Mayville Financial Corporation

Mayville, Michigan

MAYVILLE STATE BANK

Years Ended December 31, 2019 and 2018

2019 Annual Report

Rehmann

Business wisdom delivered.

MAYVILLE FINANCIAL CORPORATION

Table of Contents

MAYVILLE FINANCIAL CORPORATION (MFC) & MAYVILLE STATE BANK (MSB)

Board of Directors (Year elected to Board; Occupation)

Brad Sullivan, Chairman - 2000 .... CFO, General Housing Corp.
Dan Babcock, Vice Chairman - 2003 .... CEO, Marlette Regional Hospital
James Abbey - 2014 .... Partner, Abbey, Abbey & Thomas PLLC
Shelly Brooks - 2005 .... President/CEO, Mayville State Bank
Gary Haas, Secretary - 1981 .... Retired CEO, Mayville State Bank
David Osentoski - 2007 .... Owner, Osentoski Realty Co.
Bruce Buckmaster - 2019 .... Owner, Buckmaster Farm Services Inc.
Evan Osentoski - 2019 .... Assoc. Real Estate Broker, Osentoski Realty Co.

Officers and Employees (MSB unless otherwise noted)

Shelly Brooks .... President/CEO, MSB; President & Treasurer, MFC
Lisa Stephens .... Senior Vice President, MSB; Vice President MFC
Scott Wegrzyn .... Vice President; Bank Secrecy Officer; Loan Officer
Ben Heminger .... Assistant Vice President; Loan Officer
Rex Vroman .... Assistant Vice President; Security Officer
Bethany Wingert .... Cashier
Dana Zatkovic .... Asst. Cashier
Cammie Asmus .... Head of Operations
Anna Blackwell .... Sr. Financial Services Representative
Patricia DeSenzio .... Commercial Loan Officer
Nicole Dziuba .... Asst. Branch Manager, Millington Office
Jenna Franks .... Teller
Dawn Frenzel .... Drive-in Manager
Maria Frye .... Teller
Dawson Hilts .... Teller
Ashleigh Jackson .... Loan Review Officer/Financial Services Representative
Michelle Kiss .... Custodian
Chris Larabell .... Information Technology Officer
Kathleen Leach .... Custodian
Amy Louks .... Loan Officer
Dawn Pavelka .... Branch Manager, Millington Office
April Pelch .... Officer-in-Charge, Millington Office
Joy Perkins .... Bookkeeping Operations
Hannah Sachs .... Teller; Financial Services Representative
Kimberly Smith .... Bookkeeping Operations
Leah Sunday .... Loan Processor
Caleb Swadling .... Teller
Tina TerBush .... Teller; Financial Services Representative
Diane Travis .... Custodian
Jessica Trisch .... Teller; Financial Services Representative
Kathy Wilson .... Records Administrator
Kyndra Windsor .... Teller

Dear Shareholders:

The Board of Directors and management of Mayville Financial Corporation are pleased to submit this 135th annual report for the year ended December 31, 2019.

Net income for 2019 decreased to $610,683, resulting in a net income per share of $1.29. With the construction of the new main office building, occupancy and equipment expenses notably increased. This net income equates to a return on average assets of 0.69% and a return on average equity of 6.10%. This performance helped retain the Bank's 5-Star rating from Bauer Financial, Inc., for the quarter ending December 31, 2019; the 90th consecutive quarter the Bank has earned this superior rating. While deposit balances did decrease 3.5%, the focus of efforts for the year continued to be on building the loan portfolio. The 7.8% increase in the loan portfolio contributed to higher earnings in interest and fee income and will continue to drive profitability in the future.

Shareholders received a total of $0.75 per share in cash dividends during 2019, a return of 3.15% based on the average MFC stock price of $23.83 for the year. The Bank maintained strong capital levels, keeping the Bank in a well-capitalized position.

As we look back at 2019, we celebrate the successes and embrace the future opportunities for growth, but we also recognize the new challenges that will be faced in 2020. With news of a national pandemic and the resulting economic turmoil, the banking industry has needed to adapt to different delivery channels and ways that we interact with our customers. The Bank is positioned to offer customers numerous methods of banking without having to be face-to-face with each other. Technological advances allow customers to bank from anywhere with real time transactions. While there is great uncertainty in regards to the long-term effects of the pandemic, what remains certain is our commitment to our customers and communities. Mayville State Bank remains a safe and sound financial institution that will be here for our customers for many years to come. We know that this is a difficult time for many people, but rest assured, you can rely on your team at MSB.

Mayville State Bank remains a strong, independent and locally-owned community bank. Our mission of providing for the financial needs of our customers while delivering a good rate of return to our shareholders has remained a key factor to the Bank's success for the last 135 years. We thank you, our shareholders, for your continued interest in and support of Mayville Financial Corporation and its subsidiary, Mayville State Bank.

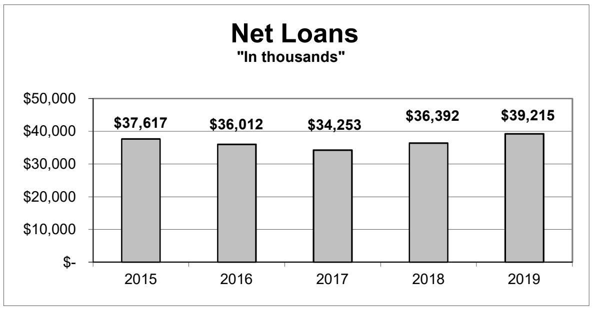
Stay safe and stay healthy.

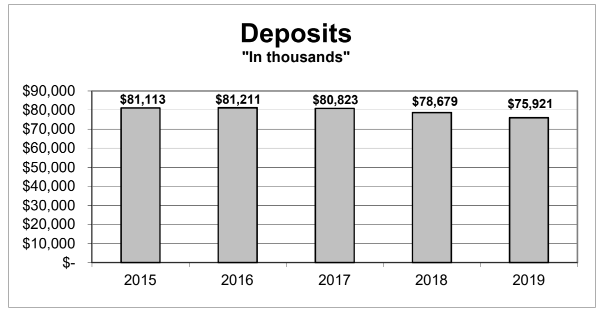
For the Board of Directors,

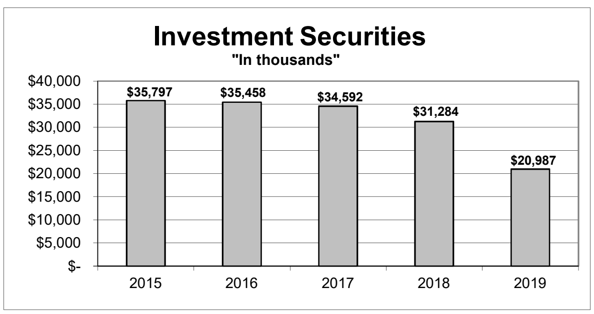
Shelly M. Brooks
President
MAYVILLE FINANCIAL CORPORATION

