TriCity Bankshares Corporation

2019

ANNUAL REPORT

WE MAKE IT HAPPEN.

For some, it's just a logo. For us, it defines what we do.

It's our North Star.

Those three arrows, pointing in. That's the trust you place in us.
Your deposits. Your investments. Your operating accounts.

Those three arrows, pointing out. That's your money at work.
A business loan. A line of credit. A donation to better our community.

Those six arrows, in and out. That's the lifeblood of business. Capital.
And we invest it, right here, in our community, helping businesses thrive.

Businesses just like yours.
So when you're ready to grow, talk to the best. **Let's make it happen. Together.**

TriCity National Bank

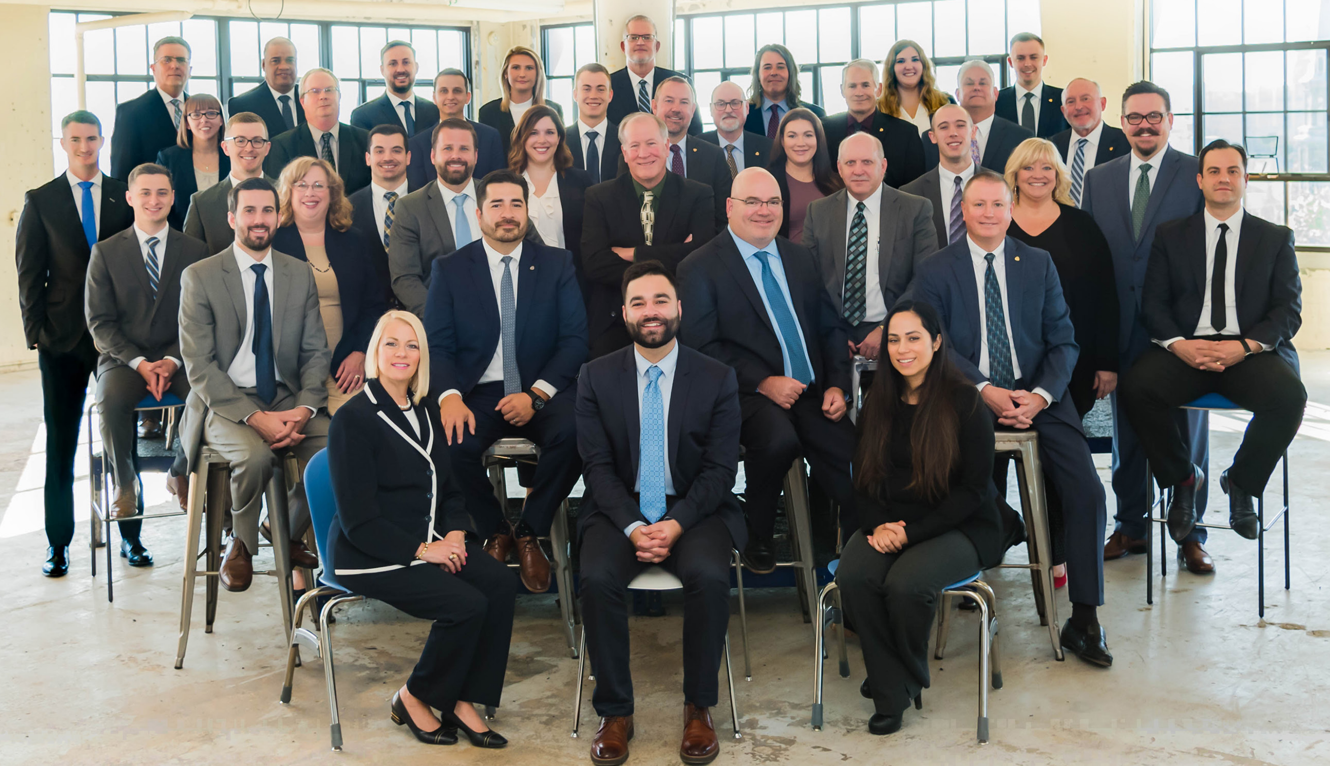

Photo taken at Coakley Brothers
— a proud Tri City customer.

TriCity National Bank

Learn more at www.tcnb.com | 414.325.1140

Member FDIC

Dear Shareholders,

True character is often revealed in a time of crisis and ours was tested during the first quarter of 2020. As we entered into the first phase of a world health crisis that will impact our global economy, we reflected on our roots. Since 1963, our Corporation has weathered many economic cycles, adjusted and continues to prosper. In good times and in bad, we have always protected your investment by staying true to our conservative banking philosophies and commitment to true community banking.

As we continue to adjust to a still unknown new normal brought on by this pandemic, our present foundation of financial soundness and strength, **as evidenced in the following reports**, would be meaningless without the team to carry forward. Our senior administration and team of value-added advisors had, earlier than most, recognized we were entering uncharted waters and formulated a plan to deal with the many unknowns of the pending crisis that we would soon be confronting. Our main focus has been to protect and preserve our greatest asset, for without our dedicated employees, we are nothing.

Early in the pandemic crisis, before any government programs, we implemented a *Tri City Cares* plan to preserve our team with job security and benefits regardless if they contract COVID-19 or need time off from work to care for another. As schools and day care facilities closed, the Corporation helped our employees with their additional childcare costs so they could continue to come to work and support their families. This will continue to be our philosophy going forward as we adjust to a new normal.

Since assuming the role of Chairman and CEO in 2016, I have messaged to every employee and incorporated into new hire trainings: *You are Bankers. Banking is a respected profession. You must have integrity and ethics because you are trusted advisors in our community. If you perform your duties well, I will do everything in my power to ensure you have a safe harbor with Tri City that you can depend on, especially during unsettling times. We want to offer a working environment where you can advance your career. And, together, we will continue to build a bank that you will be proud to retire from.*

I am so pleased at how our team of Bankers are stepping up during these trying times. In a matter of days, we formulated various contingency plans to be enacted as necessary. We quickly adjusted to new sources of income which was made possible as our wonderful Bankers worked selflessly, including long days, long nights, and on weekends, to adapt and contribute in different roles. It is humbling to witness our team giving their all.

With our dedicated Bankers as our number one asset, I am confident we will pass through this crisis and emerge an even stronger bank. While other corporations have been furloughing and laying off employees, we are building off of what we accomplished in 2019, including the establishment of a business services team, increasing our data analytics capabilities, expanding our compliance and IT departments, creating a branding team and improvements to our bank wide training. These initiatives and others planned for 2020 will drive our efforts to increase core deposits, grow our loan portfolio and gain operating efficiencies. Rest assured, your investment is in good hands.

Thank you for your continued support and please, stay safe and healthy,

Brian T. McGarry

Brian T. McGarry
Chairman of the Board and Chief Executive Officer
Tri City Bankshares Corporation

2019 Management Discussion and Analysis

The Corporation posted after-tax net income of $18.7 million for the year ended December 31, 2019, an increase of $1.7 million or 10.4%, compared to $17.0 million in 2018. Earnings per share increased to $2.10 for the year ended December 31, 2019 compared to $1.90 for 2018. The Corporation paid total dividends of $0.52 per share in 2019 compared to $0.48 per share in 2018.

After-tax net income in 2019 was comprised of a continued strong level of core operating income, along with the benefits of $2.3 million in income from death benefits of bank owned life insurance and a $0.8 million reduction in income taxes.

Core Operating Income

Management has made a focused and committed effort over the past four years to increase the amount of the Corporation's core operating income. Core operating income represents the pre-tax earnings generated by the core banking business lines and operations of the Corporation. A reconciliation of reported income before taxes to core operating income is presented below:

Core Operating Income

$ in thousands

	For the Year Ended December 31,				
	2015	2016	2017	2018	2019
Total Income Before Taxes	$ 15,901	$ 16,111	$ 18,186	$ 21,514	$ 22,453
Acquistion-related purchase accounting income	(1,905)	(1,851)	(907)	(1,667)	(1,066)
Bank owned life insurance death benefits income	(251)	0	0	0	(2,334)
Security investment sale income	(2,917)	0	0	0	0
New market tax credit investment amortization expense	0	0	0	728	1,069
Core Operating Income	$ 10,828	$ 14,260	$ 17,279	$ 20,575	$ 20,122

As provided in the reconciliation, core operating income in 2019 has grown to $20.1 million, an increase of 85.8% over 2015 and 16.5% over 2017, driven primarily by major growth in commercial and multifamily real estate loans resulting in increased interest income, offset by significant investments in personnel and IT infrastructure. The 2.3% decrease in 2019 compared to 2018 was primarily the result of increased investments in personnel. The Corporation has created and enhanced multiple areas of its banking operations over the past four years, including development and hiring of commercial and retail lenders, the formation of an expanded commercial loan credit department, the creation of a business services team to support our retail merchant customers and drive increased business customer deposits, the development of a data analytics team for work across all bank metrics, the expansion of our IT professional team, improvements in our human resource team and training programs, expanding the depth of our compliance and BSA team, and the establishment of a marketing and communications team driving our website and local market brand.

The adjustments for core operating income eliminate matters that are associated with acquisition, life insurance, security investment sales and tax credit investments outside of the core operations of the Corporation. The acquisition-related purchase accounting income includes accretable income reflected in interest income and non-accretable income reflected in noninterest income in the income statement. These amounts are associated with the 2009 FDIC acquisition of the Bank of Elmwood and amortization of original discount recorded for that acquired loan portfolio. Death benefits of bank owned life insurance are non-recurring income items outside the control of the Corporation. While all investment securities are held as available for sale, the Corporation has not sold any securities other than in 2015. The Corporation made six new markets tax credit investments in 2018 and 2019. We consider the amortization of the investments as part of our non-core operations to match the expense with the associated federal tax credit which is reflected in income taxes.

Income Statement

Net interest income was $51.1 million in 2019, an increase of $1.7 million or 3.6% compared to $49.4 million in 2018. The increase was due to a $3.3 million increase in interest income on loans and a $0.8 million increase in interest income on overnight federal funds investments, offset by a $2.0 million decrease in interest income on security investments and a $0.4 million increase in interest paid on deposits. The increase in interest income on loans was due to a combination of an increase in average loan balances outstanding in 2019 compared to 2018 and an increase in yield on loans. The increase in interest income on overnight federal fund investments was the result of the Corporation maintaining a larger level of liquidity throughout 2019 with a slightly larger yield. The decrease in interest income on security investments was due to a decrease in the average investments during 2019 compared to 2018 as the Corporation continues to invest security maturities into the loan portfolio. The increase in interest expense was primarily due to increased municipal deposits on which the Corporation pays slightly higher interest. The yield on total earning assets was 4.01% and 3.91% in 2019 and 2018, respectively. The Corporation's primary competitive advantage is its strong core deposit base, resulting in the average cost of funds being a very low 0.17% and 0.14% in 2019 and 2018, respectively. As a result, net interest margin on total average earning assets increased to 3.84% in 2019 compared to 3.77% in 2018.

There were no provisions for loan losses recorded during 2019 and 2018 due to the strong level of our loan portfolio asset quality, as further discussed in the Asset Quality section.

