# South Atlantic Bancshares, Inc.
# and Subsidiary

***Report on Consolidated Financial Statements***

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

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# Independent Auditor's Report

The Board of Directors
South Atlantic Bancshares, Inc. and Subsidiary
Myrtle Beach, South Carolina

**Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of South Atlantic Bancshares, Inc. and its Subsidiary (the "Company"), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended and the related notes to the consolidated financial statements (collectively, the "financial statements").

**Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal controls 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 reasonable 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 South Atlantic Bancshares, Inc. and its Subsidiary as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
March 8, 2021

## South Atlantic Bancshares, Inc. and Subsidiary

***Consolidated Balance Sheets***

***December 31, 2020 and 2019***

| | 2020 | 2019 |
|---|---|---|
| **Assets:** | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | $ 24,822,506 | $ 9,660,999 |
| Federal funds sold and interest-bearing deposits | 15,859,937 | 4,043,078 |
| Total cash and cash equivalents | 40,682,443 | 13,704,077 |
| Investment securities: | | |
| Securities available-for-sale | 125,228,667 | 76,398,560 |
| Nonmarketable equity securities | 643,000 | 563,700 |
| Total investment securities | 125,871,667 | 76,962,260 |
| Mortgage loans held-for-sale | 36,675,792 | 4,904,195 |
| Loans receivable | 686,893,923 | 575,721,370 |
| Less allowance for loan losses | 6,823,767 | 5,237,127 |
| Loans, net | 680,070,156 | 570,484,243 |
| Premises, furniture and equipment, net | 20,373,191 | 20,476,304 |
| Right of use operating lease asset | 7,844,894 | 8,194,535 |
| Bank-owned life insurance | 23,214,739 | 11,707,918 |
| Accrued interest receivable | 2,848,274 | 2,105,709 |
| Deferred tax assets | 1,318,215 | 1,562,868 |
| Goodwill | 5,348,699 | 5,348,699 |
| Core deposit intangible | 859,454 | 1,111,364 |
| Other assets | 1,433,075 | 1,840,037 |
| Total assets | $ 946,540,599 | $ 718,402,209 |
| **Liabilities:** | | |
| Deposits: | | |
| Noninterest-bearing transaction accounts | $ 245,321,283 | $ 156,468,826 |
| Interest-bearing transaction accounts | 108,805,486 | 75,956,855 |
| Savings and money market accounts | 356,949,142 | 252,907,360 |
| Time deposits $250,000 and over | 51,356,402 | 70,711,126 |
| Other deposits | 72,421,546 | 60,762,649 |
| Total deposits | 834,853,859 | 616,806,816 |
| Right of use operating lease liability | 7,873,927 | 8,194,535 |
| Accrued interest payable | 49,946 | 117,947 |
| Other liabilities | 5,941,137 | 4,876,637 |
| Total liabilities | 848,718,869 | 629,995,935 |
| Commitments and contingencies (Notes 12, 14, and 17) | | |
| **Shareholders' equity:** | | |
| Preferred stock, $1.00 par value per share, 5,000,000 shares authorized; no shares issued and outstanding | –– | –– |
| Common stock, $1.00 par value, 25,000,000 shares authorized; 7,509,333 and 7,504,040 shares issued and outstanding at December 31, 2020 and 2019, respectively | 7,509,333 | 7,504,040 |
| Capital surplus | 70,695,119 | 70,693,055 |
| Retained earnings | 16,505,514 | 9,309,463 |
| Accumulated other comprehensive income | 3,569,049 | 1,197,582 |
| Treasury stock, 45,728 and 20,728 shares at December 31, 2020 and 2019, respectively | (457,285) | (297,866) |
| Total shareholders' equity | 97,821,730 | 88,406,274 |
| Total liabilities and shareholders' equity | $ 946,540,599 | $ 718,402,209 |

***See Notes to Consolidated Financial Statements***

## South Atlantic Bancshares, Inc. and Subsidiary

***Consolidated Statements of Income***

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

| | 2020 | 2019 |
|---|---|---|
| **Interest income:** | | |
| Loans, including fees | $ 30,945,462 | $ 29,689,979 |
| Securities available-for-sale | 2,502,403 | 1,900,286 |
| Other interest income | 136,340 | 653,500 |
| Total | 33,584,205 | 32,243,765 |
| **Interest expense:** | | |
| Deposits | 3,545,036 | 5,332,628 |
| Other borrowings | 11,506 | 96,491 |
| Total | 3,556,542 | 5,429,119 |
| **Net interest income** | 30,027,663 | 26,814,646 |
| Provision for loan losses | 1,685,000 | 810,000 |
| **Net interest income after provision for loan losses** | 28,342,663 | 26,004,646 |
| **Noninterest income:** | | |
| Mortgage origination income | 4,151,094 | 1,947,916 |
| Debit card income | 874,144 | 794,535 |
| Merchant fee income | 529,337 | 538,872 |
| Service charges on deposit accounts | 271,157 | 368,572 |
| Net gains on sale of investment securities | 1,052,223 | 408,795 |
| Bank-owned life insurance income | 506,821 | 240,781 |
| Other income | 597,326 | 559,846 |
| Total noninterest income | 7,982,102 | 4,859,317 |
| **Noninterest expenses:** | | |
| Salaries and employee benefits | 17,144,107 | 13,964,853 |
| Net occupancy | 2,397,300 | 2,061,569 |
| Furniture and equipment | 818,428 | 865,830 |
| FDIC banking assessments | 560,662 | 285,196 |
| Advertising | 843,935 | 746,760 |
| Data processing fees | 1,081,400 | 821,862 |
| Software maintenance | 539,845 | 667,179 |
| Other operating expenses | 4,111,609 | 3,944,548 |
| Total noninterest expenses | 27,497,286 | 23,357,797 |
| **Income before income taxes** | 8,827,479 | 7,506,166 |
| Income taxes | 1,631,428 | 1,440,009 |
| **Net income** | $ 7,196,051 | $ 6,066,157 |
| **Income per common share** | | |
| Basic income per common share | $ 0.96 | $ 0.81 |
| Average common shares outstanding -– basic | 7,478,203 | 7,458,380 |
| Diluted income per common share | $ 0.96 | $ 0.80 |
| Average common shares outstanding -– diluted | 7,526,804 | 7,556,243 |

***See Notes to Consolidated Financial Statements***

## South Atlantic Bancshares, Inc. and Subsidiary

***Consolidated Statements of Comprehensive Income***

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

| | 2020 | 2019 |
|---|---|---|
| **Net income** | $ 7,196,051 | $ 6,066,157 |
| **Other comprehensive income:** | | |
| Unrealized gains arising during the period on securities available-for-sale | 4,266,960 | 2,865,596 |
| Reclassification adjustment for net gains realized in net income | (1,052,223) | (408,795) |
| Net unrealized gains on securities | 3,214,737 | 2,456,801 |
| Net effect of taxes | (843,270) | (515,928) |
| Other comprehensive income | 2,371,467 | 1,940,873 |
| **Comprehensive income** | $ 9,567,518 | $ 8,007,030 |

***See Notes to Consolidated Financial Statements***

## South Atlantic Bancshares, Inc. and Subsidiary

***Consolidated Statements of Changes in Shareholders' Equity***

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

| | Common Stock Shares | Common Stock Amount | Capital surplus | Retained earnings | Accumulated other comprehensive income (loss) | Treasury stock | Total |
|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2018** | 7,504,040 | $ 7,504,040 | $ 69,967,638 | $ 3,243,306 | $ (743,291) | $ (635,248) | $ 79,336,445 |
| Net income | – | – | – | 6,066,157 | – | – | 6,066,157 |
| Other comprehensive income, net of tax benefit of $515,928 | – | – | – | – | 1,940,873 | – | 1,940,873 |
| Stock and warrant compensation expense | – | – | 59,307 | – | – | – | 59,307 |
| Equity effect of payment on previously issued loan collateralized by common stock | – | – | 688,447 | – | – | – | 688,447 |
| Contribution of treasury stock to KSOP plan | – | – | (22,337) | – | – | 337,382 | 315,045 |
| **Balance, December 31, 2019** | 7,504,040 | 7,504,040 | 70,693,055 | 9,309,463 | 1,197,582 | (297,866) | 88,406,274 |
| Net income | – | – | – | 7,196,051 | – | – | 7,196,051 |
| Other comprehensive income, net of tax expense of $843,270 | – | – | – | – | 2,371,467 | – | 2,371,467 |
| Stock and warrant compensation expense | – | – | 41,688 | – | – | – | 41,688 |
| Adjustment to common stock related to ACB stock conversion | 5,293 | 5,293 | (5,293) | – | – | – | – |
| Purchase of treasury stock | – | – | – | – | – | (500,000) | (500,000) |
| Contribution of treasury stock to KSOP plan | – | – | (34,331) | – | – | 340,581 | 306,250 |
| **Balance, December 31, 2020** | 7,509,333 | $ 7,509,333 | $ 70,695,119 | $ 16,505,514 | $ 3,569,049 | $ (457,285) | $ 97,821,730 |

***See Notes to Consolidated Financial Statements***

# South Atlantic Bancshares, Inc. and Subsidiary

***Consolidated Statements of Cash Flows***

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

| | 2020 | 2019 |
|---|---|---|
| **Cash flows from operating activities:** | | |
| Net income | $ 7,196,051 | $ 6,066,157 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Provision for loan losses | 1,685,000 | 810,000 |
| Depreciation expense | 1,014,372 | 995,977 |
| Discount accretion and premium amortization | 297,838 | 290,895 |
| Amortization of core deposit intangibles | 251,910 | 284,238 |
| Stock and warrant compensation expense | 41,688 | 59,307 |
| Gain on sale of securities | (1,052,223) | (408,795) |
| Contribution of treasury stock to KSOP plan | 306,250 | 315,045 |
| Deferred income tax benefit | (598,617) | (161,946) |
| Accretion on acquired loans | (348,822) | (429,084) |
| Amortization of deferred loan costs and fees, net | 54,427 | (497,829) |
| Origination of loans held-for-sale | (389,787,020) | (206,728,559) |
| Proceeds from sale of loans held-for-sale | 362,169,517 | 204,696,002 |
| Net gain on sale of loans | (4,154,094) | (1,947,916) |
| Increase in cash surrender value of BOLI | (506,821) | (240,781) |
| Increase in accrued interest receivable | (742,565) | (299,675) |
| Increase (decrease) in accrued interest payable | (68,001) | 22,427 |
| (Increase) decrease in other assets and right of use operating lease asset | 756,603 | (1,013,350) |
| Increase (decrease) in other liabilities and operating lease liability | 743,892 | (115,517) |
| Net cash (used in) provided by operating activities | (22,740,615) | 1,696,596 |
| **Investing activities:** | | |
| Purchase of securities available-for-sale | (88,907,268) | (62,324,052) |
| Proceeds from sales of securities available-for-sale | 37,255,382 | 34,150,206 |
| Proceeds from maturities, calls, and paydowns of securities available-for-sale | 6,790,901 | 3,590,281 |
| (Purchases) sales of nonmarketable equity securities | (79,300) | 188,800 |
| Net increase in loans to customers | (110,976,518) | (43,732,357) |
| Purchases of premises, furniture and equipment | (911,259) | (5,369,386) |
| Purchase of BOLI | (11,000,000) | (2,000,000) |
| Net cash used by investing activities | (167,828,062) | (75,496,508) |
| **Financing activities:** | | |
| Increase in noninterest-bearing deposits | 88,852,457 | 12,434,955 |
| Increase in interest-bearing deposits | 129,194,586 | 74,033,109 |
| Proceeds from Federal Home Loan Bank Advances | - | 20,000,000 |
| Repayments of Federal Home Loan Bank Advances | - | (25,000,000) |
| Decrease in federal funds purchased | - | (10,453,000) |
| Proceeds from exercise of stock options | - | 688,447 |
| Purchase of treasury stock | (500,000) | - |
| Net cash provided by financing activities | 217,547,043 | 71,703,511 |
| **Net increase (decrease) in cash and cash equivalents** | 26,978,366 | (2,096,401) |
| **Cash and cash equivalents, beginning of year** | 13,704,077 | 15,800,478 |
| **Cash and cash equivalents, end of year** | $ 40,682,443 | $ 13,704,077 |
| **Cash paid during the year for:** | | |
| Interest | $ 3,624,543 | $ 5,406,692 |
| Income taxes | 1,980,000 | 1,463,000 |
| **Noncash investing and financing activities:** | | |
| Unrealized gain on securities available-for-sale | 3,214,737 | 2,456,801 |
| Establishment of right of use operating lease asset | - | 8,838,765 |
| Establishment of right of use operating lease liability | - | 8,838,765 |

***See Notes to Consolidated Financial Statements***

## Note 1. Summary of Significant Accounting Policies

*Organization:*

South Atlantic Bancshares, Inc. and Subsidiary (the "Company") was incorporated to serve as a bank holding company for its subsidiary, South Atlantic Bank (the "Bank"). The Bank commenced business on November 28, 2007. The principal business activity of the Bank is to provide banking services to domestic markets, principally in Horry, Georgetown, Charleston, and Beaufort counties, South Carolina. The Bank is a state-chartered commercial bank, and its deposits are insured by the Federal Deposit Insurance Corporation. The consolidated financial statements include the accounts of the parent company and its wholly-owned subsidiary after elimination of all significant intercompany balances and transactions. The Company operates as one business segment.