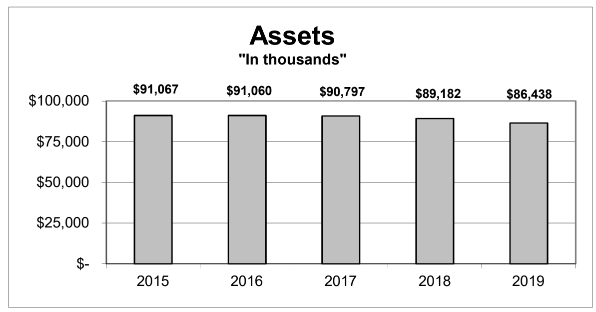
Mayville Financial Corporation

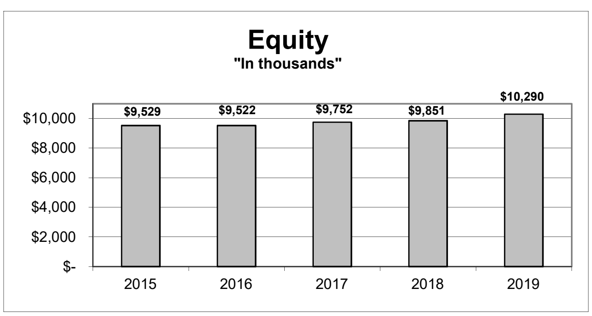
Financial Highlights - Five Years

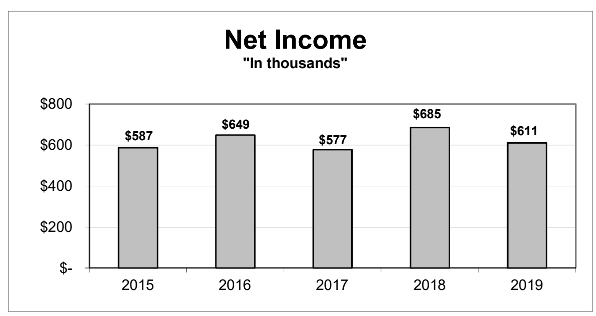






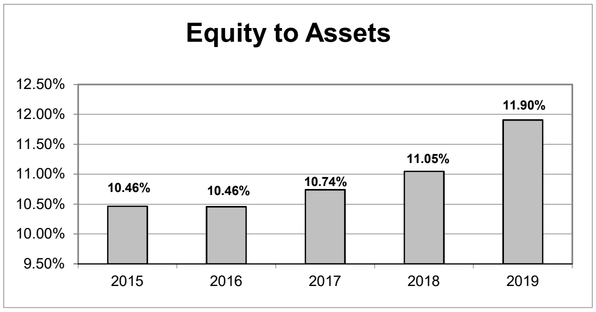


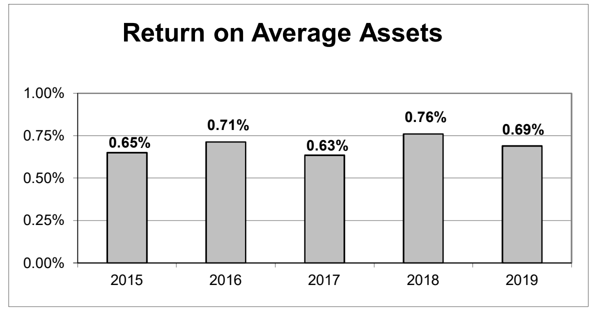


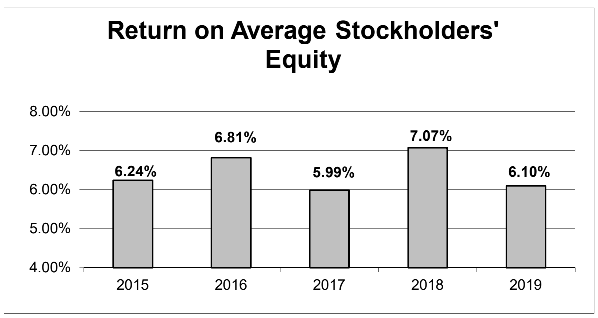


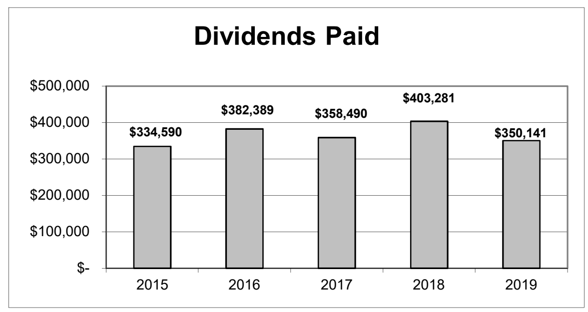
Mayville Financial Corporation

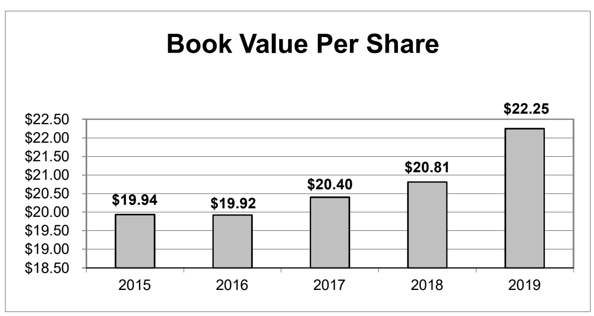
Financial Highlights - Five Years











Rehmann

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INDEPENDENT AUDITORS' REPORT

May 12, 2020

Stockholders and Board of Directors
Mayville Financial Corporation
Mayville, Michigan

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

Management's Responsibility for the Consolidated Financial Statements

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

Independent Auditors' Responsibility

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

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

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

Opinion

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

Rehmann Robson LLC

MAYVILLE FINANCIAL CORPORATION

Consolidated Balance Sheets

	December 31	
	2019	2018
ASSETS		
Cash and due from banks	$ 3,159,877	$ 3,251,235
Federal funds sold	3,814,255	2,669,000
Cash and cash equivalents	**6,974,132**	**5,920,235**
Certificates of deposit held at other financial institutions	12,090,000	8,626,000
Debt securities		
Available-for-sale	20,548,164	29,594,850
Held-to-maturity	438,390	1,688,950
Federal Home Loan Bank stock, at cost	323,100	323,100
Net loans	39,215,122	36,391,794
Accrued interest receivable	257,460	296,531
Premises and equipment, net	3,373,213	3,061,292
Bank owned life insurance	3,059,170	2,970,654
Other assets	159,175	308,753
Total assets	**$ 86,437,926**	**$ 89,182,159**
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Interest-bearing		
NOW and money market accounts	$ 12,266,897	$ 13,232,407
Savings accounts	26,423,317	26,626,413
Other time deposits	20,673,814	23,562,110
Time deposits over $250,000	668,270	315,916
Total interest-bearing	60,032,298	63,736,846
Noninterest-bearing	15,889,094	14,941,948
Total deposits	**75,921,392**	**78,678,794**
Accrued interest payable	18,001	19,178
Accrued expenses and other liabilities	208,264	633,445
Total liabilities	**76,147,657**	**79,331,417**
Commitments and contingencies (Notes 10, 11, and 12)		
Stockholders' equity		
Common stock, no par value: 1,250,000 shares authorized, 462,518 shares issued and outstanding (473,360 in 2018)	3,898,326	4,133,923
Retained earnings	6,274,977	6,014,435
Accumulated other comprehensive income (loss)	116,966	(297,616)
Total stockholders' equity	**10,290,269**	**9,850,742**
Total liabilities and stockholders' equity	**$ 86,437,926**	**$ 89,182,159**

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

MAYVILLE FINANCIAL CORPORATION

Consolidated Statements of Income

	Year Ended December 31	
	2019	2018
Interest and dividend income		
Loans (including fees)	$ 2,073,332	$ 1,957,811
Investment securities		
Available-for-sale	472,624	560,246
Held-to-maturity	23,780	33,839
Federal funds sold and other	54,106	54,210
Other interest and dividend income	230,551	212,762
Total interest and dividend income	**2,854,393**	**2,818,868**
Interest expense on deposits	202,183	215,953
Net interest income	**2,652,210**	**2,602,915**
Noninterest income		
Service charges on deposit accounts	277,936	304,901
Other	369,091	390,103
Total noninterest income	**647,027**	**695,004**
Noninterest expenses		
Compensation	1,160,825	1,146,610
Profit sharing and other employee benefits	223,383	250,183
Occupancy and equipment	309,630	194,076
FDIC assessments	24,000	19,032
ATM processing fees	128,021	130,058
Professional fees	93,134	90,761
Directors fees	81,080	69,330
Data processing fees	181,605	179,572
Impairment on asset held for sale	20,000	102,221
Other	377,376	340,778
Total noninterest expenses	**2,599,054**	**2,522,621**
Income before federal income taxes	**700,183**	**775,298**
Federal income taxes	89,500	90,000
Net income	**$ 610,683**	**$ 685,298**
Net income per basic share of common stock	**$ 1.29**	**$ 1.44**

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

MAYVILLE FINANCIAL CORPORATION

Consolidated Statements of Comprehensive Income

	Year Ended December 31	
	2019	**2018**
Available-for-sale debt securities		
Unrealized holding gains (losses) arising during the year	$ 520,712	$ (111,995)
Reclassification adjustment for net realized losses included in net income	3,958	1,166
Comprehensive income (loss) before income tax (expense) benefit	524,670	(110,829)
Income tax (expense) benefit related to other comprehensive income (loss)	(110,088)	23,067
Other comprehensive income (loss)	**414,582**	**(87,762)**
Net income	610,683	685,298
Comprehensive income	**$ 1,025,265**	**$ 597,536**