Noninterest income was $18.4 million in 2019, an increase of $1.6 million or 9.5% compared to $16.8 million in 2018. The increase was primarily due to $2.3 million in income on death benefits from bank owned life insurance policies, offset by a decrease of $0.4 million in non-accretable acquisition-related purchase accounting income and a $0.4 million reduction in gain on sale of other real estate owned. Core noninterest income as a percentage of total assets was 1.05% in 2019 compared to 1.12% in 2018.

Noninterest expense was $47.1 million in 2019, an increase of $2.4 million or 5.4% compared to $44.7 million in 2018. The increase was primarily due to a $1.5 million increase in salary and benefits, $0.5 million in IT professional services and data processing costs and $0.3 million in new markets tax credit investment amortization. The increase in salary and benefits is the result of the investments in personnel noted in the Core Operating Income discussion above. Core noninterest expense as a percentage of total assets was 3.14% in 2019 compared to 3.13% in 2018. Management will continue to invest in personnel, operations and marketing in 2020 to ensure the long-term success of the Corporation.

Income tax expense was $3.7 million in 2019 compared to $4.6 million in 2018. The Corporation's overall effective tax rate was 16.6% in 2019 compared to 21.2% in 2018. The reduction is primarily the result of an increase in federal new markets tax credits of $0.5 million and a $0.6 million benefit due to death benefits from bank owned life insurance being non-taxable. Both 2019 and 2018 benefited from the Tax Cuts and Jobs Act signed into law in December 2017 which reduced federal income tax rates effective in 2018.

Balance Sheet

Total assets were $1.47 billion as of December 31, 2019, an increase of $60.4 million or 4.3% compared to $1.41 billion as of December 31, 2018.

Cash and cash equivalents increased to $96.5 million as of December 31, 2019 compared to $65.4 million as of December 31, 2018. Included in cash and cash equivalents is $60.7 million invested in overnight funds at the Federal Reserve or with correspondent banks. The Corporation averaged $78.4 million in liquid overnight invested funds in 2019 compared to $43.2 million in 2018. The increase was due to an increase in deposits and capital, and the Corporation maintaining a liquidity level deemed appropriate for future loan growth.

The security investment portfolio as of December 31, 2019 was $383.3 million compared to $371.0 million as of December 31, 2018. Average security investment amounts during 2019 were lower than 2018, but the Corporation acquired approximately $57 million of securities in the fourth quarter of 2019 to utilize a portion of its liquidity. The investment portfolio as of December 31, 2019 was comprised of 50.7% in collateralized mortgage obligations, 36.0% in mortgage backed securities and 13.3% in municipal bonds. The security investments are structured to provide a steady level of cash flows for the Corporation to reinvest in loans, or to provide additional liquidity to manage our cost of funds and operations.

Total loans were $902.1 million as of December 31, 2019 compared to $907.5 million as of December 31, 2018. While the December 31, 2019 year end loan balance was flat compared to 2018, average loans outstanding during 2019 were $911.5 million compared to $872.8 million during 2018, an increase of 4.4%. New loan originations during 2019 totaled a record level of $314 million, but the Corporation also experienced a record level of loan payoffs of $208 million, along with normal scheduled loan reductions due to maturities and principal payments. The Corporation is continuing to focus on loan growth while maintaining strong credit discipline, which is the most prudent approach for the long-term health and profitability of the Corporation.

As shown in the table below, the loan portfolio remains well diversified. The Corporation's loan focus is on real estate. The percentage of loans in the commercial and multifamily real estate sectors have increased in 2019 and over the past few years, reflecting the Corporation's effort to expand its relationships with major real estate developers and the evolving demographics in our geographic market creating growth in multifamily developments.

Loan Portfolio Composition

$ in thousands

	December 31, 2018		December 31, 2019	
	Loan Balance	Percent of Total Loans	Loan Balance	Percent of Total Loans
Commercial & Industrial	$47,457	5.2%	$35,218	3.9%
Real Estate:				
Commercial	487,665	53.7%	506,283	56.1%
Residential	196,613	21.7%	184,557	20.5%
Multifamily	99,445	11.0%	112,250	12.4%
Construction	68,278	7.5%	59,220	6.6%
Installment & Other	8,006	0.9%	4,538	0.5%
Total	$907,464	100.00%	$902,066	100.00%

Historically, the majority of the Corporation's loans have been fixed rate with maturities of three years or less. As the Corporation has developed expanded relationships with financially strong loan customers over the past several years, and in line with market competition, the Corporation has increased its volume of fixed rate loans with maturities of three to five years. The Corporation has maintained its conservative underwriting for all loans, and we have structured prepayment penalties on longer term loans to provide interest rate protection should interest rates fall and borrowers look to refinance.

Total deposits were $1.27 billion as of December 31, 2019, an increase of $22.4 million or 1.8% compared to $1.25 billion as of December 31, 2018. Noninterest bearing demand deposits remained consistent at approximately $300 million, while interest bearing transactions accounts increased $42.4 million and money market, savings and certificate of deposit balances decreased $18.6 million.

As previously noted, the Corporation has historically maintained and utilized its large deposit base and capital to fund its activities, with no third-party borrowings. This is a significant benefit for the Corporation and a continuing focus of operations. The $1.27 billion in deposits as of December 31, 2019 are a $76.6 million increase over amounts as of December 31, 2015 or 6.4%. More importantly, core noninterest bearing demand deposits during that time have increased $63.2 million while transaction, money market and savings accounts have increased $57.3 million. Only certificate of deposit balances have decreased in the past four years, by $43.9 million.

Loan Portfolio Asset Quality

All of our asset quality measures remained strong in 2019. Nonaccrual loans totaled $4.9 million or only 0.54% of total loans as of December 31, 2019. Accruing loans that were past due 30 days and over were only $4.5 million or 0.52% as of December 31, 2019. The Corporation actually realized a slight amount of net recoveries in excess of loan charge-offs in each of 2018 and 2019. The allowance for loan losses to total loans remained strong at 1.23% as of December 31, 2019 compared to 1.21% as of December 31, 2018. In addition, the Corporation had only one property totaling $0.1 million in other real estate owned as of December 31, 2018 and no other real estate owned as of December 31, 2019.

Capital

Total stockholders' equity was $174.5 million as of December 31, 2019, an increase of $21.5 million or 14.2% compared to $153.0 million as of December 31, 2018. The increase in stockholders' equity during 2019 resulted from an increase of $14.1 million in retained earnings and an increase of $7.4 million in accumulated other comprehensive income associated with an increase in the unrealized gain on security investments as of December 31, 2019.

Total equity to total assets increased to 11.9% as of December 31, 2019 compared to 10.9% as of December 31, 2018. Book value per share increased to $19.59 as of December 31, 2019 compared to $17.18 as of December 31, 2018. The Corporation's capital ratios continued to exceed thresholds for well-capitalized banks. The Leverage Capital ratio increased to 11.75% as of December 31, 2019 compared to 11.23% as of December 31, 2018

The Corporation's Board of Directors firmly believes in maintaining a strong capital base. The Board of Directors will continue to monitor the Corporation's strategy, future earnings, on-going regulatory requirements, the economy, the marketplace, and other factors when approving future dividends.

Tri City Bankshares Corporation

Selected Financial Data

	For the Year Ended December 31,				
	2015	2016	2017	2018	2019
Results of Operations					
Interest income	$ 40,830,614	$ 44,091,245	$ 47,094,056	$ 51,298,986	$ 53,452,565
Interest expense	1,146,131	1,241,042	1,562,534	1,878,617	2,296,014
Net interest income	39,684,483	42,850,203	45,531,522	49,420,369	51,156,551
Provision for loan losses ("PLL")	3,000,000	900,000	-	-	-
Net interest income after PLL	36,684,483	41,950,203	45,531,522	49,420,369	51,156,551
Core noninterest income	14,941,998	14,379,506	14,992,594	15,721,859	15,430,526
Non-core noninterest income	4,077,085	769,702	329,920	1,106,574	3,002,577
Core noninterest expense	39,802,394	40,988,691	42,668,461	44,006,958	46,067,993
Non-core noninterest expense	-	-	-	728,278	1,069,131
Income before income taxes	15,901,172	16,110,720	18,185,575	21,513,566	22,452,530
Deferred tax adjustment	-	-	1,500,190	-	-
Income taxes	5,332,852	5,382,714	6,005,916	4,552,500	3,729,500
Net income	$ 10,568,320	$ 10,728,006	$ 10,679,469	$ 16,961,066	$ 18,723,030
Balance Sheet Data					
Assets	$ 1,332,293,272	$ 1,427,301,200	$ 1,414,721,950	$ 1,406,431,804	$ 1,466,800,227
Security investments	446,840,309	440,788,027	444,488,998	371,017,618	383,295,527
Total loans	728,697,339	799,628,467	825,842,074	907,464,082	902,066,127
Allowance for loan losses	(11,590,900)	(11,256,774)	(10,732,652)	(10,994,385)	(11,072,956)
Total loans, net	717,106,439	788,371,693	815,109,422	896,469,697	890,993,171
Deposits	1,195,119,232	1,284,805,692	1,267,051,615	1,249,302,645	1,271,749,600
Borrowings	-	-	-	-	-
Total stockholders' equity	133,771,359	138,186,448	143,865,498	153,014,924	174,466,438
Net loans to deposits	60.00%	61.36%	64.33%	71.76%	70.06%
Per Share Data					
Earnings per share	$ 1.19	$ 1.20	$ 1.20	$ 1.90	$ 2.10
Cash dividends paid	$ 0.48	$ 0.48	$ 0.48	$ 0.48	$ 0.52
Book value per share	$ 15.02	$ 15.52	$ 16.16	$ 17.18	$ 19.59
Shares outstanding	8,904,915	8,904,915	8,904,915	8,904,915	8,904,915
Performance Ratios					
Return on assets	0.79%	0.75%	0.75%	1.21%	1.28%
Return on equity	7.90%	7.76%	7.42%	11.08%	10.73%
Interest on earning assets	3.48%	3.49%	3.57%	3.91%	4.01%
Cost of funds	0.10%	0.10%	0.12%	0.14%	0.17%
Net interest margin	3.38%	3.39%	3.45%	3.77%	3.84%
Core noninterest income to assets	1.12%	1.01%	1.06%	1.12%	1.05%
Core noninterest expense to assets	2.99%	2.87%	3.02%	3.13%	3.14%
Efficiency Ratio	72.86%	71.62%	70.50%	67.56%	69.18%
Capital Ratios					
Total equity to total assets	10.04%	9.68%	10.17%	10.88%	11.89%
Leverage capital ratio	10.28%	10.06%	10.50%	11.23%	11.75%
Tier 1 risk based capital ratio	16.64%	15.99%	15.97%	16.02%	17.09%
Total risk based capital ratio	17.89%	17.24%	17.21%	17.13%	18.18%
Asset Quality Ratios					
Nonaccrual loans to total loans	1.51%	0.74%	0.56%	0.47%	0.54%
Past due loans >30 days to total loans	1.31%	1.01%	0.80%	0.82%	0.52%
Net charge-offs to total loans	0.48%	0.15%	0.06%	-0.03%	-0.01%
Other real estate owned to total assets	0.24%	0.03%	0.01%	0.01%	0.00%
Allowance for loan losses to total loans	1.59%	1.41%	1.30%	1.21%	1.23%

Independent Auditors' Report

To the Board of Directors and Stockholders of
Tri City Bankshares Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Tri City Bankshares Corporation and subsidiaries (the "Corporation"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

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

Report on Internal Control over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Corporation's internal control over financial reporting as of December 31, 2019, based on criteria established in *Internal Control-Integrated Framework (2013),* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 31, 2020 expressed an unqualified opinion.

