and the effects of external factors including competition, legal and regulatory risks.

The evaluation also considers the following risk characteristics of each loan portfolio segment:

- Residential real estate loans, including equity lines of credit, carry risks associated with the continued creditworthiness of the borrower and the changes in the value of the underlying collateral.
- Commercial real estate loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate. Commercial real estate lending typically involves higher loan principal amounts than residential lending and the repayment of these loans is generally largely dependent on the successful operation or sale of the income producing property securing the loan or the business conducted on the property securing the loan.
- Real estate development loans carry the same risks associated with real estate loans as described above. Construction loans also bear the risk that the general contractor, who may or may not be a loan customer, may not be able to finish the construction project as planned because of financial pressure unrelated to the project.
- Commercial loans carry risks associated with the successful operation of a business, in addition to other risks associated with ownership, because the repayment of these loans may be dependent upon the profitability and cash flows of the underlying business or project. In addition, there is risk associated with the value of collateral, if secured, other than real estate that may depreciate over time and cannot be appraised with as much precision.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

- Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral (e.g., rapidly-depreciating assets such as automobiles), or lack thereof. Consumer loans are more likely than real estate loans to be immediately adversely affected by job loss, divorce, illness or personal bankruptcy.

Management further divides the commercial and consumer segments into secured and unsecured classes when analyzing the portfolio.

To determine the specific reserve component of the allowance for loan losses, management evaluates all impaired loans to determine the amount of anticipated loss. Management evaluates all segments of loans for impairment, except for smaller balance homogeneous loans. Accordingly, management does not separately identify consumer loans for impairment disclosures unless such loans are the subject of a restructuring agreement. A loan is considered impaired when management determines it is probable the Company will be unable to collect all amounts when due according to the original contractual terms of the loan agreement. Impaired loans are carried at the estimated present value of total expected future cash flows, discounted at the loan's effective rate, or the fair value of the collateral, if the loan is collateral-dependent.

In connection with the acquisition of Easton, certain loans were acquired which exhibited deteriorated credit quality since origination for which the Company does not expect to collect all contractual payments. These purchased credit impaired loans are recorded at fair value, such that there is no carryover of the seller's allowance for loan losses. After acquisition, losses are recognized by an increase in the provision for loan losses.

Such purchased credit impaired loans are accounted for individually or aggregated into pools of loans based on common risk characteristics such as credit score, loan type, and date of origination. The Company estimates the amount and timing of expected cash flows for each loan pool, and the expected cash flows in excess of fair value is recorded as interest income over the remaining life of the loan pool (accretable yield). The excess of the loan pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

Over the life of the loan or pool, expected cash flows continue to be estimated. If the present value of expected cash flows is less than the carrying amount, a loss is recorded as a provision for loan losses. If the present value of expected cash flows is greater than the carrying amount, it is recognized as part of future interest income.

There were no changes in the Company's allowance for loan loss methodology during 2019 or 2018.

Premises and Equipment: Land is carried at cost. Property and equipment are stated at cost, less accumulated depreciation, which is computed on the straight-line method over the estimated useful lives of the assets, which range between 5 and 40 years.

Maintenance and repairs of property and equipment are charged to operations, and major improvements are capitalized. Upon retirement, sale, or other disposition of premises and equipment, the cost and accumulated depreciation are eliminated from the accounts, and any gain or loss is included in either noninterest income or noninterest expense, respectively.

Other Real Estate Owned (OREO): Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less cost to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in noninterest expense.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Goodwill and Intangible Assets: The Company records as goodwill the excess of purchase price over the fair value of the identifiable net assets acquired. Goodwill is subject to at least an annual assessment for impairment by applying a fair value based test. Additionally, acquired intangible assets (such as core deposit intangibles) are separately recognized if the benefit of the assets can be sold, transferred, licensed, rented, or exchanged, and amortized over their useful lives. The cost of purchased deposit relationships, based on independent valuation, is being amortized over the estimated life of 79 months.

Impairment testing on goodwill and core deposit intangibles is being performed annually upon the anniversary of the Easton acquisition, as well as when an event triggering impairment may have occurred. Accounting guidance permits preliminary assessment of qualitative factors to determine whether more substantial impairment testing is required. No indicators of impairment have occurred since the Easton acquisition in July 2015. No impairment was identified during the Company's 2019 or 2018 annual analysis of goodwill.

Bank Owned Life Insurance: Bank owned life insurance is reflected as the cash surrender value of the policies as provided by the insurer on a monthly basis.

Earnings per Share of Common Stock: The Company applies the two-class method of computing basic and diluted net income per common share. Under the two-class method, net income per common share is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Based on the Financial Accounting Standards Board ("FASB") guidance, the Company considers its Series A and B Preferred Stock to be participating securities. FASB guidance requires that all outstanding unvested share-based payment awards that contain rights to nonforfeitable dividends participate in undistributed earnings with common shareholders. Accordingly, the weighted average number of shares of the Company's common stock used in the calculation of basic and diluted net income per common share includes any unvested restricted stock of the Company's common stock outstanding. Potential common shares that may be issued by the Company relate to outstanding stock options and the Company's Series A and B Preferred Stock, and are determined using the treasury method. Earnings per share calculations are presented in Note 17.

Income Taxes: Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on the currently enacted tax laws and rates applicable to periods in which the differences are expected to affect taxable income. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable or refundable for the period adjusted for the change during the period in deferred tax assets and liabilities.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits, if any, are classified as additional income taxes in the consolidated statements of operations. As of December 31, 2019 and 2018, there was no liability recorded for unrecognized tax benefits.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Retirement Plans: The Company maintains a multiple employer defined benefit plan covering all full-time employees with more than one year of service as of October 31, 2010. This plan was frozen at October 31, 2010. The Company also maintains a 401k profit sharing plan covering substantially all employees. The Company provides a safe harbor contribution of 3% of participants' compensation and a 50% match for employee contributions up to 6%.

Stock-Based Compensation: The Company has a stock-based compensation plan, which is more fully described in Note 22. Costs resulting from share-based payments to employees are recognized in the consolidated financial statements.

Advertising Costs: Advertising costs are expensed as incurred. Advertising costs were $53,066 and $40,324 for the years ended December 31, 2019 and 2018, respectively.

Transfers of Financial Assets: Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Off-Balance-Sheet Financial Instruments: In the ordinary course of business, the Company has entered into off-balance-sheet agreements consisting primarily of commitments to extend credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

Comprehensive Income: Accounting principles generally require that recognized revenue, expenses, gains, and losses be included in net income. Certain changes in assets and liabilities, such as unrealized gains and losses on available-for-sale securities are components of other comprehensive income (loss). These components, along with net income, are reported in separate Consolidated Statements of Comprehensive Income. All the Company's other comprehensive income (loss) is related to unrealized gains and losses on available-for-sale securities for the years ended December 31, 2019 and 2018.

Mergers and Acquisitions: Business combinations are accounted for under Accounting Standards Codification ("ASC") 805, "*Business Combinations"*, using the acquisition method of accounting. The acquisition method of accounting requires an acquirer to recognize the assets acquired and the liabilities assumed at the acquisition date measured at their fair values as of that date. To determine the fair values, the Company relies on third-party valuations, such as appraisals, and third-party valuations based on discounted cash flow analyses or other valuation techniques. Under the acquisition method of accounting, the Company identifies the acquirer and the closing date and applies applicable recognition principles and conditions. Acquisition-related costs are costs the Company incurs to effect a business combination. Those costs include advisory, legal, accounting, valuation, and other professional or consulting costs. Some other examples of costs to the Company include systems conversions, integration planning consultants, and advertising costs. The Company accounts for acquisition-related costs as noninterest expense in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities are recognized in accordance with other applicable US GAAP.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Leases: On January 1, 2019, the Company adopted Accounting Standards Update ("ASU") No. 2016-02, "Leases (Topic 842)." Among other things, in the amendments in ASU 2016-02, lessees are required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (1) A lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (2) A right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. Under the new guidance, lessor accounting is largely unchanged. Certain targeted improvements were made to align, where necessary, lessor accounting with the lessee accounting model and Topic 606, Revenue from Contracts with Customers. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach does not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The FASB made subsequent amendments to Topic 842 through ASU 2018-10 ("Codification Improvements to Topic 842, Leases") and ASU 2018-11 ("Leases (Topic 842): Targeted Improvements"). Among these amendments is the provision in ASU 2018-11 that provides entities with an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which it adopts the new leases standard will continue to be in accordance with current US GAAP (Topic 840, Leases). The adoption of this standard did not have a material effect on the Company's consolidated financial statements. For further information about the Company's leases, see Note 25.

Recent Accounting Pronouncements:

During June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public business entities ("PBEs") that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer, excluding smaller reporting companies, the standard is effective for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements.

