elliott davis

Independent Auditor's Report

The Board of Directors and Shareholders
Dogwood State Bank
Raleigh, North Carolina

Report on the Financial Statements
We have audited the accompanying financial statements of Dogwood State Bank (the "Bank"), which comprise the balance sheets as of December 31, 2019 and 2018, the related statements of operations, comprehensive income (loss), changes in shareholders' equity and cash flows for the years then ended, and the related notes to the financial statements.

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

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

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

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

Opinion
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Dogwood State Bank 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.

Elliott Davis, PLLC

Raleigh, North Carolina
April 17, 2020

Dogwood State Bank
Balance Sheets
As of December 31, 2019 and 2018

(Dollars in thousands)	December 31, 2019	December 31, 2018
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 2,066	$ 2,784
Interest-earning deposits with banks	11,812	19,990
Total cash and cash equivalents	13,878	22,774
Investment securities available for sale (amortized cost of $35,473 and $9,805 at December 31, 2019 and 2018)	35,641	9,724
Investment securities held to maturity (fair value of $2,139 and $0 at December 31, 2019 and 2018)	2,182	-
Loans	256,353	214,707
Allowance for loan losses	(1,546)	(1,000)
Loans, net	254,807	213,707
Premises and equipment, net	13,365	7,321
Bank-owned life insurance	14,411	4,132
Deferred tax assets, net	1,074	211
Goodwill	7,016	7,016
Other intangible assets, net	1,095	1,631
Accrued interest receivable and other assets	4,080	4,028
Total assets	$ 347,549	$ 270,544
Liabilities		
Deposits:		
Non-interest bearing demand	$ 45,908	$ 60,280
Interest-bearing demand	18,440	25,356
Money market and savings	88,119	72,456
Time	87,944	78,587
Total deposits	240,411	236,679
Short-term FHLB advances	14,000	-
Lease obligation	4,908	-
Accrued interest payable and other liabilities	2,669	2,562
Total liabilities	$ 261,988	$ 239,241
Shareholders' equity		
Preferred stock (1,000,000 shares authorized; no shares outstanding in any period)	-	-
Voting common stock, par value $1 (20,000,000 shares authorized; 5,104,626 shares issued and outstanding at December 31, 2019); Voting common stock, par value $5 (1,000 shares authorized and 5 shares issued and outstanding at December 31, 2018)	5,105	1
Non-voting common stock, par value $1 (9,000,000 shares authorized; 5,444,920 shares issued and outstanding at December 31, 2019; no shares authorized, issued and outstanding at December 31, 2018)	5,445	-
Additional paid-in capital	76,850	30,482
Retained earnings (accumulated deficit)	(1,967)	882
Accumulated other comprehensive income (loss)	128	(62)
Total shareholders' equity	85,561	31,303
Total liabilities and shareholders' equity	$ 347,549	$ 270,544

See accompanying Notes to Financial Statements

Dogwood State Bank
Statements of Operations
For the Years Ended December 31, 2019 and 2018

(Dollars in thousands)	Year ended December 31, 2019	Year ended December 31, 2018
Interest income		
Loans	$ 11,825	$ 9,110
Investment securities	616	262
Federal funds sold and interest-earning deposits	987	251
Total interest income	13,428	9,623
Interest expense		
Deposits	2,808	1,071
Short-term FHLB advances	53	190
Lease obligation	115	-
Total interest expense	2,976	1,261
Net interest income	10,452	8,362
Provision for loan losses	553	806
Net interest income after provision for loan losses	9,899	7,556
Non-interest income		
Service charges and fees on deposit accounts	859	830
Government-guaranteed lending	55	958
Bank-owned life insurance	279	115
Gain on sales of investment securities available for sale, net	53	-
Other	71	149
Total non-interest income	1,317	2,052
Non-interest expense		
Salaries and employee benefits	7,980	4,371
Occupancy and equipment	1,177	699
Data processing	731	671
Amortization of other intangible assets	536	642
Restructuring expense	1,439	-
Other	2,986	2,251
Total non-interest expense	14,849	8,634
(Loss) income before income taxes	(3,633)	974
Income tax (benefit) expense	(876)	205
Net (loss) income	$ (2,757)	$ 769

See accompanying Notes to Financial Statements

Dogwood State Bank
Statements of Comprehensive Income (Loss)
For the Years Ended December 31, 2019 and 2018

(Dollars in thousands)	Year ended December 31, 2019	2018
Net (loss) income	$ (2,757)	$ 769
Other comprehensive income (loss)		
Unrealized gains (losses) on investment securities available for sale	302	(81)
Tax effect	(71)	19
Reclassification adjustment for realized gains on investment securities included in income before income taxes	(53)	-
Tax effect	12	-
Other comprehensive income (loss), net of tax	190	(62)
Total comprehensive (loss) income	$ (2,567)	$ 707

See accompanying Notes to Financial Statements

Dogwood State Bank
Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2019 and 2018

(Dollars in thousands)	Common stock - voting	Common stock - non-voting	Additional paid in capital	Retained earnings (accumulated deficit)	Accumulated other comprehensive income (loss)	Total shareholders' equity
*Balance, December **31**, 2017*	$ 1	$ -	$ 26,901	$ 113	$ -	$ 27,015
Adjustment resulting from 2018 sale of two branches under common control	-	-	3,581	-	-	3,581
Net income	-	-	-	769	-	769
Other comprehensive loss	-	-	-	-	(62)	(62)
Balance, December 31, 2018	-	-	30,482	882	(62)	31,303
Adoption of new lease standard	-	-	-	(92)	-	(92)
Net loss	-	-	-	(2,757)	-	(2,757)
Other comprehensive income	-	-	-	-	190	190
Restricted stock awards	505	-	(505)	-	-	-
Stock-based compensation	-	-	603	-	-	603
Recapitalization transaction	4,599	5,445	46,270	-	-	56,314
Balance December 31, 2019	$ 5,105	$ 5,445	$ 76,850	$ (1,967)	$ 128	$ 85,561

See accompanying Notes to Financial Statements

Dogwood State Bank
Statements of Cash Flows
For the Years Ended December 31, 2019 and 2018

(Dollars in thousands)	Year ended December 31, 2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (2,757)	$ 769
Adjustments to reconcile net (loss) income to cash provided (used) by operations:		
Provision for loan losses	553	806
Deferred tax expense (benefit)	(1,017)	(70)
Depreciation and amortization	1,069	868
Stock based compensation	603	-
Proceeds from sale of loans held for sale	-	6,400
Net increase (decrease) in accrued interest payable	(67)	317
Net increase in accrued interest receivable	(176)	(372)
Gain on sales of investment securities available for sale, net	(53)	-
Bank-owned life insurance	(279)	(115)
Net change in other assets	1,552	(969)
Net change in other liabilities	(315)	(87)
Net cash (used in) provided by operating activities	(887)	7,547
CASH FLOWS FROM INVESTING ACTIVITIES		
Net increase in loans	(41,866)	(27,190)
Purchases of investment securities available for sale	(39,553)	(10,412)
Purchases of investment securities held to maturity	(2,182)	-
(Purchases) sales of equity investments at cost	(574)	835
Proceeds from maturities, calls and principal repayments of investment securities available for sale	3,192	-
Proceeds from sales of investment securities available for sale	10,504	-
Purchase of bank-owned life insurance	(10,000)	-
Proceeds from sales of premises and equipment	168	-
Purchases of premises and equipment	(1,766)	(864)
Disposals of other real estate owned	22	-
Net cash used in investing activities	(82,055)	(37,631)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in time deposits	9,357	78,587
Net increase in demand, money market and savings deposits	(5,625)	(35,533)
Net change in FHLB advances	14,000	(10,000)
Proceeds from recapitalization	56,314	-
Net cash provided by financing activities	74,046	33,054
Change in cash and cash equivalents	(8,896)	2,970
Cash and cash equivalents at beginning of period	22,774	19,804
Cash and cash equivalents at end of period	$ 13,878	$ 22,774
CASH PAID DURING PERIOD FOR:		
Interest	$ 3,043	$ 944
Income taxes	469	62
SUPPLEMENTAL DISCLOSURE OF NON-CASH TRANSACTIONS		
Transfers of loans to other real estate owned	$ 213	$ -
Initial recognition of right-of-use asset	568	-
Initial recognition of lease obligation	660	-