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

MAYVILLE FINANCIAL CORPORATION

Consolidated Statements of Stockholders' Equity

	Common Stock		Retained	Accumulated Other Comprehensive	
	Shares	Amount	Earnings	Income (Loss)	Total
Balances, January 1, 2018	**477,986**	**$ 4,228,941**	**$ 5,732,418**	**$ (209,854)**	**$ 9,751,505**
Comprehensive income	-	-	685,298	(87,762)	597,536
Redemption of stock	(4,626)	(95,018)	-	-	(95,018)
Cash dividends paid ($0.85 per share)	-	-	(403,281)	-	(403,281)
Balances, December 31, 2018	**473,360**	**4,133,923**	**6,014,435**	**(297,616)**	**9,850,742**
Comprehensive income	-	-	610,683	414,582	1,025,265
Redemption of stock	(10,842)	(235,597)	-	-	(235,597)
Cash dividends paid ($0.75 per share)	-	-	(350,141)	-	(350,141)
Balances, December 31, 2019	**462,518**	**$ 3,898,326**	**$ 6,274,977**	**$ 116,966**	**$ 10,290,269**

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

MAYVILLE FINANCIAL CORPORATION

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2019	2018
Cash flows from operating activities		
Net income	$ 610,683	$ 685,298
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	194,571	66,233
Impairment of asset held for sale	20,000	102,221
Increase in cash surrender value of bank owned life insurance	(88,516)	(83,415)
Net amortization of investment securities premiums	183,689	235,399
Gain on sale of foreclosed assets	(8,366)	(17,668)
Loss on sale and disposal of asset held for sale, and premises and equipment	2,741	852
Loss on sale of investment securities	3,958	1,166
Deferred income tax benefit (expense)	89,500	(6,000)
Changes in operating assets and liabilities which provided (used) cash		
Accrued interest receivable	39,071	16,511
Other assets	(153,397)	(21,538)
Accrued interest payable	(1,177)	(1,109)
Accrued expenses and other liabilities	(425,181)	53,089
Net cash provided by operating activities	**467,576**	**1,031,039**
Cash flows from investing activities		
Net change in certificates of deposit held at other financial institutions	(3,464,000)	1,968,000
Activity in held-to-maturity securities		
Purchases	-	(1,255,699)
Maturities, prepayments and calls	1,256,014	1,158,675
Activity in available-for-sale securities		
Purchases	(1,354,601)	(3,974,434)
Maturities, sales, prepayments and calls	10,732,856	7,032,013
Loan principal originations, net	(2,841,809)	(2,139,019)
Proceeds from sales of foreclosed assets	26,847	93,968
Proceeds from sales of asset held for sale	79,900	-
Purchases of premises and equipment	(505,746)	(2,406,903)
Proceeds from sales of premises and equipment	-	2,270
Net cash provided by investing activities	**3,929,461**	**478,871**
Cash flows from financing activities		
Acceptances and withdrawals of deposits, net	(2,757,402)	(2,144,154)
Common stock repurchased	(235,597)	(95,018)
Cash dividends paid	(350,141)	(403,281)
Net cash used in financing activities	**(3,343,140)**	**(2,642,453)**
Net increase (decrease) in cash and cash equivalents	**1,053,897**	**(1,132,543)**
Cash and cash equivalents, beginning of year	5,920,235	7,052,778
Cash and cash equivalents, end of year	**$ 6,974,132**	**$ 5,920,235**

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

MAYVILLE FINANCIAL CORPORATION

Notes to Consolidated Financial Statements

1. NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation and Nature of Business

The accompanying consolidated financial statements include the accounts of *Mayville Financial Corporation,* a registered bank holding company (the "Corporation"), and its wholly owned subsidiary, Mayville State Bank (the "Bank"), and the Bank's subsidiary Mayville Financial Services. All significant intercompany accounts and transactions have been eliminated in consolidation.

The Corporation is independently owned and operates a community bank engaged in the business of retail and commercial banking services through its two branches located in Tuscola County in Michigan. Active competition, principally from other commercial banks, savings banks and credit unions, exists in all the Bank's primary markets. The Bank's results of operations can be significantly affected by changes in interest rates or changes in the automotive and agricultural industries which comprise a significant portion of the local economic environment.

Economic Uncertainties

The outbreak of a novel coronavirus (COVID-19), which the World Health Organization declared in March 2020 to be a pandemic, continues to spread throughout the United States of America and the globe. In response, many State Governors have issued temporary Executive Orders that, among other stipulations, effectively prohibit in-person work activities for most industries, businesses, and occupations, having the effect of altering the Bank's normal service delivery methods. As a result, the outbreak has disrupted the Bank's customary operating activities. The extent of the impact of COVID-19 on the Bank's operational and financial performance will depend on various developments, including the duration and spread of the outbreak, and its impact on borrowers, customers, employees, vendors, and regulatory actions, all of which cannot be predicted at this time. While management reasonably expects the COVID-19 outbreak could negatively impact the Corporation's consolidated financial condition, operating results, and timing and amounts of cash flows, the related financial consequences including the effects of potential changes in key accounting estimates, is highly uncertain.

Concentration Risks

The Bank's primary deposit products are interest and noninterest-bearing checking accounts, savings accounts, and time deposits, and its primary lending products are real estate mortgages, commercial, and consumer loans. The Bank does not have significant concentrations with respect to any one industry, customer, or depositor.

The Bank is a state chartered bank and a member of the Federal Deposit Insurance Corporation ("FDIC") Bank Insurance Fund. The Bank is subject to the regulations and supervision of the FDIC and state regulators and undergoes periodic examinations by these regulatory authorities. The Corporation is further subject to regulations and supervision of the Federal Reserve Board governing bank holding companies.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the consolidated balance sheet and the reported amounts of income and expenses during the year. Actual results could differ from those estimates. Significant estimates include but are not limited to the determination of the allowance for loan losses, the associated valuation of impaired loans, and the valuation of other assets held for sale.

Summary of Significant Accounting Policies

Accounting policies used in preparation of the accompanying consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America. The principles which materially affect the determination of the consolidated financial position and results of operations of the Corporation and its subsidiary are summarized below.

Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold. Generally, federal funds are sold for a one-day period. The Bank maintains deposit accounts in various financial institutions which generally exceed the FDIC insured limits or are not insured. Management does not believe the Corporation is exposed to any significant interest, credit or other financial risk as a result of these deposits.

Certificates of Deposit Held at Other Financial Institutions

Certificates of deposit held at other financial institutions mature within five years and are carried at cost.

Fair Value Measurements

Fair value refers to the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants in the market in which the reporting entity transacts such sales or transfers based on the assumptions market participants would use when pricing an asset or liability. Assumptions are developed based on prioritizing information within a fair value hierarchy that gives the highest priority to quoted prices in active markets (Level 1) and the lowest priority to unobservable data, such as the reporting entity's own data (Level 3).

A description of each category in the fair value hierarchy is as follows:

Level 1: Valuation is based upon quoted prices for identical instruments traded in active markets.

Level 2: Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

Level 3: Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect the estimates of assumptions that market participants would use in pricing the asset or liability.

For a further discussion of Fair Value Measurements, refer to Note 2 to the consolidated financial statements.

Investment Securities

Debt securities that management has the ability and positive intent to hold to maturity are classified as held-to-maturity and are recorded at amortized cost. Debt securities not classified as held-to-maturity are classified as available-for-sale and are recorded at fair value, with unrealized gains and losses, net of the effect of deferred income taxes, recorded in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the investment securities. Realized gains or losses on the sale of available-for-sale debt securities are recorded in investment income on the trade date and are determined using the specific identification method.

Investment securities are reviewed at each reporting period for possible other-than-temporary impairment ("OTTI"). In determining whether an other-than-temporary impairment exists for debt securities, management must assert that: (a) it does not have the intent to sell the security; and (b) it is more likely than not it will not have to sell the security before recovery of its cost basis. If these conditions are not met, the Corporation must recognize an other-than-temporary impairment charge through earnings for the difference between the debt security's amortized cost basis and its fair value. For these debt securities, the Corporation separates the total impairment into the credit loss component and the amount of the loss related to other factors.

In order to determine the amount of the credit loss for a debt security, the Corporation calculates the recovery value by performing a discounted cash flow analysis based on the current cash flows and future cash flows management expects to recover. The amount of the total other-than-temporary impairment related to the credit risk is recognized in earnings and is included in noninterest income. The amount of the total other-than-temporary impairment related to other risk factors is recognized as a component of other comprehensive income. For debt securities that have recognized an other-than-temporary impairment through earnings, if through subsequent evaluation there is a significant increase in the cash flow expected, the difference between the amortized cost basis and the cash flows expected to be collected is accreted as interest income.

Federal Home Loan Bank Stock

The Bank is a member of the Federal Home Loan Bank System and is required to invest in capital stock of the Federal Home Loan Bank of Indianapolis ("FHLB"). The amount of the required investment is based upon the available balance of the Bank's outstanding home mortgage loans or advances from the FHLB and is carried at cost plus the value assigned to stock dividends.