Baker Tilly Virchow Krause, LLP

Milwaukee, Wisconsin
March 31, 2020

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2019 and 2018

ASSETS

	2019	2018
Cash and due from banks	$ 84,918,940	$ 64,379,595
Federal funds sold	11,601,051	990,830
Total Cash and Cash Equivalents	96,519,991	65,370,425
Securities available for sale, at fair value	383,295,527	371,017,618
Loans, less allowance for loan losses of $11,072,956 and $10,994,385 as of 2019 and 2018, respectively	890,993,171	896,469,697
Premises and equipment - net	16,555,094	15,750,707
Right of use lease asset	16,143,202	-
Bank owned life insurance	42,931,999	39,255,799
Accrued interest receivable and other assets	20,361,243	18,567,558
TOTAL ASSETS	$ 1,466,800,227	$ 1,406,431,804

LIABILITIES AND STOCKHOLDERS' EQUITY

	2019	2018
LIABILITIES		
Deposits		
Demand	$ 298,876,234	$ 300,283,663
Savings and NOW	913,251,748	876,046,750
Other time	59,621,618	72,972,232
Total Deposits	1,271,749,600	1,249,302,645
Lease liability	16,143,202	-
Accrued interest payable and other liabilities	4,440,987	4,114,235
Total Liabilities	1,292,333,789	1,253,416,880
STOCKHOLDERS' EQUITY		
Cumulative preferred stock, $1 par value 200,000 shares authorized, no shares issued	-	-
Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2019 and 2018	8,904,915	8,904,915
Additional paid-in-capital	26,543,470	26,543,470
Accumulated other comprehensive income (loss)	1,031,716	(6,327,324)
Retained earnings	137,986,337	123,893,863
Total Stockholders' Equity	174,466,438	153,014,924
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 1,466,800,227	$ 1,406,431,804

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2019 and 2018

	2019	2018
INTEREST INCOME		
Loans	$ 43,921,658	$ 40,568,593
Investment securities		
Taxable	6,987,281	8,952,530
Tax exempt	897,178	937,217
Federal funds sold and due from banks	1,627,122	821,320
Other	19,326	19,326
Total Interest Income	53,452,565	51,298,986
INTEREST EXPENSE		
Deposits	2,289,362	1,876,309
Other borrowings	6,652	2,308
Total Interest Expense	2,296,014	1,878,617
Net Interest Income before Provision for Loan Losses	51,156,551	49,420,369
Provision for loan losses	-	-
Net Interest Income after Provision for Loan Losses	51,156,551	49,420,369
NONINTEREST INCOME		
Service charges on deposits	4,641,796	5,083,707
Debit card interchange	4,473,591	4,195,302
ATM	1,282,415	1,578,543
Merchant services	862,433	877,408
Loan servicing income	334,544	456,126
Net gain on sale of loans	818,065	412,969
Increase in bank owned life insurance	899,752	954,175
Bank owned life insurance death benefits	2,333,763	-
Non-accretable loan discount	668,814	1,106,574
Gain on sale of other real estate owned	5,500	379,595
Other income	2,112,430	1,784,034
Total Noninterest Income	18,433,103	16,828,433
NONINTEREST EXPENSES		
Salaries and employee benefits	26,792,477	25,333,246
Net occupancy costs	4,253,503	4,192,205
Furniture and equipment expenses	2,465,444	2,454,050
Data processing expense	4,116,722	4,065,041
Professional fees	1,644,619	1,285,585
Telecommunications expense	1,039,690	977,828
Advertising and promotional	664,543	714,439
FDIC and other regulatory assessments	488,231	719,991
Operation of other real estate owned	2,038	40,604
Office supplies	922,527	800,440
Postage	476,646	574,106
Other expense	4,270,684	3,577,701
Total Noninterest Expense	47,137,124	44,735,236
Total Income before Taxes	22,452,530	21,513,566
Less: Income tax expense	3,729,500	4,552,500
NET INCOME	$ 18,723,030	$ 16,961,066

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2019 and 2018

	2019	2018
NET INCOME	$ 18,723,030	$ 16,961,066
Other comprehensive income (loss), net of tax:		
Securities available for sale:		
Net changes in unrealized gain (loss)		
on securities available for sale	10,114,247	(4,861,644)
Tax effect	(2,755,207)	1,324,361
Total Other Comprehensive Income (Loss), net of tax:	7,359,040	(3,537,283)
COMPREHENSIVE INCOME	$ 26,082,070	$ 13,423,783

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2019 and 2018

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
BALANCES - January 1, 2018	$ 8,904,915	$ 26,543,470	$ (2,790,043)	$ 111,207,156	$ 143,865,498
Net income	-	-	-	16,961,066	16,961,066
Net changes in unrealized loss on securities available for sale	-	-	(4,861,644)	-	(4,861,644)
Tax effect	-	-	1,324,363	-	1,324,363
Total Comprehensive Income					13,423,785
Cash dividends - ($0.48 per share)	-	-	-	(4,274,359)	(4,274,359)
BALANCES - December 31, 2018	8,904,915	26,543,470	(6,327,324)	123,893,863	153,014,924
Net income	-	-	-	18,723,030	18,723,030
Net changes in unrealized gain (loss) on securities available for sale	-	-	10,114,247	-	10,114,247
Tax effect	-	-	(2,755,207)	-	(2,755,207)
Total Comprehensive Income					26,082,070
Cash dividends - ($0.52 per share)	-	-	-	(4,630,556)	(4,630,556)
BALANCES - December 31, 2019	$ 8,904,915	$ 26,543,470	$ 1,031,716	$ 137,986,337	$ 174,466,438

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019 and 2018

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 18,723,030	$ 16,961,066
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	1,949,568	1,797,531
Amortization and accretion of servicing rights, premiums and discounts	1,852,926	892,540
Net gain on sale of loans	(818,065)	(412,969)
Benefit for deferred income taxes	435,033	201,372
Proceeds from sales of loans held for sale	36,043,075	14,254,144
Originations of loans held for sale	(36,884,071)	(13,948,464)
Increase in bank owned life insurance	(899,752)	(954,175)
Gain on bank owned life insurance death benefits	(2,333,763)	-
Gain on sale of other real estate owned	(5,500)	(379,595)
Net change in fair value of other real estate owned	-	(2,330)
Net change in fair value of mortgage servicing rights	(30,365)	(68,308)
Gain on disposal of premises and equipment	598	(24,479)
Right of use lease asset amortization	747,275	-
Net change in:		
Accrued interest receivable and other assets	(5,041,393)	(3,096,523)
Lease liability	(747,275)	-
Accrued interest payable and other liabilities	326,752	1,432,391
Net cash flows from operating activities	13,318,073	16,652,201
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, prepayments and calls	67,942,011	66,238,016
Purchases	(72,777,977)	-
Net decrease (increase) in loans	7,938,398	(80,406,158)
Purchase of premises and equipment	(2,772,596)	(2,730,237)
Purchase of bank owned life insurance	(5,000,000)	-
Proceeds from bank owned life insurance death benefits	4,557,315	-
Proceeds from sale of other real estate owned	109,900	1,112,595
Proceeds from sales of premises and equipment	18,043	69,553
Net cash provided by (used in) investing activities	15,094	(15,716,231)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase (decrease) in deposits	22,446,955	(17,748,970)
Dividends paid	(4,630,556)	(4,274,359)
Net cash flows provided by (used in) from financing activities	17,816,399	(22,023,329)
Net change in cash and cash equivalents	31,149,566	(21,087,359)
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	65,370,425	86,457,784
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 96,519,991	$ 65,370,425

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2019 and 2018

(continued)

	2019	2018
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for interest	$ 2,304,750	$ 1,880,633
Cash paid for income taxes	3,755,000	3,785,000
SUPPLEMENTAL NON-CASH DISCLOSURES		
Loans receivable transferred to other real estate owned	$ -	$ 712,400
Mortgage servicing rights resulting from sales of loans	263,461	107,289
Lease liabilities arising from obtaining right of use lease assets	16,890,477	-

See accompanying notes to consolidated financial statements

NOTE 1 - Summary of Significant Accounting Policies

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank") (collectively, the "Corporation"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, Title Service of Southeast Wisconsin, Inc., a title company subsidiary, TCNB Whole Health Investment Fund LLC, TCNB Aurora Investment Fund LLC, TCNB Fire Loan Pool IF LLC, TCNB FCI Loan Pool IF LLC and TCNB Notre Dame IF LLC, subsidiaries to facilitate tax credit investments. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practices within the banking industry.

The Corporation grants commercial, real estate and installment loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation is subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation is subject to the regulations of certain regulatory agencies and undergo periodic examination by those regulatory agencies.

Use of Estimates

In preparing consolidated financial statements in conformity with U.S. 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 determination of the allowance for loan losses, deferred taxes, other than temporary impairment of securities and fair values of financial instruments.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. The Corporation maintained amounts due from banks that exceeded federally insured limits as of December 31, 2019. The Corporation has not experienced any losses in such accounts.

Securities

Securities are classified as available for sale when the Corporation intends to hold them for an indefinite period of time but not necessarily to maturity. Securities available for sale are accounted for on a trade date basis and carried at fair value, with unrealized holding gains and losses excluded from net income and reported in accumulated other comprehensive income (loss), net of tax. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other-than-temporary due to credit issues are reflected as "Other than temporary impairment of securities" in the consolidated statements of income. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of other-than-temporary impairment related to all other factors is included in other comprehensive loss, net of tax.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Loans Held for Investment

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal, reduced by an allowance for loan losses and any deferred fees or costs in originating loans. Interest income is accrued and credited to income on a daily basis based on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the loan yield using an effective interest method. The accrual of interest income on impaired loans is discontinued when, in the opinion of management, there is reasonable doubt as to the borrower's ability to meet payment of interest or principal when they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are credited to the loan receivable balance and no interest income is recognized on those loans until the principal balance is current. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. A troubled debt restructuring ("TDR") includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that the Corporation would not otherwise consider except for the borrower's financial difficulties. All TDRs are classified as impaired loans. TDRs may be on accrual or non-accrual status based upon the performance of the borrower and management's assessment of collectability. TDRs deemed non-accrual may return to accrued status based on performance in accordance with terms of the restructuring, generally 6 months.

Consistent with regulatory guidance, charge-offs are taken when specific loans, or portions thereof, are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. The Corporation's policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Corporation promptly charges-off commercial and real estate loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. All consumer loans 120 days or more past due and all other loans with principal and interest 180 days or more past due will be reviewed for potential charge-off at least quarterly.