See accompanying Notes to Financial Statements

NOTES TO FINANCIAL STATEMENTS
(dollars in thousands)

NOTE A – NATURE OF OPERATIONS AND BASIS OF PRESENTATION

Nature of Operations

Dogwood State Bank (the Company) is a state-chartered bank organized under the laws of North Carolina. The Company is headquartered in Raleigh, North Carolina, and provides a wide range of banking services and products through its four branch offices in Raleigh, Greenville, Morehead City, and Wilmington, North Carolina. The Company was previously known as Sound Bank prior to its name change in 2019.

On May 6, 2019, the Company completed a recapitalization as part of a plan to expand its operations and grow into a statewide, North Carolina community bank. The recapitalization involved a private placement of 4,599,636 shares of the Company's voting common stock and 5,444,920 shares of the Company's non-voting common stock to certain institutional and accredited individual investors. Certain of the shares of voting and non-voting common stock were sold by the Company's former parent company and sole shareholder, West Town Bancorp, Inc., directly to other investors in the recapitalization. The remaining shares of voting and non-voting common stock sold in the recapitalization were newly issued. Following the recapitalization, West Town Bancorp, Inc. remained a minority shareholder of the Company but is no longer the parent company.

Also, certain institutional investors in the recapitalization received warrants to purchase a total of 737,855 shares of non-voting common stock. The exercise price of these warrants is $10.00 per share, and the warrants expire five years from the date of issuance.

As part of its North Carolina growth plan, the Company's Board of Directors and senior executive team were restructured following completion of the recapitalization.

In 2018, the Company purchased two North Carolina-based branch offices from West Town Bank & Trust, which is a wholly owned subsidiary of West Town Bancorp, Inc., and at the time was under common control with the Company. Because this was a transaction between entities under common control, the balance sheets of the two branch offices and all related income and expenses were included in the Company's financial statements beginning with the earliest period presented.

Basis of Presentation

The accompanying financial statements include the accounts and transactions of the Company. The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Cash and Cash Equivalents

Cash and cash equivalents include cash and due from banks, interest-earning deposits with banks, and federal funds sold. Cash and cash equivalents have original maturities of three months or less. The carrying amount of such instruments is considered a reasonable estimate of fair value.

Investment Securities

The Company classifies investment securities as held to maturity, available for sale, or trading at the time of purchase. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Debt securities are classified as held to maturity where the Company has both the intent and ability to hold the securities to maturity. These securities are reported at amortized cost.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investment Securities, continued

Investment securities available for sale are carried at fair value and consist of debt securities not classified as trading or held to maturity. Unrealized holding gains and losses on investment securities available for sale are reported in other comprehensive income, net of related tax effects. Gains and losses on the sale of investment securities available for sale are determined using the specific identification method recorded on a trade date basis.

Each investment security held to maturity and available for sale in a loss position is evaluated for other-than-temporary impairment. The review includes an analysis of the facts and circumstances of each individual investment such as (1) the length of time and the extent to which the fair value has been below amortized cost, (2) changes in the earnings performance, credit rating, asset quality, or business prospects of the issuer, (3) the ability of the issuer to make principal and interest payments, (4) changes in the regulatory, economic, or technological environment of the issuer, and (5) changes in the general market condition of either the geographic area or industry in which the issuer operates.

Regardless of these factors, if the Company has developed a plan to sell the security or it is more likely than not that the Company will be forced to sell the security in the near future, then the impairment is considered other-than-temporary and the carrying value of the security is permanently written down to the current fair value with the difference between the new carrying value and the amortized cost charged to earnings. If the Company does not intend to sell the security and it is not more likely than not that it will be required to sell the security before recovery of its amortized cost basis less any current period credit loss, the other-than-temporary impairment is separated into the following: (1) the amount representing the credit loss and (2) the amount related to all other factors. The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings, and the amount of the total other-than-temporary impairment related to other factors is recognized in other comprehensive income, net of applicable taxes.

Loans

Loans that the Company has the intent and ability to hold for the foreseeable future, or until maturity, are reported at their outstanding principal balance, adjusted for any charge-offs, deferred fees or costs on originated loans and unamortized premiums or discounts on acquired loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment to the yield of the related loan. Interest on loans is recorded based on the principal amount outstanding.

The accrual of interest on impaired loans is discontinued when the future collectability of the recorded loan balance is in doubt. When the future collectability of the recorded impaired loan balance is not in doubt, interest income may be recognized on the cash basis. Generally, loans are placed on nonaccrual status when they are past due 90 days or more. When a loan is placed in nonaccrual status, all unpaid accrued interest is reversed and subsequent collections of interest and principal payments are generally applied as a reduction to the principal outstanding. Should the credit quality of a nonaccrual loan improve, the loan may be returned to an accrual status after demonstrating consistent payment history for at least six months.

A loan is classified as a troubled debt restructuring (“TDR”) when certain modifications are made to the loan terms and concessions are granted to the borrowers due to financial difficulty experienced by those borrowers. In the past, the Company has granted concessions by (1) reduction of the stated interest rate for the remaining original life of the debt or (2) extension of the maturity date at a stated interest rate lower than the current market rate for new debt with similar risk. The Company does not generally grant concessions through forgiveness of principal or accrued interest.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Loans, continued

The Company's loan policies, guidelines, and procedures establish the basic guidelines governing its lending operations. They address the types of loans sought, target markets, underwriting, collateral requirements, term, interest rate, yield considerations and compliance with laws and regulations. The loan policies are reviewed and approved annually by the Board of Directors.

Allowance for Loan Losses

The allowance for loan losses ("ALLL") is a reserve established through a provision for loan losses charged to expense. Loan balances are charged off against the ALLL when the collectability of principal is unlikely.

Subsequent recoveries, if any, are credited to the ALLL. The ALLL is maintained at a level based on management's best estimate of probable credit losses that are inherent in the loan portfolio. Management evaluates the adequacy of the ALLL on at least a quarterly basis.

The Company segments the loan portfolio into broad categories with similar risk elements for the purposes of computing the allowance for loan losses. Those categories and their specific risks are described below.

Construction/development loans – Risks common to commercial construction loans are cost overruns, changes in market demand for property, inadequate long-term financing arrangements and declines in real estate values. Residential construction loans are susceptible to those same risks as well as those associated with residential mortgage loans. Changes in market demand for property could lead to longer marketing times resulting in higher carrying costs, declining values, and higher interest rates.

Commercial real estate loans – Loans in this category are susceptible to declines in occupancy rates, business failure and general economic conditions. Also, declines in real estate values and lack of suitable alternative use for the properties are risks for loans in this category.

1-4 family loans – Residential mortgage loans are susceptible to weakening general economic conditions and increases in unemployment rates and declining real estate values.