Loans

Loans that management has the positive intent and ability to hold for the foreseeable future or until maturity or pay-off are generally reported at their outstanding unpaid principal balances adjusted for charge-offs, and the allowance for loan losses. Interest income is accrued on the unpaid principal balance. Management estimates that direct costs incurred in originating loans approximate the origination fees generated on these loans. Therefore, net deferred loan origination fees on loans classified as held-to-maturity are not included on the accompanying consolidated balance sheets.

The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Consumer loans are typically charged off no later than 180 days past due. Past due status is based on contractual terms of the loan. In all cases, loans are placed on nonaccrual or charged off at an earlier date if collection of principal and interest is considered doubtful.

All interest accrued in the current year but not collected for loans that are placed on nonaccrual or are charged off, is reversed against interest income while interest accrued but not collected in prior years is reversed against the allowance for loan losses. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured. For impaired loans not classified as nonaccrual, interest income is recognized daily as it is earned according to the terms of the loan agreement.

Nonperforming loans of the loan portfolio are comprised of those loans accounted for on a nonaccrual basis, accruing loans contractually past due 90 days or more as to interest or principal payments, and loans modified under troubled debt restructurings (nonperforming originated loans).

Allowance for Loan Losses

The allowance for loan losses (“allowance”) is an estimate of loan losses inherent in the Bank’s loan portfolio. The allowance is established through a provision for loan losses which is charged to expense. Additions to the allowance are expected to maintain the appropriateness of the total allowance after loan losses. Loan losses are charged off against the allowance when the Bank determines the loan balance to be uncollectible. Cash received on previously charged-off amounts is recorded as a recovery to the allowance.

The allowance consists of general reserves, specific reserves related to impaired loans, and an unallocated component. For loans that are classified as impaired, a specific reserve is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general reserves covers nonimpaired loans and is based on historical losses adjusted for current factors. The historical loss experience is determined by portfolio segment and is based on the actual loss history experienced by the Bank over the most recent 5 years. This actual loss experience is adjusted for economic factors based on the risks present for each portfolio segment. These economic factors include consideration of the following: levels of and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards; other changes in lending policies, procedures, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry conditions; and effects of changes in credit concentrations. These factors are inherently subjective and are driven by the repayment risk associated with each portfolio segment. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower’s prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis for commercial loans by either the present value of expected future cash flows discounted at the loan’s effective interest rate, or the fair value of the collateral, less costs to sell, if the loan is collateral dependent. A loan is collateral dependent if its repayment is expected to be provided solely by the underlying collateral.

Large groups of smaller balance homogeneous loans are collectively evaluated for impairment. Accordingly, the Bank does not separately identify individual consumer and residential loans for impairment disclosures, unless such loans are the subject of a restructuring agreement or in nonaccrual status.

The Bank evaluates the credit quality of loans in the consumer loan portfolio, including residential real estate loans, based primarily on the aging status of the loan and payment activity. Accordingly, nonaccrual loans and loans past due as to principal or interest 90 days or more are considered in a nonperforming status for purposes of credit quality evaluation.

Under certain circumstances, the Bank will provide borrowers relief through loan restructurings. A loan restructuring constitutes a troubled debt restructuring ("TDR") if for economic or legal reasons related to the borrower's financial difficulties the Bank grants a concession to the borrower that it would not otherwise consider. Restructured loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. Loans that are reported as TDRs are considered impaired and measured for impairment as described above.

The Bank assigns a risk rating to all loans except pools of homogeneous loans and periodically performs detailed internal reviews of all such loans over a certain threshold to identify credit risks and to assess the overall collectability of the portfolio. These risk ratings are also subject to examination by the Bank's regulators. During the internal reviews, management monitors and analyzes the financial condition of borrowers and guarantors, trends in the industries in which the borrowers operate and the fair values of collateral securing the loans. These credit quality indicators are used to assign a risk rating to each individual loan. The risk ratings can be grouped into five major categories, defined as follows:

Pass: A pass loan is a credit with no existing or known potential weaknesses deserving of management's close attention.

Special Mention (or Watch): Special mention loans (or watch) have a potential weakness that deserves management's close attention. If left uncorrected, this potential weakness may result in deterioration of the repayment prospects for the loan or of the Bank's credit position at some future date. Special mention (watch) loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Substandard: Loans classified as substandard are not adequately protected by the current net worth and paying capacity of the borrower or of the collateral pledged, if any. Loans classified as substandard have a well-defined weakness or weaknesses that jeopardize the repayment of the debt. Well defined weaknesses include a borrower's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time, or the failure to fulfill economic expectations. They are characterized by the distinct possibility that the Bank 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 repayment in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Loss: Loans classified as loss are considered uncollectible and are charged off immediately.

The majority of the Bank's consumer and residential loan portfolio is comprised of secured loans that are evaluated at origination on a centralized basis against standardized underwriting criteria. The ongoing measurement of credit quality of the consumer and residential loan portfolios is largely done on an exception basis. If payments are made on schedule, as agreed, then no further monitoring is performed. However, if delinquency occurs, the delinquent loans are turned over to the Bank's collection department for resolution, which generally occurs fairly rapidly and often through repossession and foreclosure. Credit quality for the entire consumer and residential loan portfolio is measured by the periodic delinquency rate, nonaccrual amounts and actual losses incurred.

The Bank maintains a separate general valuation allowance for each portfolio segment. These portfolio segments include commercial and industrial, commercial real estate, real estate construction, residential real estate, and consumer and other with risk characteristics described as follows:

Commercial and Industrial: Commercial and industrial loans generally possess a lower inherent risk of loss than real estate portfolio segments because these loans are generally underwritten to existing cash flows of operating businesses. Debt coverage is provided by business cash flows and economic trends influenced by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans.

Commercial Real Estate: Commercial real estate loans generally possess a higher inherent risk of loss than other real estate portfolio segments. Adverse economic developments or an overbuilt market impact commercial real estate projects and may result in troubled loans. Trends in vacancy rates of commercial properties impact the credit quality of these loans. High vacancy rates reduce operating revenues and the ability for the properties to produce sufficient cash flow to service debt obligations.

Real Estate Construction: Real estate construction loans generally possess a higher inherent risk of loss than other real estate portfolio segments. A major risk arises from the necessity to complete projects within a specified cost and time line. Trends in the construction industry significantly impact the credit quality of these loans, as demand drives construction activity. In addition, trends in real estate values significantly impact the credit quality of these loans, as property values determine the economic viability of construction projects.

Residential Real Estate: The degree of risk in residential mortgage lending depends primarily on the loan amount in relation to collateral value, the interest rate and the borrower's ability to repay in an orderly fashion. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate that the borrowers' capacity to repay their obligations may be deteriorating.

Consumer and Other: The consumer and other loan portfolio is comprised of a large number of small loans, including automobile, personal loans, credit cards, etc. Most loans are made directly for consumer purchases. Economic trends determined by unemployment rates and other key economic indicators are closely correlated to the credit quality of these loans. Weak economic trends indicate the borrowers' capacity to repay their obligations may be deteriorating.

Although management believes the allowance to be appropriate, ultimate losses may vary from its estimates. At least quarterly, the Board of Directors reviews the appropriateness of the allowance, including consideration of the relevant risks in the portfolio, current economic conditions and other factors. If the Board of Directors and management determine that changes are warranted based on those reviews, the allowance is adjusted. In addition, the Bank's primary regulators review the appropriateness of the allowance. The regulatory agencies may require changes to the allowance based on their judgment about information available at the time of their examination.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value, less costs to sell, on the date of transfer, establishing a new cost basis. Physical possession of residential real estate property collateralizing a consumer mortgage loan occurs when legal title is obtained upon completion of foreclosure or when the borrower conveys all interest in the property to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of the carrying amount or fair value less costs to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other noninterest expenses on the consolidated statements of income. There was no other real estate owned at December 31, 2019 or 2018.

Off-Balance Sheet Credit Related Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit arrangements. Such financial instruments are considered to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is considered insignificant, the commitments are generally recorded only when they are funded.

Premises and Equipment

Land is carried at cost. Buildings and equipment are carried at cost, less accumulated depreciation which is computed principally by the straight-line method based upon the estimated useful lives of the related assets, which range from 3 to 40 years. Major improvements are capitalized and appropriately amortized based upon the useful lives of the related assets or the expected terms of the leases, if shorter, using the straight-line method. Maintenance, repairs and minor alterations are charged to current operations as expenditures occur. Management annually reviews these assets to determine whether carrying values have been impaired.