During January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. PBEs that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

During August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement – Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement." The amendments in this ASU modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement to improve the effectiveness of disclosures in the notes to financial statements by facilitating clear communication of the information required by US GAAP that is most important to users of each entity's financial statements. The amendments for all entities are effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2019. Early adoption is permitted upon issuance of this update. The Company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various Transition Resource Group (TRG) Meetings. The effective date of each of the amendments depends on the adoption date of ASU 2016-1, ASU 2016-03, and ASU 2017-12. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief." The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The effective date and transition methodology for the amendments in ASU 2019-05 are the same as in ASU 2016-13. The Company is currently assessing the impact that ASU 2019-05 will have on its consolidated financial statements.

In November 2019, the FASB issued ASU 2019-11, "Codification Improvements to Topic 326, Financial Instruments – Credit Losses." The ASU addresses issues raised by stakeholders during the implementation of ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." Among other narrow-scope improvements, the new ASU clarifies guidance around how to report expected recoveries. "Expected recoveries" describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. While applying the credit losses standard, stakeholders questioned whether expected recoveries were permitted on assets that had already shown credit deterioration at the time of purchase (also known as PCD assets). In response to this question, the ASU permits organizations to record expected recoveries on PCD assets. In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities. The ASU includes effective dates and transition requirements that vary depending on whether or not an entity has already adopted ASU 2016-13. The Company is currently assessing the impact that ASU 2019-11 will have on its consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. The ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. For PBEs, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-12 will have on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

In January 2020, the FASB issued ASU 2020-01, "Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815." The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2016-01 made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. For PBEs, the amendments in the ASU are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2020-01 to have a material impact on its consolidated financial statements.

Note 2. Acquisition of Easton Bancorp, Inc.

On July 15, 2015, the Company completed its acquisition of Easton. The merger of Easton with and into the Company was effected pursuant to the terms and conditions of the Easton Merger Agreement. Immediately after the merger, Easton Bank & Trust, Easton's wholly owned bank subsidiaries, merged with and into the Bank. Pursuant to the Easton Merger Agreement, Easton shareholders received cash of $9.60 for each share of Easton stock held immediately prior to the effective date of the merger. The cash portion of the merger consideration was funded through a private capital raise and no borrowing was incurred by the Company or the Bank in connection with the merger. There were no replacement stock awards issued as part of the transaction.

The transaction was accounted for using the acquisition method of accounting and, accordingly, assets acquired, liabilities assumed, and consideration exchanged were recorded at fair value on the acquisition date.

A core deposit intangible of $1.5 million was recognized in connection with the acquisition of Easton. This intangible is being amortized over 79 months on an accelerated cost recovery basis with 25 months remaining at December 31, 2019.

Amortization expense of core deposit intangibles for the years ended December 31, 2019 and 2018 were $184,215 and $254,391, respectively. At December 31, 2019, the estimated future amortization expense of core deposit intangibles is as follows:

	Amount
2020	**$ 114,038**
2021	**43,861**
2022	**487**
	$ 158,386

Note 3. Investment Securities

Investment securities are summarized as follows at December 31, 2019 and 2018:

December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
Obligations of U.S. Government agencies and corporations	**$ 2,503,339**	**$ 2,761**	**$ -**	**$ 2,506,100**
Mortgage backed securities	**7,957,765**	**79,329**	**(17,121)**	**8,019,973**
Collateralized mortgage obligations	**26,850,546**	**553,995**	**(37,668)**	**27,366,873**
	37,311,650	**636,085**	**(54,789)**	**37,892,946**
Held-to-Maturity:				
Other securities	**4,639,747**	**-**	**-**	**4,639,747**
	$ 41,951,397	**$ 636,085**	**$ (54,789)**	**$ 42,532,693**

December 31, 2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Available-for-Sale:				
Obligations of U.S. Government agencies and corporations	$ 2,506,649	$ -	$ (46,749)	$ 2,459,900
Mortgage backed securities	10,077,649	25,789	(117,706)	9,985,732
Collateralized mortgage obligations	29,184,850	32,808	(450,585)	28,767,073
	$ 41,769,148	$ 58,597	$ (615,040)	$ 41,212,705

The following table shows gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 2019 and 2018:

	Less Than 12 Months		**12 Months or More**		**Total**	
December 31, 2019	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**	**Fair Value**	**Unrealized Losses**
Mortgage backed securities	**$ 1,042,833**	**$ (5,180)**	**$ 1,960,331**	**$ (11,941)**	**$ 3,003,164**	**$ (17,121)**
Collateralized mortgage obligations	**3,086,747**	**(8,287)**	**2,120,749**	**(29,381)**	**5,207,496**	**(37,668)**
	$ 4,129,580	**$ (13,467)**	**$ 4,081,080**	**$ (41,322)**	**$ 8,210,660**	**$ (54,789)**

	Less Than 12 Months		12 Months or More		Total	
December 31, 2018	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of U.S. Government agencies and corporations	$ -	$ -	$ 2,459,900	$ (46,749)	$ 2,459,900	$ (46,749)
Mortgage backed securities	1,309,771	(5,772)	7,568,061	(111,934)	8,877,832	(117,706)
Collateralized mortgage obligations	7,075,882	(16,347)	13,351,504	(434,238)	20,427,386	(450,585)
	$ 8,385,653	$ (22,119)	$ 23,379,465	$ (592,921)	$ 31,765,118	$ (615,040)

At December 31, 2019, twenty-six securities with a fair value of $8.2 million had gross unrealized losses of $54,789. At December 31, 2018, sixty-three securities with a fair value of $31.8 million had gross unrealized losses of $615,040. As of December 31, 2019 and 2018, the Company's unrealized losses in investment securities are related to interest rate fluctuations and not credit deterioration. In addition, these securities are investment grade. Since the Company does not intend to sell any of the investments before recovery of their amortized cost basis and has the ability and intent to hold these investments to maturity, the Company does not consider these investments to be other-than-temporarily impaired.

Note 3. Investment Securities (Continued)

The amortized cost and estimated fair value of debt securities at December 31, 2019, by contractual maturity are shown in the table that follows. Maturities may differ from contractual maturities in mortgage-backed securities because the mortgages underlying the securities may be called or prepaid without any penalties.

	Available-for-Sale	
December 31, 2019	**Amortized Cost**	**Fair Value**
Due in one year or less	**$ 4,026,469**	**$ 4,029,916**
Due after one year through five years	**8,915,758**	**8,990,056**
Due after five years through ten years	**4,187,225**	**4,335,701**
Due after ten years	**20,182,198**	**20,537,273**
	$ 37,311,650	**$ 37,892,946**

The held-to-maturity securities are tied to the retirement plan of the Company's Chairman and President and will begin amortizing upon his retirement until the annuity is fully disbursed. The Company did not sell any securities during the years ended December 31, 2019 and 2018.

Investment securities with a carrying value of $20.1 million and $30.0 million were pledged as collateral of certain government agencies and municipalities as required or permitted by law at December 31, 2019 and 2018, respectively.

Note 4. Loans Receivable and Allowance for Loan Losses

The Company makes loans to customers primarily on the Eastern Shore of the State of Maryland in an economy closely tied to agriculture and the seafood industry. A substantial portion of its loan portfolio consists of residential and commercial real estate mortgages. The principal categories of the loan portfolio are as follows at December 31, 2019 and 2018:

	2019	2018
Real estate loans:		
Residential real estate	**$ 104,625,543**	$ 104,332,670
Commercial real estate	**120,086,036**	120,886,483
Real estate development	**4,670,661**	2,781,210
Commercial loans:		
Secured	**18,261,887**	24,884,223
Unsecured	**360,912**	607,653
Consumer loans:		
Secured	**1,573,791**	1,474,077
Unsecured	**278,477**	297,285
Gross loans	**249,857,307**	255,263,601
Unearned income on loans	**663,994**	647,394
Allowance for loan losses	**(1,914,999)**	(1,917,677)
Net loans	**$ 248,606,302**	$ 253,993,318

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Acquired Loans

The outstanding principal balance and the carrying amount of acquired loans included in the consolidated balance sheet as of December 31, 2019 and 2018 are as follows:

	2019	2018
Outstanding principal balance	**$ 17,756,835**	$ 28,342,372
Carrying amount	**17,237,417**	27,625,204

The outstanding principal balance and related carrying amount of purchased credit impaired loans, for which the Company applies ASC 310-30, to account for interest earned, as of December 31, 2019 and 2018 are as follows:

	2019	2018
Outstanding principal balance	**$ 6,320,858**	$ 8,041,663
Carrying amount	**3,677,631**	5,028,717

The following table presents changes in the accretable yield on purchased credit impaired loans, for which the Company applies ASC 310-30, for the years ended December 31, 2019 and 2018:

	2019	2018
Balance, Beginning of Year	**$ 2,104,912**	$ 2,169,679
Accretion	**(790,795)**	(994,726)
Reclassification from nonaccretable difference, due to improvement in expected cash flows	**74,716**	494,625
Other changes, net (1)	**456,805**	435,334
Balance, End of Year	**$ 1,845,638**	$ 2,104,912

(1) Represents net increases (decreases) in expected cash flows resulting from other changes in the loan pools including, but not limited to, loan term and interest rate assumptions or the receipt of payments not originally forecasted.