Commercial and industrial loans - Risks to this loan category include industry concentration and the inability to monitor the condition of the collateral which often consists of inventory, accounts receivable and other non-real estate assets. Equipment and inventory obsolescence can also pose a risk. Declines in general economic conditions and other events can cause cash flows to fall to levels insufficient to service debt.

Home equity loans – Risks common to home equity loans and lines of credit are general economic conditions, including an increase in unemployment rates, and declining real estate values which reduce or eliminate the borrower's home equity.

Other consumer loans – Risks common to these loans include regulatory risks, unemployment and changes in local economic conditions as well as the inability to monitor collateral consisting of personal property.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Allowance for Loan Losses, continued

The evaluation of the adequacy of the ALLL includes both loans evaluated collectively for impairment and loans evaluated individually for impairment. For loans evaluated collectively for impairment, loans are grouped based on common risk characteristics. Historical loss rates are then combined with certain qualitative factors to determine the ALLL reserve rates for each loan grouping. Qualitative factors include consideration of certain internal and external factors, such as loan delinquency levels and trends, loan growth, loan portfolio composition and concentrations, local and national economic conditions, the loan review function, and other factors management deems relevant to the ALLL calculation.

A loan is considered individually impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Reserves, or charge-offs, on individually impaired loans that are collateral dependent are based on the fair value of the underlying collateral, less an estimate of selling costs, while reserves, or charge-offs, on loans that are not collateral dependent are based on either an observable market price, if available, or the present value of expected future cash flows discounted at the historical effective interest rate. The Company evaluates loans that are classified as doubtful, substandard or special mention to determine whether or not they are individually impaired. This evaluation includes several factors, including review of the loan payment status and the borrower's financial condition and operating results such as cash flows, operating income or loss, etc.

The evaluation of the ALLL is inherently subjective, and management uses the best information available to establish this estimate. However, if factors such as economic conditions differ substantially from assumptions, or if amounts and timing of future cash flows expected to be received on impaired loans vary substantially from the estimates, future adjustments to the ALLL may be necessary.

Purchased Credit-Impaired Loans

Loans acquired in a transfer, including business combinations, where there is evidence of credit deterioration since origination and it is probable at the date of acquisition that we will not collect all contractually required principal and interest payments, are accounted for as purchased credit-impaired ("PCI") loans. Where possible, PCI loans with common risk characteristics are grouped into pools at acquisition. For PCI loan pools, the excess of the cash flows initially expected to be collected over the fair value of the loans at the acquisition date (i.e., the accretable yield) is accreted into interest income over the estimated remaining life of the PCI loans using the effective yield method, provided that the timing and the amount of future cash flows is reasonably estimable. Accordingly, such loans are not classified as nonaccrual and they are considered to be accruing because their interest income relates to the accretable yield recognized under accounting for PCI loans and not to contractual interest payments. The difference between the contractually required payments and the cash flows expected to be collected at acquisition, considering the impact of prepayments, is referred to as the nonaccretable difference.

Subsequent to acquisition, estimates of cash flows expected to be collected are updated based on current assumptions regarding default rates, loss severities, and other factors that are reflective of current market conditions. If the Company has probable decreases in pool-level cash flows expected to be collected, the provision for loan losses is charged, resulting in an increase to the ALLL. If the Company has probable and significant increases in pool-level cash flows expected to be collected, the Company will first reverse any previously established ALLL and then increase interest income as a prospective yield adjustment over the remaining life of the loan pool. The impact of changes in variable interest rates is recognized prospectively as adjustments to interest income.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Equity Investments at Cost

As a requirement for membership, the Company has invested in common stock of the Federal Home Loan Bank of Atlanta. This investment, which is included in other assets, is carried at cost and is periodically evaluated for impairment.

Premises and Equipment

Land is carried at cost. Other components of premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method over the estimated useful lives of assets, which range from 37 to 40 years for buildings and three to seven years for furniture and equipment. Leasehold improvements are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Repairs and maintenance costs are charged to operations as incurred, and additions and improvements to premises and equipment are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are removed from the accounts and any gains or losses are reflected in earnings.

Premises and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Assets to be disposed of are transferred to other real estate owned and are reported at the lower of the carrying amount or fair value less costs to sell.

Bank-Owned Life Insurance

The Company has purchased life insurance policies on certain current and former employees and directors. These policies are recorded in other assets at their cash surrender value, or the amount that could be realized by surrendering the policies. Income from these policies and changes in the net cash surrender value are recorded in non-interest income.

Other Real Estate Owned

Other real estate owned is included in other assets and includes assets acquired through, or in lieu of, loan foreclosure. These properties are held for sale and are initially recorded at fair value less costs to sell upon foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed, and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and valuation adjustments are included in noninterest expense. Other real estate owned totaled $191 and $0 at December 31, 2019 and 2018, respectively.

Income Taxes

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the tax basis of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets are also recognized for operating loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that the tax benefits will not be realized.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill and Other Intangible Assets

Goodwill represents the purchase price in excess of the fair value of net assets acquired (including identifiable intangibles) in transactions accounted for as business combinations. Goodwill has an indefinite useful life and is evaluated for impairment annually, or more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value.

Other intangible assets, which consist of core deposit intangibles, are being amortized over seven-year periods using an accelerated method.

Stock-Based Compensation

Compensation cost is recognized for restricted stock awards issued to employees. Compensation cost is based on the fair value of restricted stock awards based on the market price of the Company's common stock at the date of grant. Compensation cost is recognized over the required service period, generally defined as the vesting period for restricted stock awards.

Fair Value Measurements

Fair value is defined as the exchange price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Company follows the fair value hierarchy which gives the highest priority to quoted prices in active markets (observable inputs) and the lowest priority to management's assumptions (unobservable inputs). For assets and liabilities recorded at fair value, the Company's policy is to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements.

The Company utilizes fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Available-for-sale investment securities are recorded at fair value on a recurring basis. Additionally, the Company may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans and other real estate owned. These nonrecurring fair value adjustments typically involve application of lower of cost or market accounting or write-downs of individual assets.

Assets and liabilities measured at fair value are grouped in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. An adjustment to the pricing method used within either Level 1 or Level 2 inputs could generate a fair value measurement that effectively falls to a lower level in the hierarchy. These levels are described as follows:

> Level 1 – Valuations for assets and liabilities traded in active exchange markets.
>
> Level 2 – Valuations for assets and liabilities that can be obtained from readily available pricing sources via independent providers for market transactions involving similar assets or liabilities. The Company's principal market for these securities is the secondary institutional markets, and valuations are based on observable market data in those markets.
>
> Level 3 – Valuations for assets and liabilities that are derived from other valuation methodologies, including discounted cash flow models and similar techniques, and not based on market exchange, dealer, or broker traded transactions. Level 3 valuations incorporate certain assumptions and projections in determining the fair value assigned to such assets or liabilities.

(dollars in thousands)

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Fair Value Measurements, continued

The determination of where an asset or liability falls in the fair value hierarchy requires significant judgment. The Company evaluates its hierarchy disclosures at each reporting period and based on various factors, it is possible that an asset or liability may be classified differently. However, management expects that changes in classifications between levels will be rare.

Accumulated Other Comprehensive Income (Loss)

The Company's accumulated other comprehensive income (loss) is comprised of unrealized gains and losses, net of taxes, on securities available for sale.

