DOGWOOD STATE BANK

**5401 Six Forks Road**
**Raleigh, North Carolina 27609**

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**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**TO BE HELD JUNE 22, 2021**

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**To the Shareholders of Dogwood State Bank:**

The Annual Meeting of the Shareholders of Dogwood State Bank, a North Carolina bank, will be held at 5401 Six Forks Road, Raleigh, North Carolina on Tuesday, June 22, 2021 at 2:00 p.m. for the following purposes:

- to elect four directors (Eric J. Bergevin, David S. Brody, Marc H. McConnell, and J. Fielding Miller) to serve for three-year terms expiring in 2024, and
- to act upon such other matters as may properly come before the meeting or any adjournment thereof.

The Board of Directors has set the close of business on May 17, 2021 as the record date for determining shareholders who are entitled to notice of and to vote at the Annual Meeting.

You are invited to attend the Annual Meeting in person. Whether or not you plan to attend, please complete, date, and sign the enclosed proxy card and promptly return in the postage-paid return envelope, so that your shares will be represented at the Annual Meeting. If you attend the Annual Meeting in person, you may revoke a previously submitted proxy at the Annual Meeting and vote in person. You may also choose to vote by internet or telephone; instructions for which are provided on the enclosed proxy card. You may revoke your proxy at any time before the proxy is exercised.

We are continuing to monitor the public health and travel concerns relating to COVID-19 and the status of restrictions on public gatherings that federal, state, and local governments have imposed. In the event that it is not possible or advisable to hold the Annual Meeting in person, we will announce alternative arrangements for the Annual Meeting, which may include holding the meeting by means of remote participation. Please monitor the Company's website at *www.DogwoodStateBank.com* for updated information.

A copy of our Report on Financial Statements for the years ended December 31, 2020 and 2019 is enclosed for your information and review.

By Order of the Board of Directors

D. Therit

David B. Therit
Chief Financial Officer and
Corporate Secretary

Raleigh, North Carolina
May 20, 2021

# Dogwood State Bank

*Report on Financial Statements*

*For the years ended December 31, 2020 and 2019*

# Independent Auditor's Report

To 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 "Company"), which comprise the balance sheets as of December 31, 2020 and 2019, the related statements of income (loss), 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, 2020 and 2019, 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 16, 2021

**Dogwood State Bank**

***Balance Sheets***

***As of December 31, 2020 and 2019***

*(dollars in thousands except share information)*

| | 2020 | 2019 |
|---|---|---|
| **Assets** | | |
| ***Cash and cash equivalents*** | | |
| Cash and due from banks | $ 1,952 | $ 2,066 |
| Interest-earning deposits with banks | 24,488 | 11,812 |
| Total cash and cash equivalents | 26,440 | 13,878 |
| Investment securities available for sale (amortized cost of $56,729 and $35,473 at December 31, 2020 and 2019) | 57,669 | 35,641 |
| Investment securities held to maturity (fair value of $1,782 and $2,139 at December 31, 2020 and 2019) | 1,732 | 2,182 |
| Loans held for sale | 9,996 | - |
| Paycheck Protection Program (PPP) loans | 101,110 | - |
| Loans, excluding PPP loans | 373,519 | 256,353 |
| Allowance for loan losses | (3,987) | (1,546) |
| Loans, net | 369,532 | 254,807 |
| Premises and equipment, net | 14,873 | 13,365 |
| Bank-owned life insurance | 14,908 | 14,411 |
| Goodwill | 7,016 | 7,016 |
| Other intangible assets, net | 666 | 1,095 |
| Accrued interest receivable and other assets | 7,592 | 5,154 |
| Total assets | $ 611,534 | $ 347,549 |
| **Liabilities and Shareholders' Equity** | | |
| ***Liabilities*** | | |
| Deposits: | | |
| Non-interest demand | $ 137,124 | $ 45,908 |
| Interest-bearing demand | 35,767 | 18,440 |
| Money market and savings | 169,954 | 88,119 |
| Time | 69,287 | 87,944 |
| Total deposits | 412,132 | 240,411 |
| FHLB advances | 35,000 | 14,000 |
| Paycheck Protection Program Liquidity Facility (PPPLF) borrowings | 66,711 | - |
| Lease obligations | 6,448 | 4,908 |
| Accrued interest payable and other liabilities | 3,668 | 2,669 |
| Total liabilities | 523,959 | 261,988 |
| ***Commitments and contingencies (Note 12)*** | | |
| ***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; 5,597,126 and 4,599,636 shares issued and outstanding at December 31, 2020 and 2019, respectively) | 5,597 | 5,105 |
| Non-voting common stock, par value $1 (9,000,000 shares authorized; 5,444,920 shares issued and outstanding at December 31, 2020 and 2019) | 5,445 | 5,445 |
| Additional paid-in capital | 77,603 | 76,850 |
| Accumulated deficit | (1,789) | (1,967) |
| Accumulated other comprehensive income | 719 | 128 |
| Total shareholders' equity | 87,575 | 85,561 |
| Total liabilities and shareholders' equity | $ 611,534 | $ 347,549 |

***See Notes to Financial Statements***

## Dogwood State Bank

***Statements of Income (Loss)***

***for the years ended December 31, 2020 and 2019***

*(dollars in thousands)*

| | 2020 | 2019 |
|---|---|---|
| ***Interest income*** | | |
| Loans | $ 18,834 | $ 11,825 |
| Investment securities | 1,029 | 616 |
| Federal funds sold and interest-earning deposits | 98 | 987 |
| Total interest income | 19,961 | 13,428 |
| ***Interest expense*** | | |
| Deposits | 2,330 | 2,808 |
| FHLB advances | 199 | 53 |
| PPPLF borrowings | 223 | - |
| Lease obligation | 167 | 115 |
| Total interest expense | 2,919 | 2,976 |
| Net interest income | 17,042 | 10,452 |
| Provision for loan losses | 2,448 | 553 |
| Net interest income after provision for loan losses | 14,594 | 9,899 |
| ***Non-interest income*** | | |
| Service charges and fees on deposit accounts | 649 | 859 |
| Government-guaranteed lending | 3,073 | 55 |
| Bank-owned life insurance | 497 | 279 |
| Gain on sales of investment securities available for sale | 721 | 53 |
| Other | 99 | 71 |
| Total non-interest income | 5,039 | 1,317 |
| ***Non-interest expense*** | | |
| Salaries and employee benefits | 12,314 | 7,980 |
| Occupancy and equipment | 1,658 | 1,177 |
| Data processing | 887 | 731 |
| Amortization of other intangible assets | 429 | 536 |
| Restructuring expense | 44 | 1,439 |
| Other | 4,295 | 2,986 |
| Total non-interest expense | 19,627 | 14,849 |
| Income (loss) before income taxes | 6 | (3,633) |
| Income tax benefit | (172) | (876) |
| Net income (loss) | $ 178 | $ (2,757) |