Loans Acquired Through Purchase

Loans acquired through the completion of a purchase, including loans that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Corporation will be unable to collect all contractually-required payments receivable, are initially recorded at fair value with no valuation allowance. Loans are evaluated individually at the date of acquisition to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, a loss accrual or a valuation allowance. Non-accretable discount may be taken to non-interest income if a loan pays-off or if the non-accretable discount is greater than a charge-off taken. Subsequent decreases to the expected cash flows will generally result in a change in the allowance for loan losses. Subsequent increases in cash flows result in a change in the allowance for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount with a positive impact on interest income. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as a change in the allowance for loan losses. If the Corporation does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized gains or losses are recognized through a valuation allowance by charges to income. All sales are made without recourse. Loans held for sale were $1,395,600 and zero at December 31, 2019 and 2018, respectively.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Allowance for Loan Losses

The allowance for loan losses reflects management's best estimate of the probable and inherent losses on loans and is based on a risk model developed and implemented by management and approved by the Corporation's Board of Directors.

The allowance for loan losses is a valuation allowance for probable and inherent losses incurred in the loan portfolio. Management maintains allowances for loan losses at levels deemed adequate to absorb estimated probable credit losses inherent in the loan portfolio. The adequacy of the allowance is determined based on periodic evaluations of the loan portfolios and other relevant factors. The allowance is comprised of both a specific component and a general component. Even though the entire allowance is available to cover losses on any loan, specific allowances are provided on impaired loans pursuant to accounting standards. The general allowance is based on historical loss experience, adjusted for qualitative and environmental factors.

In determining the general allowance management has segregated the loan portfolio by loan class. For each class of loan, a historical loss factor is computed. In determining the appropriate period of activity to use in computing the historical loss factor management reviews trends in net charge-off ratios. It is management’s intention to utilize a period of activity that is most reflective of current experience. Changes in the historical period are made when there is a distinct change in the trend of net charge-off experience. Management adjusts the historical loss factors for the impact of the following qualitative factors: asset quality, changes in volume and terms, policy changes, ability of management, economic trends, industry conditions, changes in credit concentrations and competitive/legal factors. In determining the impact, if any, of an individual qualitative factor, management compares the current underlying facts and circumstances surrounding a particular factor with those in the historical periods, adjusting the historical loss factor in a directionally consistent manner with changes in the qualitative factor. Management separately evaluates both the Corporation’s historical portfolio as well as acquired loans that have renewed and are eligible to be considered as part of the general allowance. Management will continue to analyze the qualitative factors on a quarterly basis, adjusting the historical loss factor both up and down, to a factor deemed appropriate for the probable and inherent risk of loss in its portfolio.

Specific allowances are determined as a result of the impairment process. When a loan is identified as impaired it is evaluated for loss using either the fair value of collateral method or the present value of cash flows method. If the present value of expected cash flows or the fair value of collateral exceeds the Corporation’s carrying value of the loan, no loss is anticipated, and no specific reserve is established. However, if the Corporation’s carrying value of the loan is greater than the present value of expected cash flows or fair value of collateral, a specific reserve is established. In either situation, loans identified as impaired are excluded from the calculation of the general reserve.

The allowance for loan losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries. The adequacy of the allowance for loan losses is reviewed and approved by the Corporation's Board of Directors on a quarterly basis. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may suggest additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

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 Corporation, (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 Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

The Corporation records a mortgage servicing right (“MSR”) asset when it continues to service borrower payments and perform maintenance activities on loans sold to secondary market investors. In the period in which the loan is sold to the secondary market investors, the gain on sale of the loan is increased by the value of the initial MSR.

The Corporation initially records servicing rights at the time of the sale of the loans to the secondary market investors. The Corporation uses the amortization method for the subsequent measurement of its MSR assets. Under the amortization method, the Corporation amortizes the value of its MSR assets in proportion to and over the life of the loan on a per loan basis. An impairment analysis is prepared on a quarterly basis by estimating the fair value of the MSR assets and comparing that value to the carrying amount. A valuation allowance is established when the carrying amount exceeds fair value. The fair value of the MSR asset is determined by using a discounted cash flow model, which estimates the present value of the future net cash flows of the servicing portfolio based on various factors, such as servicing costs, expected prepayment speeds and discount rates.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Mortgage Servicing Rights (continued)

At December 31, 2019 and 2018, the Corporation services real estate loans for investors in the secondary market, which are not included in the accompanying consolidated balance sheets, of approximately $223 million and $221 million, respectively. The related MSR assets were $1,491,001 and $1,444,069 at December 31, 2019 and 2018, respectively, and are included in accrued interest receivable and other assets on the consolidated balance sheets. MSR assets as of December 31, 2018 are reported net of a valuation allowance of $30,365. No valuation allowance was required as of December 31, 2019.

Premises and Equipment - Net

Land is carried at cost. Depreciable assets are stated at cost less accumulated depreciation. Provisions for depreciation are computed on straight-line methods over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and 15 to 40 years for buildings and lease-hold improvements. Repairs and maintenance costs are expensed as incurred.

Other Real Estate Owned

Other real estate owned (“OREO”) comprises real estate acquired in partial or full satisfaction of loans. OREO is recorded at fair value less estimated selling costs at the date of transfer, establishing a new cost basis, with any excess of the related loan balance over the fair value less expected selling costs charged to the allowance for loan losses. Subsequently, properties are evaluated and if fair value declines, a valuation allowance is recorded through operation of other real estate owned expense. The amount the Corporation ultimately recovers on repossessed assets may differ substantially from the net carrying value of these assets because of future market factors beyond the Corporation’s control. Net costs of maintaining and operating the properties are expensed to operation of other real estate owned as incurred on the consolidated statements of income.

New Markets Tax Credits

As part of its Community Reinvestment Act responsibilities and due to their favorable economics, the Corporation invests in tax credit-motivated projects primarily in the markets it serves. These projects are directed at tax credits issued under the federal New Markets Tax Credits program. As a result of the transactions, the Corporation has several Investment Fund subsidiaries. The Investment Fund subsidiaries are a limited partner in several community development entities (“CDEs”). The Corporation is not the general partner, does not have controlling ownership and is not the primary beneficiary in any of these limited partnerships and thus, the limited partnerships have not been consolidated. These investments are accounted for using the equity method of accounting and are evaluated for impairment at the end of each reporting period (see Note 7 – New Market Tax Credits - Variable Interest Entities).

Federal Reserve Bank Stock

The Corporation’s investment in Federal Reserve Bank (“FRB”) stock meets the minimum amount required by current regulations and is carried at cost, which approximates fair value.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded, or related fees are incurred or received.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Derivative Financial Instruments

The Corporation offers interest rate swap products directly to qualified commercial borrowers. The Corporation economically hedges client derivative transactions by entering into offsetting interest rate swap contracts executed with a third party. The derivative contracts have mirror-image terms, which results in the positions' changes in fair value primarily offsetting through earnings each period. The credit risk and risk of non-performance embedded in the fair value calculations is different between the dealer counterparties and the commercial borrowers which may result in a difference in the changes in the fair value of the mirror-image swaps. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the counterparty's risk in the fair value measurements. When evaluating the fair value of its derivative contracts for the effects of non-performance and credit risk, the Corporation considered the impact of netting and any applicable credit enhancements such as collateral postings, thresholds and guarantees.

At December 31, 2019 and 2018, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was $13.8 million and $14.0 million, respectively. The Corporation receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported on the consolidated balance sheets as a derivative asset and liability of $1,408,366 and $530,321 in accrued interest receivable and other assets and accrued interest payable and other liabilities at December 31, 2019 and 2018, respectively. In the event of default on a commercial borrower interest rate swap by the counterparty, a right of offset exists to allow for the commercial borrower to set off amounts due against the related commercial loan. As of December 31, 2019 and 2018, no interest rate swaps were in default and therefore all values for the commercial borrower swaps are recorded on a gross basis on the consolidated balance sheets.

Advertising Costs

All advertising costs incurred by the Corporation are expensed in the period in which they are incurred and recorded in noninterest expense.

Income Taxes

The Corporation files a consolidated federal income tax return and combined state income tax returns. Income tax expense is recorded based on the liability method. 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 enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense. The differences relate principally to the allowance for loan losses, mortgage servicing rights, new markets tax credits investments, and premises and equipment. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized. The Corporation also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position taken or expected to be taken in an income tax return. The Corporation follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to the uncertainty in these income tax positions. It is the Corporation's policy to include interest and penalties in tax expense.

Earnings Per Share

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during the periods ended December 31, 2019 and 2018.

Segment Reporting

The Corporation has determined that it has one reportable segment - community banking. The Corporation offers a range of financial products and services to external customers, including accepting deposits and originating residential, consumer and commercial loans. Revenues for each of these products and services are disclosed in the consolidated statements of income.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Employee Benefit Plan

The Corporation has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Corporation's policy is to fund contributions as accrued.

Bank Owned Life Insurance

The Corporation is the owner and primary beneficiary of life insurance policies on certain employees. Bank owned life insurance is reported at the cash surrender value of the policies. The earnings on the policies are recognized as a component of noninterest income. The policies can be liquidated, if necessary, with tax costs associated. However, the Corporation intends to hold these policies and, accordingly, the Corporation has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Lease Reporting

As discussed below, on January 1, 2019, the Corporation adopted Accounting Standards Update (ASU) No. 2016-02 "Leases (Topic 842)" and subsequent amendments thereto, which requires the Corporation to recognize leases on the consolidated balance sheets. The Corporation adopted the standard under the modified retrospective approach as of the date of adoption and elected to apply the practical expedient to account for lease and non-lease components in contracts in which the Corporation is a lessee as a single lease component.

Adoption of the lease standard resulted in the recognition of a right of use lease asset and lease liability of $15,573,043 as of January 1, 2019. Right of use lease assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. The amounts were determined based on the present value of remaining minimum lease payments, including all extension options, discounted using the Corporation's incremental borrowing rate as of the date of adoption, and any subsequent lease extensions or commencements. Since the rates inherent in the leases are generally not available, the Corporation uses the FHLB Chicago advance fixed rate for the appropriate lease term as the discount rate. There was no impact to the timing of expense recognition in the Corporation's consolidated statements of income. Prior periods were not restated and continue to be presented under legacy GAAP. Disclosures regarding the Corporation's leasing activity are presented in Note 13 – Leases.

Reclassifications

Certain 2018 amounts have been reclassified to conform to the 2019 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

Revenue Recognition

The Corporation generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The main types of revenue contracts included in non-interest income within the consolidated statements of operations are as follows.

- ***Service charges on deposits*** - Service charges on deposits consist of transaction-based fees, account maintenance fees, and overdraft services fees for various retail and business checking customers. Transaction-based fees, which includes services such as wire transfer fees and statement rendering fees are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. All deposit liabilities are considered to have one-day terms and therefore related fees are recognized as non-interest income at the time when the services are provided to the customer. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn directly from the customer's account balance.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Revenue Recognition (continued)

- ***Debit Card Interchange Income -*** The Corporation earns interchange fees from debit cardholder transactions conducted through VISA payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

- ***ATM Income -*** The Corporation earns income on automated teller machine ("ATM") transactions. This income includes fees when noncustomers use the Corporation's ATM network, when the Corporation's customers use other ATM networks and interchange income on transaction activity that occurs on the Corporation's ATM network. Income from these activities are recognized concurrently when the transactions occurs.