Segment Reporting

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Management has determined that the Company has a single operating segment, which is providing general commercial banking and financial services to individuals and businesses located in North Carolina and to customers in various states through its Small Business Administration ("SBA") lending program. The Company's various products and services are those generally offered by community banks, and the allocation of resources is based on the overall performance of the Company versus individual regions, branches, products and services.

Revenue from Contracts with Customers

All of the Company's revenues that are within the scope of ASC 606 are recognized within noninterest income. The following table presents the Company's sources of noninterest income for the years ended December 31, 2019 and 2018. Items outside the scope of ASC 606 are noted as such.

	Year ended December 31,	
	2019	2018
Non-interest income		
Service Charges and fees on deposit accounts	$ 859	$ 830
Government-guaranteed lending[1]	55	958
Bank-owned life insurance[1]	279	115
Gain on sales of investment securities available for sale, net[1]	53	-
Other[2]	71	149
Total non-interest income	$ 1,317	$ 2,052

[1]Not within the scope of ASC 606

[2]Portions within the scope of ASC 606

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue from Contracts with Customers, continued

There were no impairment losses recognized on any receivables or contract assets arising from the Company's contracts with customers during the years ended December 31, 2019 and 2018. While the Company has noninterest income related to government-guaranteed lending, changes in cash surrender value of life insurance and sales of investment securities available for sale, these are not within the scope of ASC 606. The service charge revenue generated from contracts with customers is noninterest income and relates to fees charged on deposit accounts and certain loan and deposit fees. The revenues generated from each of these contracts are recognized when a performance obligation is met, and each obligation is associated with a transaction tied to an account. Given each of these accounts are transactional and the contract is a day-to-day contract, the performance obligations on these accounts occur when the contract provision is triggered on the account, which results in the related service charge. Based on the Company's analysis, there are no fees generated for opening an account or for a service on the account where the good or service has not been transferred or prior to the performance obligation being met.

As of December 31, 2019 and 2018, the Company did not have amounts of material receivables, contract assets or contract liabilities tied to these contracts with customers. The Company believes that while loan and deposit accounts generate service charge income, these contracts do not create receivables, assets or liabilities given the fees associated with these service charges are typically charged and collected once the performance obligation is triggered. In addition, during the years ended December 31, 2019 and 2018, the Company did not recognize revenue that was included in any contract liabilities, and no revenues were recognized related to performance obligations satisfied in prior reporting periods. The Company analyzes its payment streams associated with contracts with customers on a quarterly basis. As of December 31, 2019 and 2018, the nature of the performance obligations within the contracts generating these service charges on deposit and loan accounts have a duration of one year or less. Also, based on the Company's analysis and the nature of the contracts discussed within this note, management determined that there are no significant judgements associated with the recognition of revenue associated with these contracts. Based on the Company's analysis, each of the service charge revenues discussed above are associated with the transfer of services through administration of a customer's deposit account or through an agreed-upon, fixed amount that is disclosed in the customer's contract and are charged to the customer when the related service is performed on the customer's account. In addition, based on the Company's analysis, none of the contracts discussed above required a material cost to obtain or fulfill the contract, which resulted in no capitalized asset associated with these contracts as of December 31, 2019 and 2018.

Recently Issued Accounting Pronouncements

FASB ASU 2016-13, *Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASC326)*

In June 2016, the FASB issued ASC326 to change the accounting for credit losses and modify the impairment model for certain debt securities. As discussed below, subsequent additional guidance related to ASC326 has resulted in an anticipated adoption no later than periods beginning after December 15, 2022. ASC326 introduces a new credit loss methodology which requires earlier recognition of credit losses, replacing multiple existing impairment methods in current GAAP, which generally require a loss to be incurred before it is recognized. The ASC326 amendments require loss estimates be determined over the lifetime of the asset and broaden the information an entity must consider in developing its expected credit losses. ASC326 does not specify a method for measuring expected credit losses and allows an entity to apply methods that reasonably reflect its expectations of the credit loss estimate based on the entity's size, complexity and risk profile. The standard will apply to the Company's loans, unfunded loan commitments and debt securities.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recently Issued Accounting Pronouncements, continued

The Company will apply the amendments to ASC326 through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. While early adoption was permitted beginning in first quarter 2019, the Company did not elect that option. The Company is evaluating the impact of ASC326 on the financial statements. The Company expects ASC326 will result in an increase in the recorded allowance for loan losses given the change to estimated losses over the contractual life of the loans adjusted for expected prepayments. In addition to the allowance for loan losses, the Company will also record an allowance for credit losses on held-to-maturity debt securities instead of applying the impairment model currently utilized. The amount of the adjustments will be impacted by each portfolio's composition and credit quality at the adoption date as well as economic conditions and forecasts at that time.

In November 2019, the FASB issued guidance to defer the effective dates for private companies, not-for-profit organizations, and certain smaller reporting companies applying ASC326 standards on current expected credit losses (CECL). The new effective dates will be for fiscal years beginning after December 15, 2022 including interim periods within those fiscal years. In November 2019, the FASB also issued guidance that addresses issues raised by stakeholders during the implementation of ASC326. The amendments affect a variety of topics in the Accounting Standards Codification.

FASB ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment (ASC350)*

ASC350 eliminates Step 2 from the goodwill impairment test. Under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in ASC350, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. ASC350 eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative test.

ASC350 will be effective for the Company's annual or interim goodwill impairment tests for fiscal years beginning after December 15, 2019. The Company expects to adopt the guidance related to the annual impairment test in fiscal year 2020 and does not anticipate any impact to the financial position or results of operations as a result of the adoption.

NOTE B – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recently Issued Accounting Pronouncements, continued

FASB ASU 2018-13 - Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement (ASC820)

This update to ASC820 modifies the disclosure requirements on fair value measurements by eliminating the requirements to disclose (i) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy; (ii) the policy for timing of transfers between levels; and (iii) the valuation processes for Level 3 fair value measurements. The update also adds specific disclosure requirements for fair value measurements for public entities including the requirement to disclose the changes in unrealized gains and losses for the period included in other comprehensive income for recurring Level 3 fair value measurements and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements.

The amendments to ASC820 are effective for all entities for fiscal years beginning after December 15, 2019, and all interim periods within those fiscal years. Early adoption is permitted upon issuance of the ASU. Entities are permitted to early adopt amendments that remove or modify disclosures and delay the adoption of the additional disclosures until their effective date. Adoption of this ASU is not expected to have a material impact on the Company’s financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies are not expected to have a material impact on the Company’s financial position, results of operations or cash flows.