***See Notes to Financial Statements***

# Dogwood State Bank

***Statements of Comprehensive Income (Loss)***
***for the years ended December 31, 2020 and 2019***
*(dollars in thousands)*

| | 2020 | 2019 |
|---|---|---|
| ***Net income (loss)*** | $ 178 | $ (2,757) |
| ***Other comprehensive income*** | | |
| Unrealized gains on investment securities available for sale | 1,493 | 302 |
| Tax effect | (350) | (71) |
| Reclassification adjustment for realized gains on investment securities included in income before income taxes | (721) | (53) |
| Tax effect | 169 | 12 |
| Other comprehensive income, net of tax | 591 | 190 |
| Total comprehensive income (loss) | $ 769 | $ (2,567) |

***See Notes to Financial Statements***

## Dogwood State Bank

***Statements of Changes in Shareholders' Equity***
***for the years ended December 31, 2020 and 2019***
*(dollars in thousands)*

| | Common stock - voting | Common stock - non-voting | Additional paid in capital | Accumulated deficit | Accumulated other comprehensive income (loss) | Total shareholders' equity |
|---|---|---|---|---|---|---|
| ***Balance, December 31, 2018*** | $ 1 | $ - | $ 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 |
| Net income | - | - | - | 178 | - | 178 |
| Other comprehensive income | - | - | - | - | 591 | 591 |
| Restricted stock awards | 492 | - | (492) | - | - | - |
| Stock-based compensation | - | - | 1,245 | - | - | 1,245 |
| ***Balance, December 31, 2020*** | $ 5,597 | $ 5,445 | $ 77,603 | $ (1,789) | $ 719 | $ 87,575 |

***See Notes to Financial Statements***

**Dogwood State Bank**
***Statements of Cash Flows***
***for the years ended December 31, 2020 and 2019***
*(dollars in thousands)*

| | 2020 | 2019 |
|---|---|---|
| ***Operating activities*** | | |
| Net income (loss) | $ 178 | $ (2,757) |
| Adjustments to reconcile net income (loss) to | | |
| cash used by operating activities: | | |
| Provision for loan losses | 2,448 | 553 |
| Deferred tax expense (benefit) | 473 | (1,017) |
| Depreciation and amortization | 1,706 | 1,069 |
| Other real estate owned writedowns | 25 | - |
| Fixed asset impairment | 66 | - |
| Stock based compensation | 1,245 | 603 |
| Origination of loans held for sale | (53,454) | - |
| Proceeds from sale of loans held for sale | 44,344 | - |
| Gain on sale of loans | (886) | - |
| Net decrease in accrued interest payable | (31) | (67) |
| Net increase in accrued interest receivable | (1,445) | (176) |
| Gain on sales of investment securities available for sale, net | (721) | (53) |
| Bank-owned life insurance | (497) | (279) |
| Net change in other assets | (811) | 1,552 |
| Net change in other liabilities | 817 | (315) |
| Net cash used in operating activities | (6,543) | (887) |
| ***Investing activities*** | | |
| Net increase in loans outstanding | (117,173) | (41,866) |
| Net increase in PPP loans | (101,110) | - |
| Purchases of investment securities available for sale | (57,406) | (39,553) |
| Purchases of investment securities held to maturity | - | (2,182) |
| Purchases of equity investments at cost | (961) | (574) |
| Proceeds from maturities, calls and principal repayments of investment securities available for sale | 10,897 | 3,192 |
| Proceeds from principal repayments of investment securities held to maturity | 420 | - |
| Proceeds from sales of investment securities available for sale | 25,551 | 10,504 |
| Purchase of bank-owned life insurance | - | (10,000) |
| Proceeds from sales of premises and equipment | 27 | 168 |
| Purchases of premises and equipment | (738) | (1,766) |
| Disposals of other real estate owned | 166 | 22 |
| Net cash used in investing activities | (240,327) | (82,055) |
| ***Financing activities*** | | |
| Net change in demand, money market and savings deposits | 190,378 | (5,625) |
| Net change in time deposits | (18,657) | 9,357 |
| Net increase in FHLB advances | 21,000 | 14,000 |
| Net increase in PPPLF advances | 66,711 | - |
| Proceeds from recapitalization | - | 56,314 |
| Net cash provided by financing activities | 259,432 | 74,046 |
| Change in cash and cash equivalents | 12,562 | (8,896) |
| ***Cash and cash equivalents, beginning of period*** | 13,878 | 22,774 |
| ***Cash and cash equivalents, end of period*** | $ 26,440 | $ 13,878 |
| ***Cash paid for*** | | |
| Interest | $ 2,950 | $ 3,043 |
| Income taxes | $ - | $ 469 |
| ***Supplemental disclosure of non-cash transactions*** | | |
| Transfers of loans to other real estate owned | $ - | $ 213 |
| Initial recognition of right-of-use asset | 1,687 | 568 |
| Initial recognition of lease obligation | 1,753 | 660 |

***See Notes to Financial Statements***

## Note 1. 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 six branch offices in Charlotte, Greenville, Morehead City, Raleigh, Sanford and Wilmington, North Carolina. The Company also supports various guaranteed government lending (GGL) programs of the Small Business Administration (SBA) through its small business lending division.

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.

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.

*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 2. 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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*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.

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 held for sale:*

Loans held for sale include the portion of loans originated through the small business lending division that are expected to be sold to the SBA. Loans held for sale are carried at fair value.