*Management's 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 and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the statements of income for the periods covered. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, including valuation allowances for impaired loans, business combination accounting, including valuation of goodwill and core deposit intangibles, and the valuation of real estate acquired in connection with foreclosures or in satisfaction of loans. In connection with the determination of the allowances for losses on loans and foreclosed real estate, management obtains independent appraisals for significant properties. Management must also make estimates in determining the estimated useful lives and methods for depreciating premises and equipment.

While management uses available information to recognize losses on loans and foreclosed real estate, future additions to the allowances may be necessary based on changes in local economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the Company's allowances for losses on loans and foreclosed real estate. Such agencies may require the Company to recognize additions to the allowances based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the allowances for losses on loans and foreclosed real estate may change materially in the near term.

*Concentrations of credit risk:*

Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of loans receivable, investment securities, federal funds sold and amounts due from banks.

The Company makes loans to individuals and small businesses for various personal and commercial purposes primarily in Horry, Georgetown, Charleston, and Beaufort counties in South Carolina. Additionally, management is not aware of any concentrations of loans to classes of borrowers or industries that would be similarly affected by economic conditions.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Concentrations of credit risk, continued:*

In addition to monitoring potential concentrations of loans to particular borrowers or groups of borrowers, industries and geographic regions, management monitors exposure to credit risk from concentrations of lending products and practices such as loans that subject borrowers to substantial payment increases (e.g. principal deferral periods, loans with initial interest-only periods, etc.), and loans with high loan-to-value ratios. Management has determined that there is no concentration of credit risk associated with its lending policies or practices. Additionally, there are industry practices that could subject the Company to increased credit risk should economic conditions change over the course of a loan's life. However, to offset this risk, the Company makes variable rate loans and fixed rate principal-amortizing loans with maturities prior to the loan being fully amortized (i.e. balloon payment loans usually five to seven years). These loans are underwritten and monitored to manage the associated risks. Therefore, management believes that these particular practices do not subject the Company to unusual credit risk.

The Company's investment portfolio consists principally of obligations of the United States, its agencies or its corporations and general obligation municipals. In the opinion of management, there is no concentration of credit risk in its investment portfolio. The Company places its deposits and correspondent accounts with and sells its federal funds to high quality institutions. Management believes credit risk associated with correspondent accounts is not significant.

*Cash and cash equivalents:*

Cash and cash equivalents consist of cash and due from banks and interest-bearing cash with banks. Cash and cash equivalents have maturities of three months or less. Accordingly, the carrying amount of such instruments is considered a reasonable estimate of fair value. As of December 31, 2019, the Company was required by regulation to maintain an average cash reserve balance based on a percentage of deposits. The amounts of these reserve balances at December 31, 2019 was approximately $1,730,000 and the reserve requirement was satisfied by cash held at the Bank. During 2020, the cash and cash equivalents requirement was eliminated with no plans to reinstate the requirement.

*Securities available-for-sale:*

Securities available-for-sale are carried at amortized cost and adjusted to estimated market value by recognizing the aggregate unrealized gains or losses in a valuation account. Aggregate market valuation adjustments are recorded in shareholders' equity net of deferred income taxes. Reductions in market value considered by management to be other than temporary are reported as a realized loss and a reduction in the cost basis of the security. The adjusted cost basis of investments available-for-sale is determined by specific identification and is used in computing the gain or loss upon sale.

Interest income includes amortization of purchase premium or discount. Premiums and discounts on securities are amortized on the level-yield method without anticipating prepayments, except for mortgage-backed securities where prepayments are anticipated. Gains and losses on sale are recorded on the trade date and determined using the specific identification method.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Nonmarketable equity securities:*

Nonmarketable equity securities include the cost of the Company's investment in the stock of the Federal Home Loan Bank. The stock has no quoted market value and no ready market exists. Investment in Federal Home Loan Bank stock is a condition of borrowing from the Federal Home Loan Bank. At December 31, 2020 and 2019, the investment in Federal Home Loan Bank stock was $643,000 and $563,700, respectively. Dividends received on the stock are included in interest income.

*Mortgage loans held-for-sale:*

The Bank's mortgage activities are comprised of accepting residential mortgage loan applications, qualifying borrowers to standards established by investors, funding residential mortgages, and selling mortgages to investors under pre-existing commitments. The commitments to originate fixed rate mortgage loans and the commitments to sell these loans to a third party are both derivative contracts. The fair value of these derivative contracts is immaterial and has no effect on the recorded amounts in the financial statements. Funded residential mortgages held temporarily for sale to investors are recorded at the lower of cost or estimated market value. Application and origination fees collected by the Bank are recognized as income upon sale to the investor.

*Loans receivable:*

Loans are stated at their unpaid principal balance adjusted for any unamortized deferred fees and costs. Interest income is accrued on the unpaid principal balance using the simple interest method and is recorded in the period earned.

When serious doubt exists as to the collectability of a loan or when a loan becomes contractually 90 days past due as to principal or interest, interest income is generally discontinued unless the estimated net realizable value of collateral exceeds the principal balance and accrued interest. When interest accruals are discontinued, income earned but not collected is reversed.

Loan origination and commitment fees and certain direct loan origination costs (principally salaries and employee benefits) are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using a method that approximates a level yield.

The Company identifies impaired loans through its normal internal loan review process. Loans on the Company's problem loan watch list are considered potentially impaired loans. These loans are evaluated in determining whether all outstanding principal and interest are expected to be collected. Loans are not considered impaired if a minimal payment delay occurs and all amounts due, including accrued interest at the contractual interest rate for the period of delay, are expected to be collected.

Impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or fair value of the collateral less estimated selling costs if the loan is collateral dependent. Impairment is recorded as a specific reserve within the allowance for loan losses.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Troubled debt restructurings (TDRs):*

The Company designates loan modifications as TDRs when, for economic or legal reasons related to the borrower's financial difficulties, it grants a concession to the borrower that it would not otherwise consider. Loans on nonaccrual status at the date of modification are initially classified as nonaccrual TDRs. Loans on accruing status at the date of modification are initially classified as accruing TDRs at the date of modification, if the note is reasonably assured of repayment and performance is in accordance with its modified terms. Such loans may be designated as nonaccrual loans subsequent to the modification date if reasonable doubt exists as to the collection of interest or principal under the restructuring agreement. Nonaccrual TDRs are returned to accrual status when there is economic substance to the restructuring, there is well documented credit valuation of the borrower's financial condition, the remaining balance is reasonably assured of repayment in accordance with its modified terms, and the borrower has demonstrated repayment performance in accordance with the modified terms for a reasonable period of time (generally a minimum of six months).

*Allowance for loan losses:*

The allowance for loan losses is based on management's ongoing evaluation of the loan portfolio and reflects an amount that, in management's opinion, is adequate to absorb losses in the existing portfolio. In evaluating the portfolio, management takes into consideration numerous factors, including current economic conditions, prior loan loss experience, the composition of the loan portfolio, and management's estimate of anticipated credit losses. The provision for loan losses charged to operating expenses reflects the amount deemed appropriate by management to establish an adequate reserve to meet the probable loan losses present in the current portfolio. An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. 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. Loans that are determined to be uncollectable are charged against the allowance. Provisions for loan losses and recoveries on loans previously charged off are added to the allowance.

While management uses the best information available to make evaluations, future adjustments may be necessary if economic conditions differ substantially from the assumptions used in making the evaluation. The allowance for loan losses is subject to periodic evaluation by various regulatory authorities and may be subject to adjustment upon their examination.

*Business combinations and method of accounting for loans acquired:*

The Company accounts for its acquisitions under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805, Business Combinations, which requires the use of the acquisition method of accounting. All identifiable assets acquired, including loans, are recorded at fair value. No allowance for loan losses related to the acquired loans is recorded on the acquisition date because the fair value of the loans acquired incorporates assumptions regarding credit risk. As provided for under GAAP, management has up to twelve months following the date of the acquisition to finalize the fair values of acquired assets and assumed liabilities. Once management has finalized the fair values of acquired assets and assumed liabilities within this twelve month period, management considers such values to be the Day 1 fair values (Day 1 Fair Values).

**Note 1. Summary of Significant Accounting Policies, Continued**

*Business combinations and method of accounting for loans acquired, continued:*

There are two methods to account for acquired loans as part of a business combination. Acquired loans that contain evidence of credit deterioration on the date of purchase are carried at the net present value of expected future proceeds in accordance with ASC 310-30. All other acquired loans are recorded at their initial fair value, adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and any other adjustment to carrying value in accordance with ASC 310-20.

In determining the Day 1 Fair Values of acquired loans without evidence of credit deterioration at the date of acquisition, management includes (i) no carryover of any previously recorded allowance for loan losses and (ii) an adjustment of the unpaid principal balance to reflect an appropriate market rate of interest, given the risk profile and grade assigned to each loan. This adjustment will be accreted into earnings as a yield adjustment, using the effective yield method, over the remaining life of each loan.

To the extent that current information indicates it is probable that the Company will collect all amounts according to the contractual terms thereof, such loan is not considered impaired and is not considered in the determination of the required allowance for loan losses. To the extent that current information indicates it is probable that the Company will not be able to collect all amounts according to the contractual terms thereon, such loan is considered impaired and is considered in the determination of the required level of allowance for loan and lease losses.

Subsequent to the acquisition date, increases in cash flows expected to be received in excess of the Company's initial estimates are reclassified from nonaccretable difference to accretable yield and are accreted into interest income on a level-yield basis over the remaining life of the loan. Decreases in cash flows expected to be collected are recognized as impairment through the provision for loan losses.

*Goodwill and core deposit intangible:*

In connection with business combinations, the Company records core deposit intangibles, representing the value of the acquired core deposit base. Core deposit intangibles are amortized over their estimated useful lives ranging up to 10 years.

Goodwill represents the excess of the purchase price over the fair value of the net identifiable assets acquired in a business combination. The Company reviews the carrying value of goodwill on an annual basis and on an interim basis if certain events or circumstances indicate that an impairment loss may have been incurred. An impairment charge is recognized if the carrying value of the reporting unit's goodwill exceeds it's implied fair value. During the fourth quarter of 2020, as a result of market volatility caused by the COVID-19 pandemic, the Company determined that it did not satisfy the more likely than not qualitative assessment that the fair value of the reporting unit exceeded its carrying value, including goodwill. As a result, the Company elected to perform a quantitative assessment in which the fair value of the reporting unit exceeded its carrying value, resulting in no impairment.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Premises and equipment:*

Premises, furniture and equipment are stated at cost, less accumulated depreciation. Depreciation expense is computed by the straight-line method, based on the estimated useful lives for buildings and improvements of 40 years, for furniture and equipment of five to 10 years and for software of three years. Leasehold improvements are amortized over the life of each respective lease. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the income statement when incurred. Maintenance and repairs are charged to current expense. The costs of major renewals and improvements are capitalized.