- ***Merchant Services Income*** - The Corporation earns merchant services income for selling and servicing merchant card processing to customers. The Corporation uses a third party to process the credit/debit cards at point of sale. The Corporation receives monthly payments for servicing the merchant terminals, which is earned over the course of the month, representing the period over which the Corporation satisfies the performance obligation. A per transaction fee and a percent of the overall transaction amount makes up the monthly merchant service fee collected from each customer. In addition, merchant services sell merchant terminal machines which is recognized at the time of sale.

- ***Gain/Losses on Sale of OREO –*** The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction prices and related gain (loss) on sale if a significant financing component is present.

- ***Other Non-Interest Income*** – The main items in this revenue category are other loan closing related fees, prepayment fees and title fees which are all recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Also included in other income are financial advisory fees which are contractually agreed with each customer and earned over time as the Corporation provides the contracted monthly or quarterly services.

Subsequent Events

Subsequent events were evaluated through March 31, 2020, the date the consolidated financial statements were available to be issued.

As a result of the spread of the COVID-19 coronavirus, economic uncertainties have arisen which are likely to negatively impact net interest income. Other financial impact could occur, though such potential impact is unknown at this time.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Accounting Pronouncements Effective in 2019

Leases

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02, *Leases (Topic 842).* The amendments in this update increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. For leases with a term of 12 months or less, the amendments permit lessees to make an accounting policy election by class of underlying assets not to recognize lease assets and lease liabilities. For finance leases, the amendments in this update require a lessee to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; (2) recognize interest on the lease liability separately from amortization of the right-of-use asset in the statements of income; (3) classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statements of cash flows. For operating leases, the amendments in this update require a lessee to (1) recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, on the balance sheet; (2) recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; (3) classify all cash payments within operating activities in the statements of cash flows.

In July 2018, the FASB issued ASU 2018-11, *Leases (Topic 842)*. This ASU allows entities the option to initially apply the new lease standard at the adoption date and recognize the cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This additional transition method changes only when an entity is required to initially apply the transition requirements of the new lease standard; it does not change how those requirements apply. This ASU also provides a practical expedient to not separate non-lease components from the associated lease component. Lessor practical expedient is limited to circumstances in which the non-lease component(s) otherwise would be accounted for under the new revenue guidance and both (1) the timing and pattern of transfer are the same for the non-lease component(s) and associated lease component and (2) the lease component, if accounted for separately, would be classified as an operating lease. As noted above in Note 1 under in the section titled Lease Reporting, the Corporation adopted the leasing standard effective January 1, 2019.

Premium Amortization

In March 2017, the FASB issued ASU 2017-08, *Premium Amortization on Purchased Callable Debt Securities.* ASU 2017-08 shortens the amortization for premiums on purchased callable debt securities to the earliest call date (i.e. yield-to-earliest call amortization), rather than amortizing over the full contractual term. The ASU does not change the accounting for securities held at a discount. The amendments apply to callable debt securities with explicit, noncontingent call features that are callable at fixed prices and on preset dates. If a security may be prepaid based on prepayments of the underlying loans, not because the issuer has exercised a date specific call option, it is excluded from the scope of the new standard. However, for instruments with contingent call features, once the contingency is resolved and the security is callable at a fixed price and preset date, the security is within the scope of the amendment. Further, the amendments apply to all premiums on callable debt securities, regardless of how they were generated. The amendments require companies to reset the effective yield using the payment terms of the debt security if the call option is not exercised on the earliest call date. If the security has additional call dates, any excess of the amortized cost basis over the amount repayable by the issuer at the next call date should be amortized to the next call date. The adoption of ASU 2017-12 in 2019 did not have a material effect on the operating results or financial position of the Corporation.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Accounting Pronouncements for Future Adoption

Financial Instruments – Credit Losses – Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument.

The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination (“PCD assets”), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price (“gross up approach”) to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above.

Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis.

In November 2019, the FASB issued ASU 2019-10 which amends the effective date of ASU 2016–13. The Corporation must adopt this guidance in 2023. Management has engaged a third-party vendor to assist in the implementation of the standard and is in the process of analyzing loan level data for modeling purposes. Management is currently evaluating the impact of adoption of the new standard on the consolidated operations, financial position and cash flows of the Corporation.

Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, *Fair Value Measurement (Topic 820).* This ASU modifies disclosure requirements on fair value measurements. The following disclosure requirements were removed: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, (3) the valuation processes for Level 3 fair value measurements and (4) for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The following disclosure requirements were modified: (1) in lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities, (2) for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee’s assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly, and (3) the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The adoption of this guidance will not have a financial statement impact. The Corporation must adopt this guidance in 2020 and will update disclosures accordingly.

NOTE 2 - Fair Value of Financial Instruments

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, and otherwise Level 2 and finally Level 3 if a Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Corporation can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

Securities available for sale - The fair value of securities available for sale is determined by obtaining market price quotes from independent third parties wherever such quotes are available. Where such quotes are not available, management utilizes independent third-party valuation analysis to support these estimates and judgments in determining fair value. The subsequent table presents, for the periods noted, the Corporation's fair value of securities available for sale in accordance with the fair value hierarchy described above.

Impaired loans - The Corporation does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using either the fair value of collateral method or the present value of cash flows method. Those impaired loans requiring an allowance represent loans for which the fair value of the expected repayments or collateral does not exceed the recorded investments in such loans. For individually evaluated impaired loans, the significant unobservable inputs include the present value of expected future cash flows discounted at the loans effective interest rate, the underlying collateral for collateral-dependent loans, or the estimated liquidity of the note, resulting in an average discount of approximately 21% for those impaired loans requiring an allowance. The Corporation records these impaired loans as nonrecurring level 3 in the fair value hierarchy. On December 31, 2019 and 2018, all of the impaired loans were evaluated based on the fair value of the collateral.

Mortgage servicing rights - The fair value of MSRs is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Corporation's portfolio of serviced loans and is categorized as level 2 in the fair value hierarchy.

Other real estate owned - Loans on which the underlying collateral has been repossessed are recorded at fair value less estimated costs to sell upon transfer to OREO establishing a new cost basis. Fair value is based upon independent market prices or appraised values of the collateral less estimated selling costs of 10% and is categorized as level 3 in the fair value hierarchy.

Interest rate swaps – Values of these instruments are obtained through an independent pricing source utilizing information which may include market observed quotations for swaps, LIBOR rates, forward rates and rate volatility and are categorized as level 2 in the fair value hierarchy.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Further, while the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments at the reporting date.

NOTE 2 - Fair Value of Financial Instruments (cont.)

Financial instruments measured at fair value on a recurring basis for 2019 and 2018 are summarized below:

Assets	Balance at 12/31/2019	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of state and political subdivision	$ 51,247,038	$ -	$ 51,247,038	$ -
Collateralized mortgage obligations	194,208,525	-	194,208,525	-
Mortgage-backed securities	137,839,964	-	137,839,964	-
Total securities available for sale	$ 383,295,527	$ -	$ 383,295,527	$ -
Interest rate swaps - other assets	$ 1,408,366	$ -	$ 1,408,366	$ -
Liabilities				
Interest rate swaps - other liabilities	$ 1,408,366	$ -	$ 1,408,366	$ -

Assets	Balance at 12/31/2018	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of state and political subdivision	$ 43,809,127	$ -	$ 43,809,127	$ -
Collateralized mortgage obligations	182,826,120	-	182,826,120	-
Mortgage-backed securities	144,382,371	-	144,382,371	-
Total securities available for sale	$ 371,017,618	$ -	$ 371,017,618	$ -
Interest rate swaps - other assets	$ 530,321	$ -	$ 530,321	$ -
Liabilities				
Interest rate swaps - other liabilities	$ 530,321	$ -	$ 530,321	$ -

Financial instruments measured at fair value on a non-recurring basis for 2019 and 2018 are summarized below:

	Balance at 12/31/2019	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 7,486,899	$ -	$ -	$ 7,486,899
Mortgage servicing rights	1,767,518	-	1,767,518	-
Other real estate owned, net	-	-	-	-
Totals	$ 9,254,417	$ -	$ 1,767,518	$ 7,486,899

	Balance at 12/31/2018	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 7,010,050	$ -	$ -	$ 7,010,050
Mortgage servicing rights	1,444,069	-	1,444,069	-
Other real estate owned, net	104,400	-	-	104,400
Totals	$ 8,558,519	$ -	$ 1,444,069	$ 7,114,450

NOTE 2 - Fair Value of Financial Instruments (cont.)

The estimated fair values of financial instruments as of December 31,

		2019		2018	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS					
Cash and due from banks	1	$ 84,918,940	$ 84,918,940	$ 64,379,595	$ 64,379,595
Federal funds sold	2	11,601,051	11,601,051	990,830	990,830
Available for sale securities	2	383,295,527	383,295,527	371,017,618	371,017,618
Federal reserve stock	2	322,100	322,100	322,100	322,100
Loans held for investment	3	890,993,171	898,937,000	896,469,697	881,063,000
Bank owned life insurance	2	42,931,999	42,931,999	39,255,799	39,255,799
Mortgage servicing rights, net	2	1,491,001	1,767,518	1,444,069	1,444,069
Interest rate swaps	2	1,408,366	1,408,366	530,321	530,321
Accrued interest receivable	2	3,643,328	3,643,328	3,622,802	3,622,802
FINANCIAL LIABILITIES					
Deposits	2	$ 1,271,749,600	$ 1,271,153,600	$ 1,249,302,645	$ 1,247,750,645
Interest rate swaps	2	1,408,366	1,408,366	530,321	530,321
Accrued interest payable	2	74,001	74,001	82,744	82,744

The estimated fair value of fee income on letters of credit outstanding at December 31, 2019 and December 31, 2018 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2019 and December 31, 2018.

NOTE 3 - Cash and Due from Banks

The Corporation is required to maintain vault cash and reserve balances with the FRB based upon a percentage of deposits. These requirements were $4,340,000 at December 31, 2019 and $33,722,000 at December 31, 2018.

NOTE 4 - Available for Sale Securities

The following table presents the amortized costs and fair values of available for sale securities as of December 31,

	2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 50,505,249	$ 758,370	$ (16,581)	$ 51,247,038
Collateralized mortgage obligations	193,931,978	719,148	(442,601)	194,208,525
Mortgage-backed securities	137,440,333	769,861	(370,230)	137,839,964
Totals	$ 381,877,560	$ 2,247,379	$ (829,412)	$ 383,295,527

	2018			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 44,026,349	$ 209,310	$ (426,532)	$ 43,809,127
Collateralized mortgage obligations	187,193,210	1,012	(4,368,102)	182,826,120
Mortgage-backed securities	148,494,339	-	(4,111,968)	144,382,371
Totals	$ 379,713,898	$ 210,322	$ (8,906,602)	$ 371,017,618

The amortized cost and fair value of available for sale securities as of December 31, 2019, by contractual maturity are shown below. Expected maturities will differ from contractual maturities for collateralized mortgage obligations and mortgage backed securities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2019	
	Amortized Cost	Fair Value
Due in one year or less	$ 7,779,507	$ 7,789,784
Due after one year less than 5 years	13,302,370	13,406,136
Due after 5 years less than 10 years	13,761,858	13,956,131
Due over 10 years	15,661,514	16,094,987
	50,505,249	51,247,038
Collateralized mortgage obligations	193,931,978	194,208,525
Mortgage backed securities	137,440,333	137,839,964
Totals	$ 381,877,560	$ 383,295,527

NOTE 4 - Available for Sale Securities (cont.)