**Note 2. Summary of Significant Accounting Policies, Continued**

*Paycheck Protection Program (PPP) loans:*

Loans originated by the Company under the PPP represent the outstanding balance of loans to assist small businesses and non-profit organizations affected by the COVID-19 pandemic. PPP loans are fully guaranteed by the SBA, and management believes substantially all of these loans will ultimately be forgiven under PPP rules. As of December 31, 2020, PPP loans totaled $101,110. None of these loans are past due or otherwise impaired.

During the first quarter of 2021, the Company participated in the second round of funding authorized by the Economic Aid to Hard-Hit Small Businesses, Nonprofits and Venues Act.

*Loans, excluding PPP 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. Prior to 2020, 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.

During 2020, pursuant to Section 4013 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the Company deferred loan payments for various customers who were experiencing financial strain resulting from the COVID-19 pandemic. Loans receiving payment deferrals were not considered to be delinquent and were not classified as TDRs.

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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*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 risks for the purposes of computing the allowance for loan losses. Certain of these broad groupings are further segmented based on additional risks used to calculate the ALLL. Management evaluates loans originated under GGL programs separately from loans originated from traditional sources due to risks specific to GGL lending, including risks related to customers being out of the Company’s primary market areas.

The Company’s loan segments and the specific risks of each segment are described below.

*Construction/development loans* – Risks common to construction/development loans are cost overruns, changes in market demand for property, inadequate long-term financing arrangements and declines in real estate values. Construction/ development loans are further segmented into consumer construction/development loans, GGL construction/ development loans and other construction/ development loans. Consumer construction/ development loans are also susceptible to risks 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. Commercial real estate loans are further segmented into loans secured by non-owner occupied commercial real estate, loans secured by owner-occupied real estate that are originated under GGL programs, and loans secured by all other owner-occupied commercial real estate.

*1-4 family loans* – Residential mortgage loans are susceptible to weakening general economic conditions and increases in unemployment rates and declining real estate values. This segment includes loans secured by both first lien and subordinate lien positions.

*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. Commercial and industrial loans are further segmented into loans related to the solar industry, commercial and industrial loans estate that are originated under GGL programs, and all other commercial and industrial loans.

**Note 2. Summary of Significant Accounting Policies, Continued**

*Allowance for loan losses, continued:*

*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.

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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*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.

*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 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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*Income taxes:*

Deferred tax assets and liabilities are included in other assets. Deferred tax assets and liabilities reflect 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.

*Other real estate owned:*

Other real estate owned is included in other assets and includes assets acquired through loan foreclosure. These properties are held for sale and are initially recorded at fair value less costs to sell upon foreclosure. After 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. There was no other real estate owned as of December 31, 2020. Other real estate owned totaled $191 at December 31, 2019.

*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.

*Stock-based compensation:*

Compensation cost is recognized for restricted stock awards granted 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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*Fair value measurements, continued:*

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.

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 investment securities available for sale.

*(dollars in thousands except per share information)*

**Note 2. Summary of Significant Accounting Policies, Continued**

*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 GGL 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, 2020 and 2019. Items outside the scope of ASC 606 are noted as such.

| | 2020 | 2019 |
|---|---|---|
| Non-interest income | | |
| Service charges and fees on deposit accounts | $ 649 | $ 859 |
| Government-guaranteed lending[1] | 3,073 | 55 |
| Bank-owned life insurance[1]` | 497 | 279 |
| Gain on sales of investments securities available for sale, net[1] | 721 | 53 |
| Other[2] | 99 | 71 |
| | $ 5,039 | $ 1,317 |

[1] Not within the scope of ASC 606
[2] Portions within the scope of ASC 606

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, 2020 and 2019. 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. 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. 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 related contracts are day-to-day contracts, 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.

**Note 2. Summary of Significant Accounting Policies, Continued**

*Revenue from contracts with customers, continued:*

As of December 31, 2020 and 2019, 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, 2020 and 2019, 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, 2020 and 2019, 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, 2020 and 2019.

*Recently issues 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 impairment methods currently allowed under accounting principles generally accepted in the United States of America. 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 2. Summary of Significant Accounting Policies, Continued**

*Recently issues 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. The Company does not expect these amendments to have a material effect on its consolidated 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 except per share information)*

## Note 3. 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:

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Loss | Unrealized Gain | Fair Value |
| Investment securities available for sale: | | | | |
| Agency mortgage-backed | $ 26,778 | $ (34) | $ 381 | $ 27,125 |
| Commercial mortgage-backed | 4,214 | - | 2 | 4, 216 |
| Agency CMO/REMIC | 3,248 | - | 96 | 3,344 |
| Taxable municipals | 15,749 | (12) | 447 | 16,184 |
| Corporate bonds | 6,740 | (5) | 65 | 6,800 |
| | $ 56,729 | $ (51) | $ 991 | $ 57,669 |
| Investment securities held to maturity: | | | | |
| Agency mortgage-backed | $ 1,732 | $ - | $ 50 | $ 1,782 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Loss | Unrealized Gain | Fair Value |
| 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 |
| | $ 35,473 | $ (126) | $ 294 | $ 35,641 |
| Investment securities held to maturity: | | | | |
| Agency mortgage-backed | $ 2,182 | $ (43) | $ - | $ 2,139 |

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.

*(dollars in thousands except per share information)*

**Note 3. Investment Securities, Continued**

| | December 31, 2020 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| Investment securities available for sale with scheduled maturities: | | |
| Within 1 year | $ 1,107 | $ 1,123 |
| After 1 through 5 years | 30,371 | 30,891 |
| After 5 years through 10 years | 10,982 | 11,009 |
| After 10 years | 14,269 | 14,646 |
| | $ 56,729 | $ 57,669 |
| Investment securities held to maturity with scheduled maturities: | | |
| After 5 years through 10 years | $ 1,732 | $ 1,782 |

| | December 31, 2019 | |
|---|---|---|
| | Amortized Cost | Fair Value |
| 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 |
| | $ 35,473 | $ 35,741 |
| Investment securities held to maturity with scheduled maturities: | | |
| After 5 years through 10 years | $ 2,182 | $ 2,139 |

As of December 31, 2020 and 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, 2020 and 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, 2020 and 2019.

As of December 31, 2020, the Company held no individual investment securities with an aggregate book value greater than 10 percent of total shareholders' equity.