Asset Held for Sale

Asset held for sale is stated at the lower of net book value or fair value less costs to sell and is included in other assets on the accompanying consolidated balance sheets.

Bank Owned Life Insurance

The Bank holds life insurance policies purchased on the lives of key members of management. In the event of death of one of these individuals, the Bank, as beneficiary of the policies, would receive a specified cash payment equal to the face value of the policy. Such policies are recorded at their cash surrender value, or the amount that can be currently realized as of the balance sheet date. The change in cash surrender value is an adjustment of premiums paid in determining the net expense or income recognized under the contracts for the year and is included in other noninterest income.

Income Taxes

Deferred income tax assets and liabilities are determined using the liability (or balance sheet) method. Under this method, the net deferred income tax asset or liability is determined based on the federal income tax effects of the temporary differences between the book and tax bases of the various balance sheet assets and liabilities and gives current recognition to changes in federal income tax rates and laws. Valuation allowances are established, where necessary, to reduce deferred tax assets to the amount expected more likely than not to be realized. Income tax expense is the tax payable or refundable for the year plus or minus the change during the year in deferred tax assets and liabilities.

Advertising Costs

The cost of advertising and promotions are expensed as incurred. The Corporation incurred $36,105 and $35,486 in advertising costs in 2019 and 2018, respectively.

Net Income Per Share

Net income per basic share of common stock represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the year, which was 471,994 and 476,490 and in 2019 and 2018, respectively.

Subsequent Events

In preparing these consolidated financial statements, the Corporation has evaluated, for potential recognition or disclosure, significant events or transactions that occurred during the period subsequent to December 31, 2019, the most recent consolidated balance sheet presented herein, through May 12, 2020, the date these consolidated financial statements were available to be issued. No significant such events or transactions were identified, other than the economic uncertainties matter described above.

New Accounting Pronouncement

ASU No. 2014-09, *Revenue from Contracts with Customers* and all subsequent amendments to the ASU (collectively, "ASC 606") - On January 1, 2019, the Corporation adopted ASC 606, which creates a single framework for recognizing revenue from contracts with customers that are within its scope. The new guidance further revises when it's appropriate to recognize a gain or loss from the transfer of nonfinancial assets. The majority of the Corporation's revenues are derived from interest income, including loans and securities, and other sources, that are outside the scope of ASC 606. The Corporation's revenue sources that are within the scope of ASC 606, including service charges on deposits and interchange income, are presented within noninterest income on the accompanying consolidated statements of income and are recognized as revenue as the Corporation satisfies its obligations to the customer. Refer to Note 15 for further discussion on the Corporation's accounting policies of revenue recognition within the scope of ASC 606.

The Corporation adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2019. Results for periods beginning after January 1, 2019 are presented under ASC 606 while prior period amounts continue to be reported in accordance with previous GAAP. The adoption of ASC 606 did not result in a change to the accounting for any of the in-scope revenue streams; therefore, no cumulative effective adjustment was recorded.

ASU No. 2016-13, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,* was issued in 2016 with the intention of improving financial reporting by requiring timelier recording of credit losses on loans and certain other financial instruments held by financial institutions.

The ASU requires that the measurement of all expected credit losses for financial assets that are measured at amortized cost at the reporting date be based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions will also use forward-looking information to develop their credit loss estimates.

The ASU requires enhanced disclosures to assist investors and other financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an institution's portfolio.

In addition, the ASU amends existing guidance on accounting for credit losses on available for-sale debt securities, purchased financial assets with credit deterioration, and also applies to certain off-balance sheet credit exposures.

The ASU on credit losses will take effect for years beginning after December 15, 2022. Management is currently evaluating the provisions of ASU 2016-13 to determine the potential impact on the Corporation's consolidated financial statements.

2. FAIR VALUE MEASUREMENTS

The Corporation utilizes fair value measurements to record fair value adjustments to certain assets and to determine fair value disclosures. Marketable securities available-for-sale are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis such as investment securities held-to-maturity, impaired loans, foreclosed assets, and certain other assets. These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets.

Following is a description of the valuation methodologies and key inputs used to measure financial assets recorded at fair value. The description includes an indication of the level of the fair value hierarchy in which the assets are classified.

Debt Securities

Debt securities classified as available-for-sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 1 securities include U.S. Treasury notes, if any. Level 2 fair value measurement is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model based valuation techniques such as the present value of future cash flows, adjusted for the security's credit rating, prepayment assumptions and other factors such as credit loss and liquidity assumptions. Level 2 securities include states and municipal securities and mortgage-backed securities, and securities issued by government-sponsored entities and municipal bonds in active markets. Securities classified as Level 3 include securities in less liquid markets and may include certain municipal securities. The Corporation does not have any Level 3 securities at December 31, 2019 or 2018.

Loans

The Corporation does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and an allowance for loan losses is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with accounting standards for subsequent measurement of receivables. The fair value of impaired loans is estimated using one of several methods, including collateral value, fair value of similar debt, enterprise value, liquidation value, and discounted cash flows. 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. At December 31, 2019 and 2018, substantially all of the total impaired loans were evaluated based on the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Corporation classifies the impaired loan as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation classifies the impaired loan as nonrecurring Level 3.

Asset Held for Sale

The carrying amounts for assets held for sale are reported in the accompanying 2018 consolidated balance sheet under "other assets". Upon transfer from premises and equipment, assets held for sale are adjusted to and subsequently carried at the lower of carrying value or fair value less costs to sell. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral. When the fair value of the collateral is based on an observable market price or current appraised value, the Corporation classifies the asset held for sale as nonrecurring Level 2. When a current appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Corporation classifies the asset held for sale as a nonrecurring Level 3.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain assets could result in a different fair value measurement at the reporting date.

Assets Recorded at Fair Value on a Recurring Basis

The following tables set forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a recurring basis as of December 31:

	Assets at Fair Value			
2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
Corporate bonds	$ -	$ 2,893,081	$ -	$ 2,893,081
Government-sponsored enterprises	-	4,546,574	-	4,546,574
States and municipal	-	11,285,582	-	11,285,582
Mortgage-backed	-	1,822,927	-	1,822,927
Total assets at fair value	**$ -**	**$ 20,548,164**	**$ -**	**$ 20,548,164**

	Assets at Fair Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Investment securities available-for-sale:				
Corporate bonds	$ -	$ 1,958,462	$ -	$ 1,958,462
Government-sponsored enterprises	-	11,159,795	-	11,159,795
States and municipal	-	14,740,937	-	14,740,937
Mortgage-backed	-	1,735,656	-	1,735,656
Total assets at fair value	**$ -**	**$ 29,594,850**	**$ -**	**$ 29,594,850**

Assets Recorded at Fair Value on a Nonrecurring Basis

The following table sets forth by level, within the fair value hierarchy, the recorded amount of assets measured at fair value on a nonrecurring basis as of December 31:

	Assets at Carrying Value			
2019	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans (1)	$ -	$ -	$ 415,840	$ 415,840

	Assets at Carrying Value			
2018	**Level 1**	**Level 2**	**Level 3**	**Total**
Impaired loans (1)	$ -	$ -	$ 319,176	$ 319,176
Asset held for sale (2)	-	-	99,900	99,900

(1) Certain impaired loans were remeasured and reported at fair value through a specific valuation allowance based upon the estimated fair value of the underlying collateral. Impaired loans of $415,840 and $319,176 at December 31, 2019 and 2018, respectively, were reduced by a specific valuation allowance totaling $132,000 and $61,000 as of December 31, 2019 and 2018, respectively.

(2) The asset held for sale had a write-down during 2018 resulting in a charge to earnings of $102,221. There were no assets held for sale as of December 31, 2019; however, there was a write-down during 2019 resulting in a charge to earnings of $20,000.