*Other real estate owned:*

Other real estate owned includes real estate acquired through foreclosure. Other real estate owned is initially recorded at fair value at the date of foreclosure less estimated costs of disposal, which establishes a new cost. Any write-down to fair value at the time of transfer to foreclosed assets is charged to the allowance for loan losses. After foreclosure, valuations are periodically performed by management and are carried at the lower of cost or fair value less estimated costs of disposal. Property is evaluated regularly to ensure the recorded amount is supported by its current fair value and valuation allowances to reduce the carrying amount to fair value less estimated costs to dispose are recorded as necessary. Revenue and expense from the operations of foreclosed assets and changes in the valuation allowances are included in net expenses from foreclosed assets in other operating expenses.

*Income taxes:*

The Company accounts for income taxes in accordance with ASC 740, Income Taxes. Under ASC 740, deferred tax assets or liabilities are computed based upon the difference between financial statement and income tax bases of assets and liabilities using the enacted marginal tax rate. The Company has provided a valuation allowance on its net deferred tax assets where it is more likely than not such assets will not be realized.

The Company recognizes the tax benefit from an uncertain tax position only if it is more likely than not the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon settlement. See Note 10 Income Taxes for additional information. The Company records any penalties and interest attributed to uncertain tax positions as a component of income tax expense.

*Advertising expense:*

Advertising and public relations costs are generally expensed as incurred. External costs incurred in producing media advertising are expensed the first time the advertising takes place. External costs relating to direct mailing costs are expensed in the period in which the direct mailings are sent.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Income per share:*

Basic income per share represents income available to shareholders divided by the weighted-average number of common shares outstanding during the period. Dilutive income per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. The only potential common share equivalents are those related to stock options and warrants. Stock options and warrants which are anti-dilutive are excluded from the calculation of diluted net income per share. The dilutive effect of options and warrants outstanding under the Company's stock compensation plan is reflected in diluted earnings per share by the application of the treasury stock method. Retroactive recognition has been given for the effects of all stock dividends.

*Stock-based compensation:*

The Company accounts for stock options and warrants under the fair value recognition provisions of FASB ASC 718, Stock Based Compensation. Compensation expense is recognized as salaries and benefits in the consolidated statements of income.

*Merchant fee income:*

Merchant fee income represents fees received by the Bank related to credit card processing. These fees are recorded on the accrual basis of accounting.

*Statement of cash flows:*

For purposes of reporting cash flows in the financial statements, the Company considers certain highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Cash equivalents include amounts due from banks, federal funds sold, and interest-bearing deposits. Generally, federal funds are sold for one-day periods.

Changes in the valuation account of securities available-for-sale, including the deferred tax effects, are considered non-cash transactions for purposes of the statement of cash flows and are presented in detail in the notes to the consolidated financial statements.

*Off-balance-sheet financial instruments:*

In the ordinary course of business, the Company enters into off-balance-sheet financial instruments consisting of commitments to extend credit and letters of credit. These financial instruments are recorded in the financial statements when they become payable by the customer.

*Reclassifications:*

Certain prior year amounts have been reclassified to conform with the current year presentation. These reclassifications had no effect on the previously reported results of operations or shareholders’ equity.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Recently adopted accounting pronouncements*

In March 2016, the FASB amended the Revenue from Contracts with Customers topic of the Accounting Standards Codification to clarify the implementation guidance on principal versus agent considerations. The updates to the principal versus agent guidance: (i) require an entity to determine whether it is a principal or an agent for each distinct good or service (or a distinct bundle of goods or services) to be provided to the customer; (ii) illustrate how an entity that is a principal might apply the control principle to goods, services, or rights to services, when another party is involved in providing goods or services to a customer and (iii) clarify that the purpose of certain specific control indicators is to support or assist in the assessment of whether an entity controls a good or service before it is transferred to the customer, provide more specific guidance on how the indicators should be considered, and clarify that their relevance will vary depending on the facts and circumstances. The Company's revenue is primarily comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and non-interest income. A description of the Company's revenue streams accounted for under ASC 606, Revenue from contracts with customers follows:

*Service charges on deposit accounts:* The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer's account balance.

*Debit card income:* The Company earns interchange fees from debit cardholder transactions conducted through payment networks. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, with the transaction processing services provided to the cardholder. Fees are recognized on a daily basis.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). ASU 2016-02 applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. For leases with a term of 12 months or less, a practical expedient is available whereby a lessee may elect, by class of underlying asset, not to recognize an ROU asset or lease liability. At inception, lessees must classify all leases as either finance or operating. The Company adopted the guidance using the modified retrospective approach on January 1, 2019 and elected the practical expedients for transition including the transition option provided in ASU 2018-11. The practical expedients allow the Company to largely account for existing operating leases consistent with current guidance except for the incremental balance sheet recognition for leases. The adoption of ASU 2016-02 resulted in the recognition of right-of-use assets and lease liabilities totaling $8.8 million on January 1, 2019. As of December 31, 2020 and 2019, the balance was $7.8 million and $8.2 million, respectively.

**Note 1. Summary of Significant Accounting Policies, Continued**

Recently issued accounting pronouncements:

In January 2017, the FASB amended the Goodwill and Other Topic of the Accounting Standards Codification to simplify the accounting for goodwill impairment for public business entities and other entities that have goodwill reported in their financial statements and have not elected the private company alternative for the subsequent measurement of goodwill. The amendment removes Step 2 of the goodwill impairment test. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The effective date and transition requirements for the technical corrections will be effective for the Company for reporting periods beginning after December 15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted this guidance as of January 1, 2020. The amendments did not have a material effect on the Company's financial statements.

In June 2016, the FASB issued guidance to change the accounting for credit losses and modify the impairment model for certain debt securities. The amendments will be effective for the Company for reporting periods beginning after December 15, 2022. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company will apply the amendments to the ASU through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. The Company is evaluating the impact of the ASU on the consolidated financial statements. In addition to the allowance for loan losses, the Company will also record an allowance for credit losses on 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 2018, the FASB issued guidance to amend the Financial Instruments—Credit Losses topic of the Accounting Standards Codification. The guidance aligns the implementation date of the topic for annual financial statements of nonpublic companies with the implementation date for their interim financial statements. The guidance also clarifies that receivables arising from operating leases are not within the scope of the topic, but rather, should be accounted for in accordance with the leases topic. The amendments will be effective for the Company for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. Early adoption is permitted for all organizations for periods beginning after December 15, 2018. The Company is currently in the process of evaluating the impact of adoption of this guidance on its financial statements.

In November 2019, the FASB issued guidance that addresses issues raised by stakeholders during the implementation of ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The amendments affect a variety of Topics in the Accounting Standards Codification. For entities that have not yet adopted the amendments in ASU 2016-13, the amendments are effective for fiscal years beginning after December 15, 2022 including interim periods within those fiscal years. The Company is currently evaluating the impact of adoption of this guidance on its financial statements.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Recently issued accounting pronouncements, continued:*

In December 2019, the FASB issued guidance to simplify accounting for income taxes by removing specific technical exceptions that often produce information investors have a hard time understanding. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. The amendments are effective for fiscal years beginning after December 15, 2021, and interim periods within annual reporting periods beginning after December 15, 2022. Early adoption is permitted. The Company does not expect these amendments to have a material effect on its financial statements.

In March 2020, the FASB issued guidance that makes narrow-scope improvements to various aspects of the financial instrument guidance, including the current expected credit losses (CECL) guidance issued in 2016. The amendments related to conforming amendments: For public business entities, the amendments are effective upon issuance of this final ASU. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years beginning after December 15, 2020. Early application is permitted. The effective date of the amendments to ASU 2016-01 is for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. All other entities should adopt the amendments in ASU 2016-13 during 2023. Early adoption will continue to be permitted. For entities that have not yet adopted the guidance in ASU 2016-13, the effective dates and the transition requirements for these amendments are the same as the effective date and transition requirements in ASU 2016- 13. The impact of these amendments did not have a material effect on the Company’s financial statements.

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

*Risks and uncertainties:*

In the normal course of its business, the Company encounters two significant types of risks: economic and regulatory. There are three main components of economic risk: interest rate risk, credit risk, and market risk. The Company is subject to interest rate risk to the degree that its interest-bearing liabilities mature or reprice at different speeds, or on different basis, than its interest-earning assets. Credit risk is the risk of default on the Company's loan portfolio that results from a borrower's inability or unwillingness to make contractually required payments. Market risk reflects changes in the value of collateral underlying loans receivable and the valuation of real estate held by the Company.

The Company is subject to the regulations of various governmental agencies. These regulations can and do change significantly from period to period. The Company also undergoes periodic examinations by the regulatory agencies, which may subject it to further changes with respect to asset valuations, amounts of required loss allowances and operating restrictions from the regulators' judgments based on information available to them at the time of their examination.

**Note 1. Summary of Significant Accounting Policies, Continued**

*Risks and uncertainties, continued:*

The 2019 novel coronavirus (or "COVID-19") has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. Following the COVID-19 outbreak in December 2019 and January 2020, market interest rates declined significantly. The federal banking agencies encouraged financial institutions to prudently work with borrowers and passed legislation to provide relief from reporting loan classifications due to modifications related to the COVID-19 outbreak. The spread of COVID-19 has caused us to modify our business practices, including employee travel, employee work locations, and cancellation of physical participation in meetings, events and conferences. The rapid development and fluidity of this situation precludes any predication as to the ultimate impact of the COVID-19 outbreak. Nevertheless, the outbreak presents uncertainty and risk with respect to the Company, its performance, and its financial results.

**Note 2. Core Deposit Intangibles**

In connection with prior business combinations, the Company recorded core deposit intangibles, representing the value of the acquired core deposit base. As of December 31, 2020 and 2019, respectively, core deposit intangible was $859,454 and $1,111,364. The estimated future amortization is subject to change to the extent management determines it is necessary to make adjustments to the carrying value or estimated useful life of the core deposit intangibles.

Amortization expense for core deposit intangible is expected to be as follows.

| | |
|---|---|
| Year 1 | $ 219,579 |
| Year 2 | 187,248 |
| Year 3 | 154,917 |
| Year 4 | 122,587 |
| Year 5 | 90,256 |
| Thereafter | 84,867 |
| Total | $ 859,454 |

Amortization expense of $251,910 and $284,238 related to the core deposit intangible was recognized in 2020 and 2019, respectively.