*(dollars in thousands except per share information)*

## Note 3. Investment Securities, Continued

The following table summarizes realized securities gains and losses for the years ended December 31:

| | 2020 | 2019 |
|---|---|---|
| Realized gains | $ 772 | $ 108 |
| Realized losses | (51) | (55) |
| | $ 721 | $ 53 |

## Note 4. Loans and Allowance for Loan Losses

The following table summarizes the Company loans by type:

| | 2020 | 2019 |
|---|---|---|
| Construction/development-GGL | $ 8,713 | $ 127 |
| Construction/development – other | 51,131 | 20,750 |
| Commercial real estate – owner occupied-GGL | 6,092 | 4,008 |
| Commercial real estate – owner occupied-other | 70,375 | 58,637 |
| Commercial real estate – non-owner occupied | 83,703 | 42,107 |
| Commercial and industrial-GGL | 11,633 | 1,508 |
| Commercial and industrial-solar | 30,329 | 31,910 |
| Commercial and industrial-other | 45,888 | 31,230 |
| 1-4 family | 50,458 | 46,169 |
| Home equity | 12,410 | 9,142 |
| Construction/development - residential | 1,018 | 8,628 |
| Other consumer | 1,769 | 2,137 |
| | $ 373,519 | $ 256,353 |

The preceding table and all following disclosures exclude $101,110 of PPP loans originated during 2020. There were no PPP loans outstanding as of December 31, 2019.

As of December 31, 2020 and 2019, loans with a recorded investment of $130,552 and $143,564, respectively, were pledged to secure borrowings or available lines of credit with correspondent banks.

As of December 31, 2020 and 2019, there were no loans to directors and executive officers outstanding.

### PCI 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 $2,739 and $3,599 as of December 31, 2020 and 2019, respectively.

***(dollars in thousands except per share information)***

**Note 4. Loans and Allowance for Loan Losses, Continued**

*Allowance for loan losses:*

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:

| | 2020 | 2019 |
|---|---|---|
| Accretable yield at beginning of period | $ 663 | $ 616 |
| Accretion | (263) | (282) |
| Reclassification of nonaccretable differences | 49 | 205 |
| Other changes, net | (9) | 124 |
| Accretable yield at end of period | $ 440 | $ 663 |

***(dollars in thousands except per share information)***

## Note 4. Loans and Allowance for Loan Losses, Continued

*Allowance for loan losses, continued:*

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

| | December 31, 2020 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Construction/ development GGL | Construction/ development other | Commercial real estate-owner occupied - GGL | Commercial real estate-owner occupied - other | Commercial real estate-non-owner occupied | Commercial and industrial-GGL | Commercial and industrial-solar | Commercial and industrial-other | 1-4 family | Home equity | Construction/ development residential | Other consumer | Total |
| Beginning balance | $ 2 | $ 78 | $ 61 | $ 134 | $ 86 | $ 101 | $ 554 | $ 150 | $ 307 | $ 21 | $ 26 | $ 26 | $ 1,546 |
| Charge-offs | - | - | - | - | - | - | - | (1) | - | - | (7) | - | (8) |
| Recoveries | - | - | - | - | - | - | - | - | - | - | 1 | - | 1 |
| Provision (credit) for loan losses | 162 | 380 | 54 | 328 | 468 | 182 | 243 | 326 | 259 | 63 | (14) | (3) | 2,448 |
| Ending balance | $ 164 | $ 458 | $ 115 | $ 462 | $ 554 | $ 283 | $ 797 | $ 475 | $ 566 | $ 84 | $ 6 | $ 23 | $ 3,987 |

| | December 31, 2019 | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Construction/ development GGL | Construction/ development other | Commercial real estate-owner occupied - GGL | Commercial real estate-owner occupied - other | Commercial real estate-non-owner occupied | Commercial and industrial-GGL | Commercial and industrial-solar | Commercial and industrial-other | 1-4 family | Home equity | Construction/ development residential | Other consumer | Total |
| Beginning balance | $ - | $ 17 | $ - | $ 28 | $ - | $ - | $ 563 | $ 281 | $ 35 | $ 52 | $ 20 | $ 4 | $ 1,000 |
| Charge-offs | - | - | - | - | - | - | - | (17) | - | (1) | - | - | (18) |
| Recoveries | - | - | - | - | - | - | - | - | 1 | 10 | - | - | 11 |
| Provision (credit) for loan losses | 2 | 61 | 61 | 106 | 86 | 101 | (9) | (114) | 271 | (40) | 6 | 22 | 553 |
| Ending balance | $ 2 | $ 78 | $ 61 | $ 134 | $ 86 | $ 101 | $ 554 | $ 150 | $ 307 | $ 21 | $ 26 | $ 26 | $ 1,546 |

*(dollars in thousands except per share information)*

## Note 4. Loans and Allowance for Loan Losses, Continued

### *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:

**December 31, 2020**

| | Construction/ development GGL | Construction/ development other | Commercial real estate-owner occupied - GGL | Commercial real estate-owner occupied - other | Commercial real estate-non-owner occupied | Commercial and industrial-GGL | Commercial and industrial-solar | Commercial and industrial-other | 1-4 family | Home equity | Construction/ development residential | Other consumer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses-ending balance: | | | | | | | | | | | | | |
| Collectively evaluated for impairment | $ 164 | $ 443 | $ 110 | $ 445 | $ 554 | $ 283 | $ 797 | $ 475 | $ 303 | $ 84 | $ 6 | $ 19 | $ 3,683 |
| Individually evaluated for impairment | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Purchased non-impaired | - | 15 | 5 | 3 | - | - | - | - | 44 | - | - | 4 | 71 |
| Purchase credit impaired | - | - | - | 14 | - | - | - | - | 219 | - | - | - | 233 |
| | $ 164 | $ 458 | $ 115 | $ 462 | $ 554 | $ 283 | $ 797 | $ 475 | $ 566 | $ 84 | $ 6 | $ 23 | $ 3,987 |
| Loans-ending balance: | | | | | | | | | | | | | |
| Collectively evaluated for impairment | $ 8,713 | $ 49,269 | $ 5,843 | $ 61,484 | $ 75,353 | $ 11,633 | $ 30,329 | $ 42,734 | $ 38,686 | $ 10,266 | $ 1,018 | $ 1,159 | $ 336,487 |
| Individually evaluated for impairment | - | 9 | - | - | - | - | - | - | 220 | 36 | - | - | 265 |
| Purchased non-impaired | - | 1,834 | 249 | 8,360 | 7,148 | - | - | 3,020 | 10,896 | 2,068 | - | 453 | 34,028 |
| Purchase credit impaired | - | 19 | - | 531 | 1,202 | - | - | 134 | 656 | 40 | - | 157 | 2,739 |
| | $ 8,713 | $ 51,131 | $ 6,092 | $ 70,375 | $ 83,703 | $ 11,633 | $ 30,329 | $ 45,888 | $ 50,458 | $ 12,410 | $ 1,018 | $ 1,769 | $ 373,519 |