(dollars in thousands)

NOTE C – INVESTMENT SECURITIES

The following tables summarize the amortized cost, gross unrealized gains and losses, and fair value of investment securities available for sale and held to maturity by major classification:

	Amortized Cost	Unrealized Loss	Unrealized Gain	Fair Value
December 31, 2019:				
Investment securities available for sale:				
Agency mortgage-backed	$ 19,946	$ (56)	$ 152	$ 20,042
Agency CMO/REMIC	7,236	(20)	35	7,251
Taxable municipals	5,291	(50)	66	5,307
Corporate bonds	3,000	-	41	3,041
Total	$ 35,473	$ (126)	$ 294	$ 35,641
Investment securities held to maturity:				
Agency mortgage-backed	$ 2,182	$ (43)		$ 2,139
December 31, 2018:				
Investment securities available for sale:				
Agency mortgage-backed	$ 5,593	$ (75)	$ -	$ 5,518
Agency CMO/REMIC	2,736	-	22	2,758
Taxable municipals	1,226	(28)	-	1,198
Corporate bonds	250	-	-	250
Total	$ 9,805	$ (103)	$ 22	$ 9,724

(dollars in thousands)

NOTE C – INVESTMENT SECURITIES (continued)

The amortized cost and fair values of investment securities available for sale, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
December 31, 2019:		
Investment securities available for sale with scheduled maturities:		
Within 1 year	$ -	$ -
After 1 through 5 years	24,991	25,131
After 5 years through 10 years	5,913	5,957
After 10 years	4,569	4,553
Total	$ 35,473	$ 35,641
Investment securities held to maturity with scheduled maturities:		
After 5 years through 10 years	$ 2,182	$ 2,139
December 31, 2018:		
Investment securities available for sale with scheduled maturities:		
Within 1 year	$ -	$ -
After 1 through 5 years	5,433	5,414
After 5 years through 10 years	3,146	3,112
After 10 years	1,226	1,198
Total	$ 9,805	$ 9,724

As of December 31, 2019, no investment securities have been in an unrealized loss position for more than a twelve-month period. The securities in an unrealized loss position as of December 31, 2019 continue to perform and are expected to perform through maturity, and the issuers have not experienced significant adverse events that would call into question their ability to repay these debt obligations according to contractual terms. Further, because the Company does not intend to sell these investments and does not believe that it will be required to sell the investments before recovery of their amortized cost bases, which may be maturity, unrealized losses on such securities were not considered to represent other-than-temporary impairment as of December 31, 2019.

As of December 31, 2019, the Company held no individual investment securities with an aggregate book value greater than 10 percent of total shareholders' equity.

The following table summarizes realized securities gains and losses for the periods presented:

	Year ending December 31,	
	2019	2018
Realized gains	$ 108	$ -
Realized losses	(55)	-
Net realized gains	$ 53	$ -

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES

The following table summarizes the Company's loans by type:

	December 31, 2019	December 31, 2018
Commercial:		
Construction/development	$ 20,877	$ 16,931
Commercial real estate	104,752	71,226
Commercial and industrial	64,648	52,899
Consumer		
1-4 family	46,169	47,293
Home equity	9,142	10,832
Construction/development	8,628	12,173
Other consumer	2,137	3,353
Total loans	$ 256,353	$ 214,707

As of December 31, 2019 and 2018, loans with a recorded investment of $143,564 and $92,213, respectively, were pledged to secure borrowings or available lines of credit with correspondent banks.

The Company has deposit relationships and has granted loans to certain directors and executive officers of the Company and their related interests. Such loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other borrowers and, in management's opinion, do not involve more than the normal risk of collectability. All loans to directors and executive officers or their related interests are submitted to the Board of Directors for approval. There were no loans to directors and executive officers outstanding as of December 31, 2019. As of December 31, 2018, loans to directors and executive officers totaled $2,814.

Purchased Credit-Impaired Loans

Loans for which it is probable at acquisition that all contractually required payments will not be collected are considered PCI loans. The outstanding balance of PCI loans consists of the undiscounted sum of all amounts, including amounts deemed principal, interest, fees, penalties, and other under the loan, owed by the borrower at the reporting date, whether or not currently due and whether or not any such amounts have been written or charged off. The unpaid principal balance of PCI loans was $3,599 and $4,543 as of December 31, 2019 and 2018, respectively.

The following table summarizes changes in accretable yield, or income expected to be collected, related to the Company's PCI loans for the periods presented:

	2019	2018
Accretable yield at beginning of period	$ 616	$ 481
Accretion	(282)	(326)
Reclassification of nonaccretable differences	205	326
Other changes, net	124	135
Accretable yield at end of period	$ 663	$ 616

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

Allowance for Loan Losses

The following tables summarize the activity in the allowance for loan losses for the periods presented:

	Commercial construction/ development	Commercial real estate	Commercial and industrial	1-4 family residential	Home equity	Consumer construction/ development	Other consumer	Total
Year ended December 31, 2019								
Beginning balance	$ 17	$ 28	$ 844	$ 35	$ 52	$ 20	$ 4	$ 1,000
Charge-offs	-	-	(17)	-	(1)	-	-	(18)
Recoveries	-	-	-	1	10	-	-	11
Provision for (recover of) losses	63	253	(22)	271	(40)	6	22	553
Ending balance	$ 80	$ 281	$ 805	$ 307	$ 21	$ 26	$ 26	$ 1,546
Year ended December 31, 2018								
Beginning balance	$ 6	$ 71	$ -	$ 84	$ 11	$ 12	$ -	$ 184
Charge-offs	-	-	-	(5)	-	-	(9)	(14)
Recoveries	-	-	-	10	13	-	1	24
Provision for (recover of) losses	11	(43)	844	(54)	28	8	12	806
Ending balance	$ 17	$ 28	$ 844	$ 35	$ 52	$ 20	$ 4	$ 1,000

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The following tables summarize the ending allowance for loans losses and the recorded investment in loans by portfolio segment and impairment method:

	Commercial construction/ development	Commercial real estate	Commercial and industrial	1-4 family residential	Home equity	Consumer construction/ development	Other consumer	Total
December 31, 2019:								
Allowance for loan losses - ending balance:								
Collectively evaluated for impairment	$ 71	$ 275	$ 804	$ 84	$ 21	$ 26	$ 23	$ 1,304
Individually evaluated for impairment	-	-	-	-	-	-	-	-
Purchased non-impaired	9	6	1	-	-	-	3	19
Purchased credit impaired	-	-	-	223	-	-	-	223
Total	$ 80	$ 281	$ 805	$ 307	$ 21	$ 26	$ 26	$ 1,546
Loan - ending balance								
Collectively evaluated for impairment	$ 16,838	$ 73,886	$ 60,545	$ 24,857	$ 5,133	$ 8,107	$ 1,170	$ 190,536
Individually evaluated for impairment	-	-	-	137	170	-	-	307
Purchased non-impaired	3,844	28,785	3,956	20,186	3,797	521	967	62,056
Purchased credit impaired	195	2,081	147	989	42	-	-	3,454
Total	$ 20,877	$ 104,752	$ 64,648	$ 46,169	$ 9,142	$ 8,628	$ 2,137	$ 256,353
December 31, 2018:								
Allowance for loan losses - ending balance:								
Collectively evaluated for impairment	$ 17	$ 28	$ 844	$ 35	$ 52	$ 20	$ 4	$ 1,000
Individually evaluated for impairment	-	-	-	-	-	-	-	-
Purchased non-impaired	-	-	-	-	-	-	-	-
Purchased credit impaired	-	-	-	-	-	-	-	-
Total	$ 17	$ 28	$ 844	$ 35	$ 52	$ 20	$ 4	$ 1,000
Loan - ending balance								
Collectively evaluated for impairment	$ 6,141	$ 27,254	$ 49,273	$ 14,804	$ 4,954	$ 8,716	$ 1,797	$ 112,939
Individually evaluated for impairment	-	-	-	127	196	-	-	323
Purchased non-impaired	10,640	41,607	3,516	30,668	5,604	3,457	1,556	97,048
Purchased credit impaired	150	2,365	110	1,694	78	-	-	4,397
Total	$ 16,931	$ 71,226	$ 52,899	$ 47,293	$ 10,832	$ 12,173	$ 3,353	$ 214,707

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt including current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans according to credit risk. The Company uses the following general definitions for risk ratings:

- **Pass.** These loans range from superior quality with minimal credit risk to loans requiring heightened management attention but that are still an acceptable risk and continue to perform as contracted.

- **Special Mention.** Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the institution's credit position at some future date.