## Note 3. Investment Securities

The amortized cost and estimated fair values of securities available-for-sale were:

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Mortgage-backed securities | $ 28,754,807 | $ 1,003,356 | $ 19,995 | $ 29,738,168 |
| SBA loan pools | 7,059,649 | 165,186 | 10,306 | 7,214,529 |
| SBA asset-backed securities | 17,766,983 | 521,806 | 650 | 18,288,139 |
| Obligations of state and local governments | 60,516,565 | 3,260,269 | 233,869 | 63,542,964 |
| Corporate debt securities | 6,400,000 | 87,762 | 42,896 | 6,444,866 |
| | $ 120,498,004 | $ 5,038,379 | $ 307,716 | $ 125,228,667 |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Mortgage-backed securities | $ 46,712,414 | $ 576,907 | $ 175,836 | $ 47,113,485 |
| SBA loan pools | 8,164,285 | 149,693 | 40,829 | 8,273,149 |
| SBA asset-backed securities | 1,760,847 | 19,003 | – | 1,779,850 |
| Obligations of state and local governments | 11,845,088 | 1,027,227 | 42,739 | 12,829,576 |
| Corporate debt securities | 6,400,000 | 2,500 | – | 6,402,500 |
| | $ 74,882,634 | $ 1,775,330 | $ 259,404 | $ 76,398,560 |

The following is a summary of maturities of securities available-for-sale as of December 31, 2020. The amortized cost and estimated fair values are based on the contractual maturity dates except for mortgage-backed securities, which may mature earlier than their contractual maturity dates due to principal prepayments.

| | Securities Available-for-Sale | |
|---|---|---|
| | Amortized Cost | Estimated Fair Value |
| Due after one year but within five years | $ 7,824,610 | $ 7,999,616 |
| Due after five years but within ten years | 77,121,709 | 79,304,145 |
| Due after ten years | 6,796,878 | 8,186,738 |
| Mortgage-backed securities | 28,754,807 | 29,738,168 |
| Total | $ 120,498,004 | $125,228,667 |

**Note 3. Investment Securities, Continued**

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

| | December 31, 2020 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| **Available-for-sale:** | **Fair value** | **Unrealized losses** | **Fair value** | **Unrealized losses** | **Fair value** | **Unrealized losses** |
| Mortgage-backed securities | $ 3,388,481 | $ 19,995 | $ – | $ – | $ 3,388,481 | $ 19,995 |
| SBA loan pools | – | – | 385,501 | 10,306 | 385,501 | 10,306 |
| SBA asset-backed securities | 1,039,586 | 650 | – | – | 1,039,586 | 650 |
| Obligations of state and local governments | 12,026,396 | 233,869 | – | – | 12,026,396 | 233,869 |
| Corporate debt securities | 2,957,104 | 42,896 | – | – | 2,957,104 | 42,896 |
| | $ 19,411,567 | $ 297,410 | $ 385,501 | $ 10,306 | $ 19,797,068 | $ 307,716 |

| | December 31, 2019 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Twelve months or more | | Total | |
| **Available-for-sale:** | **Fair value** | **Unrealized losses** | **Fair value** | **Unrealized losses** | **Fair value** | **Unrealized losses** |
| Mortgage-backed securities | $ 17,893,532 | $ 175,836 | $ – | $ – | $ 17,893,532 | $ 175,836 |
| SBA loan pools | 1,704,169 | 25,370 | 492,309 | 15,459 | 2,196,478 | 40,829 |
| Obligations of state and local governments | 1,871,556 | 42,739 | – | – | 1,871,556 | 42,739 |
| | $ 21,469,257 | $ 243,945 | $ 492,309 | $ 15,459 | $ 21,961,566 | $ 259,404 |

There was one security with an unrealized loss for greater than twelve months at December 31, 2020 and 2019.

Management evaluates securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

In analyzing an issuer's financial condition, management considers whether the securities are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and industry analysts' reports. As management has the ability to hold debt securities until maturity, or for the foreseeable future if classified as available-for-sale, no declines are deemed to be other than temporary.

## Note 3. Investment Securities, Continued

Sales of investment securities available-for-sale for the years ended December 31 are as follows:

| | 2020 | 2019 |
|---|---|---|
| Proceeds | $ 37,255,382 | $ 34,150,206 |
| Realized gains | 1,364,275 | 510,923 |
| Realized losses | 312,052 | 102,128 |
| Total investment securities gains, net | $ 1,052,223 | $ 408,795 |

At December 31, 2020, securities with a book value of $32,548,446 and a fair value of $33,917,280 were pledged to secure a line with Federal Reserve Discount Window. Also, there were two securities with a book value of $1,367,222 and a market value of $1,462,127 pledged to secure public funds. At December 31, 2019, a security with a book value of $313,980 and market value of $383,569 was pledged to secure public funds.

## Note 4. Loans Receivable

Following is a summary of loans by major classification as of December 31:

| | 2020 | 2019 |
|---|---|---|
| **All Loans:** | | |
| Commercial | $ 113,900,921 | $ 44,331,270 |
| Commercial real estate | 415,526,524 | 370,856,416 |
| Consumer | 9,355,637 | 8,619,148 |
| Consumer real estate | 150,189,111 | 151,874,214 |
| Total gross loans receivable | 688,972,193 | 575,681,048 |
| Net unearned origination (fees) costs | (2,078,270) | 40,322 |
| Allowance for loan losses | (6,823,767) | (5,237,127) |
| Loans, net | $ 680,070,156 | $ 570,484,243 |

Loans receivable, net at December 31 for purchased non-credit impaired loans and nonacquired loans are summarized by category as follows:

| | 2020 | 2019 |
|---|---|---|
| **Purchased Non-Credit Impaired Loans (ASC 310-20) and Nonacquired Loans:** | | |
| Commercial | $ 113,891,189 | $ 44,297,887 |
| Commercial real estate | 413,529,386 | 368,943,941 |
| Consumer | 9,346,839 | 8,601,888 |
| Consumer real estate | 149,715,951 | 151,339,676 |
| Total gross loans receivable | 686,483,365 | 573,183,392 |
| Net unearned origination (fees) costs | (2,078,270) | 40,322 |
| Allowance for loan losses | (6,823,767) | (5,237,127) |
| Loans, net | $ 677,581,328 | $ 567,986,587 |

**Note 4. Loans Receivable, Continued**

Loans receivable, net at December 31 for purchased credit impaired loans are summarized by category as follows:

| | 2020 | 2019 |
|---|---|---|
| **Purchased Credit Impaired Loans (ASC 310-30):** | | |
| Commercial | $ 9,732 | $ 33,383 |
| Commercial real estate | 1,997,138 | 1,912,475 |
| Consumer | 8,798 | 17,260 |
| Consumer real estate | 473,160 | 534,538 |
| Total gross loans receivable | 2,488,828 | 2,497,656 |
| Net unearned origination (fees) costs | – | – |
| Allowance for loan losses | – | – |
| Loans, net | $ 2,488,828 | $ 2,497,656 |

Included in the loan totals at December 31, 2020 and 2019 were $14,308,931 and $28,840,720 in purchased loans. No allowance for loan losses related to the purchased loans is recorded on the acquisition date because the fair value of the loans purchased incorporates assumptions regarding credit risk. Subsequent to the purchase date and after any credit discounts have been fully used, the methods utilized to estimate the required allowance for loan losses are the same as originated loans.

There are two methods to account for purchased loans as part of a business combination. Purchased loans that contain evidence of credit deterioration on the date of purchase are carried at the net present value of expected future proceeds in accordance with ASC 310-30 and are considered purchased credit impaired (PCI) loans. All other purchased loans are recorded at their initial fair value, adjusted for subsequent advances, pay downs, amortization or accretion of any premium or discount on purchase, charge-offs and any other adjustment to carrying value in accordance with ASC 310-20.

PCI loans are aggregated into pools of loans based on common risk characteristics such as the type of loan, payment status, or collateral type. The Company estimates the amount and timing of expected cash flows for each purchased loan pool and the expected cash flows in excess of the amount paid are recorded as interest income over the remaining life of the pool (accretable yield). The excess of the pool's contractual principal and interest over expected cash flows is not recorded (nonaccretable difference).

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

At December 31, 2020 and 2019, the outstanding balance and recorded investment of PCI loans was $2.5 million.

The table below presents changes in the value of PCI loans for the year ended December 31, 2020.

| | |
|---|---|
| Balance at the beginning of period | $ 2,497,656 |
| Net reductions for payments, foreclosures, and accretion | 8,828 |
| Balance at end of period, net of allowance for loan losses on PCI loans | $ 2,488,828 |

**Note 4. Loans Receivable, Continued**

The table below presents changes in the value of the accretable yield for PCI loans as of December 31:

| | 2020 | 2019 |
|---|---|---|
| Accretable yield, beginning of period | $ 591,735 | $ 550,171 |
| Additions | – | – |
| Accretion | (352,647) | (250,852) |
| Reclassification from (to) nonaccretable balance, net (a) | 365,441 | (276,761) |
| Other changes, net (b) | 83,725 | 569,177 |
| Accretable yield, end of period | $ 688,254 | $ 591,735 |

(a) Reclassifications from the nonaccretable balance were driven by changes in credit mark, offset by impairment.
(b) Other changes, net include the impact of changes in expectations of cash flows, which may vary from period to period due to the impact of modifications and changes to prepayments assumptions, as well as the impact of changes interest rates on variable loans.

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was signed into law, which established the Paycheck Protection Program (PPP). Under the program, the Small Business Administration (SBA) will forgive loans, in whole or in part, made by approved lenders to eligible borrowers for paycheck and other permitted purposes in accordance with the requirements of the program. These loans carry a fixed rate of 1.00% and a term of two years, if not forgiven, in whole or in part. The loans are 100% guaranteed by the SBA and as long as the borrower submits its loan forgiveness application within ten months of completion of the covered period, the borrower is not required to make any payments until the forgiveness amount is remitted to the lender by the SBA. The Bank received a processing fee ranging from 1% to 5% based on the size of the loan from the SBA. The fees are deferred and amortized over the life of the loans in accordance with ASC 310-20. The Bank received approximately $3.8 million of processing fees and has recognized approximately $1.9 million during the period ended December 31, 2020. The Bank has provided $91.7 million in funding to 1,013 customers through the PPP during 2020.

The SBA began accepting PPP forgiveness applications on August 10, 2020. Borrowers must submit the application within ten months of the completion of the covered period. Once the borrower has submitted the application, the Bank has 60 days to review, issue a lender decision, and submit to the SBA. Once the application is submitted, the SBA has 90 days to review and remit the appropriate forgiveness amount to the Bank plus any interest accrued through the date of payment. As of December 31, 2020, the Bank has processed 178 PPP forgiveness applications with a total loan balance of approximately $18.3 million. As of December 31, 2020, the Bank has $73.4 million of PPP loans that remain outstanding.

Regulatory agencies, as set forth in the Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (initially issued on March 22, 2020 and revised on April 7, 2020), have encouraged financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. This guidance allows banks to elect not to categorize loan modifications as troubled debt restructurings (TDRs) if the modifications are related to COVID-19, executed on a loan that was not more than 30 days past due as of December 31, 2019, and executed between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the date of termination of the National Emergency. All short term loan modifications made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not considered TDRs.

## Note 4. Loans Receivable, Continued

Beginning in March 2020, the Bank provided payment accommodations to customers, consisting of real estate, food service, entertainment & recreation and construction loans, to borrowers negatively impacted by COVID-19. The Bank processed principal deferments to 92 customers, with an aggregate loan balance of $66.2 million, during the period ending December 31, 2020. The principal deferments represent 9.6% of the Bank's total loan portfolio as of December 31, 2020. Borrowers current prior to relief, who were not experiencing financial difficulty prior to COVID-19, were determined not to be considered TDRs. Additionally, of the 92 customers that received payment accommodations, only 5 customers are still in deferral as of December 31, 2020, with an aggregate loan balance of $5.7 million.