**December 31, 2019**

| | Construction/ development GGL | Construction/ development other | Commercial real estate-owner occupied - GGL | Commercial real estate-owner occupied - other | Commercial real estate-non-owner occupied | Commercial and industrial-GGL | Commercial and industrial-solar | Commercial and industrial-other | 1-4 family | Home equity | Construction/ development residential | Other consumer | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Allowance for loan losses-ending balance: | | | | | | | | | | | | | |
| Collectively evaluated for impairment | $ - | $ 71 | $ 57 | $ 132 | $ 86 | $ 101 | $ 554 | $ 149 | $ 84 | $ 21 | $ 26 | $ 23 | $ 1,304 |
| Individually evaluated for impairment | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Purchased non-impaired | 2 | 7 | 4 | 2 | - | - | - | 1 | - | - | - | 3 | 19 |
| Purchase credit impaired | - | - | - | - | - | - | - | - | 223 | - | - | - | 223 |
| | $ 2 | $ 78 | $ 61 | $ 134 | $ 86 | $ 101 | $ 554 | $ 150 | $ 307 | $ 21 | $ 26 | $ 26 | $ 1,546 |
| Loans-ending balance: | | | | | | | | | | | | | |
| Collectively evaluated for impairment | $ - | $ 16,838 | $ 3,734 | $ 41,536 | $ 28,616 | $ 488 | $ 31,910 | $ 28,147 | $ 24,857 | $ 5,132 | $ 1,170 | $ 8,107 | $ 190,535 |
| Individually evaluated for impairment | - | - | - | - | - | - | - | - | 137 | 170 | - | - | 307 |
| Purchased non-impaired | 127 | 3,717 | 274 | 16,235 | 12,276 | 1,020 | - | 2,936 | 20,186 | 3,798 | 7,458 | (5,970) | 62,057 |
| Purchase credit impaired | - | 195 | - | 866 | 1,215 | - | - | 147 | 989 | 42 | - | - | 3,454 |
| | $ 127 | $ 20,750 | $ 4,008 | $ 58,637 | $ 42,107 | $ 1,508 | $ 31,910 | $ 31,230 | $ 46,169 | $ 9,142 | $ 8,628 | $ 2,137 | $ 256,353 |

*(dollars in thousands except per share information)*

**Note 4. 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.

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

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Total |
| Construction/development-GGL | $ 8,713 | $ - | $ - | $ 8,713 |
| Construction/development-other | 51,078 | - | 53 | 51,131 |
| Commercial real estate-owner occupied-GGL | 2,688 | 3,404 | - | 6,092 |
| Commercial real estate-owner occupied-other | 69,825 | 373 | 177 | 70,375 |
| Commercial real estate-non-owner occupied | 83,656 | 47 | - | 83,703 |
| Commercial and industrial-GGL | 11,499 | - | 134 | 11,633 |
| Commercial and industrial-solar | 30,329 | - | - | 30,329 |
| Commercial and industrial-other | 45,249 | 528 | 111 | 45,888 |
| 1-4 family | 50,063 | 92 | 303 | 50,458 |
| Home equity | 12,375 | - | 35 | 12,410 |
| Construction/development-residential | 849 | - | 169 | 1,018 |
| Other consumer | 1,727 | 22 | 20 | 1,769 |
| | $ 368,051 | $ 4,466 | $ 1,002 | $ 373,519 |

*(dollars in thousands except per share information)*

## Note 4. Loans and Allowance for Loan Losses, Continued

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Pass | Special Mention | Substandard | Total |
| Construction/development-GGL | $ 127 | $ - | $ - | $ 127 |
| Construction/development-other | 20,591 | - | 159 | 20,750 |
| Commercial real estate-owner occupied-GGL | 4,008 | - | - | 4,008 |
| Commercial real estate-owner occupied-other | 57,821 | 563 | 253 | 58,637 |
| Commercial real estate-non-owner occupied | 42,107 | - | - | 42,107 |
| Commercial and industrial-GGL | 1,508 | - | - | 1,508 |
| Commercial and industrial-solar | 31,910 | - | - | 31,910 |
| Commercial and industrial-other | 30,896 | 206 | 128 | 31,230 |
| 1-4 family | 45,770 | 115 | 284 | 46,169 |
| Home equity | 8,838 | 5 | 299 | 9,142 |
| Construction/development-residential | 8,628 | - | - | 8,628 |
| Other consumer | 2,117 | 16 | 4 | 2,137 |
| | $ 254,321 | $ 905 | $ 1,217 | $ 256,353 |

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

| | December 31, 2020 | | | December 31, 2019 | | |
|---|---|---|---|---|---|---|
| | 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 |
| Construction/development-GGL | $ - | $ - | $ - | $ - | $ - | $ - |
| Construction/development-other | 23 | - | 44 | 87 | - | 159 |
| Commercial real estate-owner occupied-GGL | - | - | - | 115 | - | - |
| Commercial real estate-owner occupied-other | - | - | - | - | - | - |
| Commercial real estate-non-owner occupied | - | 83 | - | - | - | - |
| Commercial and industrial-GGL | - | - | - | - | - | - |
| Commercial and industrial-solar | - | - | - | - | 2 | - |
| Commercial and industrial-other | 4 | 181 | - | - | - | - |
| 1-4 family | 91 | 54 | 29 | 183 | 19 | 242 |
| Home equity | - | 30 | 15 | 170 | - | 146 |
| Construction/development | - | - | 169 | - | - | - |
| Other consumer | 4 | - | - | 7 | 2 | 1 |
| | $ 122 | $ 348 | $ 257 | $ 562 | $ 23 | $ 548 |