- **Substandard.** Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

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

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The following tables summarize the risk category of loans by class of loans:

	Pass	Special Mention	Substandard	Total
December 31, 2019:				
Commercial				
Construction/development	$ 20,718	$ -	$ 159	$ 20,877
Commercial real estate	103,936	563	253	104,752
Commercial and industrial	64,314	206	128	64,648
Consumer:				
1-4 family	45,770	115	284	46,169
Home equity	8,838	5	299	9,142
Construction/development	8,628	-	-	8,628
Other consumer	2,117	16	4	2,137
Total	$ 254,321	$ 905	$ 1,127	$ 256,353
December 31, 2018:				
Commercial				
Construction/development	$ 16,755	$ -	$ 176	$ 16,931
Commercial real estate	69,864	1,086	276	71,226
Commercial and industrial	52,716	21	162	52,899
Consumer:				
1-4 family	46,294	213	786	47,293
Home equity	10,535	6	291	10,832
Construction/development	12,173	-	-	12,173
Other consumer	3,341	6	6	3,353
Total	$ 211,678	$ 1,332	$ 1,697	$ 214,707

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The following tables summarize the past due status of loans based on contractual terms:

	December 31, 2019			December 31, 2018		
	30-59 days past due	60-89 days past due	90+ days past due	30-59 days past due	60-89 days past due	90+ days past due
Commercial:						
Construction/development	$ 87	$ -	$ 159	$ -	$ -	$ 3
Commercial real estate	115	-	-	28	21	-
Commercial and industrial	-	2	-	-	-	-
Consumer:						
1-4 family	183	19	242	138	56	314
Home equity	170	-	146	17	-	-
Construction/development	-	-	-	-	-	-
Other consumer	7	2	1	5	-	-
Total	$ 562	$ 23	$ 548	$ 188	$ 77	$ 317

The following table summarizes the recorded investment in loans that are 90 days or more past due and still accruing and on nonaccrual status as of December 31, 2019 and 2018:

	December 31, 2019		December 31, 2018	
	90+ days past due and accruing	Nonaccrual	90+ days past due and accruing	Nonaccrual
Commercial:				
Construction/development	$ 159	$ -	$ 3	$ -
Commercial real estate	-	-	-	-
Commercial and industrial	-	-	-	-
Consumer:				
1-4 family	200	137	314	119
Home equity	-	154	-	186
Construction/development	-	-	-	-
Other consumer	1	-	-	3
Total	$ 360	$ 291	$ 317	$ 308

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The following tables present the recorded investment and related allowance in impaired loans by loan type:

	With a recorded allowance	With no recorded allowance	Total	Unpaid principal balance	Related allowance recorded
December 31, 2019:					
1-4 family	$ -	$ 137	$ 137	$ 137	$ -
Home equity	-	170	170	170	-
Total	$ -	$ 307	$ 307	$ 307	$ -
December 31, 2018:					
1-4 family	$ -	$ 127	$ 127	$ 129	$ -
Home equity	-	196	196	198	-
Total	$ -	$ 323	$ 323	$ 327	$ -

The following table provides the average recorded investment in impaired loans by loan type:

	Year ended December 31,	
	2019	2018
1-4 family	$ 149	$ 139
Home equity	167	221
Consumer	-	8
Total	$ 316	$ 368

There was no interest income earned on impaired loans during the years ended December 31, 2019 and 2018.

The Company may modify certain loans under terms that are below market in order to maximize the amount collected from a borrower that is experiencing financial difficulties. These modifications are considered to be TDRs. TDRs are evaluated individually for impairment based on the collateral value, if the loan is determined to be collateral dependent, or discounted expected cash flows, if the loan is not determined to be collateral dependent. The Company has no commitments to lend additional funds to any borrowers that have had a loan modified in a TDR.

(dollars in thousands)

NOTE D – LOANS AND ALLOWANCE FOR LOAN LOSSES (continued)

The following table provides the number and recorded investment of TDRs outstanding at December 31, 2019 and 2018:

	December 31, 2019		December 31, 2018	
	Recorded investment	Number	Recorded investment	Number
Commercial real estate	$ 46	2	$ 69	2
1-4 family	401	7	755	8
Home equity	22	1	27	1
Construction/development	-	-	4	1
	$ 469	10	$ 855	12

There were no new TDRs during 2019. As of December 31, 2019 and 2018, there were no TDRs that were not performing in accordance with the modified loan terms.

The Company does not generally forgive principal or unpaid interest as part of when restructuring loans. Therefore, the recorded investment in TDRs during 2019 and 2018 did not change following the modifications.

NOTE E – PREMISES AND EQUIPMENT

A summary of premises and equipment is presented in the table below:

	December 31, 2019	December 31, 2018
Land	$ 1,820	$ 1,820
Buildings and leasehold improvements	11,565	5,737
Furniture and equipment	1,405	1,415
Less accumulated deprecation	(1,425)	(1,651)
Total	$ 13,365	$ 7,321

Depreciation on premises and equipment, which is recorded in occupancy and equipment expense, totaled $291 and $204 for the years ended December 31, 2019 and 2018, respectively.

As of December 31, 2019, buildings and leasehold improvements included $4,845 related to the Company’s right of use lease asset recorded for its headquarters location in Raleigh, North Carolina.

(dollars in thousands)

NOTE F – LEASES

The following table summarizes the Company's lease assets and liabilities as of December 31, 2019:

Description	Balance sheet classification	December 31, 2019	
Assets:			
Finance	Premises and equipment	$	4,845
Operating	Accrued interest receivable and other assets		457
Total leased assets		$	5,302
Liabilities:			
Finance	Lease obligations	$	4,908
Operating	Accrued interest payable and other liabilities		489
Total lease liabilities		$	5,397

The following table provides information regarding the payments in future periods that will reduce lease-related liabilities outstanding as of December 31, 2019:

	Finance		Operating		Total	
2020	$	211	$	179	$	390
2021		227		149		376
2022		244		64		308
2023		262		68		330
2024		281		29		310
Thereafter		3,683		-		3,683
Total	$	4,908	$	489	$	5,397

The following table provides the weighted average remaining lease term (in years) and the weighted average discount rate of finance and operating leases as of December 31, 2019:

	Finance	Operating
Weighted average remaining lease term in years	14.2	3.2
Weighted average discount rate	3.24%	2.75%

(dollars in thousands)

NOTE G – GOODWILL AND OTHER INTANGIBLE ASSETS

The table below summarizes the changes in carrying amounts of goodwill and other intangibles (core deposit intangibles) for the periods presented:

	Goodwill		Core deposit intangible	
Balance at December 31, 2017	$	7,016	$	2,273
Amortization		-		(642)
Balance at December 31, 2018		7,016		1,631
Amortization		-		(536)
Balance at December 31, 2019	$	7,016	$	1,095

Goodwill represents the excess of the purchase price over the fair value of acquired net assets under the acquisition method of accounting. The acquisition that generated the Company’s goodwill was a nontaxable event and, as a result, there is no tax basis in the goodwill, and none of the goodwill is deductible for tax purposes.

Goodwill is evaluated for impairment annually or more frequently if events occur or circumstances change that may indicate that impairment exists. The most recent goodwill impairment evaluation, which was performed as of December 31, 2019, considered multiple valuations of the Company. No goodwill impairment was recorded during 2019 or 2018.

The value of acquired core deposit relationships was determined using the present value of the difference between a market participant's cost of obtaining alternative funds and the cost to maintain the acquired deposit base. The core deposit intangibles are amortized over a seven-year period using an accelerated method.