The following is a summary of information pertaining to our allowance for loan losses (by purpose code) as of and for the year ended December 31, 2020. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| | Commercial | Commercial Real Estate | Consumer | Consumer Real Estate | Total |
|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | |
| Beginning balance | $ 440,497 | $ 3,362,726 | $ 76,914 | $ 1,356,990 | $ 5,237,127 |
| Charge-offs | 24,061 | – | 6,313 | 89,286 | 119,660 |
| Recoveries | 14,739 | 1,600 | 2,229 | 2,732 | 21,300 |
| Provisions | 140,491 | 1,184,842 | 29,682 | 329,985 | 1,685,000 |
| Ending balance | $ 571,666 | $ 4,549,168 | $ 102,512 | $ 1,600,421 | $ 6,823,767 |
| Ending balances: | | | | | |
| Individually evaluated for impairment | $ – | $ – | $ 6,377 | $ – | $ 6,377 |
| Collectively evaluated for impairment | $ 571,666 | $ 4,549,168 | $ 96,135 | $ 1,600,421 | $ 6,817,390 |
| **Loans receivable:** | | | | | |
| Ending balance – total | $ 113,900,921 | $ 415,526,524 | $ 9,355,637 | $ 150,189,111 | $ 688,972,193 |
| Ending balances: | | | | | |
| Individually evaluated for impairment | $ 15,533 | $ – | $ 27,695 | $ 47,873 | $ 91,101 |
| Collectively evaluated for impairment | $ 113,885,388 | $ 415,526,524 | $ 9,327,942 | $ 150,141,238 | $ 688,881,092 |
| Purchased credit impaired loans | $ 9,732 | $ 1,997,138 | $ 8,798 | $ 473,160 | $ 2,488,828 |

## Note 4. Loans Receivable, Continued

The following is a summary of information pertaining to our allowance for loan losses (by purpose code) as of and for the year ended December 31, 2019. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

| | Commercial | Commercial Real Estate | Consumer | Consumer Real Estate | Total |
|---|---|---|---|---|---|
| **Allowance for loan losses:** | | | | | |
| Beginning balance | $ 385,067 | $ 2,688,777 | $ 67,332 | $ 1,258,769 | $ 4,399,945 |
| Charge-offs | – | – | (7,982) | – | (7,982) |
| Recoveries | 21,200 | 2,239 | 10,558 | 1,167 | 35,164 |
| Provisions | 34,230 | 671,710 | 7,006 | 97,054 | 810,000 |
| Ending balance | $ 440,497 | $ 3,362,726 | $ 76,914 | $ 1,356,990 | $ 5,237,127 |
| Ending balances: | | | | | |
| Individually evaluated for impairment | $ 23,996 | $ – | $ 6,097 | $ – | $ 30,093 |
| Collectively evaluated for impairment | $ 416,501 | $ 3,362,726 | $ 70,817 | $ 1,356,990 | $ 5,207,034 |
| **Loans receivable:** | | | | | |
| Ending balance – total | $ 44,331,270 | $ 370,856,416 | $ 8,619,148 | $ 151,874,214 | $ 575,681,048 |
| Ending balances: | | | | | |
| Individually evaluated for impairment | $ 23,996 | $ 4,360 | $ 32,518 | $ 593,809 | $ 654,683 |
| Collectively evaluated for impairment | $ 44,307,274 | $ 370,852,056 | $ 8,586,630 | $ 151,280,405 | $ 575,026,365 |
| Purchased credit impaired loans | $ 33,383 | $ 1,912,475 | $ 17,260 | $ 534,538 | $ 2,497,656 |

### Credit Quality Indicators

Loans are categorized into risk categories based on relevant information about the ability of borrowers to service their debt, such as: current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The following definitions are utilized for risk ratings, which are consistent with the definitions used in supervisory guidance:

***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 substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.

***Loss*** – Loans classified as loss are considered uncollectable.

## Note 4. Loans Receivable, Continued

Loans not meeting the criteria above that are analyzed individually as part of the above-described process are considered to be pass-rated loans.

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2020:

| All Loans: | Commercial | Commercial Real Estate | Consumer | Consumer Real Estate | Total |
|---|---|---|---|---|---|
| **Grade:** | | | | | |
| Pass | $ 113,863,326 | $ 414,554,638 | $ 9,310,703 | $ 149,224,159 | $ 686,952,826 |
| Special mention | 13,165 | 535,101 | 16,239 | 406,782 | 971,287 |
| Substandard | 24,430 | 436,785 | 28,695 | 558,170 | 1,048,080 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 113,900,921 | $ 415,526,524 | $ 9,355,637 | $ 150,189,111 | $ 688,972,193 |
| **Purchased non-credit impaired loans (ASC 310-20) and nonacquired loans:** | | | | | |
| **Grade:** | | | | | |
| Pass | $ 113,863,326 | $ 413,058,576 | $ 9,301,905 | $ 148,966,496 | $ 685,190,303 |
| Special mention | 3,433 | 323,307 | 16,239 | 255,698 | 598,677 |
| Substandard | 24,430 | 147,503 | 28,695 | 493,757 | 694,385 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 113,891,189 | $ 413,529,386 | $ 9,346,839 | $ 149,715,951 | $ 686,483,365 |
| **Purchased credit impaired loans (ASC 310-30):** | | | | | |
| **Grade:** | | | | | |
| Pass | $ – | $ 1,496,062 | $ 8,798 | $ 257,663 | $ 1,762,523 |
| Special mention | 9,732 | 211,794 | – | 151,084 | 372,610 |
| Substandard | – | 289,282 | – | 64,413 | 353,695 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 9,732 | $ 1,997,138 | $ 8,798 | $ 473,160 | $ 2,488,828 |

## Note 4. Loans Receivable, Continued

The following is an analysis of our loan portfolio by credit quality indicators at December 31, 2019:

| **All Loans:** | **Commercial** | **Commercial Real Estate** | **Consumer** | **Consumer Real Estate** | **Total** |
|---|---|---|---|---|---|
| **Grade:** | | | | | |
| Pass | $ 44,268,704 | $ 369,358,321 | $ 8,569,228 | $ 150,766,423 | $ 572,962,676 |
| Special mention | 18,379 | 1,413,981 | 17,402 | 397,404 | 1,847,166 |
| Substandard | 44,187 | 84,114 | 32,518 | 710,387 | 871,206 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 44,331,270 | $ 370,856,416 | $ 8,619,148 | $ 151,874,214 | $ 575,681,048 |

| **Purchased non-credit impaired loans (ASC 310-20) and nonacquired loans:** | **Commercial** | **Commercial Real Estate** | **Consumer** | **Consumer Real Estate** | **Total** |
|---|---|---|---|---|---|
| **Grade:** | | | | | |
| Pass | $ 44,262,064 | $ 367,684,090 | $ 8,551,968 | $ 150,461,437 | $ 570,959,559 |
| Special mention | 2,704 | 1,175,737 | 17,402 | 245,620 | 1,441,463 |
| Substandard | 33,119 | 84,114 | 32,518 | 632,619 | 782,370 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 44,297,887 | $ 368,943,941 | $ 8,601,888 | $ 151,339,676 | $ 573,183,392 |

| **Purchased credit impaired loans (ASC 310-30):** | | | | | |
|---|---|---|---|---|---|
| **Grade:** | | | | | |
| Pass | $ 6,640 | $ 1,674,231 | $ 17,260 | $ 304,986 | $ 2,003,117 |
| Special mention | 15,675 | 238,244 | – | 151,784 | 405,703 |
| Substandard | 11,068 | – | – | 77,768 | 88,836 |
| Doubtful | – | – | – | – | – |
| Loss | – | – | – | – | – |
| Total | $ 33,383 | $ 1,912,475 | $ 17,260 | $ 534,538 | $ 2,497,656 |

## Note 4. Loans Receivable, Continued

The following is a past due aging analysis of our loan portfolio at December 31, 2020:

| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| **All Loans:** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 113,900,921 | $ 113,900,921 | $ – |
| Commercial real estate | – | – | 193,158 | 193,158 | 415,333,366 | 415,526,524 | – |
| Consumer | – | – | – | – | 9,355,637 | 9,355,637 | – |
| Consumer real estate | – | – | – | – | 150,189,111 | 150,189,111 | – |
| Total | $ – | $ – | $ 193,158 | $ 193,158 | $ 688,779,035 | $ 688,972,193 | $ – |
| **Purchased non-credit impaired Loans (ASC 310-20) and nonacquired loans:** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 113,891,189 | $ 113,891,189 | $ – |
| Commercial real estate | – | – | – | – | 413,529,386 | 413,529,386 | – |
| Consumer | – | – | – | – | 9,346,839 | 9,346,839 | – |
| Consumer real estate | – | – | – | – | 149,715,951 | 149,715,951 | – |
| Total | $ – | $ – | $ – | $ – | $ 686,483,365 | $ 686,483,365 | $ – |
| **Purchased credit impaired loans (ASC 310-30):** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 9,732 | $ 9,732 | $ – |
| Commercial real estate | – | – | 193,158 | 193,158 | 1,803,980 | 1,997,138 | – |
| Consumer | – | – | – | – | 8,798 | 8,798 | – |
| Consumer real estate | – | – | – | – | 473,160 | 473,160 | – |
| Total | $ – | $ – | $ 193,158 | $ 193,158 | $ 2,295,670 | $ 2,488,828 | $ – |

## Note 4. Loans Receivable, Continued

The following is a past due aging analysis of our loan portfolio at December 31, 2019:

| | 30 - 59 Days Past Due | 60 - 89 Days Past Due | Greater Than 90 Days | Total Past Due | Current | Total Loans Receivable | Recorded Investment > 90 Days and Accruing |
|---|---|---|---|---|---|---|---|
| **All Loans:** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 44,331,270 | $ 44,331,270 | $ – |
| Commercial real estate | – | – | – | – | 370,856,416 | 370,856,416 | – |
| Consumer | – | – | – | – | 8,619,148 | 8,619,148 | – |
| Consumer real estate | – | – | 530,577 | 530,577 | 151,343,637 | 151,874,214 | – |
| Total | $ – | $ – | $ 530,577 | $ 530,577 | $ 575,150,471 | $ 575,681,048 | $ – |
| **Purchased non-credit impaired Loans (ASC 310-20) and nonacquired loans:** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 44,297,887 | $ 44,297,887 | $ – |
| Commercial real estate | – | – | – | – | 368,943,941 | 368,943,941 | – |
| Consumer | – | – | – | – | 8,601,888 | 8,601,888 | – |
| Consumer real estate | – | – | 530,577 | 530,577 | 150,809,099 | 151,339,676 | – |
| Total | $ – | $ – | $ 530,577 | $ 530,577 | $ 572,652,815 | $ 573,183,392 | $ – |
| **Purchased credit impaired loans (ASC 310-30):** | | | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ 33,383 | $ 33,383 | $ – |
| Commercial real estate | – | – | – | – | 1,912,475 | 1,912,475 | – |
| Consumer | – | – | – | – | 17,260 | 17,260 | – |
| Consumer real estate | – | – | – | – | 534,538 | 534,538 | – |
| Total | $ – | $ – | $ – | $ – | $ 2,497,656 | $ 2,497,656 | $ – |

The following is an analysis of our impaired loan (including nonaccrual loans) portfolio detailing the related allowance recorded at December 31, 2020:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance needed: | | | | | |
| Commercial | $ 15,533 | $ 15,533 | $ – | $ 17,409 | $ 1,511 |
| Commercial real estate | – | – | – | – | – |
| Consumer | – | – | – | – | – |
| Consumer real estate | 47,873 | 47,873 | – | 54,692 | 1,356 |
| | 63,406 | 63,406 | – | 72,101 | 2,867 |
| With an allowance recorded: | | | | | |
| Commercial | $ – | – | – | – | – |
| Commercial real estate | – | – | – | – | – |
| Consumer | 27,695 | 27,695 | 6,377 | 30,117 | 1,127 |
| Consumer real estate | – | – | – | – | – |
| | 27,695 | 27,695 | 6,377 | 30,117 | 1,127 |
| Total: | | | | | |
| Commercial | $ 15,533 | $ 15,533 | $ – | $ 17,409 | $ 1,511 |
| Commercial real estate | – | – | – | – | – |
| Consumer | 27,695 | 27,695 | 6,377 | 30,117 | 1,127 |
| Consumer real estate | 47,873 | 47,873 | – | 54,692 | 1,356 |
| | $ 91,101 | $ 91,101 | $ 6,377 | $ 102,218 | $ 3,994 |