Available for sale securities with an amortized cost of $166,733,594 and $124,539,635 at December 31, 2019 and December 31, 2018, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following table presents the portion of the Corporation's available for sale securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position as of December 31:

	2019					
	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 1,214,397	$ (11,668)	$ 2,500,841	$ (4,913)	$ 3,715,238	$ (16,581)
Collateralized mortgage obligations	70,009,307	(371,716)	6,093,130	(70,885)	76,102,437	(442,601)
Mortgage-backed securities	58,748,499	(370,230)	-	-	58,748,499	(370,230)
Totals	$ 129,972,203	$ (753,614)	$ 8,593,971	$ (75,798)	$ 138,566,174	$ (829,412)

	2018					
	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 4,981,904	$ (7,858)	$ 16,946,136	$ (418,674)	$ 21,928,040	$ (426,532)
Collateralized mortgage obligations	21,999,664	(185,879)	160,551,381	(4,182,223)	182,551,045	(4,368,102)
Mortgage-backed securities	19,808,934	(158,563)	124,573,437	(3,953,405)	144,382,371	(4,111,968)
Totals	$ 46,790,502	$ (352,300)	$ 302,070,954	$ (8,554,302)	$ 348,861,456	$ (8,906,602)

Management does not believe any individual unrealized loss as of December 31, 2019 represents other than temporary impairment. The Corporation held nine investment securities as of December 31, 2019 that had unrealized losses existing for greater than 12 months, which consisted of three collateralized mortgage obligations, no mortgage-backed securities and six obligations of states and political subdivisions. The Corporation held one hundred twenty-three investment securities at December 31, 2018 that had unrealized losses existing for greater than 12 months, which consisted of fifty collateralized mortgage obligations, thirty-four mortgage-backed securities and thirty-nine obligations of states and political subdivisions. Management believes the temporary impairment in fair value was caused by market fluctuation in interest rates. Management does not believe that the Corporation will experience any losses on these investments.

NOTE 5 – Loans

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

	2019	2018
Commercial	$ 35,218,336	$ 47,457,101
Real Estate		
Construction	59,219,938	68,278,197
Commercial	506,283,528	487,664,412
Residential	184,556,612	196,612,774
Multifamily	112,249,983	99,445,469
Installment and other	4,537,730	8,006,129
	902,066,127	907,464,082
Less: Allowance for loan losses	(11,072,956)	(10,994,385)
Net loans	$ 890,993,171	$ 896,469,697

NOTE 5 – Loans (cont.)

The following table presents the contractual aging of the recorded investment in loans as of December 31:

2019	Current Loans	Days Past Due 30-59	Days Past Due 60-89	Days Past Due Over 90	Days Past Due Total	Total Loans
Commercial	$ 35,218,336	$ -	$ -	$ -	$ -	$ 35,218,336
Real Estate						
Construction	59,208,999	10,939	-	-	10,939	59,219,938
Commercial	504,734,447	1,368,339	129,084	51,658	1,549,081	506,283,528
Residential	181,634,713	2,434,975	293,763	193,161	2,921,899	184,556,612
Multifamily	112,249,983	-	-	-	-	112,249,983
Installment and other	4,350,969	35,571	0	151,190	186,761	4,537,730
Total loans	897,397,447	3,849,824	422,847	396,009	4,668,680	902,066,127
Purchase credit-impaired loans	(4,008,759)	(216,299)	0	-	(216,299)	(4,225,058)
Total loans, excluding purchase credit-impaired Loans	$ 893,388,688	$ 3,633,525	$ 422,847	$ 396,009	$ 4,452,381	$ 897,841,069

2018	Current Loans	Days Past Due 30-59	Days Past Due 60-89	Days Past Due Over 90	Days Past Due Total	Total Loans
Commercial	$ 47,437,089	$ 10,052	$ 9,960	$ -	$ 20,012	$ 47,457,101
Real Estate						
Construction	68,278,197	-	-	-	-	68,278,197
Commercial	487,259,024	239,168	48,567	117,653	405,388	487,664,412
Residential	192,034,010	3,419,371	370,260	789,133	4,578,764	196,612,774
Multifamily	99,445,469	-	-	-	-	99,445,469
Installment and other	7,711,199	32,676	122,464	139,790	294,930	8,006,129
Total loans	902,164,988	3,701,267	551,251	1,046,576	5,299,094	907,464,082
Purchase credit-impaired loans	(4,703,235)	(158,829)	(189,865)	-	(348,694)	(5,051,929)
Total loans, excluding purchase credit-impaired Loans	$ 897,461,753	$ 3,542,438	$ 361,386	$ 1,046,576	$ 4,950,400	$ 902,412,153

Commercial loans deemed to be inadequately collateralized and past due 90 days or more for principal or interest are placed in a non-accrual status. Residential real estate loans are not subject to these guidelines if well-secured, as deemed by the Senior Loan Committee, and in the process of collection.

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31:

	2019	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ -	$ -
Real Estate		
Construction	-	-
Commercial	2,643,614	-
Residential	2,196,733	-
Multifamily	-	-
Installment and other	12,698	146,196
Total Loans	4,853,045	146,196
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	-	-
Residential	(78,154)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(78,154)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,774,891	$ 146,196

	2018	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ 30,778	$ -
Real Estate		
Construction	-	-
Commercial	1,697,673	-
Residential	2,511,170	-
Multifamily	-	-
Installment and other	22,518	127,923
Total Loans	4,262,139	127,923
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	-	-
Residential	(38,297)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(38,297)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,223,842	$ 127,923

NOTE 5 – Loans (cont.)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those 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 improbable. Assets that do not currently expose the Corporation to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses that may or may not be within the control of the customer are classified as "Pass." Residential Real Estate and Installment and Other loans are not rated and are included in groups of homogeneous loans with similar risk and loss characteristics and are not included in the table below. The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31:

	2019				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 35,112,117	$ 88,324	$ 17,895	$ -	$ 35,218,336
Real Estate					
Construction	58,527,188	-	692,750	-	59,219,938
Commercial	486,458,088	9,566,420	10,259,020	-	506,283,528
Multifamily	112,101,685	-	148,298	-	112,249,983
Total	$ 692,199,078	$ 9,654,744	$ 11,117,963	$ -	$ 712,971,785
Current	$ 690,871,882	$ 9,654,744	$ 10,885,139	$ -	$ 711,411,765
30-59	1,198,112	-	181,166	-	1,379,278
60-89	129,084	-	-	-	129,084
Over 90	-	-	51,658	-	51,658
Total	$ 692,199,078	$ 9,654,744	$ 11,117,963	$ -	$ 712,971,785

	2018				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 46,668,173	$ 137,683	$ 651,245	$ -	$ 47,457,101
Real Estate					
Construction	66,812,760	-	1,465,437	-	68,278,197
Commercial	470,429,348	9,867,808	7,367,256	-	487,664,412
Multifamily	99,320,620	-	124,849	-	99,445,469
Total	$ 683,230,901	$ 10,005,491	$ 9,608,787	$ -	$ 702,845,179
Current	$ 683,220,941	$ 10,005,491	$ 9,193,347	$ -	$ 702,419,779
30-59	-	-	249,220	-	249,220
60-89	9,960	-	48,567	-	58,527
Over 90	-	-	117,653	-	117,653
Total	$ 683,230,901	$ 10,005,491	$ 9,608,787	$ -	$ 702,845,179

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in residential real estate and installment and other loan classes based on payment activity as of December 31:

	2019		
	Performing	Nonperforming	Total
Residential Real Estate	$ 182,359,879	$ 2,196,733	$ 184,556,612
Installment & Other	4,378,836	158,894	4,537,730
Totals	$ 186,738,715	$ 2,355,627	$ 189,094,342

	2018		
	Performing	Nonperforming	Total
Residential Real Estate	$ 194,101,604	$ 2,511,170	$ 196,612,774
Installment & Other	7,855,688	150,441	8,006,129
Totals	$ 201,957,292	$ 2,661,611	$ 204,618,903

At December 31, 2019, the Corporation has identified $18.2 million of loans as impaired, including $13.4 million of performing TDRs. As of December 31, 2018, the Corporation has identified $18.2 million of loans as impaired, including $13.9 million of performing TDRs. The Corporation evaluates loans placed on the watch list for impairment. A loan is identified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing TDR consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans as of December 31 follows:

	2019	2018
Loans for which there was a related allowance for loan loss	$ 9,448,472	$ 8,533,363
Impaired loans with no related allowance	8,760,147	9,704,802
Total Impaired Loans	$ 18,208,619	$ 18,238,165
Average quarterly balance of impaired loans	$ 18,057,261	$ 19,272,225
Related allowance for loan losses	1,961,573	1,523,313
Interest income recognized while impaired	629,427	652,632

At December 31, 2019 and 2018, the Corporation had residential real estate loans in foreclosure with a carrying value of $262,298 and $770,961, respectively.

NOTE 5 – Loans (cont.)

The following table presents loans individually evaluated for impairment by class of loans as of December 31:

	2019			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 33	$ 33	$ -	$ -
Real Estate				
Construction	12,050	-	12,050	-
Commercial	1,926,290	105,155	1,821,135	-
Residential	7,102,565	251,589	6,850,976	-
Multifamily	-	-	-	-
Installment and other	80,275	4,289	75,986	-
Total	9,121,213	361,066	8,760,147	-
Loans with a related allowance recorded:				
Commercial	24,278	-	24,278	19,278
Real Estate				
Construction	678,764	-	678,764	254,764
Commercial	3,197,127	8,830	3,188,297	1,287,298
Residential	5,600,057	42,924	5,557,133	400,233
Multifamily	-	-	-	-
Installment and other	-	-	-	-
Total	9,500,226	51,754	9,448,472	1,961,573
Total Impaired Loans	$ 18,621,439	$ 412,820	$ 18,208,619	$ 1,961,573

	2018			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 10,404	$ 351	$ 10,053	$ -
Real Estate				
Construction	23,221	-	23,221	-
Commercial	2,719,475	239,348	2,480,127	-
Residential	7,554,654	429,541	7,125,113	-
Multifamily	-	-	-	-
Installment and other	68,922	2,634	66,288	-
Total	10,376,676	671,874	9,704,802	-
Loans with a related allowance recorded:				
Commercial	51,006	475	50,531	45,532
Real Estate				
Construction	737,020	-	737,019	241,019
Commercial	1,082,503	-	1,082,503	478,503
Residential	6,664,218	34,964	6,629,256	757,205
Multifamily	-	-	-	-
Installment and other	34,055	-	34,054	1,054
Total	8,568,802	35,439	8,533,363	1,523,313
Total Impaired Loans	$ 18,945,478	$ 707,313	$ 18,238,165	$ 1,523,313

NOTE 5 – Loans (cont.)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31:

2019	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 319,384	$ 478,905	$ 3,474,815	$ 6,230,043	$ 384,270	$ 106,968	$ 10,994,385
Charge-offs	(13,126)	-	(137,313)	(88,436)	-	(3,306)	(242,181)
Recoveries	10,707	-	111,949	191,118	-	6,978	320,752
Provisions	-	-	-	-	-	-	-
Ending Balance	$ 316,965	$ 478,905	$ 3,449,451	$ 6,332,725	$ 384,270	$ 110,640	$ 11,072,956
Loans:							
Recorded Investment	$ 35,218,336	$ 59,219,938	$ 506,283,528	$ 184,556,612	$ 112,249,983	$ 4,537,730	$ 902,066,127
Allowance for loan losses:							
Individually evaluated for impairment	19,278	254,764	1,287,298	400,233	-	-	1,961,573
Collectively evaluated for impairment	297,687	224,141	2,162,153	5,932,492	384,270	110,640	9,111,383
Total allowance for loan losses	316,965	478,905	3,449,451	6,332,725	384,270	110,640	11,072,956
Ending Balance	$ 34,901,371	$ 58,741,033	$ 502,834,077	$ 178,223,887	$ 111,865,713	$ 4,427,090	$ 890,993,171
Ending Balance:							
Individually evaluated for impairment	$ 24,278	$ 690,814	$ 5,009,432	$ 10,359,439	$ -	$ 75,986	$ 16,159,949
Collectively evaluated for impairment	35,194,058	58,482,103	500,930,640	170,362,592	112,249,983	4,461,744	881,681,120
Purchase credit-impaired:							
Individually evaluated for impairment	-	-	-	2,048,670	-	-	2,048,670
Collectively evaluated for impairment	-	47,021	343,456	1,785,911	-	-	2,176,388
Total ending balance	$ 35,218,336	$ 59,219,938	$ 506,283,528	$ 184,556,612	$ 112,249,983	$ 4,537,730	$ 902,066,127

2018	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 316,485	$ 478,905	$ 3,302,951	$ 6,123,320	$ 383,966	$ 127,025	$ 10,732,652
Charge-offs	-	-	(200,418)	(103,226)	-	(43,559)	(347,203)
Recoveries	2,899	-	372,282	209,949	304	23,502	608,936
Provisions	-	-	-	-	-	-	-
Ending Balance	$ 319,384	$ 478,905	$ 3,474,815	$ 6,230,043	$ 384,270	$ 106,968	$ 10,994,385
Loans:							
Recorded Investment	$ 47,457,101	$ 68,278,197	$ 487,664,412	$ 196,612,774	$ 99,445,469	$ 8,006,129	$ 907,464,082
Allowance for loan losses:							
Individually evaluated for impairment	45,532	241,019	478,503	757,205	-	1,054	1,523,313
Collectively evaluated for impairment	273,852	237,886	2,996,312	5,472,838	384,270	105,914	9,471,072
Total allowance for loan losses	319,384	478,905	3,474,815	6,230,043	384,270	106,968	10,994,385
Ending Balance	$ 47,137,717	$ 67,799,292	$ 484,189,597	$ 190,382,731	$ 99,061,199	$ 7,899,161	$ 896,469,697
Ending Balance:							
Individually evaluated for impairment	$ 60,584	$ 760,240	$ 3,562,630	$ 11,622,868	$ -	$ 97,178	$ 16,103,500
Collectively evaluated for impairment	47,396,517	67,479,166	484,083,454	179,998,260	99,445,469	7,905,787	886,308,653
Purchase credit-impaired							
Individually evaluated for impairment	-	-	-	2,131,501	-	3,164	2,134,665
Collectively evaluated for impairment	-	38,791	18,328	2,860,145	-	-	2,917,264
Total ending balance	$ 47,457,101	$ 68,278,197	$ 487,664,412	$ 196,612,774	$ 99,445,469	$ 8,006,129	$ 907,464,082

NOTE 5 – Loans (cont.)

The Corporation continues to evaluate purchased loans for impairment in accordance with U.S. GAAP. The purchased loans were considered impaired at the acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31:

	2019		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	112,389	-	47,021
Commercial	781,332	128,238	433,504
Residential	7,875,874	14,680,307	17,131,107
Multifamily	-	-	-
Installment and other	-	25,002	14,642
Total	$ 8,769,595	$ 14,833,547	$ 17,626,274

	2018		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	73,729	-	38,791
Commercial	72,819	263,206	219,229
Residential	10,182,557	17,011,288	20,312,950
Multifamily	-	13,390	-
Installment and other	12,664	34,999	25,710
Total	$ 10,341,769	$ 17,322,883	$ 20,596,680

As of December 31, 2019, the estimated contractually required payments receivable on credit impaired and non-credit impaired loans was $8.8 million and $14.8 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2019 on all purchased loans is $17.6 million. As a result, there is $6.0 million of remaining discount on the purchased loans. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows as of December 31, 2019. The difference between the contractually required payments at acquisition and the cash flow expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a change to the allowance for loan losses. Subsequent increases in cash flows will result in a change in the allowance for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

NOTE 5 – Loans (cont.)

The change in the carrying amount of accretable yield for purchased loans was as follows for the years ended December 31:

	For the Year Ended December 31, 2019	For the Year Ended December 31, 2018
Beginning Balance	$ 1,778,132	$ 2,064,960
Additions	51,656	273,115
Accretion(1)	(397,458)	(559,943)
Ending Balance	$ 1,432,330	$ 1,778,132

(1) Accretable yield is recognized in interest income as the purchased loans pay down, mature, renew or pay off.

Contractual maturities of loans with accretable yield range from 1 year to 30 years. Actual maturities may differ from contractual maturities because borrowers have the right to prepay or renew their loan prior to maturity or the loan may be charged off.

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of $7.6 million and $8.8 million as of December 31, 2019, and 2018, respectively. During 2019 repayments totaled $1.2 million. Certain affiliated parties of the Corporation are investors in loan participations of the Corporation. The outstanding balance of loan participations with affiliated parties totaled $1.7 million and $1.9 million at December 31, 2019 and 2018, respectively. The participations represent investments by the affiliated parties in a portion of the affiliated party loans described aggregate amounts described above.

Residential and commercial real estate loans approximating $6.7 million and $7.7 million as of December 31, 2019 and 2018, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 5 – Loans (cont.)

A TDR includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that it would not otherwise consider except for the borrower's financial difficulties. Modifications include below market interest rates, interest-only terms, forgiveness of principal, or an exceptionally long amortization period. Most of the Corporation's modifications are below market interest rate concessions. A TDR may be either on accrual or nonaccrual status based upon the performance of the borrower and management's assessment of collectability. If a TDR is placed on nonaccrual status, it remains there until it performs under the restructured terms for a sufficient period of time, generally six consecutive months at which time it is returned to accrual status.

The following is a summary of TDRs as of December 31:

	2019		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 24,278	$ 19,278
Real Estate			
Construction	3	690,814	254,764
Commercial	12	2,799,613	461,136
Residential	124	11,569,806	400,233
Multifamily	-	-	-
Installment & Other	4	63,287	-
Total Loans	144	$ 15,147,798	$ 1,135,411

	2018		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 29,806	$ 24,806
Real Estate			
Construction	4	760,239	241,019
Commercial	11	2,363,030	478,503
Residential	128	12,432,857	757,205
Multifamily	-	-	-
Installment & Other	5	77,824	1,054
Total Loans	149	$ 15,663,756	$ 1,502,587

There were no TDR's as of December 31, 2019 and 2018 that defaulted during the period and were modified within the previous 12 months. TDR's in default are past due 90 days or more at the end of the period.

NOTE 5 - Loans (cont.)

A summary of the type of modifications made on TDR's that occurred during 2019 and 2018 are noted in the table below.

	For the Year Ended December 31, 2019					
	Modification of Terms	Reduction of Interest Rate	Modification to Interest-only Payments	Forgiveness of Debt	Bankruptcy	Total
	Balance	Balance	Balance	Balance	Balance	Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	520,309	-	166,353	90,049	-	776,711
Residential	186,478	149,718	306,724	-	218,506	861,426
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	$ 706,787	$ 149,718	$ 473,077	$ 90,049	$ 218,506	$ 1,638,137
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	1	-	1	1	-	3
Residential	3	4	1	-	2	10
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	4	4	2	1	2	13

	For the Year Ended December 31, 2018					
	Modification of Terms	Reduction of Interest Rate	Modification to Interest-only Payments	Forgiveness of Debt	Bankruptcy	Total
	Balance	Balance	Balance	Balance	Balance	Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	117,653	117,653
Residential	1,010,646	67,914	241,793	-	14,323	1,334,676
Multifamily	-	-	-	-	-	-
Installment & Other	-	4,630	-	-	-	4,630
Total Loans	$ 1,010,646	$ 72,544	$ 241,793	$ -	$ 131,976	$ 1,456,959
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	1	1
Residential	12	2	3	-	1	18
Multifamily	-	-	-	-	-	-
Installment & Other	-	1	-	-	-	1
Total Loans	12	3	3	-	2	20

NOTE 6 - Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation as of December 31 and are summarized as follows:

	2019	2018
Land	$ 6,674,467	$ 6,663,629
Buildings and leasehold improvements	32,163,529	30,767,746
Furniture and equipment	16,647,199	15,634,642
Total	55,485,195	53,066,017
Less: Accumulated depreciation	(38,930,101)	(37,315,310)
Net Premises and Equipment	$ 16,555,094	$ 15,750,707

NOTE 7 – New Markets Tax Credits - Variable Interest Entities

The Corporation invests in CDEs that are designed to generate a return primarily through the realization of New Markets Tax Credits. The CDEs are formed as limited partnerships and limited liability companies in which the Corporation invests as a limited partner/investor member through equity contributions. The economic performance of the CDEs, which are variable interest entities ("VIEs"), is subject to the performance of their underlying loans. The Corporation has determined that it is not the primary beneficiary of any CDE as it lacks the power to direct the activities that most significantly impact the economic performance of the underlying loans or to affect their ability to operate in compliance with the rules and regulations necessary for the qualification of tax credits generated by equity investments. This power is held by the general partners and managing members who exercise full and exclusive control of the operations of the VIEs.

As of December 31, 2019 and 2018, the carrying amounts of these investments in CDEs that generate the tax credits, included in accrued interest receivable and other assets in the consolidated balance sheets, totaled $8.8 million and $6.5 million, respectively. The risk of loss in these investments is tied to the ability of the CDE to operate in compliance with the rules and regulations necessary for the qualification of the tax credits generated by equity investments. As of December 31, 2019 and 2018 there are no compliance issues associated with these entities.

NOTE 8 – Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets as of December 31 is as follows:

	2019	2018
Accrued interest receivable	$ 3,643,328	$ 3,622,802
Federal Reserve Bank stock	322,100	322,100
Mortgage servicing rights	1,491,001	1,444,069
Other real estate owned	-	104,400
Interest rate swap	1,408,366	530,321
Investment in New Markets Tax Credit CDEs	8,834,450	6,501,109
Prepaid expenses and other assets	4,661,998	6,042,757
Total	$ 20,361,243	$ 18,567,558

NOTE 9 - Deposits

The distribution of deposits at December 31 is as follows:

	2019	2018
Noninterest bearing demand	$ 298,876,234	$ 300,283,663
Interest bearing NOW accounts	463,117,927	420,682,938
Money Market	216,301,871	219,818,792
Savings	233,831,950	235,545,020
Other time	59,621,618	72,972,232
Total	$ 1,271,749,600	$ 1,249,302,645

The aggregate amount of time deposits, each with a minimum denomination of $250,000, was $6,974,902 and $12,054,131 as of December 31, 2019 and 2018, respectively.