The following table presents estimated future amortization expense for the Company's other intangible assets:

2020	$	429
2021		323
2022		217
2023		111
2024		15
Thereafter		-
Total	$	1,095

Other intangible assets are evaluated for impairment if events and circumstances indicate a potential for impairment. Such an evaluation of other intangible assets is based on acquired core deposit account attrition analysis. No impairment charges were recorded for other intangible assets during 2019 or 2018.

(dollars in thousands)

NOTE H – INCOME TAXES

The significant components of the provision for income taxes for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Current tax provision:		
Federal	$ 141	$ 240
State	-	35
Total current tax provision	141	275
Deferred tax provision:		
Federal	(922)	(61)
State	(95)	(9)
Total deferred tax provision	(1,017)	(70)
Total income tax (benefit) expense	$ (876)	$ 205

The difference between the provision for income taxes and the amounts computed by applying the statutory federal income tax rate of 21 percent for 2019 and 2018 to income before income taxes is summarized below:

	2019	2018
Income tax (benefit) expense at federal statutory rate	$ (763)	$ 205
Increase (decrease) resulting from:		
State income taxes, net of federal benefit	(75)	(21)
Bank-owned life insurance	(59)	(24)
Other permanent difference, net	21	45
Total income tax (benefit) expense	$ (876)	$ 205

(dollars in thousands)

NOTE H – INCOME TAXES (continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred taxes at December 31, 2019 and 2018 are as follows:

	2019	2018
Deferred tax asset relating to:		
Allowance for loan losses	$ 355	$ 234
Deferred compensation	208	306
Net operating loss carryforwards	1,292	-
Amortization of intangible assets	167	65
Unrealized losses on investment securities available for sale	-	19
Other	42	79
Total deferred tax assets	2,064	703
Deferred tax liabilities relating to:		
Premises and equipment	(900)	(455)
Unrealized gains on investment securities available for sale	(39)	-
Acquisition accounting	(29)	(33)
Other	(22)	(4)
Total deferred tax liabilities	(990)	(492)
Deferred tax asset, net	$ 1,074	$ 211

The Company had $5,646 of post-2017 net operating losses which can be carried forward indefinitely and applied against future taxable income. These net operating losses will not expire. The Company's policy is to report interest and penalties, if any, related to uncertain tax positions in income tax expense in the Statements of Operations. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2016. As of December 31, 2019 and 2018, the Company had no uncertain tax positions.

The Company's net deferred tax asset was $1,074 and $211 at December 31, 2019 and 2018, respectively. In evaluating whether it will realize the full benefit of the net deferred tax asset, the Company evaluated both positive and negative evidence, including among other things recent earnings trends, projected earnings, and asset quality. As of December 31, 2019, management concluded that the Company's net deferred tax asset was fully realizable. The Company will continue to monitor deferred tax assets closely to evaluate whether it will be able to realize the full benefit of its net deferred tax asset or whether there is any need for a valuation allowance. Significant negative trends in credit quality, losses from operations or other factors could impact the realization of the deferred tax asset in the future.

(dollars in thousands)

NOTE I – DEPOSITS

The scheduled maturities of time deposits as of December 31, 2019 are presented below:

	Less than $250	$250 and greater	Total
2020	$ 53,834	$ 22,316	$ 76,150
2021	4,052	3,072	7,124
2022	1,477	1,524	3,001
2023	934	263	1,197
2024	218	254	472
Total	$ 60,515	$ 27,429	$ 87,944

Brokered deposits totaled $12,992 and $6,492 as of December 31, 2019 and 2018, respectively.

NOTE J –FHLB ADVANCES

A summary of FHLB advances as of December 31, 2019 is presented below:

Description	Balance	Interest rate	Maturity date
Fixed rate amortizing advance	$ 2,000	1.79%	August 31, 2020
Fixed rate amortizing advance	2,000	1.86%	July 31, 2020
Fixed rate amortizing advance	2,500	1.91%	July 31, 2020
Fixed rate amortizing advance	2,000	2.04%	January 13, 2020
Fixed rate amortizing advance	1,500	1.68%	January 13, 2020
Fixed rate amortizing advance	4,000	1.66%	January 31, 2020
	$ 14,000		

There were no FHLB advances outstanding as of December 31, 2018.

The Company had access to an additional $49,181 at the FHLB on a secured basis as of December 31, 2019. As of December 31, 2019, the Company also had unused unsecured federal funds lines of credit with various counterparty banks totaling $60,000.

NOTE K – COMMITMENTS AND CONTINGENCIES

The Company 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. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract or notional amounts of those instruments reflect the Company's maximum exposure. The Company uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Commitments to extend credit, which totaled $47,459 and $25,235 at December 31, 2019 and 2018, respectively, represent agreements to lend to a customer as long as there is no violation of conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee.

NOTE K – COMMITMENTS AND CONTINGENCIES (continued)

Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company, upon extension of credit is based on a credit evaluation of the borrower. Collateral obtained varies but may include real estate, equipment, stocks, bonds, and certificates of deposit.

The Company has been named defendant in legal actions arising from normal business activities in which damages in various amounts are claimed. Although the amount of any liability with respect to such matters cannot be determined, in the opinion of management, any liability arising from these matters are not expected to have a material effect on the Company's financial statements.

NOTE L – STOCK-BASED COMPENSATION AND RETIREMENT PLANS

Restricted Stock

During 2019, the Company awarded 527,490 shares of restricted stock to various employees. All awards vest over a 5-year period. Compensation cost related to non-vested restricted stock was $603 for the year ended December 31, 2019. As of December 31, 2019, there was $4,447 in unrecognized compensation cost related to non-vested restricted stock.

Defined Contribution Plans

The Company sponsors a 401(k) plan for substantially all employees. Participants may make voluntary contributions resulting in salary deferrals in accordance with Section 401(k) of the Internal Revenue Code. The plan provides for employer contributions of up to 4 percent of pre-tax salary contributed by each participant. Employer contributions to the 401(k) plans totaled $166 for the year ended December 31, 2019, compared to $86 for 2018.

Supplemental Employment Retirement Plan

As of December 31, 2019, the Company had a $907 accrued liability related to obligations to two former employees, representing the present value of the future payments expected to be made pursuant to the terms of a non-qualified plan.

NOTE M – FAIR VALUE

Fair Value of Financial Instruments

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Fair value estimates may not be realized in an immediate settlement, and the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company.

Cash and Cash Equivalents

The carrying amount reported in the balance sheets for cash and cash equivalents approximates fair value. The fair value of cash and cash equivalents is measured using level 1 inputs.

(dollars in thousands)

NOTE M – FAIR VALUE (continued)

Investment Securities Available for Sale
Fair values are determined in the manner described above. The fair value of investment securities available for sale is measured using level 2 inputs.

Investment Securities Held to Maturity
Fair values are determined in the manner described above. The fair value of investment securities held to maturity is measured using level 2 inputs.

Loans
The fair value of loans represents the amount at which the loans of the Company could be exchanged on the open market, based upon the current lending rate for similar types of lending arrangements discounted over the remaining life of the loans. For fixed rate loans and for variable rate loans with infrequent re-pricing or re-pricing limits, fair value is based on discounted cash flows using current market rates applied to the cash flow analysis. The fair value of non-impaired loans is measured using level 2 inputs. The fair value of impaired loans relies on level 3 inputs.