Quantitative information about Level 3 fair value measurements is as follows as of December 31:

2019	Level 3 Instruments			
Instrument	**Fair Value**	**Valuation Technique**	**Unobservable Input**	**Range**
Impaired loans	$ 415,840	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	5% - 40%

Notes to Consolidated Financial Statements

2018	Level 3 Instruments			
Instrument	Fair Value	Valuation Technique	Unobservable Input	Range
Impaired loans	$ 319,176	Discounted Appraisal Value	Discount Applied to Collateral Appraisal	5% - 40%
Asset held for sale	$ 99,900	Market Valuation	Discount Applied to Collateral	5% - 10%

3. INVESTMENT SECURITIES

The amortized cost and fair value of available-for-sale debt securities, including gross unrealized gains and losses, are summarized as follows as of December 31:

2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-Maturity				
States and municipal	$ 438,390	$ 5,771	$ -	$ 444,161
Available-for-Sale				
Corporate bonds	2,822,864	73,162	2,945	2,893,081
Government-sponsored enterprises	4,537,284	14,972	5,682	4,546,574
States and municipal	11,224,430	63,413	2,261	11,285,582
Mortgage-backed	1,815,645	9,862	2,580	1,822,927
Total available-for-sale	20,400,223	161,409	13,468	20,548,164
Total	**$ 20,838,613**	**$ 167,180**	**$ 13,468**	**$ 20,992,325**

2018	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Held-to-Maturity				
States and municipal	$ 1,688,950	$ 2,498	$ 4,087	$ 1,687,361
Available-for-Sale				
Corporate bonds	1,979,151	-	20,689	1,958,462
Government-sponsored enterprises	11,284,318	-	124,523	11,159,795
States and municipal	14,916,237	-	175,300	14,740,937
Mortgage-backed	1,791,873	-	56,217	1,735,656
Total available-for-sale	29,971,579	-	376,729	29,594,850
Total	**$ 31,660,529**	**$ 2,498**	**$ 380,816**	**$ 31,282,211**

There were no securities pledged as of December 31, 2019 or 2018.

The amortized cost and fair value of held-to-maturity securities and available-for-sale securities grouped by contractual maturity at December 31, 2019, are summarized as follows:

	Maturing				
	Due in One Year Or Less	Due After One Year Through Five Years	Due After Five Years Through Ten Years	Securities with Variable Monthly Payments	Total
Held-to-Maturity					
States and municipal	$ 141,569	$ 296,821	$ -	$ -	$ 438,390
Available-for-sale					
Corporate bonds	-	2,822,864	-	-	2,822,864
Government-sponsored enterprises	1,549,598	2,987,686	-	-	4,537,284
States and municipal	3,394,452	7,829,978	-	-	11,224,430
Mortgage-backed	-	-	-	1,815,645	1,815,645
Total available-for-sale	4,944,050	13,640,528	-	1,815,645	20,400,223
Total amortized cost	**$ 5,085,619**	**$ 13,937,349**	**$ -**	**$ 1,815,645**	**$ 20,838,613**
Fair value	**$ 5,090,593**	**$ 14,078,805**	**$ -**	**$ 1,822,927**	**$ 20,992,325**

Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations.

Because of their variable monthly payments, mortgage-backed securities are not reported by a specific maturity group.

There were $1,211,734 and $998,490 in proceeds from sales of available-for-sale securities during 2019 and 2018, respectively. Gross realized losses amounted to $4,001 and $1,166 and gross realized gains of $43 and $0 in 2019 and 2018, respectively. This resulted in a reclassification of $3,958 ($3,127 net of tax) and $1,166 ($921 net of tax) from accumulated other comprehensive loss to loss on sale of securities, a component of other noninterest expense on the consolidated statements of income in 2019 and 2018, respectively.

Information pertaining to securities with unrealized losses aggregated by investment category and the length of time that individual securities have been in a continuous loss position at December 31 is as follows:

2019	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Loss	Over 12 Months Fair Value	Over 12 Months Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities available-for-sale						
Corporate bonds	$ 418,058	$ 2,945	$ -	$ -	$ 418,058	$ 2,945
Government-sponsored enterprises	-	-	2,241,640	5,682	2,241,640	5,682
States and municipal	-	-	1,817,997	2,261	1,817,997	2,261
Mortgage-backed	-	-	164,803	2,580	164,803	2,580
Total securities available-for-sale	**$ 418,058**	**$ 2,945**	**$ 4,224,440**	**$ 10,523**	**$ 4,642,498**	**$ 13,468**

2018	Less than 12 Months Fair Value	Less than 12 Months Gross Unrealized Loss	Over 12 Months Fair Value	Over 12 Months Gross Unrealized Loss	Fair Value	Total Gross Unrealized Losses
Securities held-to-maturity						
States and municipal	$ 1,275,832	$ 1,519	$ 258,786	$ 2,568	$ 1,534,618	$ 4,087
Securities available-for-sale						
Corporate bonds	$ 1,958,462	$ 20,689	$ -	$ -	$ 1,958,462	$ 20,689
Government-sponsored enterprises	2,496,176	3,472	8,663,619	121,051	11,159,795	124,523
States and municipal	2,039,043	7,387	12,701,894	167,913	14,740,937	175,300
Mortgage-backed	-	-	1,735,656	56,217	1,735,656	56,217
Total securities available-for-sale	**$ 6,493,681**	**$ 31,548**	**$ 23,101,169**	**$ 345,181**	**$29,594,850**	**$ 376,729**

As of December 31, 2019, the Corporation’s investment security portfolio consisted of 80 securities, 12 of which were in an unrealized loss position. The unrealized losses are related to the Corporation’s corporate bonds, government-sponsored enterprises, states and municipal and mortgage-backed securities.

As of December 31, 2019 and 2018, management conducted an analysis to determine whether securities currently in an unrealized loss position should be considered other-than-temporarily-impaired (“OTTI”). Such analyses considered, among other factors, the following criteria:

- Has the value of the investment declined more than what is deemed reasonable based on a risk and maturity adjusted discount rate?
- Is the investment credit rating below investment grade?
- Is it probable that the issuer will be unable to pay the amount when due?
- Is it more likely than not that the Corporation will not have to sell the security before recovery of its cost basis?
- Has the duration of the investment been extended for an unreasonable period of time?

Based on the Corporation’s analysis using the above criteria, the fact that management has asserted that it does not have the intent to sell these securities in an unrealized loss position, and that it is more likely than not the Corporation will not have to sell the securities before recovery of their cost basis, management does not believe that the values of any securities are other-than-temporarily impaired as of December 31, 2019 or 2018.

4. LOANS AND ALLOWANCE FOR LOAN LOSSES

The Bank grants commercial, consumer and residential mortgage loans to customers situated primarily in the Tuscola County Area. The ability of the Bank’s debtors to honor their contracts is dependent upon the real estate and general economic conditions in this area. Substantially all of the consumer and residential loans are collateralized by various items of property, while commercial loans are collateralized primarily by business assets and personal guarantees; a portion of loans are unsecured.

The allowance for loan losses and recorded investment in loans are as follows for the years ended December 31:

2019	Commercial and Industrial	Commercial Real Estate	Real Estate Construction	Residential Real Estate	Consumer and Other	Unallocated	Total
Allowance for loan losses:							
Balance at beginning of year	$ 7,001	$ 39,848	$ 2,534	$ 271,628	$ 23,628	$ 227,311	$ 571,950
Provision for loan losses	2,413	(6,948)	(963)	(12,251)	5,003	12,746	-
Loans charged-off	-	-	-	-	(14,288)	-	(14,288)
Recoveries	-	-	-	-	10,256	-	10,256
Balance at end of year	**$ 9,414**	**$ 32,900**	**$ 1,571**	**$ 259,377**	**$ 24,599**	**$ 240,057**	**$ 567,918**
Allowance for loan losses attributable to:							
Individually evaluated for impairment	$ -	$ -	$ -	$ 118,000	$ 14,000	$ -	$ 132,000
Collectively evaluated for impairment	9,414	32,900	1,571	141,377	10,599	240,057	435,918
Total allowance for loan losses	**$ 9,414**	**$ 32,900**	**$ 1,571**	**$ 259,377**	**$ 24,599**	**$ 240,057**	**$ 567,918**
Loans:							
Individually evaluated for impairment	$ -	$ 165,904	$ -	$ 1,068,842	$ 42,531		$ 1,277,277
Collectively evaluated for impairment	1,369,277	5,082,861	628,594	27,859,725	3,565,306		38,505,763
Total loans	1,369,277	5,248,765	628,594	28,928,567	3,607,837		39,783,040
Accrued interest receivable	7,089	22,227	1,480	84,800	8,806		124,402
Total recorded investment in loans	**$ 1,376,366**	**$ 5,270,992**	**$ 630,074**	**$ 29,013,367**	**$ 3,616,643**		**$ 39,907,442**