An analysis of the allowance for loan losses follows for the years ended December 31, 2019 and 2018:

	2019	2018
Balance, beginning of year	**$ 1,917,677**	$ 1,846,815
Charge-offs	**(2,567)**	(101,916)
Recoveries	**8,211**	4,714
Provision for (recovery of) loan losses	**(8,322)**	168,064
Balance, end of year	**$ 1,914,999**	$ 1,917,677

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

A summary of the break down in the allowance for loan losses, by segment, follows for the years ended December 31, 2019 and 2018:

	Residential Real Estate	Commercial Real Estate	Real Estate Development	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for Loan Losses:							
Balance, December 31, 2018	$ 555,415	$ 1,032,015	$ 57,451	$ 268,044	$ 4,752	$ -	$ 1,917,677
Charge-offs	-	-	-	-	(2,567)	-	(2,567)
Recoveries	-	-	-	-	8,211	-	8,211
Provision for loan losses	44,604	16,055	9,998	(77,765)	(2,519)	1,305	(8,322)
Balance, December 31, 2019	$ 600,019	$ 1,048,070	$ 67,449	$ 190,279	$ 7,877	$ 1,305	$ 1,914,999
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Ending balance: collectively evaluated for impairment	$ 600,019	$ 1,048,070	$ 67,449	$ 190,279	$ 7,877	$ 1,305	$ 1,914,999
Ending balance: acquired impaired loans	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Balance, December 31, 2019	$ 104,625,543	$ 120,086,036	$ 4,670,661	$ 18,622,799	$ 1,852,268	$ -	$ 249,857,307
Ending balance: individually evaluated for impairment	$ 496,797	$ 2,223,287	$ -	$ -	$ 28,081	$ -	$ 2,748,165
Ending balance: collectively evaluated for impairment	$ 101,985,055	$ 116,744,749	$ 4,597,476	$ 18,280,044	$ 1,824,187	$ -	$ 243,431,511
Ending balance: acquired impaired loans	$ 2,143,691	$ 1,118,000	$ 73,185	$ 342,755	$ -	$ -	$ 3,677,631

	Residential Real Estate	Commercial Real Estate	Real Estate Development	Commercial and Industrial	Consumer	Unallocated	Total
Allowance for Loan Losses:							
Balance, December 31, 2017	$ 555,995	$ 870,232	$ 127,871	$ 282,093	$ 10,458	$ 166	$ 1,846,815
Charge-offs	(16,628)	(80,468)	-	-	(4,820)	-	(101,916)
Recoveries	-	-	-	-	4,714	-	4,714
Provision for loan losses	16,048	242,251	(70,420)	(14,049)	(5,600)	(166)	168,064
Balance, December 31, 2018	$ 555,415	$ 1,032,015	$ 57,451	$ 268,044	$ 4,752	$ -	$ 1,917,677
Ending balance: individually evaluated for impairment	$ -	$ -	$ -	$ 1,441	$ -	$ -	$ 1,441
Ending balance: collectively evaluated for impairment	$ 555,415	$ 1,032,015	$ 57,451	$ 266,603	$ 4,752	$ -	$ 1,916,236
Ending balance: acquired impaired loans	$ -	$ -	$ -	$ -	$ -	$ -	$ -
Balance, December 31, 2018	$ 104,332,670	$ 120,886,483	$ 2,781,210	$ 25,491,876	$ 1,771,362	$ -	$ 255,263,601
Ending balance: individually evaluated for impairment	$ 531,069	$ 4,555,485	$ -	$ 17,564	$ 31,398	$ -	$ 5,135,516
Ending balance: collectively evaluated for impairment	$ 101,346,066	$ 114,230,880	$ 2,702,308	$ 25,080,150	$ 1,739,964	$ -	$ 245,099,368
Ending balance: acquired impaired loans	$ 2,455,535	$ 2,100,118	$ 78,902	$ 394,162	$ -	$ -	$ 5,028,717

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Management evaluates the credit quality of all loans based on an internal grading system that estimates the borrower's capability to repay the contractual terms of their loan agreement as scheduled or at all. The Company's internal risk grading is based on experiences with similarly graded loans. Management analyzes risk grades on an ongoing basis. In addition, risk grades are assessed and validated by an independent loan review performed at least annually.

The Company's internally assigned grades are as follows:

- Pass – Loans classified as pass are supported by adequate financial statements, adequately secured by collateral and borrower demonstrates the ability to repay from normal business operations.
- Special Mention – Loans classified as special mention have a potential weakness that deserves management's close attention and include loans with characteristics such as significant guideline or policy exceptions that are not offset by appropriate mitigating factors, extending loans that are currently performing satisfactorily but with potential weaknesses that may, if not corrected, weaken the asset or inadequately protect the Company's position at some future date and loans where the development of adverse economic conditions subsequent to origination would substantially increase the level of risk, but may not jeopardize liquidation of the collateral.
- Substandard – Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans are classified substandard that have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected. Loans in the category are characterized by deterioration in quality exhibited by any number of well-defined weaknesses requiring corrective action. The repayment ability of the borrower is marginal or weak and the loan may have exhibited excessive overdue status or extensions and/or renewals.
- Doubtful – Loans classified as doubtful have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and therefore improbable. However, the loans are not yet rated loss because events may occur that could salvage the debt.
- Loss – Loans classified as loss are considered uncollectible and of such little value that their continuance as bankable assets is not warranted.

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

The following table represents the credit quality of loans, by class, as of December 31, 2019 and 2018:

Balance, December 31, 2019	**Pass**	**Special Mention**	**Substandard**	**Doubtful**	**Loss**
Real estate loans:					
Residential real estate	**$ 102,838,490**	**$ 501,678**	**$ 1,285,375**	**$ -**	**$ -**
Commercial real estate	**118,037,257**	**1,060,409**	**988,370**	**-**	**-**
Real estate development	**4,584,263**	**-**	**86,398**	**-**	**-**
Commercial loans:					
Secured	**18,258,944**	**2,943**	**-**	**-**	**-**
Unsecured	**360,912**	**-**	**-**	**-**	**-**
Consumer loans:					
Secured	**1,567,188**	**-**	**6,603**	**-**	**-**
Unsecured	**278,477**	**-**	**-**	**-**	**-**
Total	**$ 245,925,531**	**$ 1,565,030**	**$ 2,366,746**	**$ -**	**$ -**

Balance, December 31, 2018	Pass	Special Mention	Substandard	Doubtful	Loss
Real estate loans:					
Residential real estate	$ 103,346,843	$ -	$ 985,827	$ -	$ -
Commercial real estate	115,935,583	-	4,950,900	-	-
Real estate development	2,689,015	-	92,195	-	-
Commercial loans:					
Secured	24,866,659	-	17,564	-	-
Unsecured	607,653	-	-	-	-
Consumer loans:					
Secured	1,429,561	-	44,516	-	-
Unsecured	297,285	-	-	-	-
Total	$ 249,172,599	$ -	$ 6,091,002	$ -	$ -

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Past due loans based on contractual payment status, including loans on nonaccrual status, presented by class before unearned fees were as follows 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**	**Recorded Investments >90 Days Accruing**	**Non-Accrual Loans**
Real estate loans:								
Residential real estate	**$ 140,354**	**$ 32,092**	**$ 525,530**	**$ 697,976**	**$ 103,927,567**	**$ 104,625,543**	**$ -**	**$ 542,669**
Commercial real estate	**-**	**-**	**-**	**-**	**120,086,036**	**120,086,036**	**-**	**-**
Real estate development	**-**	**-**	**13,030**	**13,030**	**4,657,631**	**4,670,661**	**-**	**12,993**
Commercial loans:								
Secured	**-**	**-**	**6,603**	**6,603**	**18,255,284**	**18,261,887**	**-**	**-**
Unsecured	**-**	**-**	**-**	**-**	**360,912**	**360,912**	**-**	**-**
Consumer loans:								
Secured	**33,552**	**-**	**-**	**33,552**	**1,540,239**	**1,573,791**	**-**	**6,603**
Unsecured	**-**	**-**	**-**	**-**	**278,477**	**278,477**	**-**	**-**
Total	**$ 173,906**	**$ 32,092**	**$ 545,163**	**$ 751,161**	**$ 249,106,146**	**$ 249,857,307**	**$ -**	**$ 562,265**