Deposits
The fair value of time deposits is based on discounted cash flows using current market rates applied to the cash flow analysis for each time deposit. Other non-maturity deposits are reported at their carrying values. The fair value of deposits is measured using level 2 inputs.

Short-Term Borrowings
Fair values of short-term borrowings are estimated using discounted cash flow analyses based on the Company's current incremental borrowing rates for similar types of borrowing arrangements. Estimated maturity dates are also included in the calculation of fair value for these borrowings. The fair value of short-term borrowings is measured using level 2 inputs.

Off-Balance Sheet Instruments
Off-balance sheet instruments include commitments to extend credit, standby letters of credit, and financial guarantees. Because of the uncertainty involved in attempting to assess the likelihood and timing of commitments being drawn upon, coupled with the lack of an established market and the wide diversity of fee structures, the Company does not believe it is meaningful to provide an estimate of fair value for these instruments.

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

	December 31, 2019		December 31, 2018	
	Carrying value	Fair value	Carrying value	Fair value
Cash and cash equivalents	$ 13,878	$ 13,878	$ 22,774	$ 22,774
Investment securities available for sale	35,641	35,641	9,724	9,724
Investment securities held to maturity	2,182	2,139	-	-
Loans, net	254,807	251,001	213,707	206,921
Deposits	240,411	243,595	236,679	228,231
Short-term borrowings	14,000	13,994	-	-

(dollars in thousands)

NOTE M – FAIR VALUE (continued)

Recurring – Investment Securities Available for Sale
Investment securities available for sale are reported at fair value utilizing measurements from independent third party sources, which are level 2 inputs. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the bond's terms and conditions, among other things. The following tables summarize the Company's investment securities available for sale measured at fair value on a recurring basis as of December 31, 2019 and December 31, 2018, segregated by the level of the valuation inputs within the fair value hierarchy.

	Level 1	Level 2	Level 3	Total
December 31, 2019:				
Agency mortgage-backed	$ -	$ 20,042	$ -	$ 20,042
Agency CMO/REMIC	-	7,251	-	7,251
Taxable municipals	-	5,307	-	5,307
Corporate bonds	-	3,041	-	3,041
Total	$ -	$ 35,641	$ -	$ 35,641
December 31, 2018:				
Agency mortgage-backed	$ -	$ 5,518	$ -	$ 5,518
Agency CMO/REMIC	-	2,758	-	2,758
Taxable municipals	-	1,198	-	1,198
Corporate bonds	-	250	-	250
Total	$ -	$ 9,724	$ -	$ 9,724

Non Recurring - Loans
The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired when management concludes that payment of principal and interest will not be made in accordance with the contractual terms of the loan agreement. Once a loan is identified as individually impaired, management measures impairment using one of several methods, including appraised collateral value and /or tax assessed value, liquidation value and discounted expected cash flow. Those impaired loans not requiring an allowance represent loans for which the fair value of the expected repayments or collateral exceed the recorded investments in such loans. The Company frequently obtains appraisals prepared by external professional appraisers and applies discounts ranging from 5 percent to 40 percent depending on various factors including the type of property, condition and location. In certain instances, the Company prepares internally generated valuations from on-site inspections, third-party valuation models or other information.

Non Recurring –Other Real Estate Owned
Properties included in other real estate owned are adjusted to fair value at the time of foreclosure. Subsequently, foreclosed assets are carried at the lower of carrying value or fair value. Fair value is based upon independent market prices or recent appraised values of the collateral. Appraisal values are then adjusted to reflect estimated selling costs and other adjustments management deems appropriate due to absorption rates and other market conditions. Adjusted appraisal values are considered level 3 inputs.

(dollars in thousands)

NOTE M – FAIR VALUE (continued)

The following table summarizes the Company's assets recorded at fair value on a non-recurring basis as of December 31, 2019 and December 31, 2018, segregated by the level of the valuation inputs within the fair value hierarchy. Impaired loans are reported net of the related specific allowance.

	Level 1	Level 2	Level 3	Total
December 31, 2019:				
Impaired loans	$ -	$ -	$ 307	$ 307
Other real estate	-	-	191	191
December 31, 2018:				
Impaired loans	-	-	323	323
Other real estate	-	-	-	-

NOTE N - REGULATORY CAPITAL REQUIREMENTS

The Company is required to maintain reserve and clearing balances with the Federal Reserve Bank in the form of vault cash or deposits.

Banking regulators have established various ratios to monitor capital adequacy. Failure to comply with these capital adequacy requirements may affect various bank activities including the ability to undertake new business initiatives such as acquisitions and branch expansion, access to funding and cost of new business initiatives, the ability to pay dividends, the ability to repurchase shares or other capital instruments, the cost of deposit insurance, and the level of regulatory oversight.

Based on current regulatory guidance, banks are required to maintain a common equity tier 1 ratio of 4.50 percent, a tier 1 leverage ratio of 4.00 percent, a tier 1 risk-based capital ratio of 6.00 percent and a total risk-based capital ratio of 8.00 percent. Current regulations also require creation and maintenance of a capital conservation buffer in addition to the regulatory minimum capital requirements. The capital conservation buffer was phased in over four years beginning January 1, 2016, at 0.625 percent of risk-weighted assets. After increasing each subsequent year by an additional 0.625 percent, at January 1, 2018, the capital conservation buffer was 1.875 percent, and, as fully phased in on January 1, 2019, the capital conservation buffer is 2.50 percent.

Based on the most recent communications from its regulators, the Company is well-capitalized under the regulatory framework for prompt corrective action.

(dollars in thousands)

NOTE N - REGULATORY CAPITAL REQUIREMENTS (continued)

As of December 31, 2019, and 2018, the Company exceeded all applicable capital adequacy requirements.

	December 31, 2019					
	Actual		Minimum to be adequately capitalized		Minimum to be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1	$ 76,807	26.90%	$ 12,850	4.50%	$ 18,561	6.50%
Tier 1 leverage	76,807	23.47%	13,093	4.00%	16,366	5.00%
Tier 1 risk-based capital	76,807	26.90%	17,133	6.00%	22,844	8.00%
Total risk-based capital	78,353	27.44%	22,844	8.00%	28,555	10.00%

	December 31, 2018					
	Actual		Minimum to be adequately capitalized		Minimum to be well capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Common equity tier 1	$ 23,101	11.07%	$ 9,388	4.50%	$ 13,560	6.50%
Tier 1 leverage	23,101	9.42%	9,805	4.00%	12,257	5.00%
Tier 1 risk-based capital	23,101	11.07%	12,517	6.00%	16,689	8.00%
Total risk-based capital	24,101	11.55%	16,689	8.00%	20,861	10.00%

NOTE O – SUBSEQUENT EVENTS

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

The 2019 novel coronavirus (“COVID-19”) has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. These events may adversely affect business and consumer confidence, generally, and the Company and its customers, and their respective suppliers, vendors and processors may be adversely affected.

Following the COVID-19 outbreak in December 2019 and January 2020, market interest rates have declined significantly, with the 10-year Treasury bond falling below 1.00 percent on March 3, 2020 for the first time. On March 3, 2020, the Federal Open Market Committee (FOMC) reduced the target federal funds rate by 50 basis points to 1.00 percent to 1.25 percent. Subsequently on March 16, 2020, the FOMC further reduced the target federal funds rate by an additional 100 basis points to 0.00 percent to 0.25 percent. These reductions in interest rates and other effects of the COVID-19 outbreak may adversely affect the Company’s financial condition and results of operations.

The Company evaluated subsequent events through the date its financial statements were issued, and no other subsequent events were noted through April 17, 2020.