Notes to Consolidated Financial Statements

2018		Commercial and Industrial		Commercial Real Estate		Real Estate Construction		Residential Real Estate		Consumer and Other		Unallocated		Total
Allowance for loan losses:														
Balance at beginning of year	$	3,794	$	12,660	$	773	$	304,727	$	28,229	$	165,822	$	516,005
Provision for loan losses		3,207		27,188		1,761		(103,238)		9,593		61,489		-
Loans charged-off		-		-		-		-		(21,391)		-		(21,391)
Recoveries		-		-		-		70,139		7,197		-		77,336
Balance at end of year	**$**	**7,001**	**$**	**39,848**	**$**	**2,534**	**$**	**271,628**	**$**	**23,628**	**$**	**227,311**	**$**	**571,950**
Allowance for loan losses attributable to:														
Individually evaluated for impairment	$	-	$	-	$	-	$	61,000	$	-	$	-	$	61,000
Collectively evaluated for impairment		7,001		39,848		2,534		210,628		23,628		227,311		510,950
Total allowance for loan losses	**$**	**7,001**	**$**	**39,848**	**$**	**2,534**	**$**	**271,628**	**$**	**23,628**	**$**	**227,311**	**$**	**571,950**
Loans:														
Individually evaluated for impairment	$	-	$	153,088	$	-	$	1,076,519	$	-			$	1,229,607
Collectively evaluated for impairment		1,061,067		4,543,691		1,013,424		26,571,428		2,544,527				35,734,137
Total loans		1,061,067		4,696,779		1,013,424		27,647,947		2,544,527				36,963,744
Accrued interest receivable		1,163		25,559		-		85,275		8,267				120,264
Total recorded investment in loans	**$**	**1,062,230**	**$**	**4,722,338**	**$**	**1,013,424**	**$**	**27,733,222**	**$**	**2,552,794**			**$**	**37,084,008**

Notes to Consolidated Financial Statements

The following table shows the loans allocated by management's internal risk ratings as of December 31:

2019	Commercial Credit Risk Profile by Risk Rating				
	Pass	Special Mention or Watch	Substandard	Doubtful	Total
Risk Rating					
Commercial and industrial	$ 1,122,931	$ 246,346	$ -	$ -	$ 1,369,277
Commercial real estate	4,956,544	126,317	165,904	-	5,248,765
Total	**$ 6,079,475**	**$ 372,663**	**$ 165,904**	**$ -**	**$ 6,618,042**

The following table shows the homogeneous loans allocated by payment activity as of December 31:

2019	Consumer Credit Risk Profile by Payment Activity			
	Real Estate Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 628,594	$ 28,878,096	$ 3,607,837	$ 33,114,527
Nonperforming	-	50,471	-	50,471
Total	**$ 628,594**	**$ 28,928,567**	**$ 3,607,837**	**$ 33,164,998**

The following table shows the loans allocated by management's internal risk ratings as of December 31:

2018	Commercial Credit Risk Profile by Risk Rating				
	Pass	Special Mention or Watch	Substandard	Doubtful	Total
Risk Rating					
Commercial and industrial	$ 788,935	$ 272,132	$ -	$ -	$ 1,061,067
Commercial real estate	4,406,332	137,359	-	153,088	4,696,779
Total	**$ 5,195,267**	**$ 409,491**	**$ -**	**$ 153,088**	**$ 5,757,846**

The following table shows the homogeneous loans allocated by payment activity as of December 31:

2018	Consumer Credit Risk Profile by Payment Activity			
	Real Estate Construction	Residential Real Estate	Consumer and Other	Total
Payment activity				
Performing	$ 1,013,424	$ 27,605,213	$ 2,537,926	$ 31,156,563
Nonperforming	-	42,734	6,601	49,335
Total	**$ 1,013,424**	**$ 27,647,947**	**$ 2,544,527**	**$ 31,205,898**

The following table shows an aging analysis of the loan portfolio by time past due as of December 31:

2019	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 1,369,277	$ -	$ -	$ -	$ 1,369,277
Commercial real estate	5,023,991	58,870	165,904	-	5,248,765
Real estate construction	628,594	-	-	-	628,594
Residential real estate	28,010,312	867,784	-	50,471	28,928,567
Consumer and other	3,538,178	69,659	-	-	3,607,837
Total	**$ 38,570,352**	**$ 996,313**	**$ 165,904**	**$ 50,471**	**$ 39,783,040**

2018	Accruing Interest				
	Current	30-89 Days Past Due	More Than 90 Days Past Due	Total Nonaccrual	Total Loans
Commercial and industrial	$ 1,061,067	$ -	$ -	$ -	$ 1,061,067
Commercial real estate	4,696,779	-	-	-	4,696,779
Real estate construction	1,013,424	-	-	-	1,013,424
Residential real estate	26,740,016	865,197	13,547	29,187	27,647,947
Consumer and other	2,450,544	87,382	6,601	-	2,544,527
Total	**$ 35,961,830**	**$ 952,579**	**$ 20,148**	**$ 29,187**	**$ 36,963,744**

The following table presents information related to impaired loans as of December 31:

2019	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial real estate	$ 165,904	$ 165,904	$ -	$ 159,496	$ 7,566
Residential real estate	695,533	695,533	-	717,620	46,587
Loans with an allowance recorded					
Residential real estate	373,309	373,309	118,000	$ 375,810	$ 14,472
Consumer and other	42,531	42,531	14,000	48,587	3,630
Total impaired loans					
Commercial real estate	165,904	165,904	-	159,496	7,566
Residential real estate	1,068,842	1,068,842	118,000	1,093,430	61,059
Consumer and other	42,531	42,531	14,000	48,587	3,630
Total	**$ 1,277,277**	**$ 1,277,277**	**$ 132,000**	**$ 1,301,513**	**$ 72,255**

2018	Loan Balance	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
Loans with no related allowance recorded					
Commercial real estate	$ 153,088	$ 153,088	$ -	$ 156,450	$ 9,438
Residential real estate	757,343	757,343	-	776,420	53,551
Loans with an allowance recorded					
Residential real estate	319,176	319,176	61,000	325,164	18,494
Total impaired loans					
Commercial real estate	153,088	153,088	-	156,450	9,438
Residential real estate	1,076,519	1,076,519	61,000	1,101,584	72,045
Total	**$ 1,229,607**	**$ 1,229,607**	**$ 61,000**	**$ 1,258,034**	**$ 81,483**

The Bank does not have material commitments to lend additional funds to borrowers with loans whose terms have been modified in troubled debt restructurings or whose loans are on nonaccrual.

A summary of loans that were modified in troubled debt restructurings during 2019, is as follows:

	Troubled Debt Restructurings		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
Residential real estate	1	$ 99,687	$ 99,687

All modifications during 2019 consisted of interest rate reductions.

There were no loans modified in troubled debt restructurings during 2018.

TDRs that defaulted during 2019 and 2018 were not significant.

5. FORECLOSED ASSETS

Real estate owned activity was as follows:

	2019	2018
Beginning balance	$ -	$ 76,300
Loans transferred to real estate owned	18,481	-
Sales of real estate owned	(18,481)	(76,300)
End of year	**$ -**	**$ -**

There were no formal foreclosure proceedings in process at December 31, 2019 or 2018.

Income and expenses related to foreclosed assets are included in other noninterest income and expenses on the consolidated statements of income and consist of the following:

	2019	2018
Net gain on sales	$ 8,336	$ 17,668
Operating expenses	(653)	(4,971)
	$ 7,683	**$ 12,697**

6. PREMISES AND EQUIPMENT

Net premises and equipment consists of the following amounts at December 31:

	2019	2018
Land and improvements	$ 136,403	$ 318,428
Buildings and improvements	3,450,716	3,637,415
Furniture and equipment	650,938	1,288,690
Total	4,238,057	5,244,533
Less accumulated depreciation	864,844	2,183,241
Premises and equipment, net	**$ 3,373,213**	**$ 3,061,292**

Depreciation expense was $194,571 and $66,233 for 2019 and 2018, respectively.

In 2018, the Corporation transferred a building with a carrying value of $202,121 from buildings and improvements to other assets. Subsequently, the property was listed for sale, at which time management performed a valuation and recorded an impairment charge of $102,221 in 2018. In 2019, the Corporation recorded an additional impairment, based on market value at that time, of $20,000. The building was sold in 2019.