December 31, 2018	30 - 59 Days Past Due	60-89 Days Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investments >90 Days Accruing	Non-Accrual Loans
Real estate loans:								
Residential real estate	$ 28,946	$ -	$ 281,278	$ 310,224	**$ 104,022,446**	$ 104,332,670	$ -	$ 471,629
Commercial real estate	293,874	-	3,655,822	3,949,696	**116,936,787**	120,886,483	-	3,655,822
Real estate development	-	-	13,293	13,293	**2,767,917**	2,781,210	-	13,293
Commercial loans:								
Secured	-	-	-	-	**24,884,223**	24,884,223	-	17,564
Unsecured	-	-	-	-	**607,653**	607,653	-	-
Consumer loans:								
Secured	-	-	44,516	44,516	**1,429,561**	1,474,077	-	44,516
Unsecured	-	-	-	-	**297,285**	297,285	-	-
Total	$ 322,820	$ -	$ 3,994,909	$ 4,317,729	$ 250,945,872	$ 255,263,601	$ -	$ 4,202,824

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Information relating to individually impaired loans, excluding acquired impaired loans, by class of loans, was as follows as of December 31, 2019:

December 31, 2019	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real estate loans:					
Residential real estate	$ 496,797	$ 583,525	$ -	$ 503,386	$ 31,135
Commercial real estate	2,223,287	2,307,364	-	4,288,398	37,577
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	3,513	370
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	28,081	28,081		29,747	1,206
Unsecured	-	-	-	-	-
With an allowance recorded:					
Real estate loans:					
Residential real estate	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	3,513	370
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Total:					
Real estate loans:					
Residential real estate	$ 496,797	$ 583,525	$ -	$ 503,386	$ 31,135
Commercial real estate	2,223,287	2,307,364	-	4,288,398	37,577
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	7,026	740
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	28,081	28,081	-	29,747	1,206
Unsecured	-	-	-	-	-

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

Information relating to individually impaired loans, excluding acquired impaired loans, by class of loans, was as follows as of December 31, 2018:

December 31, 2018	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance:					
Real estate loans:					
Residential real estate	$ 531,069	$ 591,749	$ -	$ 455,834	$ 30,985
Commercial real estate	4,555,485	4,590,585	-	4,426,927	22,637
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	31,398	31,398		32,945	1,566
Unsecured	-	-	-	-	-
With an allowance recorded:					
Real estate loans:					
Residential real estate	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	17,564	18,159	1,441	7,258	761
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	-	-	-	-	-
Unsecured	-	-	-	-	-
Total:					
Real estate loans:					
Residential real estate	$ 531,069	$ 591,749	$ -	$ 455,834	$ 30,985
Commercial real estate	4,555,485	4,590,585	-	4,426,927	22,637
Real estate development	-	-	-	-	-
Commercial loans:					
Secured	17,564	18,159	1,441	7,258	761
Unsecured	-	-	-	-	-
Consumer loans:					
Secured	31,398	31,398	-	32,945	1,566
Unsecured	-	-	-	-	-

Note 4. Loans Receivable and Allowance for Loan Losses (Continued)

A summary of loans modified as TDRs is presented, by loan class, as follows for the years ended December 31, 2019 and 2018:

December 31, 2019	**Number of Contracts**	**Pre-Modification Investment**	**Post-Modification Investment**
Real estate development	**1**	**$ 16,363**	**$ 16,363**
		$ 16,363	**$ 16,363**

December 31, 2018	Number of Contracts	Pre-Modification Investment	Post-Modification Investment
Residential real estate	1	$ 180,817	$ 188,215
		$ 180,817	$ 188,215

For the purposes of this disclosure, the Company defines default as any payment that occurs more than 90 days past the due date, charge-off or foreclosure subsequent to modification. No troubled debt restructurings defaulted within twelve months of modification during the years ended December 31, 2019 and 2018.

Note 5. Premises and Equipment

Premises and equipment are comprised of the following at December 31, 2019 and 2018:

	2019	2018
Land	**$ 1,101,521**	$ 1,101,521
Buildings and land improvements	**6,328,896**	6,301,605
Furniture, fixtures and equipment	**2,981,426**	2,623,020
	10,411,843	10,026,146
Accumulated depreciation	**(5,299,041)**	(4,858,911)
Premises and equipment, net	**$ 5,112,802**	$ 5,167,235
Depreciation expense	**$ 440,130**	$ 447,808

Note 6. Other Real Estate Owned

As of December 31, 2019, there were no residential real estate properties included in other real estate owned. There were no consumer mortgage loans secured by residential real estate in process of foreclosure as of December 31, 2019.

The table below reflects changes in OREO for the years ended December 31, 2019 and 2018:

	2019	2018
Balance, beginning of year	**$ 641,705**	$ 334,239
Properties acquired at foreclosure	**2,742,360**	526,166
Sale of foreclosed properties	**(458,610)**	(218,700)
Valuation adjustments	**(288,456)**	-
Balance, end of year	**$ 2,636,999**	$ 641,705

Note 6. Other Real Estate Owned (Continued)

Expenses applicable to other real estate owned include the following for the years ended December 31, 2019 and 2018:

	2019	2018
Net (gain) loss on sales of real estate	**$ (87,762)**	$ 6,274
Valuation adjustments	**288,456**	-
Operating expenses, net of rental income	**19,852**	22,268
	$ 220,546	$ 28,542

Note 7. Deposits

The aggregate amount of time deposits in denominations of $250,000 or greater was $19.0 million and $19.7 million at December 31, 2019 and 2018, respectively.

The scheduled maturities of time deposits are as follows:

2020	**$ 36,685,024**
2021	**11,600,716**
2022	**7,456,571**
2023	**12,134,176**
2024	**3,806,259**
Thereafter	**245,606**
	$ 71,928,352

At December 31, 2019 and 2018, there was one customer relationship where the balances on deposit exceeded 5% of outstanding deposits. This customer relationship comprised 9.08% and 11.44% of the outstanding deposits at December 31, 2019 and 2018, respectively.

Overdrafts reclassified from deposits to loans totaled $40,334 and $29,071 at December 31, 2019 and 2018, respectively.

Note 8. Junior Subordinated Debt

On July 15, 2015, in connection with the Easton acquisition, the Company assumed $3,000,000 in junior subordinated debt to the Easton Capital Trust I, to fully and unconditionally guarantee the preferred securities issued by the Easton Trust. These long-term obligations, which qualify as Tier 1 capital, constitute a full and unconditional guarantee by the Company of the Easton Capital Trust obligations. The junior subordinated debt will mature on February 8, 2034, which may be shortened to a date not earlier than February 8, 2009, if certain conditions, including regulatory approvals, are met. The junior subordinated debentures, which are the only assets of the trust, are subordinate to all present and future senior indebtedness of the Company. The junior subordinated debt accrues interest at a floating rate equal to the 3-month LIBOR plus 2.85%, payable quarterly. The quarterly interest rate on the debentures was 4.75913% at December 31, 2019. The quarterly distributions on the preferred securities will be paid at the same rate that interest is paid on the junior subordinated debentures. The accrued interest on these obligations totaled $21,671 at December 31, 2019. In accordance with ASC 810-10-15-14 “Consolidation-Overall-Scope and Scope Exceptions,” the Company did not eliminate through consolidation the Company’s $93,000 equity investment in Easton Capital Trust I. Instead, the Company reflected this equity investment in the “Other assets” line item in the consolidated balance sheet.

Note 8. Junior Subordinated Debt (Continued)

In conjunction with the acquisition of Easton, the junior subordinated debt was recorded at fair value. The original fair value discount was $679,615 and is being amortized into interest expense over the remaining life of the borrowing. The balance of the junior subordinated debt appearing on the Company's balance sheet as of December 31, 2019 totaled $2.5 million, which is net of the unamortized fair value discount of $522,992.

Note 9. Senior Subordinated Debt

At December 31, 2019 and 2018, total outstanding noncumulative subordinated notes of the Company totaled $4.1 million. The notes outstanding at December 31, 2019 and 2018 have a fixed rate of interest of 7%, payable quarterly, are callable at par upon origination and mature on July 1, 2025. The Company has the right to redeem the notes, in whole or in part, on any interest payment date on or after July 1, 2020.

Note 10. Available Borrowings and Contingency Funding Lines

The Company has credit availability of approximately $8.1 million with various correspondent banks for short-term liquidity needs, if necessary. As of December 31, 2019 and 2018, there were no outstanding balances on these credit facilities.

The Company maintains a $94.3 million line of credit with the Federal Home Loan Bank of Atlanta ("FHLB"). The interest rate and term of each advance from the line is dependent upon the advance and commitment type. Advances on the line are secured by the Company's qualifying loans. As of December 31, 2019, the lendable book value of these qualifying loans totaled $72.8 million. Advances on the line in excess of this amount require pledging of additional assets, including other types of loans and investment securities. As of December 31, 2019 and 2018, there were $40.0 million in unfunded letters of credit outstanding against the FHLB line of credit.