*(dollars in thousands except per share information)*

## Note 4. Loans and Allowance for Loan Losses, Continued

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, 2020 and 2019:

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | 90+ Days Past Due and Accruing | Nonaccural | 90+ Days Past Due and Accruing | Nonaccrual |
| Construction/development-GGL | $ - | $ - | $ - | $ - |
| Construction/development-other | 44 | 9 | 159 | - |
| Commercial real estate-owner occupied-GGL | - | - | - | - |
| Commercial real estate-owner occupied-other | - | | - | - |
| Commercial real estate-non-owner occupied | - | - | - | - |
| Commercial and industrial-GGL | - | - | - | - |
| Commercial and industrial-solar | - | - | - | - |
| Commercial and industrial-other | - | - | - | - |
| 1-4 family | - | 220 | 200 | 137 |
| Home equity | - | 27 | - | 154 |
| Construction/development-residential | - | - | - | - |
| Other consumer | - | - | - | - |
| | $ 44 | $ 256 | $ 360 | $ 291 |

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, 2020:* | | | | | |
| Construction/development-other | $ - | $ 9 | $ 9 | $ 9 | $ - |
| Home equity | - | 36 | 36 | 36 | - |
| 1-4 family | - | 220 | 220 | 220 | - |
| | $ - | $ 265 | $ 265 | $ 265 | $ - |
| *December 31, 2019:* | | | | | |
| Home equity | $ - | $ 170 | $ 170 | $ 170 | $ - |
| 1-4 family | - | 137 | 137 | 137 | - |
| | $ - | $ 307 | $ 307 | $ 307 | $ - |

***(dollars in thousands except per share information)***

**Note 4. Loans and Allowance for Loan Losses, Continued**

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

| | Year ended December 31 | |
|---|---|---|
| | 2020 | 2019 |
| Construction/development-other | $ 2 | $ - |
| Home equity | 114 | 149 |
| 1-4 family | 177 | 167 |
| | $ 293 | $ 316 |

There was no interest income earned on impaired loans during the years ended December 31, 2020 and 2019.

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.

During 2020, pursuant to Section 4013 of the CARES Act, the Company deferred scheduled payments for 78 loans with an outstanding balance of $37,984 to provide temporary relief to customers under COVID-related financial stress. As of December 31, 2020, eight loans with an outstanding balance of $6,796 remained on a deferred status. None of these loans were classified as TDRs as of December 31, 2020.

The following table provides the number and recorded investment of TDRs outstanding at December 31, 2020 and 2019:

| | December 31, 2020 | | December 31, 2019 | |
|---|---|---|---|---|
| | Recorded Investment | Number | Recorded Investment | Number |
| Commercial real estate-owner occupied-other | $ 151 | 1 | $ 46 | 2 |
| Home equity | 66 | 2 | 401 | 7 |
| 1-4 family | 15 | 1 | 22 | 1 |
| | $ 232 | 4 | $ 469 | 10 |

As of December 31, 2020 and 2019, 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 2020 and 2019 did not change following the modifications.

*(dollars in thousands except per share information)*

## Note 5. Premises and Equipment

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

| | December 31, 2020 | December 31, 2019 |
|---|---|---|
| Land | $ 1,820 | $ 1,820 |
| Buildings and leasehold improvements | 13,164 | 11,565 |
| Furniture and equipment | 1,769 | 1,405 |
| Less accumulated depreciation | (1,880) | (1,425) |
| | $ 14,873 | $ 13,365 |

Depreciation on premises and equipment, which is recorded in occupancy and equipment expense, totaled $824 and $291 for the years ended December 31, 2020 and 2019, respectively.

As of December 31, 2020 and 2019, buildings and leasehold improvements included $6,194 and $4,845, respectively, related to the Company's right of use lease assets.

## Note 6. Leases

The following table summarizes the Company's lease assets and liabilities as of December 31, 2020 and 2019:

| Description | Balance Sheet Classification | 2020 | 2019 |
|---|---|---|---|
| Assets: | | | |
| Finance | Premises and equipment | $ 6,194 | $ 4,845 |
| Operating | Accrued interest receivable and other assets | 692 | 457 |
| Total leased assets | | $ 6,886 | $ 5,302 |
| Liabilities: | | | |
| Finance | Lease obligations | $ 6,449 | $ 4,908 |
| Operating | Accrued interest payable and other liabilities | 719 | 489 |
| Total lease liabilities | | $ 7,168 | $ 5,397 |

*(dollars in thousands except per share information)*

**Note 6. Leases, Continued**

The following table provides information regarding the minimum lease payments in future periods that will reduce lease-related liabilities outstanding as of December 31, 2020:

| | Finance Leases | Operating Leases | Total |
|---|---|---|---|
| 2021 | $ 598 | $ 250 | $ 848 |
| 2022 | 614 | 165 | 779 |
| 2023 | 631 | 170 | 801 |
| 2024 | 648 | 132 | 780 |
| 2025 | 665 | 30 | 695 |
| Thereafter | 4,516 | - | 4,516 |
| Total minimum lease payments | 7,672 | 747 | 8,419 |
| Discount | (1,223) | (28) | (1,251) |
| Lease liability | $ 6,449 | $ 719 | $ 7,168 |

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, 2020:

| | Finance Leases | Operating Leases |
|---|---|---|
| Weighted average remaining lease term in years | 11.6 | 3.5 |
| Weighted average discount rate | 2.61% | 2.05% |

**Note 7. Goodwill and Other Intangible Assets**

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

| | Goodwill | Other Intangible Assets |
|---|---|---|
| Balance at December 31, 2018 | $ 7,016 | $ 1,631 |
| Amortization | - | (536) |
| Balance at December 31, 2019 | 7,016 | 1,095 |
| Amortization | - | (429) |
| Balance at December 31, 2020 | $ 7,016 | $ 666 |

*(dollars in thousands except per share information)*

**Note 7. Goodwill and Other Intangible Assets, Continued**

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 was performed as of December 31, 2020. No goodwill impairment was recorded during 2020 or 2019.

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. Core deposit intangibles are evaluated for impairment if events and circumstances indicate impairment may exist.