Scheduled maturities of time deposits at December 31 are:

	2019	2018
Due within one year	$ 34,763,063	$ 44,975,997
After one year but within two years	13,426,282	13,697,913
After two years but within three years	5,464,231	6,039,374
After three years but within four years	4,090,556	4,343,535
After four years but within five years	1,877,486	3,915,413
Total	$ 59,621,618	$ 72,972,232

Deposits from the Corporation’s directors and related parties at December 31, 2019 and December 31, 2018 amounted to $8,585,297 and $6,710,567, respectively.

NOTE 10 - Other Borrowings

The Corporation has the ability to borrow (purchase) federal funds of up to $70,000,000 under a revolving line-of-credit. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature daily. There were no federal funds purchased outstanding as of December 31, 2019 or 2018.

The Corporation may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $3,971,438 and $7,241,374 as of December 31, 2019 and 2018, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $4,412,709 and $8,045,971 as of December 31, 2019 and 2018, respectively.

NOTE 11 - Income Taxes

Income tax expense (benefit) consists of the following components for the year ending December 31:

	2019	2018
Current income taxes		
Federal	$ 1,740,237	$ 2,629,459
State	1,554,230	1,721,669
Total current income taxes	3,294,467	4,351,128
Deferred income taxes		
Federal	438,902	229,819
State	(3,869)	(28,447)
Total deferred income taxes	435,033	201,372
Total income taxes	$ 3,729,500	$ 4,552,500

The net deferred income tax assets in the accompanying consolidated balance sheets include the following amounts of deferred income tax assets and liabilities at December 31:

	2019	2018
Deferred income tax assets:		
Allowance for loan losses	$ 3,107,008	$ 3,083,811
Reserve for health plan	184,948	257,646
Depreciation	-	129,717
Non-accrual interest	43,310	54,323
Lease liability	4,397,408	-
Loss carryforwards	31,572	34,203
Unrealized losses on securities available for sale	-	2,368,956
Other	6,810	6,808
Total deferred income tax assets	7,771,056	5,935,464
Deferred income tax liabilities:		
Loan acquisition fair market valuation	(404,104)	(465,692)
Depreciation	(203,441)	-
Right of use lease asset	(4,397,408)	-
Mortgage servicing rights	(406,164)	(393,379)
New Markets Tax Credit Investments	(407,760)	(268,990)
Unrealized gains on securities available for sale	(386,251)	-
Other	(78,486)	(129,721)
Total deferred income tax liabilities	(6,283,614)	(1,257,782)
Net deferred income tax asset	$ 1,487,442	$ 4,677,682

The Corporation has state net operating loss carryforwards of approximately $506,000 and $548,000 as of December 31, 2019 and 2018, respectively. The net operating loss carryforwards expire in 2032.

Realization of the deferred income tax asset over time is dependent upon the Corporation generating sufficient taxable income in future periods. In determining that realization of the deferred income tax asset recorded was more likely than not, the Corporation gave consideration to a number of factors including its recent earnings history, its expectations for earnings in the future, and where applicable, the expiration dates associated with tax carryforwards.

NOTE 11 - Income Taxes (cont.)

A reconciliation of statutory federal income taxes based upon income before taxes to the provision for federal and state income taxes is as follows:

	2019		2018	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income taxes at statutory rate	$ 4,715,035	21.00%	$ 4,517,847	21.00%
Adjustments for:				
Tax exempt interest on municipal obligations	(188,408)	-0.84%	(196,816)	-0.91%
Increase in taxes resulting from state income taxes, net of federal tax benefit	1,223,826	5.45%	1,335,958	6.21%
Increase in cash surrender value of life insurance	(188,948)	-0.84%	(200,377)	-0.93%
Gain from life insurance death benefits	(490,090)	-2.18%	-	0.00%
New markets tax credits	(1,335,087)	-5.95%	(885,951)	-4.12%
Other - net	(6,828)	-0.03%	(18,161)	-0.08%
Income tax expense	$ 3,729,500	16.61%	$ 4,552,500	21.17%

As of December 31, 2019 and 2018, the Corporation had no uncertain tax positions. The Corporation’s policy is to record interest and penalties related to income tax liabilities in income tax expense. The Corporation, along with its subsidiaries, files U.S. federal and Wisconsin income tax returns. The Corporation’s federal tax returns for 2015 and prior and its 2014 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

NOTE 12 - Employee Benefit Plan

The Corporation has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Corporation may make regular and matching contributions to the plan each year. In 2019 and 2018, the Corporation provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. The Corporation recorded contribution expense of $804,358 and $762,057 in 2019 and 2018, respectively.

NOTE 13 - Leases

The Corporation leases various banking facilities under operating lease agreements from various companies. The majority of the agreements include renewal options. The Corporation includes lease renewal options in the lease term and determination of right of use lease assets and lease liabilities, given it is reasonably certain the Corporation will exercise the options. The discount rate used to capitalize the operating leases is the FHLB Chicago advance fixed rate as of January 1, 2019, or the date of any subsequent lease extension or commencement, considering the remaining lease term including all renewal options. The right of use lease asset and lease liability amount as of December 31, 2019 is $16,143,202. The initial lease liability at the adoption of the right of use lease accounting was $15,573,043 on January 1, 2019. The Corporation had one lease extension and remeasurement in 2019 adding $1,317,434 to the right of use lease asset and lease liability. Lease liability amortization in 2019 was $747, 275. As of December 31, 2019, the weighted-average remaining lease term is 22.4 years and the weighted average discount rate used in the determination of lease liabilities is 3.70%.

Rental amounts under the operating lease agreements are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to $1,323,347 and $1,470,766 in 2019 and 2018 respectively, with no significant amounts associated with variable escalation adjustments. The rental expense amounts include $813,914 and $797,815 respectively, for four of the facilities leased from a company held by a director and major shareholder of the Corporation. Included in 2018 rental expense is $130,000 in lease buyout payments.

NOTE 13 – Leases (cont.)

Contractual lease payment obligations, including all unexecuted options, for each of the next five years and thereafter, in addition to a reconciliation to the Corporation's lease liability are as follows as of December 31, 2019:

2020	$ 1,261,308
2021	1,205,936
2022	1,205,936
2023	1,180,936
2024	1,180,936
Thereafter	17,911,785
Total lease payments	$ 23,946,837
Less interest	(7,803,635)
Present value of lease payments	$ 16,143,202

Contractual lease payments do not reflect annual escalation increases based on the Consumer Price Index.

Office space at certain facilities is leased to unrelated third parties under operating lease agreements. The terms of the agreements vary, with some being month to month arrangements, some including lessee renewal options, and some having fixed or variable Consumer Price Index escalation provisions. Rental income included in net occupancy costs was $1,003,994 and $1,000,168 for the years ended December 31, 2019 and 2018, respectively.

Contractual lessee payment obligations, excluding all unexecuted options, for each of the next five years and thereafter are as follows as of December 31, 2019:

2020	$ 668,516
2021	538,032
2022	474,163
2023	348,156
2024	107,137
Thereafter	155,016
Total lessee payments	$ 2,291,020

NOTE 14 - Commitments and Contingencies

The Corporation is a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, financial guarantees and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the consolidated balance sheets.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contract or notional amount of the Corporation's exposure to off-balance sheet risk as of December 31, are as follows:

	2019	2018
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 150,692,959	$ 138,586,127
Standby letters of credit	9,210,008	11,906,723
	$ 159,902,967	$ 150,492,850

NOTE 14 - Commitments and Contingencies (cont.)

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

NOTE 15 - Stockholders' Equity

Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies.

Under Federal Reserve regulations, the Bank is limited as to the amount it may lend to its affiliates, including the Corporation. Such loans are required to be collateralized by investments defined in the regulations. In addition, the maximum amount available for transfer from the Bank to the Corporation in the form of loans is limited to 10% of the Bank's stockholders' equity in the case of any one affiliate or 20% in the case of all affiliates.

NOTE 16 - Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the federal banking agencies. The final rules implementing BASEL Committee on Banking Supervisor’s Capital Guidance for U.S. banks (“BASEL III rules”) became effective for the Bank on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule and fully phased in as of January 1, 2019. Beginning in 2016, an additional capital conservation buffer was added to the minimum requirements for capital adequacy purposes. The capital conservation buffer is required to ensure that the Bank conserves capital when it is most needed, to better handle periods of economic activity. The capital conservation buffer comprises common equity Tier 1 capital above its minimum capital requirements. The buffer is determined relative to risk-weighted assets. A depository and lending institution with a buffer of less than 2.5% (or the required phase-in amount in years prior to 2019) will be subject to limitations on capital distributions, including dividend payments and certain discretionary bonus payments to executive officers. The Bank’s capital is sufficient to meet the fully phased-in conservation buffer as of December 31, 2019 and 2018.

Failure to meet minimum capital requirements can initiate certain mandatory and additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Corporation’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 its assets, liabilities, and certain off-balance sheet items calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2019, that the Bank meets all capital adequacy requirements to which it is subject.

NOTE 16 - Regulatory Capital Requirements (cont.)

The Federal Reserve Bank has established capital guidelines for bank holding companies. These guidelines allow small bank holding companies, as defined, an exemption from regulatory capital requirements. The Corporation meets the eligibility criteria and is exempt from regulatory capital requirements.

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

The Bank’s actual capital amounts and ratios as of December 31 are as follows:

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019						
Total capital (to risk-weighted assets)	$ 182,414,000	18.0%	$ 81,188,560	8.0%	$ 101,485,700	10.0%
Tier 1 capital (to risk-weighted assets)	$ 171,341,000	16.9%	$ 60,891,420	6.0%	$ 81,188,560	8.0%
Common Equity Tier 1 (to risk-weighted assets)	$ 171,341,000	16.9%	$ 45,668,565	4.5%	$ 65,965,705	6.5%
Tier 1 capital (to average assets)	$ 171,341,000	11.6%	$ 59,070,560	4.0%	$ 73,838,200	5.0%
As of December 31, 2018						
Total capital (to risk-weighted assets)	$ 168,375,000	17.1%	$ 78,654,960	8.0%	$ 98,318,700	10.0%
Tier 1 capital (to risk-weighted assets)	$ 157,381,000	16.0%	$ 58,991,220	6.0%	$ 78,654,960	8.0%
Common Equity Tier 1 (to risk-weighted assets)	$ 157,381,000	16.0%	$ 44,243,415	4.5%	$ 63,907,155	6.5%
Tier 1 capital (to average assets)	$ 157,381,000	11.2%	$ 56,033,640	4.0%	$ 70,042,050	5.0%

NOTE 17 - Concentration of Credit Risk

Practically all of the Corporation's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area of Southeastern Wisconsin. Although the Corporation has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of this market area. The concentration of credit by type of loan is set forth in Note 5.