Note 11. Retirement Plans

The Company participates in a multiple employer defined benefit pension plan covering all full-time employees with more than one year of service. This plan was frozen at October 31, 2010. No additional cash payments are expected to be contributed to the plan for the period ended June 30, 2020. Pension plan expense was $38,985 and $42,872 for the years ended December 31, 2019 and 2018, respectively.

The Company has a 401k profit sharing plan covering substantially all employees. The Company provides a safe harbor contribution of 3% of participants' compensation and a 50% match for employee contributions up to 6%. Related expenses were $154,354 and $161,941 for the years ended December 31, 2019 and 2018, respectively.

Note 12. Deferred Compensation Arrangements

The Company had a voluntary deferred compensation plan that permitted directors and certain officers to defer receipt of directors' fees or a portion of compensation until a later time. The Company purchased life insurance contracts on the participants with the premiums being paid from the deferred fees and compensation. The Company is the owner and sole beneficiary of all life insurance. The cash surrender value of the life insurance totaled $2.1 million and $2.0 million at December 31, 2019 and 2018, respectively. Accrued benefit obligations utilizing a 7% interest factor totaled $328,454 and $415,459 at December 31, 2019 and 2018, respectively. Income, net of expenses, related to this plan was $48,739 and $36,894, respectively, for the year ended December 31, 2019 and 2018.

Note 12. Deferred Compensation Arrangements (Continued)

The Company has an executive supplemental retirement and life insurance plan for the benefit of its former Chairman and President. The Company has purchased life insurance on the participant and is the owner of the policies. Split dollar death benefits are also provided to the Company and this participant. The Company's portion of the cash surrender value of the life insurance policy totaled $6.3 million and $6.2 million at December 31, 2019 and 2018, respectively. The accrued benefit obligation utilizing a 6% interest factor totaled $853,560 at December 31, 2019 and 2018. Total expense, net of income, related to this plan was $46,887 for the year ended December 31, 2019. Income, net of expenses, related to this plan was $35,757 for the year ended December 31, 2018.

In 2011, the Company began an executive supplemental retirement and life insurance plan for the benefit of its current Chairman and President. The Company purchased life insurance on the participant in February 2012 and is the owner of the policy. In 2017, the Company increased the executive supplemental retirement and life insurance plan for the benefit of the current Chairman and President. During 2019, the Company amended the executive's supplemental retirement and life insurance plan to add a Lifetime Income Non-Qualified Solution ("LINQS+). Under the LINQS+ plan, the Company provides the Chairman and President with an annual lifetime benefit upon retirement. In connection with the LINQS+ plan, the Company purchased annuity contracts from insurance entities which pays the Company a fixed benefit payment stream for the life of the executive beginning upon his retirement. The employer paid an upfront lump-sum premium payment to the insurance entities to purchase the annuity contracts. The Company's portion of the cash surrender value of the life insurance policy totaled $3.8 million and $3.7 million at December 31, 2019 and 2018, respectively. The carrying values of the LINQS+ annuity contracts at December were $4.6 million. The accrued benefit obligation utilizing a 6% interest factor totaled $1.2 million and $1.0 million at December 31, 2019 and 2018, respectively. Expenses, net of income, related to this plan were $63,350 and $190,635 for December 31, 2019 and 2018, respectively.

The split dollar death benefit agreement with the former Chairman and President provides for death benefits to be paid to his beneficiaries. This arrangement constitutes post-retirement benefits under ASC Topic 715 – "Retirement Benefits." This pronouncement required the recording of expense and liability for these post-retirement benefits prior to retirement, based on the present value of the future benefits, calculated on life expectancy, post retirement term insurance costs, and the related amounts of death benefits being provided. Ultimately, at the time of the former Chairman and President's death, the Company will record income equal to cumulative accrued expense. The accrued obligation was $1.6 million at December 31, 2019 and 2018.

In conjunction with the Easton acquisition, the Company assumed a supplemental retirement benefit for an Easton executive officer. The benefits vest at the rate of 10% per year and is funded by Bank Owned Life Insurance ("BOLI") policy. As of December 31, 2019 and 2018, the liability totaled $762,129 and $818,038, respectively. The balance of the BOLI totaled $2.3 million and $2.2 million at December 31, 2019 and 2018, respectively. Income, net of expenses, related to this plan was $24,896 and $23,363 for the years ended December 31, 2019 and 2018, respectively.

Note 13. Restriction on Dividends

The Company is subject to certain restrictions on the amount of dividends that it may pay without regulatory approval. The Company normally restricts dividends to a lesser amount. The ability of the Company to pay dividends is largely dependent on the ability of the Bank to pay dividends to the Company. In general, under Maryland law, the Bank may declare a cash dividend, after providing for due or accrued expenses, losses, interest, and taxes, from its undivided profits, or with the prior approval of the Maryland Commissioner of Financial Regulation, from its surplus in excess of 100% of its required stock. The Company paid cash dividends totaling $1.2 million and $300,339 to common stock and preferred stock holders during 2019 and 2018, respectively.

Note 14. Regulatory Matters

As of December 31, 2019, the most recent notification from the Federal Reserve Bank categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Common Equity Tier 1 risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the Bank's well capitalized category.

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 possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Company's and Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable for bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Total, Common Equity Tier 1, and Tier 1 Capital (as defined in the regulations) to risk-weighted assets (as defined) and Tier 1 Capital (as defined) to average assets (as defined). Management believes, as of December 31, 2019 and 2018, the Company and the Bank met all capital adequacy requirements to which they were subject.

Because total assets on a consolidated basis are less than $3 Billion, the Company is not subject to the consolidated capital requirements imposed by the Bank Holding Company Act. Consequently, the Company does not calculate its financial ratios on a consolidated basis.

On January 1, 2015, the Bank applied changes to the regulatory capital framework that were approved on July 9, 2013 by the federal banking regulators (the Basel III Final Rule). The regulatory risk-based capital amounts presented below for December 31, 2019 and 2018 include: (1) common equity tier 1 capital (CET1) which consists principally of common stock (including surplus) and retained earnings with adjustments for goodwill, intangible assets and deferred taxes; (2) Tier 1 capital which consists principally of CET1 plus the Bank's "grandfathered" trust preferred securities; and (3) Tier 2 capital which consists principally of Tier 1 capital plus a limited amount of the allowance for loan losses. In addition, the Bank has made the one-time irrevocable election to continue treating accumulated other comprehensive income (AOCI) under regulatory standards that were in place prior to the Basel III Final Rule in order to eliminate volatility of regulatory capital that can result from fluctuations in AOCI and the inclusion of AOCI in regulatory capital, as would otherwise be required under the Basel III Capital Rule. The capital conservation buffer was phased in from 0.00% for 2015 to 2.50% by 2019. The capital conservation buffer for 2019 was 2.50% and for 2018 was 1.875%. The table below also reflects the minimum regulatory and certain prompt corrective action capital ratio requirements that began on January 1, 2015.

Note 14. Regulatory Matters (Continued)

The Bank's actual and required capital amounts and ratios are presented as follows as of December 31, 2019 and 2018:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Active Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
As of December 31, 2019:						
Total Capital [to Risk Weighted Assets]	**$ 52,685,000**	**20.89%**	**$ 20,176,240**	**8.00%**	**$ 25,220,300**	**10.00%**
Common Equity Tier 1 Capital [to Risk Weighted Assets]	**50,699,000**	**20.10%**	**11,349,135**	**4.50%**	**16,393,195**	**6.50%**
Tier 1 Capital [to Risk Weighted Assets]	**50,699,000**	**20.10%**	**15,132,180**	**6.00%**	**20,176,240**	**8.00%**
Tier 1 Capital [to Average Assets]	**50,699,000**	**13.58%**	**14,931,080**	**4.00%**	**18,663,850**	**5.00%**

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Active Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Total Capital [to Risk Weighted Assets]	$ 49,725,000	19.88%	$ 20,006,720	8.00%	$ 25,008,400	10.00%
Common Equity Tier 1 Capital [to Risk Weighted Assets]	47,549,000	19.01%	11,253,780	4.50%	16,255,460	6.50%
Tier 1 Capital [to Risk Weighted Assets]	47,549,000	19.01%	15,005,040	6.00%	20,006,720	8.00%
Tier 1 Capital [to Average Assets]	47,549,000	13.07%	14,551,920	4.00%	18,189,900	5.00%

Note 15. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction and the State of Maryland. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examinations by tax authorities for years prior to 2016.