7. DEPOSITS

Scheduled maturities of time deposits for each of the five years succeeding December 31, 2019, and thereafter, are summarized as follows:

Year	Amount
2020	$ 15,760,959
2021	2,140,960
2022	1,565,275
2023	1,297,302
2024	576,513
Thereafter	1,075
Total	**$ 21,342,084**

8. FEDERAL INCOME TAXES

Significant components of the Corporation's deferred income tax assets and liabilities presented in the accompanying consolidated balance sheets (measured at a 21% tax rate) within other assets are comprised of the following amounts as of December 31:

	2019	2018
Deferred tax assets		
Allowance for loan losses	$ 79,000	$ 79,000
Nonaccrued interest	1,000	-
Asset impairment	-	21,000
Net operating loss	108,000	-
Depreciation	-	2,000
Unrealized loss on available-for-sale securities	-	79,000
Total deferred tax assets	**188,000**	**181,000**
Deferred tax liabilities		
Prepaid expenses	2,000	3,000
Depreciation	173,000	-
Accretion	5,500	2,000
FHLB stock dividends	4,000	4,000
Unrealized gain on available-for-sale securities	31,000	-
Total deferred tax liabilities	**215,500**	**9,000**
Net deferred tax (liability) asset	**$ (27,500)**	**$ 172,000**

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 stipulations, permits net operating loss (NOL) carryovers and carrybacks to offset 100% of taxable income for taxable years beginning before 2021. In addition, NOLs incurred in 2018, 2019 and 2020 may be carried back to each of the five preceding taxable years to generate a refund on previously paid federal income taxes. Management is in the process of completing a cost segregation study and estimates that additional depreciation expense will be recognized for tax purposes in 2019 resulting in a NOL for tax purposes. Management has evaluated the impact of these tax law changes and intends that the entire NOL will be carried back resulting in an expected cash refund of approximately $174,000 in 2020. In addition, due to differing statutory income tax rates in effect between the year of NOL originations and the timing of its utilization, the Corporation anticipates the realization of an income tax benefit of approximately $77,000 may be reflected in its 2020 operating results following this planned carryback claim.

The provision for federal income taxes consists of the following components for the years ended December 31:

	2019	2018
Currently payable	$ -	$ 96,000
Deferred expense (benefit)	89,500	(6,000)
Income taxes	**$ 89,500**	**$ 90,000**

A reconciliation between federal income tax expense reported and the amount computed by applying the statutory federal income tax rate of 21% to income before federal income taxes is as follows for the years ended December 31:

	2019	2018
Income tax provision at statutory rate	$ 147,000	$ 163,000
Effect of tax-exempt interest income	(44,000)	(55,000)
Other - net	(13,500)	(18,000)
Income taxes	**$ 89,500**	**$ 90,000**

The Corporation concluded that there are no significant uncertain tax positions requiring recognition in the Corporation's consolidated financial statements based on the evaluation performed for the years 2016 through 2019, the years which remain subject to examination by major tax jurisdictions as of December 31, 2019. The Corporation does not expect the total amount of unrecognized tax benefits ("UTB") (e.g. tax deductions, exclusions, or credits claimed or expected to be claimed) to significantly increase in the next 12 months. The Corporation does not have any amounts accrued for interest and penalties related to UTBs at December 31, 2019 or 2018, and it is not aware of any claims for such amounts by federal or state income tax authorities.

9. RELATED PARTY TRANSACTIONS

Loans

In the ordinary course of business, the Bank grants loans to certain directors, executive officers and their affiliates. Such loans aggregated approximately $949,000 and $1,101,000 as of December 31, 2019 and 2018, respectively.

Deposits

Deposits of Corporation directors, executive officers and their affiliates were approximately $1,773,000 and $1,995,000 as of December 31, 2019 and 2018, respectively.

10. OFF-BALANCE SHEET ACTIVITIES

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Bank's exposure to credit loss is represented by the contractual amount of these commitments. The Bank follows the same credit policy in making commitments, including requirements for collateral, as it does for on-balance-sheet instruments; no significant losses are anticipated as a result of these commitments.

At December 31, 2019 and 2018, the following financial instruments were outstanding whose contract amounts represent credit risk:

	Contract Amount	
	2019	2018
Unfunded commitments under lines of credit	$ 4,486,000	$ 4,727,000
Commercial and standby letters of credit	147,500	310,600

Commitments to extend credit, if any, are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The amount of collateral obtained, if it is deemed necessary by the Bank, is based on management's credit evaluation of the customer.

Unfunded commitments under commercial lines of credit, revolving home equity lines of credit and overdraft protection agreements are commitments for possible future extensions of credit to existing customers. The commitments for equity lines of credit may expire without being drawn upon. These lines of credit are uncollateralized and usually do not contain a specified maturity date and may not be drawn upon to the total extent to which the Bank is committed. A majority of such commitments are at fixed rates of interest; a portion is unsecured.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments, if deemed necessary. The Bank considers standby letters of credit to be guarantees; however, as the amount of the liability related to such guarantees on the commitment date is not significant, a liability related to such guarantees is not recorded at December 31, 2019 or 2018.

11. REGULATORY REQUIREMENTS

Capital Requirements

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

Failure to meet capital requirements can initiate regulatory action. The final rules related to the implementation of the Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective for the Bank on January 1, 2015, with full compliance of all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. The capital conservation buffer as of December 31, 2019 is 2.50% (1.875% for 2018). The net unrealized gain or loss on available for sale securities is not included in computing regulatory capital.

Quantitative measurements established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table). Management believes, as of December 31, 2019 and 2018, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category. The Bank's actual capital amounts and ratios as of December 31, 2019 and 2018 are also presented in the table.

	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total Capital to Risk Weighted Weighted Assets	$ 10,113	24.10 %	$ 4,407	10.500 %	$ 4,197	10.00 %
Tier 1 (Core) Capital to Risk Weighted Assets	9,588	22.85	3,567	8.500	3,357	8.00
Common Tier 1 (CET1)	9,588	22.85	2,938	7.000	2,728	6.50
Tier 1 (Core) Capital to Average Assets	9,588	22.85	3,425	4.000	4,281	5.00

December 31, 2018	Actual		Minimum Capital Requirements		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(Dollars in thousands)						
Total Capital to Risk Weighted Weighted Assets	$ 9,938	24.21 %	$ 4,053	9.875 %	$ 4,105	10.00 %
Tier 1 (Core) Capital to Risk Weighted Assets	9,430	22.97	3,233	7.875	3,284	8.00
Common Tier 1 (CET1)	9,430	22.97	2,617	6.375	2,668	6.50
Tier 1 (Core) Capital to Average Assets	9,430	22.97	3,534	4.000	4,418	5.00

Restrictions on Cash and Amounts Due from Banks

Banks are generally required by regulatory agencies to maintain legal cash reserves based on the level of certain customer deposits. There was no required reserve balance at December 31, 2019 or 2018.

Restrictions on Dividends, Loans and Advances

Federal and state banking regulations place certain restrictions on the amount of loans or advances that can be extended to the Corporation by the Bank and dividends that can be paid to the Corporation by the Bank. The total amount of dividends which may be paid at any date is generally limited to the retained earnings of the Bank, and loans or advances are limited to 10% of the Bank’s capital stock and surplus on a secured basis. In addition, dividends paid by the Bank to the Corporation would be prohibited if the effect thereof would cause the Bank’s capital to be reduced below applicable minimum capital requirements.

12. CONTINGENCIES

Litigation

The Corporation may be party to litigation arising during the normal course of business. No such litigation has been asserted as of December 31, 2019.

Environmental Issues

As a result of acquiring real estate from foreclosure proceedings, the Corporation is subject to potential claims and possible legal proceedings involving environmental matters. No such claims have been asserted as of December 31, 2019.

13. EMPLOYEE BENEFIT PLANS

The Bank sponsors a profit sharing plan qualified under Section 401(k) of the Internal Revenue Code. Substantially all full-time employees of the Bank are covered under the Plan. Contributions to the Plan are discretionary, and amounted to $25,500 and $29,000 in 2019 and 2018, respectively.

14. SUPPLEMENTAL CASH FLOWS INFORMATION

Other Cash Flow Information

Cash paid for interest and income taxes amounted to the following during the years ended December 31:

	2019	2018
Interest	$ 203,360	$ 217,062
Income taxes	$ 110,696	$ 48,477

Non-Cash Investing Activities

Collateral repossessed on real estate loans having carrying values in the amount of $18,481 and $76,300 on the date of transfer was transferred to foreclosed assets in 2019 and 2018, respectively.

15. REVENUE FROM CONTRACTS WITH CUSTOMERS

The Corporation's primary revenue streams accounted for under ASC 606 relates to service charges on deposit accounts. The Bank earns fees from its deposit customers for transaction-based fees, account maintenance, and overdraft services. Transaction-based fees, including these for services such as ATM fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Bank fulfills the customer's request. Account maintenance fees, which primarily relate to monthly account maintenance, are earned over the course of the month, which represents the period over which the Bank satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are deducted from the customer's account balance.

As it relates to other real estate owned for which the Bank finances the sale of property to the buyer, the Bank would assess whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction is probable. Once these criteria are met, the other real estate asset would be derecognized and the gain or loss on sale would be recorded.

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