**Note 4. Loans Receivable, Continued**

The following is an analysis of our impaired loan (including nonaccrual loans) portfolio detailing the related allowance recorded at December 31, 2019:

| | Recorded Investment | Unpaid Principal Balance | Related Allowance | Average Recorded Investment | Interest Income Recognized |
|---|---|---|---|---|---|
| With no related allowance needed: | | | | | |
| Commercial | $ – | $ – | $ – | $ – | $ – |
| Commercial real estate | 4,360 | 4,360 | – | 13,005 | 936 |
| Consumer | – | – | – | – | – |
| Consumer real estate | 593,809 | 593,809 | – | 610,694 | 10,694 |
| | 598,169 | 598,169 | – | 623,699 | 11,630 |
| With an allowance recorded: | | | | | |
| Commercial | $ 23,996 | $ 23,996 | $ 23,996 | $ 25,745 | $ 2,246 |
| Commercial real estate | – | – | – | – | – |
| Consumer | 32,518 | 32,518 | 6,097 | 35,386 | 1,323 |
| Consumer real estate | – | – | – | – | – |
| | 56,514 | 56,514 | 30,093 | 61,131 | 3,569 |
| Total: | | | | | |
| Commercial | $ 23,996 | $ 23,996 | $ 23,996 | $ 25,745 | $ 2,246 |
| Commercial real estate | 4,360 | 4,360 | – | 13,005 | 936 |
| Consumer | 32,518 | 32,518 | 6,097 | 35,386 | 1,323 |
| Consumer real estate | 593,809 | 593,809 | – | 610,694 | 10,694 |
| | $ 654,683 | $ 654,683 | $ 30,093 | $ 684,830 | $ 15,199 |

The following is an analysis of our nonaccrual loan portfolio recorded at December 31:

| | 2020 | 2019 |
|---|---|---|
| Commercial real estate | $ 193,158 | $ – |
| Consumer real estate | – | 530,577 |
| Total | $ 193,158 | $ 530,577 |

The following table summarizes the carrying balance of troubled debt restructurings (TDRs) as of December 31:

| | 2020 | 2019 |
|---|---|---|
| Performing TDRs | $ 91,101 | $ 124,106 |
| Nonperforming TDRs | – | – |
| Total | $ 91,101 | $ 124,106 |

Loans classified as TDRs may be removed from this status for disclosure purposes after a specified period of time if the restructured agreement specifies an interest rate equal to or greater than the rate that the lender was willing to accept at the time of the restructuring for a new loan with comparable risk, the loan is performing in accordance with the terms specified by the restructured agreement, and compliance with certain other requirements.

**Note 4. Loans Receivable, Continued**

During the year ended December 31, 2020, the bank modified one commercial loan that was considered to be a TDR. The loan was originally a commercial line of credit restructured to interest only and lowered payment amount. The pre-modification investment and post-modification investment was $15,533. During the year ended December 31, 2019, there were no new TDRs identified.

No loans previously identified as TDRs went into default (as defined by non-accrual classification) during the year ended December 31, 2020.

**Note 5. Premises, Furniture and Equipment**

Premises, furniture and equipment is summarized as follows as of December 31:

| | 2020 | 2019 |
|---|---|---|
| Land | $ 7,421,993 | $ 7,421,993 |
| Buildings and leasehold improvements | 14,320,630 | 13,450,433 |
| Furniture and equipment | 5,475,805 | 5,112,578 |
| Software | 841,841 | 824,141 |
| Automobile | 32,895 | 32,895 |
| Construction in progress | 278,829 | 827,816 |
| Total | 28,371,993 | 27,669,856 |
| Less accumulated depreciation | 7,998,802 | 7,193,552 |
| Premises, furniture and equipment, net | $ 20,373,191 | $ 20,476,304 |

Depreciation expense for the years ended December 31, 2020 and 2019 was $1,014,372 and $995,977, respectively.

**Note 6. Deposits**

At December 31, 2020, the scheduled maturities of time deposits are as follows:

| | |
|---|---|
| 2021 | $ 87,395,292 |
| 2022 | 12,599,281 |
| 2023 | 5,848,039 |
| 2024 | 17,299,248 |
| 2025 | 636,088 |
| Total | $ 123,777,948 |

The Bank had brokered deposits of $22,008,000 as of December 31, 2020. The Bank had brokered deposits of $5,000,000 as of December 31, 2019.

## Note 7. Advances from Federal Home Loan Bank

As of December 31, 2020, and 2019, respectively, there were no outstanding advances from the Federal Home Loan Bank (FHLB).

Pursuant to collateral agreements with the FHLB, advances are secured by stock in the FHLB and by qualifying first mortgage, home equity lines of credit and commercial real estate loans. As of December 31, 2020, the pledged collateral totaled approximately $34.8 million.

## Note 8. Stock Compensation Plan

The Company has adopted a 2007 Stock Incentive Plan and a 2017 Stock Incentive Plan, under which an aggregate of 659,130 and 575,000 shares of common stock, respectively, have been reserved for issuance as stock options by the Company. The options are granted at an exercise price at least equal to the fair value of the common stock at the date of grant and expire ten years from the date of the grant. The vesting period for option grants will vary based on the timing of the grant. Options that expire without issuance, forfeitures, shares used as partial payment to the Company for the purchase price of the award, or an award settled in cash, including for payroll taxes, are added back to the shares available to be awarded under the plan. As of December 31, 2020, a total of 242 and 554,500 shares were remaining in the plans to be issued.

In connection with the merger of Atlantic Community, the Company assumed the obligations of Atlantic Bancshares, Inc. which included five different Incentive Stock Option plans. As a result, the Company registered an aggregate 115,612 shares of common stock related to these plans. There are no additional shares available to be awarded under any of the Plans. All options were fully vested at the time of the merger.

Activity in the Company's stock option plans is summarized in the following table.

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| Outstanding at January 1, | 237,920 | $ 9.53 | 205,220 | $ 9.05 |
| Granted | – | – | 39,000 | 12.50 |
| Acquired in a merger | – | – | – | – |
| Exercised | – | – | – | – |
| Forfeited/Expired | (6,600) | 10.32 | (6,300) | 12.10 |
| Outstanding at December 31, | 231,320 | $ 9.51 | 237,920 | $ 9.53 |
| Exercisable at December 31, | 196,691 | $ 9.04 | 166,630 | $ 8.66 |

The aggregate intrinsic value of the 231,320 and 237,920 stock options outstanding at December 31, 2020 and 2019 was $646,669 and $732,936, respectively. The aggregate intrinsic value of 196,691 and 166,630 stock options exercisable at December 31, 2020 and 2019 was $636,805 and $658,023, respectively. Intrinsic value represents the amount by which the fair market value of the underlying stock exceeds the exercise price of the stock option.

## Note 8. Stock Compensation Plan, Continued

The following table summarizes information about stock options outstanding under the Company's Plans at December 31:

| | 2020 | 2019 |
|---|---|---|
| Number of options | 231,320 | 237,920 |
| Weighted average remaining life | 6 years | 7 years |
| Weighted average exercise price | $ 9.51 | $ 9.53 |
| High exercise price | $ 14.30 | $ 14.30 |
| Low exercise price | $ 5.10 | $ 5.10 |
| Aggregate intrinsic value | $ 646,669 | $ 732,936 |

During 2020, the Company did not grant any stock options. During 2019, options granted ratably vest over the terms below. The fair value of each option granted was estimated on the date of the grant using the Black-Scholes option pricing, resulting in a total expense of $82,728. The Black-Scholes model with assumptions for stock options granted in 2019 are presented below:

| Grant date | July 18 | July 18 |
|---|---|---|
| Total number of options granted | 25,000 | 14,000 |
| Expected volatility | 20.57% | 20.57% |
| Expected term | 10 years | 10 years |
| Expected dividend | 0.00% | 0.00% |
| Risk-free rate | 2.04% | 2.04% |
| Grant date fair value | 2.298 | 2.298 |
| Vesting | 5 years | 3 years |
| Exercise Price | $12.50 | $12.50 |

As of December 31, 2020, there was $128,826 of total unrecognized compensation cost related to non-vested stock option grants under the plans. The cost is expected to be recognized over a weighted-average period of six years as of December 31, 2020.

## Note 9. Stock Warrants

The organizers of the Company received stock warrants giving them the right to purchase one share of common stock for every share they purchased in the initial offering of the Company's common stock up to 13,310 shares at a price of $7.51 per share, as adjusted for the stock dividends. The warrants vest ratably over a five year period and terminate ten years after date of grant. During 2017, the warrants expiration date was extended another ten years. Warrants held by directors of the Company will expire 90 days after the director ceases to be a director or officer of the Company (365 days if due to death or disability).

In 2020 and 2019, no warrants were issued or cancelled. At December 31, 2020, there were 119,790 outstanding and exercisable. These warrants will expire in 2027 unless otherwise extended.

## Note 10. Income Taxes

Income tax expense is summarized as follows for the years ended December 31:

| | 2020 | 2019 |
|---|---|---|
| **Current income tax expense:** | | |
| Federal | $ 2,160,219 | $ 1,556,580 |
| State | 69,827 | 45,375 |
| Total | 2,230,046 | 1,601,955 |
| **Deferred income tax expense (benefit):** | | |
| Federal | (376,942) | (98,986) |
| State | (221,676) | (62,960) |
| Total | (598,618) | (161,946) |
| Income tax expense | $ 1,631,428 | $ 1,440,009 |

The gross amounts of deferred tax assets and deferred tax liabilities are as follows as of December 31:

| | 2020 | 2019 |
|---|---|---|
| **Deferred tax assets:** | | |
| Allowance for loan losses | $ 1,394,527 | $ 993,084 |
| Net operating loss carryforward | 1,188,036 | 1,256,669 |
| Organization and start-up costs | 19,190 | 39,817 |
| Federal and state credits | 695,196 | 535,579 |
| Stock based compensation | 153,321 | - |
| Deferred compensation | 513,534 | 341,442 |
| Other | 22,267 | 71,183 |
| Total deferred tax assets | 3,986,071 | 3,237,774 |
| Valuation allowance | (205,437) | (189,930) |
| Net deferred tax assets | 3,780,634 | 3,047,844 |
| **Deferred tax liabilities:** | **2020** | **2019** |
| Accumulated depreciation | $ 994,227 | 881,383 |
| Loan origination costs | 268,699 | 257,270 |
| Prepaid expenses | 22,576 | 22,576 |
| Purchase accounting adjustments | 15,302 | 5,403 |
| Unrealized gain on securities available-for-sale | 1,161,615 | 318,344 |
| Total deferred tax liabilities | 2,462,419 | 1,484,976 |
| Net deferred tax asset | $ 1,318,215 | $ 1,562,868 |

Deferred tax assets represent the future tax benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. Management's judgment is based on estimates concerning future income earned and positive earnings for the years ended December 31, 2020 and 2019. Management has concluded that sufficient positive evidence exists to overcome any and all negative evidence in order to meet the "more likely than not" standard regarding the realization of the net deferred tax assets. As of December 31, 2020 and 2019, a small valuation allowance in the amount of $205,437 and $189,930, respectively, remains for state holding company losses.

**Note 10. Income Taxes, Continued**

The Company has a federal net operating loss carryforward of $4,795,973 and $5,197,439 as of December 31, 2020 and 2019, respectively. The Company has a state net operating loss carryforward of $4,579,272 and $4,182,418 as of December 31, 2020 and 2019, respectively. These net operating loss carryforwards begin to expire in the year 2028.

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 21% in 2020 and 2019, respectively, to income before income taxes follows for the years ended December 31:

| | 2020 | 2019 |
|---|---|---|
| Tax expense at statutory rate | $ 1,853,770 | $ 1,576,295 |
| State income tax, net of federal income tax benefit | (119,961) | (13,892) |
| Change in valuation allowance | 15,507 | 15,868 |
| Cash surrender value of life insurance | (106,432) | (50,564) |
| Other municipal income | (105,701) | (97,250) |
| ISO/NQSO | 8,754 | 12,454 |
| Other | 85,491 | (2,902) |
| Income tax expense | $ 1,631,428 | $ 1,440,009 |

Tax returns for 2017 and subsequent years are subject to examination by taxing authorities. The Company has analyzed the tax positions taken or expected to be taken on its tax returns and concluded it has no liability related to uncertain tax positions in accordance with ASC Topic 740.