The provision for income taxes consists of the following for the years ended December 31, 2019 and 2018:

	2019	2018
Current tax expense	**$ 514,762**	$ 203,839
Deferred tax expense	**760,921**	887,935
Total income tax expense	**$ 1,275,683**	$ 1,091,774

Note 15. Income Taxes (Continued)

The income tax provision differs from the amount of income tax determined by applying the U.S. federal income tax rate to pretax income due to the following:

	2019	2018
Expense at Federal statutory rate	$ 1,019,176	$ 938,620
Differences resulting from:		
State income tax expense, net of federal tax effect	241,785	217,156
Tax exempt income	(61,140)	(71,357)
Other	75,862	7,355
Provision for income taxes	$ 1,275,683	$ 1,091,774

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities are summarized below as of December 31, 2019 and 2018:

	2019	2018
Deferred tax assets:		
Other real estate owned	$ -	$ 67,917
Allowance for loan losses	428,953	429,690
Accrued expenses	650,645	635,567
Net operating loss carryforward, federal and state	3,488,454	3,717,873
Nonaccrual interest	123,251	381,356
Other	33,847	85,434
Acquisition accounting adjustments	601,956	296,883
Unrealized loss on securities available-for-sale	-	161,368
Deferred tax assets	5,327,106	5,776,088
Deferred tax liabilities:		
Accumulated depreciation	(611,549)	(144,154)
Deferred costs and fees on loans, net	(182,715)	(178,147)
Unrealized gain on securities available-for-sale	(168,576)	-
Other	(6,366)	(5,020)
Deferred tax liabilities	(969,206)	(327,321)
	4,357,900	5,448,767
Valuation allowance	-	-
Net deferred tax assets	$ 4,357,900	$ 5,448,767

Under the provisions of the Internal Revenue Code, the Company has $12.5 million of net operating loss carryforwards which can be offset against future taxable income. The carryforwards expire through December 31, 2034. The full realization of tax benefits associated with carryforwards depends predominately upon the recognition of ordinary income during the carryforward period. The federal portion of net operating loss carryforwards available to offset taxable income is limited to $833,717 annually under IRS code section 382. The Company believes it will generate sufficient future taxable income to fully utilize the remaining deferred tax assets. The Company has generated taxable income for three continuous years, resulting in a significant utilization of its net operating loss carryforwards, and it has no reason to believe this trend will not continue.

Note 16. Fair Value Measurements

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (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. There are three levels of inputs that mat be used to measure fair values:

Level 1 - Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 - Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 - Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Company to measure certain assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities Available-for-Sale: Securities available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

The following table presents the balances of financial assets measured at fair value on a recurring basis as of December 31, 2019 and 2018:

		Fair Value Measurements at December 31, 2019 Using		
Description	Fair Value as of December 31, 2019	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Available-for-Sale Securities:				
Obligations of U.S. Government agencies and corporations	$ 2,506,100	$ -	$ 2,506,100	$ -
Mortgage backed securities	8,019,973	-	8,019,973	-
Collateralized mortgage obligations	27,366,873	-	27,366,873	-
Total available for sale securities	37,892,946	-	37,892,946	-
Held-to-Maturity Securities:				
Other debt securities	4,639,747	-	-	4,639,747
	$ 42,532,693	$ -	$ 37,892,946	$ 4,639,747

Note 16. Fair Value Measurements (Continued)

Description	Fair Value as of December 31, 2018	Fair Value Measurements at December 31, 2018 Using: Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Available-for-Sale Securities:				
Obligations of U.S. Government agencies and corporations	$ 2,459,900	$ -	$ 2,459,900	$ -
Mortgage backed securities	9,985,732	-	9,985,732	-
Collateralized mortgage obligations	28,767,073	-	28,767,073	-
Total available for sale securities	$ 41,212,705	$ -	$ 41,212,705	$ -

Certain assets are measured at fair value on a nonrecurring basis in accordance with US GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including, but not limited to, equipment, inventory, and accounts receivable. The vast majority of the Company’s collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparables or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business’s financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports (Level 3). Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other Real Estate Owned (OREO): OREO sold subsequent to year-end is determined using the subsequent sales price (Level 1). Other OREO is measured at fair value in the same manner as described above for impaired loans. Any subsequent write-downs are recorded as OREO write-downs on the Consolidated Statements of Income.

Note 16. Fair Value Measurements (Continued)

The following table presents the balances of assets measured at fair value on a nonrecurring basis as of December 31, 2019 and 2018:

		Fair Value Measurements at December 31, 2019 Using		
Description	**Fair Value as of December 31, 2019**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**
Impaired loans, net	**$ -**	**$ -**	**$ -**	**$ -**
Other real estate owned, net	**2,636,999**	**-**	**-**	**2,636,999**

		Fair Value Measurements at December 31, 2018 Using		
Description	Fair Value as of December 31, 2018	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Impaired loans, net	$ 16,123	$ -	$ -	$ 16,123
Other real estate owned, net	641,705	-	-	641,705

The following table presents information about Level 3 fair value measurements for December 31 2019 and 2018:

December 31, 2019			
Description	**Valuation Technique**	**Unobservable Input**	**Range (Weighted Average)**
Other real estate owned, net	**Discounted appraised value**	**Selling expenses**	**10.00% (10.00%)**

December 31, 2018			
Description	Valuation Technique	Unobservable Input	Range (Weighted Average)
Impaired loans, net	Discounted cash flows	Discount rate	6.00% (6.00%)
Other real estate owned, net	Discounted appraised value	Selling expenses	10.00% (10.00%)
	Discounted appraised value	Discount for lack of marketability and age of appraisal	0.00% - 37.48% (18.95%)

Note 16. Fair Value Measurements (Continued)

The carrying amount and fair value of the Company's financial instruments at December 31, 2019 and 2018 were as follows:

		Fair Value Measurements Using			
December 31, 2019	**Carrying Value**	**Quoted Prices in Active Markets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Other Unobservable Inputs (Level 3)**	**Total Fair Value**
Financial Assets:					
Cash and due from banks	**$ 51,269,882**	**$ 51,269,882**	**$ -**	**$ -**	**$ 51,269,882**
Federal funds sold	**845,731**	**845,731**	**-**	**-**	**845,731**
Investment securities	**42,532,693**	**-**	**37,892,946**	**4,639,747**	**42,532,693**
Restricted securities	**1,754,200**	**-**	**1,754,200**	**-**	**1,754,200**
Loans, net	**248,606,302**	**-**	**-**	**248,375,145**	**248,375,145**
Cash surrender value of life insurance	**14,500,925**	**-**	**14,500,925**	**-**	**14,500,925**
Accrued interest receivable	**661,314**	**661,314**	**-**	**-**	**661,314**
Financial Liabilities:					
Deposits	**313,585,870**	**-**	**-**	**314,266,858**	**314,266,858**
Junior subordinated debt	**2,570,008**	**-**	**-**	**3,303,048**	**3,303,048**
Senior subordinated debt	**4,100,000**	**-**	**-**	**4,145,288**	**4,145,288**
Accrued interest payable	**165,272**	**165,272**	**-**	**-**	**165,272**

		Fair Value Measurements Using			
December 31, 2018	Carrying Value	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)	Total Fair Value
Financial Assets:					
Cash and due from banks	$ 51,239,155	$ 51,239,155	$ -	$ -	$ 51,239,155
Federal funds sold	583,038	583,038	-	-	583,038
Investment securities	41,212,705	-	41,212,705	-	41,212,705
Restricted securities	1,733,700	-	1,733,700	-	1,733,700
Loans, net	253,993,318	-	-	251,951,846	251,951,846
Cash surrender value of life insurance	14,209,783	-	14,209,783	-	14,209,783
Accrued interest receivable	650,840	650,840	-	-	650,840
Financial Liabilities:					
Deposits	319,512,728	-	-	319,073,644	319,073,644
Junior subordinated debt	2,536,753	-	-	3,178,461	3,178,461
Senior subordinated debt	4,100,000	-	-	4,166,921	4,166,921
Accrued interest payable	131,691	131,691	-	-	131,691

Note 17. Income per Share

The Company applies the two-class method of computing basic and diluted net income per common share. Under the two-class method, net income per common share is determined for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Based on authoritative guidance, the Company considers its non-vested restricted stock, Series A and Series B Preferred stock to be participating securities. The following table shows the computation of basic and diluted net income per common share for the periods presented. Potential dilutive common stock had no effect on income per common share otherwise available to common shareholders for the years ended December 31, 2019 and 2018.