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

| | | |
|---|---|---|
| 2021 | $ | 323 |
| 2022 | | 217 |
| 2023 | | 111 |
| 2024 | | 15 |
| 2025 | | - |
| Thereafter | | - |
| | $ | 666 |

No impairment charges were recorded for other intangible assets during 2020 or 2019.

SBA servicing assets, which are included in other assets, represent the present value of projected future servicing income when an SBA loan is sold servicing retained. The SBA servicing asset is amortized over the servicing life of the loan and is subject to impairment based on changes in servicing values.

*(dollars in thousands except per share information)*

## Note 8. Income Taxes

The significant components of the provision for income taxes for the years ended December 31, 2020 and 2019 are as follows:

| | 2020 | 2019 |
|---|---|---|
| Current tax provision: | | |
| Federal | $ (645) | $ 141 |
| State | - | - |
| Total current tax (benefit) provision | (645) | 141 |
| Deferred tax provision: | | |
| Federal | 481 | (922) |
| State | (8) | (95) |
| Total current tax provision (benefit) | 473 | (1,017) |
| Total income tax benefit | $ (172) | $ (876) |

The difference between the provision for income taxes and the amounts computed by applying the statutory federal income tax rate of 21 percent for 2020 and 2019 to income before income taxes is summarized below:

| | 2020 | 2019 |
|---|---|---|
| Income tax (benefit) expense at federal statutory rate | $ 1 | $ (763) |
| Increase (decrease) resulting from: | | |
| State income taxes, net of federal benefit | (6) | (75) |
| Bank-owned life insurance | (104) | (59) |
| Tax law change regarding NOL carrybacks | (246) | - |
| Nondeductible expenses | 69 | - |
| Other permanent difference, net | 114 | 21 |
| Total income tax benefit | $ (172) | $ (876) |

*(dollars in thousands except per share information)*

## Note 8. 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, 2020 and 2019 are as follows:

| | 2020 | 2019 |
|---|---|---|
| Deferred tax asset relating to: | | |
| Allowance for loan losses | $ 916 | $ 355 |
| Deferred compensation | 208 | 208 |
| Net operating loss carryforwawrds | 342 | 1,292 |
| Amortization of intangible assets | 153 | 167 |
| Other | 85 | 42 |
| Total deferred tax assets | 1,704 | 2,064 |
| Deferred tax liabilities relating to: | | |
| Premises and equipment | (978) | (900) |
| Unrealized gains on investment securities available for sale | (221) | (39) |
| Acquisition accounting | (86) | (29) |
| Other | - | (22) |
| Total deferred tax liabilities | (1,285) | (990) |
| Deferred tax asset, net | $ 419 | $ 1,074 |

As of December 31, 2020, the Company had $1,431 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. On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted in response to the COVID-19 pandemic. The CARES Act, among other things, permits carryovers and carrybacks to offset 100 percent of taxable income for taxable years beginning before 2021. In addition, the CARES Act allows net operating losses incurred in 2020, 2019 and 2018 to be carried back to each of the five preceding taxable years to generate a refund of previously paid income taxes. The Company utilized this provision in the CARES Act by carrying back the 2019 net operating loss to tax years 2018, 2017 and 2016, generating a benefit through the ability to carry back to higher tax rate years.

The Company’s net deferred tax asset was $419 and $1,074 at December 31, 2020 and 2019, 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, 2020, 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.

The Company’s policy is to report interest and penalties, if any, related to uncertain tax positions in income tax expense. As of December 31, 2020 and 2019, the Company had no uncertain tax positions.

*(dollars in thousands except per share information)*

**Note 8. Income Taxes, Continued**

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 2017.

**Note 9. Deposits**

The scheduled maturities of time deposits as of December 31, 2020 are presented below:

| | Less than $250 | $250 and Greater | Total |
|---|---|---|---|
| 2021 | $ 42,322 | $ 11,731 | $ 54,053 |
| 2022 | 5,344 | 1,535 | 6,879 |
| 2023 | 7,500 | 271 | 7,771 |
| 2024 | 309 | 262 | 571 |
| 2025 | 13 | - | 13 |
| | $ 55,488 | $ 13,799 | $ 69,287 |

**Note 10. FHLB Advances**

A summary of FHLB advances as of December 31, 2020 and 2019 is presented below:

| Description | Interest rate | Maturity Date | 2020 | 2019 |
|---|---|---|---|---|
| Fixed rate credit | 1.66% | January 31, 2020 | $ - | $ 4,000 |
| Fixed rate credit | 1.68% | January 13, 2020 | - | 1,500 |
| Fixed rate credit | 2.04% | January 13, 2020 | - | 2,000 |
| Fixed rate credit | 1.91% | July 31, 2020 | - | 2,500 |
| Fixed rate credit | 1.09% | July 31, 2020 | - | 2,000 |
| Fixed rate credit | 1.79% | August 31, 2020 | - | 2,000 |
| Fixed rate credit | 0.21% | January 7, 2021 | 5,000 | - |
| Fixed rate credit | 0.23% | January 22, 2021 | 10,000 | - |
| Fixed rate credit | 0.51% | January 26, 2021 | 1,500 | - |
| Fixed rate credit | 0.23% | January 28, 2021 | 9,000 | - |
| Fixed rate hybrid | 0.53% | March 26, 2021 | 2,500 | - |
| Fixed rate hybrid | 0.93% | September 24, 2021 | 3,000 | - |
| Fixed rate hybrid | 0.65% | January 31, 2022 | 4,000 | - |
| Total FHLB advances | | | $ 35,000 | $ 14,000 |

As of December 31, 2020, the Company had access to an additional $46,185 at the FHLB on a secured basis. As of December 31, 2020, the Company also had unused unsecured federal funds lines of credit with various counterparty banks totaling $70,000.

**Note 11. PPPLF Borrowings**

During 2020, the Company partially funded PPP loan originations through the Federal Reserve's facility established to facilitate PPP lending. As of December 31, 2020, the Company had ten advances outstanding, all of which have a fixed interest rate of one percent and scheduled maturities during the second quarter of 2022. Advances are repaid as PPP loans are forgiven or earlier if the Company's elects to do so. PPP loans totaling $66,711 were pledged to secure the PPPLF borrowings outstanding at December 31, 2020.