**Note 11. Employee Benefits**

The Bank sponsors a defined contribution 401(k) plan covering substantially all full-time employees. Under the plan and present policies, participants are permitted to make contributions up to the deferral limits allowed by the Internal Revenue Service. The Company contributes to the Plan annually upon approval by the Board of Directors. The amount of the contributions made is at the discretion of the Board with vesting of these employer contributions occurring over each employee’s initial five years of employment. During the years ended December 31, 2020 and 2019, the Bank recognized $276,359 and $237,625, respectively, in expenses related to this plan which are included in salaries and employee benefits.

On January 1, 2013, we converted our defined contribution 401(k) contribution plan into a 401(k) Employee Stock Ownership Plan (“KSOP”), which provides a mechanism for Company employees to invest in the Company. Each employee who has attained age 21, is employed at least 90 days, has completed at least 500 hours of service in a Plan year, and is employed the last business day of the plan year is eligible to participate in the KSOP. Upon approval of the Board to contribute shares to employees, the Company recognizes the related compensation expense in the year the shares are allocated to employees. For the years ended December 31, 2020 and 2019, there was compensation expense of $306,250 and $315,045 related to contribution of shares to the KSOP, which is included in salaries and employee benefits. Twenty-five thousand shares were contributed and allocated to employees for 2020 and 2019, respectively.

**Note 11. Employee Benefits, Continued**

The Bank has a Salary Continuation Plan (the "Plan") for certain senior officers. The Plan provides an annual post-retirement cash payment beginning after a chosen retirement date for certain officers of the Bank. The officers will receive an annual payment from the Bank equal to the promised benefits. In connection with this plan, life insurance contracts were purchased on the officers. During 2020, an additional $11,000,000 contract was purchased. The cash value of the life insurance contracts increased $506,821 and $240,781 for the years ended December 31, 2020 and 2019, respectively and are included in noninterest income. Cash values of the policies were $23,214,739 and $11,707,918 at December 31, 2020 and 2019, respectively. The corresponding liability associated with the Plan was $2,153,302 and $1,350,898 at December 31, 2020 and 2019, respectively and is included in other liabilities. Expenses related to the Plan were $802,404 and $365,255 for the years ended December 31, 2020 and 2019, respectively and are included in salaries and employee benefits.

The Bank also has a Director Retirement Plan ("Director Plan") for its Board of Directors. The Director Plan provides an additional source of retirement income to a Director for a period of time upon their separation from the Bank in recognition of their service to the Bank. The corresponding liability associated with the Director Plan was $292,098 and $275,014 for the years ended December 31, 2020 and 2019, respectively, and is included in other liabilities. Expenses related to the Director Plan were $167,084 and $54,006 for the years ended December 31, 2020 and 2019, respectively and are included in other operating expenses.

**Note 12. Leases**

The Bank has entered into agreements to lease various office facilities under non-cancellable operating lease agreements. At December 31, 2020, the Company's leases had remaining lease terms of one year to 17 years, which include options to extend or terminate the lease. These options to extend or terminate the lease are included when it is reasonably certain that the options will be exercised.

Lease expense totaled $934,721 and $935,029 for the years ended December 31, 2020 and 2019, respectively and is included in net occupancy. We do not apply the recognition requirements of ASC 842 to short-term leases and recognize the lease payments on a straight-line basis over the term of the lease.

Supplemental balance sheet information related to operating leases at December 31;

| | 2020 | 2019 |
|---|---|---|
| Right of use operating lease asset | $ 7,844,894 | $ 8,194,535 |
| Right of use operating lease liability | 7,873,927 | 8,194,535 |
| Weighted average remaining lease term | 15.12 | 15.49 |
| Weighted average discount rate | 3.35% | 3.33% |

**Note 12. Leases, Continued**

Minimum future rental payments under non-cancelable operating leases having remaining terms in excess of one year, for each of the next five years and thereafter in the aggregate are:

| | |
|---|---|
| 2021 | $ 936,887 |
| 2022 | 841,037 |
| 2023 | 632,852 |
| 2024 | 650,623 |
| 2025 and thereafter | 7,832,307 |
| Total | $ 10,893,706 |

Effective January 1, 2021, the Company entered into a lease agreement to lease a new branch location on Hilton Head Island. The lease had an initial term of ten years, with additional options to extend for two additional five-year periods. In connection with this lease, the Bank will record right of use operating assets and liabilities of approximately $583,000 at inception. These assets and liabilities were calculated using a discount rate of 1.32 percent. Future rental payments related to this lease are included in the schedule above.

The Company is leasing a portion of its Murrells Inlet and Mount Pleasant locations to unrelated tenants. Lease income generated from these tenants totaled $127,169 and $41,975 during the years ended December 31, 2020 and 2019, respectively and is included in other income.

**Note 13. Related Party Transactions**

Certain parties (principally certain directors and executive officers of the Company, their immediate families, and their business interests) are loan customers of and have other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. As of December 31, 2020 and 2019, the Company had related party loans totaling $9,816,025 and $10,398,993, respectively.

In 2017, three executives of the Bank exercised 402,799 stock options with the Company. A note receivable, in the amount of $3,392,274, was issued for the exercise of the options. The total for the note receivable was determined to be the contractual exercise price of the stock options, adjusted for federal and state income taxes. During 2020, the note was renewed with an interest rate of 0.18% per annum and is due and payable on demand by the Company, no later than June 8, 2023.

During 2019, the loan balance decreased $725,000 related to a paydown for one of the three executives. The balance as of December 31, 2020 and 2019, was $3,062,268.

Deposits by directors, including their affiliates and executive officers, were approximately $49,699,755 and $41,467,393 at December 31, 2020 and 2019, respectively.

## Note 14. Commitments and Contingencies

The Company is subject to claims and lawsuits which arise primarily in the ordinary course of business. Management is not aware of any legal proceedings which would have a material adverse effect on the financial position or operating results of the Company.

## Note 15. Income per Share

Basic income per share is computed by dividing net income by the weighted-average number of common shares outstanding. Diluted income per share is computed by dividing net income by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding stock warrants and stock options. Retroactive recognition has been given for the effects of all stock dividends. The effect from stock options on incremental shares from the assumed conversions for basic income per share and diluted income per share are presented below:

| | 2020 | 2019 |
|---|---|---|
| **Income per common share – basic computation:** | | |
| Net income | $ 7,196,051 | $ 6,066,157 |
| Average common shares outstanding – basic | 7,478,203 | 7,458,380 |
| Basic income per common share | $ 0.96 | $ 0.81 |
| **Income per common share – diluted computation:** | | |
| Net income | $ 7,196,051 | $ 6,066,157 |
| Average commons shares outstanding – basic | 7,478,203 | 7,458,380 |
| Incremental shares from assumed conversions: | | |
| Stock options and warrants | 48,601 | 97,863 |
| Average common shares outstanding – diluted | 7,526,804 | 7,556,243 |
| Diluted income per common share | $ 0.96 | $ 0.80 |

At December 31, 2020, the Company excluded 115,916 potentially dilutive shares of common stock issuable upon exercise of stock options with a weighted average exercise price of $11.15 from the computation of dilutive income per common share because of their antidilutive effect. At December 31, 2019, the Company excluded 45,660 potentially dilutive shares of common stock issuable upon exercise of stock options with a weighted average exercise price of $12.44 from the computation of dilutive income per common share because of their antidilutive effect.

## Note 16. Regulatory Matters

The Company and the Bank are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative measures of the Company's and the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company's and the Bank's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk-weightings, and other factors.

**Note 16. Regulatory Matters, Continued**

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum ratios (set forth in the table below) of Tier 1, Common Equity Tier 1 (CET1), and total capital as a percentage of assets and off-balance-sheet exposures, adjusted for risk-weights ranging from 0% to 150%. Tier 1 capital of the Bank consists of common stockholders' equity, excluding the unrealized gain or loss on securities available-for-sale, minus certain intangible assets, while CET1 is comprised of Tier 1 capital, adjusted for certain regulatory deductions and limitations. Tier 2 capital consists of the allowance for loan losses subject to certain limitations. Total capital for purposes of computing the capital ratios consists of the sum of Tier 1 and Tier 2 capital.

The Company and the Bank are also required to maintain capital at a minimum level based on average assets (as defined), which is known as the leverage ratio. Only the strongest institutions are allowed to maintain capital at the minimum requirement. All others are subject to maintaining ratios 1% to 2% above the minimum.

Effective March 31, 2015, quantitative measures established by applicable regulatory standards, including the newly implemented Basel III revised capital adequacy standards and relevant provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd Frank Act), require the Bank to maintain (i) a minimum ratio of Tier 1 capital to average total assets, after certain adjustments, of 4.00%, (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of 6.00%, (iii) a minimum ratio of total-capital to risk-weighted assets of 8.00% and (iv) a minimum ratio of CET1 to risk-weighted assets of 4.50%. A "well-capitalized" institution must generally maintain capital ratios 2% higher than the minimum guidelines.

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, the Bank is required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer is required to consist solely of CET1, but the buffer applies to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer was phased in incrementally over time, beginning January 1, 2016 at 0.625% and becoming fully effective on January 1, 2019. The capital conservation buffer consists of an additional amount of Tier 1 capital equal to 2.50% of risk-weighted assets, which was in effect for the year ended December 31, 2020.

As of its most recent regulatory examination, the Bank was deemed well-capitalized under the regulatory framework for prompt corrective action. To be categorized as well-capitalized, the Bank must maintain total risk-based, Tier 1 risk-based, and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events that management believes have changed the Bank's categories.

## Note 16. Regulatory Matters, Continued

The following table summarizes the capital ratios and the regulatory minimum requirements of the Bank at December 31:

| | Actual | | For capital adequacy purposes Minimum | | To be well-capitalized under prompt corrective action provisions Minimum | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Amount | Ratio | Amount | Ratio |
| **December 31, 2020** | | | | | | |
| Total capital (to risk-weighted assets) | $ 81,701,000 | 12.18% | 53,657,000 | 8.00% | $ 67,071,000 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 74,877,000 | 11.16% | 40,243,000 | 6.00% | 53,657,000 | 8.00% |
| Tier 1 capital (to average assets) | 74,877,000 | 8.08% | 37,090,000 | 4.00% | 46,363,000 | 5.00% |
| Common equity tier 1 capital (to risk-weighted assets) | 74,877,000 | 11.16% | 30,182,000 | 4.50% | 43,596,000 | 6.50% |
| **December 31, 2019** | | | | | | |
| Total capital (to risk-weighted assets) | $ 68,958,000 | 11.91% | 46,308,000 | 8.00% | 57,885,000 | 10.00% |
| Tier 1 capital (to risk-weighted assets) | 63,721,000 | 11.01% | 34,731,000 | 6.00% | 46,308,000 | 8.00% |
| Tier 1 capital (to average assets) | 63,721,000 | 9.07% | 28,088,000 | 4.00% | 35,110,000 | 5.00% |
| Common equity tier 1 capital (to risk-weighted assets) | 63,721,000 | 11.01% | 26,048,000 | 4.50% | 37,625,000 | 6.50% |

## Note 17. Unused Lines of Credit

As of December 31, 2020, the Company had available lines of credit to purchase federal funds from unrelated banks totaling $45,500,000. These lines of credit are available on a one to fourteen day basis for general corporate purposes. As of December 31, 2020 and 2019, respectively, there was no outstanding balance on the lines of credit for federal funds.

The Company also has an additional line of credit with the Federal Home Loan Bank with available funds totaling $34,779,591. As of December 31, 2020 and 2019, respectively, there was no outstanding balance on the line.

## Note 18. Restrictions on Dividends

The ability of the Company to pay cash dividends is dependent upon receiving cash in the form of dividends from its banking subsidiary. Federal and state banking regulations restrict the amount of dividends that can be paid. Dividends are payable only from the retained earnings of the banking subsidiary and may be limited to the amount of current year earnings without prior regulatory approval. The retained earnings of the banking subsidiary were approximately $24,541,964 and $16,994,068 at December 31, 2020 and 2019, respectively.

### Note 19. Financial Instruments with Off-Balance-Sheet Risk

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments consist of commitments to extend credit and standby letters of credit. Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A commitment involves, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The Company's exposure to credit loss in the event of nonperformance by the other party to the instrument is represented by the contractual notional amount of the instrument. Since certain commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company uses the same credit policies in making commitments to extend credit as it does for on-balance-sheet instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities.