	Years Ended	
	December 31, 2019	December 31, 2018
Basic Net Income Per Common Share		
Net income available to common shareholders	**$ 3,577,676**	$ 3,377,847
Less: Net income allocated to participating securities	**1,222,765**	1,159,323
Net income allocated to common shareholders	**2,354,911**	2,218,524
Weighted average common shares outstanding for basic net income per common share	**3,966,783**	3,941,546
Basic net income per common share	**$ 0.59**	$ 0.56
Diluted Net Income Per Common Share		
Net income available to common shareholders	**$ 3,577,676**	$ 3,377,847
Weighted average common shares outstanding for basic net income per common share	**3,966,783**	3,941,546
Effect of dilutive securities, equity compensation	**33,677**	33,057
Effect of dilutive securities, participating securities	**2,059,713**	2,059,713
Weighted average common shares outstanding for diluted net income per common share	**6,060,173**	6,034,316
Diluted net income per common share	**$ 0.59**	$ 0.56

Options to acquire 226,000 and 101,000 shares of common stock were not included in computing diluted income per common share for the year ended December 31, 2019 and 2018, respectively, because their effects were anti-dilutive.

Note 18. Financial Instruments with Off-Balance Sheet Risk

The Company is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financial needs of its customers. These financial instruments include commitments to extend credit, commitments under credit card arrangements, and commercial and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the consolidated balance sheets. The contract amounts of those instruments reflect the extent of involvement the Company has in particular classes of financial instruments.

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

Note 18. Financial Instruments with Off-Balance Sheet Risk (Continued)

The contract amounts of these financial instruments at December 31 2019 and 2018 are as follows:

	2019	2018
Commitments to extend credit	**$ 39,885,917**	$ 33,740,842
Standby letters of credit	**1,276,574**	1,612,272
	$ 41,162,491	$ 35,353,114

Commitments to extend credit are agreements to lend to a customer as long as there are no violations of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but may include inventory, real estate, equipment, and securities.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third-party. Those guarantees are primarily issued to support public and private borrowing arrangements and, generally, have terms of one year or less. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting these commitments. In the event the customer does not perform in accordance with the terms of the agreement with the third-party, the Company would be required to fund the commitment. The maximum potential amount of future payments the Company could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Company would be entitled to seek recovery from the customer.

Note 19. Commitments and Contingencies

In the ordinary course of business, the Company has various outstanding commitments and contingent liabilities that are not reflected in the accompanying consolidated financial statements. In the opinion of management, after consultation with legal counsel, the ultimate disposition of these matters is not expected to have a material adverse effect on the financial condition of the Company.

Note 20. Related Party Transactions

In the normal course of banking business, loans are made to officers, directors and their affiliated interests. In the opinion of management, these loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and did not involve more than normal risks of collectibility or present other unfavorable features. At December 31, 2019 and 2018, these loans totaled approximately $6.3 million and $5.6 million, respectively. Additions during 2019 totaled approximately $1.7 million and principal repayments totaled approximately $989,310.

In addition, the Company held deposits of $9.9 million and $11.5 million from officers and directors at December 31, 2019 and 2018, respectively.

Note 21. Concentrations of Credit

All of the Company's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Company's market area. The concentrations of credit by type of loan are set forth in Note 4. Commercial and standby letters of credit were granted primarily to commercial borrowers.

Note 22. Equity Plans

The Company adopted the 2010 Delmarva Bancshares, Inc. Stock Option Plan (the "Plan) to provide a means for selected key employees and directors to increase their personal financial interest in the Company, thereby stimulating their efforts and strengthening their desire to remain with the Company. Under the plan up to 100,000 shares of common stock are reserved for issuance. Options granted under the plan will have a ten year life with a five year vesting period that begins on the date of the grant, and are exercisable at a price equal to the fair value of the Company's common stock on the date of the grant.

During 2015, the shareholders of the Company approved the Delmarva Bancshares, Inc. 2015 Equity Incentive Plan (the "Incentive Plan") that provides for the grant of stock options, restricted stock, restricted stock units, and other stock-based awards to the Company's officers, employees, directors, advisors and consultants. A total of 342,500 shares of common stock have been reserved for the issuance of awards under the Incentive Plan. Unless otherwise provided in the applicable equity award agreement, restricted stock recipients will have the right to receive dividends, if any, with respect to such shares of restricted stock, to vote such shares and to receive all other shareholder rights, except that the participant may not sell, transfer, pledge or otherwise dispose of the restricted stock until the restrictions have expired.

Stock Options Grants

Accounting standards require companies to recognize the cost of employee services rendered in exchange for awards of equity instruments, such as stock options, based on the fair value of those awards at the date of grant. The fair value of each award is estimated on the date of grant using the Black-Scholes option pricing model that uses the assumptions noted in the table below. Expected volatilities are based on historical volatilities of the Company's common stock. The Company uses the simplified method to estimate the expected life of the options by averaging the vesting period and the ten year life of the option. The risk-free interest rate is estimated based on the U.S. Treasury yield curve in effect at the time of the grant. There were 125,000 and 101,000 stock options granted during 2019 and 2018, respectively.

The fair value of the options granted during the year ended December 31, 2019 and 2018 was $3.11 and $4.80, respectively, which were determined using the following weighted average assumptions as of the grant date:

	2019	2018
Dividend yield	**1.09%**	0.00%
Expected term	**9.4 years**	10 years
Expected volatility	**42.37%**	47.63%
Risk-free interest rate	**2.66%**	2.80%

Note 22. Equity Plans (Continued)

Stock Option Grants (Continued)

A summary of the activity in the stock option plan for 2019 follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (1)
Outstanding at beginning of year	181,000	$ 6.39	7	
Granted	125,000	7.60	10	
Exercised	-	-	-	
Expired and Forfeited	(5,000)	7.50	-	
Outstanding at end of year	**301,000**	**$ 6.87**	**8**	**$ 266,500**
Options exercisable, end of year	**83,200**			

(1) Intrinsic value is the amount by which the fair value of the underlying common stock exceeds the exercise price of a stock option as of December 31, 2019.

As of December 31, 2019, there was $756,681 of unrecognized stock option expense related to non-vested stock options under the Plan. The cost is expected to be recognized over the weighted-average remaining life of five years. Stock option based compensation expense recognized in 2019 and 2018 totaled $100,817 and $62,328, respectively, for stock options granted.

Equity Awards

There were 40,824 and 42,903 shares in stock granted under the Incentive Plan during 2019 and 2018, respectively. During the years ended December 31, 2019 and 2018, the Company recorded $267,842 and $218,972 of expense, respectively, related to vesting of stock grants.

	Shares	Weighted Average Grant Price
Nonvested, December 31, 2017	21,547	$ 6.05
Granted	42,903	7.87
Forfeited	(5,359)	6.99
Vested	(33,796)	7.37
Nonvested, December 31, 2018	25,295	$ 7.18
Granted	**40,824**	**8.03**
Forfeited	**(8,308)**	**7.49**
Vested	**(35,277)**	**7.59**
Nonvested, December 31, 2019	**22,534**	**$ 7.96**

At December 31, 2019, there was $179,360 of total unrecognized compensation expense related to nonvested restricted stock grants that is expected to be recognized over the next two years.

Note 23. Parent Company Only Condensed Financial Information

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Balance Sheets
December 31, 2019 and 2018

	2019	2018
Assets:		
Cash and due from banks	**$ 71,609**	$ 23,914
Investment in bank subsidiary	**55,156,424**	52,095,362
Other assets	**965,804**	667,102
Total assets	**$ 56,193,837**	$ 52,786,378
Liabilities:		
Senior subordinated debt	**$ 4,100,000**	$ 4,100,000
Junior subordinated debt	**2,570,008**	2,536,753
Accrued interest payable	**21,671**	24,548
Other liabilities	**-**	91,251
Total liabilities	**6,691,679**	6,752,552
Stockholders' Equity:		
Preferred stock	**20,597**	20,597
Common stock	**39,455**	39,201
Additional paid in capital	**44,154,234**	43,866,712
Retained earnings (deficit)	**4,875,152**	2,502,391
Accumulated other comprehensive (loss)	**412,720**	(395,075)
Total stockholders' equity	**49,502,158**	46,033,826
Total liabilities and stockholders' equity	**$ 56,193,837**	$ 52,786,378

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Statements of Income
Years Ended December 31, 2019 and 2018

	2019	2018
Dividend from subsidiary	**$ 1,850,000**	$ 855,000
Interest expense on subordinated notes	**484,872**	475,788
Other expenses	**334,861**	369,351
Total expenses	**819,733**	845,139
Income before income taxes and equity in undistributed income of subsidiary	**1,030,267**	9,861
Income tax benefit	**294,142**	222,474
Equity in undistributed income of subsidiary	**2,253,267**	3,145,512
Net income	**$ 3,577,676**	$ 3,377,847

Note 23. Parent Company Only Condensed Financial Information (Continued)

Delmarva Bancshares, Inc.
(Parent Corporation Only)

Condensed Statements of Cash Flows
Years Ended December 31, 2019 and 2018

	2019	2018
Cash Flows from Operating Activities:		
Net income	$ 3,577,676	$ 3,377,847
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Net accretion of acquisition accounting adjustments	33,255	32,800
Undistributed income of subsidiary	(2,253,267)	(3,145,512)
Deferred income tax (benefit)	(294,142)	(222,476)
Stock based compensation, net	368,659	281,300
Changes in assets and liabilities:		
Increase in other assets	(4,560)	(30,000)
(Decrease) increase in other liabilities and accrued interest payable	(94,128)	13,502
Net cash provided by operating activities	1,333,493	307,461
Cash Flows from Investing Activities:		
Net cash used in investing activities	-	-
Cash Flows from Financing Activities:		
Repurchase of common stock	(80,883)	(65,879)
Dividends on common and preferred stock	(1,204,915)	(300,339)
Net cash used in financing activities	(1,285,798)	(366,218)
Increase (decrease) in cash and cash equivalents	47,695	(58,757)
Cash and Cash Equivalents, Beginning of Year	23,914	82,671
Cash and Cash Equivalents, End of Year	$ 71,609	$ 23,914

Note 24. Revenue From Contracts With Customers

All of the Company's revenue from contracts with customers in the Scope of ASC 606 is recognized within Non-Interest Income. The following table presents the Company's sources of Non-Interest Income for the twelve months ended December 31, 2019 and 2018, respectively. Items outside the scope of ASC 606 are noted as such.