**Note 12. 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 $97,111 and $47,459 at December 31, 2020 and 2019, 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. As of December 31, 2020 and 2019, the Company had a reserve for unfunded commitments of $93 and $0, respectively.

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.

**Note 13. Stock-Based Compensation and Retirement Plans**

*Restricted stock:*

The Company's 2019 Omnibus Incentive Plan authorizes up to 1,205,346 shares of the Company's voting common stock to be awarded under various incentive programs. Pursuant to authority under the 2019 Omnibus Incentive Plan, the Company adopted a restricted stock program that allows shares of stock to be awarded to employees. All shares vest over a five year period.

*(dollars in thousands except per share information)*

**Note 13. Stock-Based Compensation and Retirement Plans, Continued**

The following table provides information on the number of shares of restricted stock awarded in each of the years ended December 31, 2020 and 2019, the aggregate number of shares awarded as of December 31, 2020 and 2019, the restricted stock expense recorded during the years ended December 31, 2020 and 2019, and the unrecognized compensation cost for non-vested restricted stock awards as of December 31, 2020 and 2019:

| | 2020 | 2019 |
|---|---|---|
| Shares of restricted stock awarded during current year | 492,500 | 504,990 |
| Shares of restricted stock awarded as of December 31 | 997,490 | 504,990 |
| Restricted stock expense recognized in current year | $ 1,245 | $ 603 |
| Unrecognized compensation cost related to non-vested restricted stock awards as of December 31 | 8,127 | 4,447 |

*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 $261 for the year ended December 31, 2020, compared to $166 for 2019.

*Supplemental employment retirement plan:*

As of December 31, 2020 and 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 14. 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.

**Note 14. Fair Value, Continued**

*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.

*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 held for sale:*

Fair values of SBA loans held for sale are based on estimated instrument-level gains or losses to be realized upon sale, which management consider to be level 2 inputs.

*PPP loans:*

The carrying value of PPP loans approximates fair value. Management anticipates substantially all of these loans will be forgiven under PPP rules within a 12-month period following origination.

*Loans, excluding PPP loans, net:*

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.

*(dollars in thousands except per share information)*

**Note 14. Fair Value, Continued**

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, 2020 and 2019 were as follows:

| | | Fair Value | | | |
|---|---|---|---|---|---|
| | December 30, 2020 | | | | |
| | Carrying Value | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs | Total |
| Total cash and cash equivalents | $ 26,440 | $ 26,440 | $ - | $ - | $ 26,440 |
| Investment securities available for sale | 57,669 | - | 57,669 | - | 57,669 |
| Investment securities held to maturity | 1,732 | - | 1,782 | - | 1,782 |
| Loans held for sale | 9,996 | - | 9,996 | - | 9,996 |
| PPP loans | 101,110 | - | 101,110 | - | 101,110 |
| Loans, excluding PPP loans, net | 369,532 | - | 381,938 | 265 | 381,903 |
| Deposits | 412,132 | - | 411,583 | - | 411,583 |
| FHLB advances | 35,000 | - | 35,000 | - | 35,000 |
| PPPLF borrowings | 66,711 | - | 66,766 | - | 66,766 |
| | December 30, 2019 | | | | |
| Total cash and cash equivalents | $ 13,878 | $ 13,878 | $ - | $ - | $ 13,878 |
| Investment securities available for sale | 35,641 | - | 35,641 | - | 35,641 |
| Investment securities held to maturity | 2,182 | - | 2,139 | - | 2,139 |
| Loans, excluding PPP loans, net | 254,807 | - | 250,694 | 307 | 251,001 |
| Deposits | 240,411 | - | 243,595 | - | 243,595 |
| FHLB advances | 14,000 | - | 13,994 | - | 13,994 |

*(dollars in thousands except per share information)*

**Note 14. 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 inputs.

*Recurring – loans held for sale:*

Loans held for sale are reported at fair value utilizing projected sale price guidance, which is a level 2 input. The fair value measurements consider observable data that may include dealer quotes, market spreads, live trading levels, trade execution data, among other inputs.

The following tables summarize the Company's investment securities available for sale measured at fair value on a recurring basis as of December 31, 2020 and December 31, 2019, segregated by the level of the valuation inputs within the fair value hierarchy.

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Agency mortgage-backed | $ - | $ 27,125 | $ - | $ 27,125 |
| Commercial mortgage-backed | - | 4,216 | - | 4,216 |
| Agency CMO/REMIC | - | 3,344 | - | 3,344 |
| Taxable municipals | - | 16,184 | - | 16,184 |
| Corporate bonds | - | 6,800 | - | 6,800 |
| Loans held for sale | - | 9,996 | - | 9,996 |
| | $ - | $ 67,665 | $ - | $ 67,665 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| 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 |
| | $ - | $ 35,641 | $ - | $ 35,641 |

**Note 14. Fair Value, Continued**

*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. No impaired loans were recorded at fair value as of December 31, 2020 or 2019.

*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. There was no other real estate owned as of December 31, 2020. As of December 31, 2019, other real estate owned totaling $191 was carried at fair value.

**Note 15. 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.

*(dollars in thousands except per share information)*

## Note 15. Regulatory Capital Requirements, Continued

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

As of December 31, 2020, and 2019, the Company exceeded all applicable capital adequacy requirements.

| | 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | Minimum to be adequately capitalized | | Maximum to be well capitalized | |
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| Common equity tier 1 | $ 78,898 | $ 18.96% | $ 18,722 | $ 4.50% | $ 27,043 | $ 6.50% |
| Tier 1 leverage | 78,898 | 15.32% | 20,600 | 4.00% | 25,750 | 5.00% |
| Tier 1 risk-based capital | 78,898 | 18.96% | 24,963 | 6.00% | 33,284 | 8.00% |
| Total risk-based capital | 82,978 | 19.94% | 33,284 | 8.00% | 41,605 | 10.00% |

| | 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Less than 12 Months | | Minimum to be adequately capitalized | | Maximum 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% |

## Note 16. Subsequent Events

The Company evaluated subsequent events through the date its financial statements were issued, and, except as noted below, no subsequent events were noted through April 16, 2021.

During the first quarter of 2021, the Company completed a secondary offering of its voting common stock in a private placement. The Company issued a total of 2,326,839 shares at an offering price of $12 per share, resulting in an additional $27,922 of new capital.