Collateral held for commitments to extend credit and letters of credit varies, but may include accounts receivable, inventory, property, plant, equipment, and income-producing commercial properties.

The following table summarizes the Bank's off-balance-sheet financial instruments whose contract amounts represent credit risk at December 31:

| | 2020 | 2019 |
|---|---|---|
| Commitments to extend credit | $ 166,935,223 | $ 180,034,832 |
| Letters of credit | 1,171,069 | 1,443,727 |
| Total | $ 168,106,292 | $ 181,478,559 |

### Note 20. Fair Value of Financial Instruments

Accounting standards require disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

The accounting standard defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. It also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted market prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as U.S. Treasuries and money market funds.

**Note 20. Fair Value of Financial Instruments, Continued**

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments, mortgage-backed securities, municipal bonds, corporate debt securities, and derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data. This category generally includes certain derivative contracts and impaired loans.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. For example, this category generally includes certain private equity investments, retained residual interests in securitizations, residential mortgage servicing rights, and highly-structured or long-term derivative contracts.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a recurring basis:

***Investment Securities Available-for-Sale*** – Investment securities 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 assumptions. Level 1 securities include those traded on an active exchange such as the New York Stock Exchange, Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

***Mortgage Loans Held-for-Sale*** – The fair values of mortgage loans held-for-sale are derived from an active market of similar loans and as such are classified as Level 2 in the fair value hierarchy.

**Note 20. Fair Value of Financial Instruments, Continued**

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy.

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Obligations of state and local governments | $ 63,542,964 | $ – | $ 63,542,964 | $ – |
| Mortgage-backed securities | 29,738,168 | – | 29,738,168 | – |
| SBA loan pools | 7,214,529 | – | 7,214,529 | – |
| SBA asset-backed securities | 18,288,139 | – | 18,288,139 | – |
| Corporate debt securities | 6,444,866 | – | 6,444,866 | – |
| Mortgage loans held-for-sale | 36,675,792 | – | 36,675,792 | – |
| Total | $ 161,904,460 | $ – | $ 161,904,460 | $ – |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Obligations of state and local governments | $ 12,829,576 | $ – | $ 12,829,576 | $ – |
| Mortgage-backed securities | 47,113,485 | – | 47,113,485 | – |
| SBA loan pools | 8,273,149 | – | 8,273,149 | – |
| SBA asset-backed securities | 1,779,850 | – | 1,779,850 | – |
| Corporate debt securities | 6,402,500 | – | 6,402,500 | – |
| Mortgage loans held-for-sale | 4,904,195 | – | 4,904,195 | – |
| Total | $ 81,302,755 | $ – | $ 81,302,755 | $ – |

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). Following is a description of valuation methodologies used for assets and liabilities recorded at fair value on a non-recurring basis.

***Impaired Loans*** – The Company 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 are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represent loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2020 and 2019, substantially all of the impaired loans were evaluated based upon 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 Company records the loan as nonrecurring Level 2. When an 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 Company records the loan as nonrecurring Level 3.

**Note 20. Fair Value of Financial Instruments, Continued**

***Other Real Estate Owned*** – Foreclosed assets are adjusted to fair value upon transfer of the loans to other real estate owned. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. 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 a current appraised value, the Company recorded the foreclosed asset as nonrecurring Level 2. When an 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 Company records the foreclosed asset as nonrecurring Level 3. As of December 31, 2020 and 2019, respectively, the Company had no OREO.

The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) as of December 31, for which a nonrecurring change in fair value has been recorded during the years ended December 31.

| | December 31, 2020 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Impaired loans | | | | |
| Commercial | $ 15,533 | $ – | $ 15,533 | $ – |
| Commercial real estate | – | – | – | – |
| Consumer | 21,318 | – | 21,318 | – |
| Consumer real estate | 47,873 | – | 47,873 | – |
| Total impaired loans | $ 84,724 | $ – | $ 84,724 | $ – |

| | December 31, 2019 | | | |
|---|---|---|---|---|
| | Total | Level 1 | Level 2 | Level 3 |
| Impaired loans | | | | |
| Commercial | $ – | $ – | $ – | $ – |
| Commercial real estate | 4,360 | – | 4,360 | – |
| Consumer | 26,421 | – | 26,421 | – |
| Consumer real estate | 593,809 | – | 593,809 | – |
| Total impaired loans | $ 624,590 | $ – | $ 624,590 | $ – |

The following methods and assumptions were used to estimate the fair value of significant financial instruments:

***Cash and Due from Banks*** – The carrying amount is a reasonable estimate of fair value.

***Federal Funds Sold and Interest-Bearing Deposits*** – Federal funds are sold for a term of one day, and the carrying amount approximates the fair value.

**Note 20. Fair Value of Financial Instruments, Continued**

***Securities Available-for-Sale*** – Investment securities 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 security's credit rating, prepayment assumptions and other factors such as credit loss assumptions. Level 1 securities include those traded on an active exchange, such as the New York Stock Exchange, U.S. Treasury securities that are traded by dealers or brokers in active over-the-counter markets and money market funds. Level 2 securities include mortgage-backed securities issued by government sponsored entities, municipal bonds and corporate debt securities. Securities classified as Level 3 include asset-backed securities in less liquid markets.

***Nonmarketable Equity Securities*** – The carrying value of these securities approximates the fair value since no ready market exists for the stocks.

***Mortgage Loans Held-for-Sale*** – The carrying value of mortgage loans held-for-sale approximates fair value.

***Loans Receivable*** – The valuation of loans receivable is estimated using the exit price notion which incorporates factors, such as enhanced credit risk, illiquidity risk and market factors that sometimes exist in exit prices in dislocated markets. This credit risk assumption is intended to approximate the fair value that a market participant would realize in a hypothetical orderly transaction. The Company's loan portfolio is initially fair valued using a segmented approach. The Company divides its loan portfolio into the following categories: variable rate loans, impaired loans and all other loans. The results are then adjusted to account for credit risk as described above.

For variable-rate loans that reprice frequently and have no significant change in credit risk, fair values approximate carrying values. Fair values for impaired loans are estimated using discounted cash flow models or based on the fair value of the underlying collateral.

***Bank-Owned Life Insurance*** – The carrying amount is a reasonable estimate of fair value.

***Deposits*** – The fair value of demand deposits, savings, and money market accounts is the amount payable on demand at the reporting date. The fair values of certificates of deposit and other time deposits are estimated using a discounted cash flow calculation that applies current interest rates to a schedule of aggregated expected maturities.

***Advances from Federal Home Loan Bank (FHLB)*** – For disclosure purposes, the fair value of the FHLB fixed rate borrowing is estimated using discounted cash flows, based on the current incremental borrowing rates for similar types of borrowing arrangements. The carrying value of advances from Federal Home Loan Bank approximates fair value.

***Accrued Interest Receivable and Payable*** – The carrying value of these instruments is a reasonable estimate of fair value.

***Off-Balance Sheet Financial Instruments*** – Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and the counterparties' credit standing.

### Note 20. Fair Value of Financial Instruments, Continued

The carrying values and estimated fair values of the Company's financial instruments as of December 31 are as follows:

| | 2020 | | 2019 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| **Financial Assets:** | | | | |
| Cash and due from banks | $ 24,822,506 | $ 24,822,506 | $ 9,660,999 | $ 9,660,999 |
| Federal funds sold and interest bearing deposits | 15,859,937 | 15,859,937 | 4,043,078 | 4,043,078 |
| Securities available-for-sale | 125,228,667 | 125,228,667 | 76,398,560 | 76,398,560 |
| Nonmarketable equity securities | 643,000 | 643,000 | 563,700 | 563,700 |
| Loans held-for-sale | 36,675,792 | 36,675,792 | 4,904,195 | 4,904,195 |
| Loans receivable, net | 680,070,156 | 679,555,264 | 570,484,243 | 566,526,267 |
| Bank-owned life insurance | 23,214,739 | 23,214,739 | 11,707,918 | 11,707,918 |
| Accrued interest receivable | 2,848,274 | 2,848,274 | 2,105,709 | 2,105,709 |
| **Financial Liabilities:** | | | | |
| Demand deposit, interest-bearing transaction, and savings accounts | 711,075,911 | 711,075,911 | 485,333,039 | 485,333,039 |
| Certificates of deposit and other time deposits | 123,777,948 | 125,549,196 | 131,473,775 | 132,572,716 |
| Accrued interest payable | 49,946 | 49,946 | 117,947 | 117,947 |
| | **Notional Amount** | **Estimated Fair Value** | **Notional Amount** | **Estimated Fair Value** |
| **Off-Balance Sheet Financial Instruments:** | | | | |
| Commitments to extend credit | $ 166,935,223 | $ – | $ 180,034,832 | $ – |
| Letters of credit | 1,171,069 | – | 1,443,727 | – |

**Note 21. South Atlantic Bancshares, Inc. and Subsidiary (Parent Company Only)**

Following is condensed financial information of South Atlantic Bancshares, Inc. (parent company only) as of and for the years ended December 31:

**Condensed Balance Sheets**

| | 2020 | 2019 |
|---|---|---|
| **Assets** | | |
| Cash | $ 10,839,967 | $ 14,830,179 |
| Investment in bank subsidiary | 86,042,681 | 72,623,319 |
| Loans | 3,062,268 | 3,062,268 |
| Other assets | 366,547 | 373,146 |
| Total assets | $ 100,311,463 | $ 90,888,912 |
| **Liabilities and shareholders' equity** | | |
| Other liabilities | $ 2,489,733 | $ 2,482,638 |
| Shareholders' equity | 97,821,730 | 88,406,274 |
| Total liabilities and shareholders' equity | $ 100,311,463 | $ 90,888,912 |

**Condensed Statements of Income**

| | 2020 | 2019 |
|---|---|---|
| **Income** | $ 23,232 | $ 45,752 |
| **Expenses:** | | |
| Salaries and benefits | 350,438 | 368,430 |
| Other | 107,086 | 89,968 |
| Total | 457,524 | 458,398 |
| **Loss before income taxes and equity in undistributed income of banking subsidiary** | (434,292) | (412,646) |
| Income tax benefit | 82,447 | 17,669 |
| Equity in income of banking subsidiary | 7,547,896 | 6,461,134 |
| Net income | $ 7,196,051 | $ 6,066,157 |

**Note 21. South Atlantic Bancshares, Inc. and Subsidiary (Parent Company Only), Continued**

**Condensed Statements of Cash Flows**

| | 2020 | 2019 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ 7,196,051 | $ 6,066,157 |
| Adjustments to reconcile net income to net cash used in operating activities | | |
| Equity in undistributed income of banking subsidiary | (7,547,896) | (6,461,134) |
| Stock and warrant compensation expense | 41,688 | 59,307 |
| Contribution of treasury stock to ESOP plan | 306,250 | 315,045 |
| Increase in accrued expenses and other liabilities | 7,096 | 424,530 |
| Decrease (increase) in other assets | 6,599 | (48,400) |
| Net cash provided by operating activities | 9,788 | 355,505 |
| **Investing activities:** | | |
| Net increase in investment in bank | (3,500,000) | – |
| Net decrease in loans | – | 725,000 |
| Net cash provided by (used in) investing activities | (3,500,000) | 725,000 |
| **Financing activities:** | | |
| Purchase of treasury stock | (500,000) | – |
| Net cash used in financing activities | (500,000) | – |
| Net increase (decrease) in cash and cash equivalents | (3,990,212) | 1,080,505 |
| **Cash, beginning of year** | 14,830,179 | 13,749,674 |
| **Cash, end of year** | $ 10,839,967 | $ 14,830,179 |

**Note 22. Subsequent Events**

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Non-recognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. Management has reviewed events occurring through March 8, 2021, the date the financial statements were available to be issued and no subsequent events occurred requiring accrual or disclosure.