	2019	2018
Non-interest income		
Service charges on deposits	$ 701,255	$ 710,227
Other fees and commissions	840,543	666,769
Income on bank owned life insurance	291,143	309,230
Income from recoveries on loans	23,446	303,367
Other income	18,293	40,674
	$ 1,874,680	$ 2,030,267
Amount in-scope	$ 1,560,091	$ 1,417,670
Amount out -of-scope	$ 314,589	$ 612,597

Note 24. Revenue From Contracts With Customers (Continued)

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

Service Charges on Deposit Accounts: The Company earns fees from its deposit customers primarily for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as foreign ATM use fees and stop payment charges, are recognized at the time the transaction is executed or occurs as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

Other Fees and Commissions: The Company earns other fees and commissions which are primarily comprised of interchange income, safety deposit box rental fees, and check commissions. In particular, interchange fees are earned from debit cardholder transactions whenever the Company's debit cards are processed through card payment networks such as Visa. Safe deposit box rental fees are earned over the course of a month representing the period over which the Company satisfies the performed obligation whereas check commissions are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request.

Income on Bank-Owned Life Insurance: The Company earns income on bank-owned life insurance held on various legacy and current employees. The Company records these policies at their cash surrender value, which is estimated using information provided by insurance carriers as of a valuation date. Income is recognized based on the changes in cash surrender value as of a valuation date.

Income from Recoveries on Loans: The Company periodically receives payments on loans previously charged-off by Easton prior to the 2015 acquisition. Since these loans were not valued as part of the acquisition, the Company records these recoveries as income when received.

Other Income: The Company earns income from other miscellaneous revenue streams on an annual basis which are recognized at the time the transaction is executed or earned over the course of the month based on the type of service rendered.

Note 25. Leases

On January 1, 2019, the Company adopted ASU No. 2016-02, "Leases (Topic 842)" and all subsequent ASUs that modified Topic 842. The Company elected the prospective application approach provided by ASU No. 2018-11 and did not adjust prior periods for ASC 842. There was no cumulative effect adjustment at adoption. The Company also elected certain practical expedients within the standard and did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. Prior to adoption, all of the Company's leases were classified as operating leases and remained operating leases at adoption. The implementation of the new standard resulted in recognition of a right-of-use asset and lease liability of $161,805 for one lease existing at the date of adoption.

Contracts that commence subsequent to adoption are evaluated to determine whether they are or contain a lease in accordance with Topic 842. The Company has elected the practical expedient provided by Topic 842 not to allocate consideration in a contract between lease and non-lease components. The Company also elected, as provided by the standard, not to recognize right-of-use assets and lease liabilities for short-term leases, defined by the standard as leases with terms of 12 months or less. The Company has not entered into any new operating leases since adoption.

Lease liabilities represent the Company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and, if applicable, prepaid rent, initial direct costs, and any incentives received from the lessor.

Note 25. Leases (Continued)

Lease payments

Lease payments for short-term leases are recognized as lease expense on a straight-line basis over the lease term, or for variable lease payments, in the period in which the obligation was incurred. Payments for leases with terms longer than twelve months are included in the determination of the lease liability. Payments may be fixed for the term of the lease or variable. If the lease agreement provides a known escalator, such as a specified percentage increase per year or a stated increase at a specified time, the variable payment is included in the cash flows used to determine the lease liability. If the variable payment is based upon an unknown escalator, such as the consumer price index at a future date, the increase is not included in the cash flows used to determine the lease liability. Three of the Company's leases provide known escalators that are included in the determination of the lease liability. The remaining leases do not have variable payments during the term of the lease.

Options to extend, residual value guarantees, and restrictions and covenants

The lease contains two renewal options. However, the Company did not include the additional time and lease payments for the option in the calculation of the lease liability since the Company is not reasonably certain it will exercise these options. The lease does not provide for residual value guarantees and none provide restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The following table presents the operating lease right-of-use asset and operating lease liability as of December 31, 2019:

	Classification in the Consolidated Balance Sheet	December 31, 2019
Operating lease right-of-use asset	Other assets	$ 130,652
Operating lease liability	Other liabilities	130,652

The following table presents the weighted average operating lease term and the weighted average discount rate for operating the lease as of December 31, 2019:

	December 31, 2019
Weighted average remaining lease term, in years	3.8
Weighted average discount rate	4.49%

The following table presents the components of operating lease expense and supplemental cash flow information for the years ended December 31, 2019 and 2018:

	2019	2018
Lease Expense		
Operating lease expense	$ 38,431	NR
Short-term lease expense	8,400	NR
Total lease expense (1)	$ 46,831	$ 45,130
Cash paid for amounts included in lease liability	$ 38,431	NR

(1) Included in premises and equipment expense in the Company's consolidated statement of income.

Note 25. Leases (Continued)

The following table presents a maturity schedule of undiscounted cash flows that contribute to the operating lease liability as of December 31, 2019:

Year		Amount
2020	$	37,164
2021		37,164
2022		37,164
2023		30,970
Total undiscounted cash flows		142,462
Less: discount		(11,810)
Operating lease liability	$	130,652

Note 26. Subsequent Events

The Company evaluated subsequent events that have occurred after the balance sheet date, but before the financial statements are issued. There are two types of subsequent events (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Subsequent events have been considered through March 13, 2020, the date financial statements were available to be issued. Based on the evaluation, the Company did not identify any recognized or unrecognized subsequent events that would have required adjustment to and disclosure in the audited financial statements.

DELMARVA BANCSHARES, INC. AND 1880 BANK

DIRECTORS OF DELMARVA BANCSHARES, INC. AND 1880 BANK

Kim C. Liddell – President and Chairman of the Board
William W. Brooks – Chairman of Audit and Compliance Committees
John F. Luthy, III
E. Thomas Merryweather – Vice Chairman of the Board
Tom E. Powley
William L. Wise, III – Assistant Secretary

DIRECTORS EMERITUS

F. Levi Ruark
G. Allen L. Tyler

EXECUTIVE OFFICERS

Kim C. Liddell – President, Chief Executive Officer
Steven M. Belote – Executive Vice President, Chief Financial Officer
Judann Culver – Executive Vice President, Chief Operations Officer, Secretary
Dane C. Schriver – Executive Vice President, Chief Loan Officer
Gregory J. Olinde – Executive Vice President, Chief Credit Officer, CRA Officer

BANKING OFFICERS

Elizabeth K. Casselbury – Branch Manager, Hurlock Office
Deborah M. Fitzhugh – Vice President, Branch Manager, Woods Road Office
Brenda L. Forbes-Butler – Consumer Loan Officer
Taylor Gilden – Vice President, Controller
Peggy A. Hall – Senior Vice President, Senior Credit Officer
Gene Spear – Assistant Vice President, IT Manager
Timothy A. McCarter – Vice President, Loan Officer
Karean “KC” Morris – Vice President, Deposit Operations and Customer Service Manager
Lisa A. Neild – Vice President, Compliance/BSA/Security Officer
Lawson Newcomb – Assistant Vice President, Commercial Banking Officer
Jennifer Patrick – Branch Manager, Idlewild Office
Marianne S. Pepper – Assistant Branch Manager, Assistant Cashier
Kimberly D. Rada – Assistant Vice President, Branch Manager, Glebe Road Office
Donna J. Schnoor – Assistant Vice President, Branch Manager, High Street Office
Trevor Carouge – Senior Vice President, Senior Loan Officer
David A. VanDerveer – Assistant Vice President, Commercial Banking Officer
Milly L. Wroten – Senior Vice President, Loan Operations Manager

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