Farmers Bank of Willards

2020 Annual Report

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THE FARMERS BANK OF WILLARDS

Financial Highlights

	2020	2019	2018	2017	2016
At year end					
Assets	**$ 445,550,721**	$ 389,484,790	$ 375,596,642	$ 348,778,738	$ 335,999,597
Deposits	**367,738,349**	298,118,304	300,165,471	281,328,487	266,853,421
Loans, net	**309,544,222**	331,455,253	325,637,727	309,093,798	293,285,859
Stockholders' equity	**45,599,802**	43,119,631	40,326,991	38,253,625	36,827,606
Average balances					
Assets	**$ 425,128,854**	$ 386,047,014	$ 365,890,774	$ 346,385,258	$ 322,498,833
Deposits	**342,151,221**	302,709,983	293,693,257	276,828,944	256,181,900
Loans, net	**321,937,236**	329,341,317	315,667,327	302,952,681	277,480,590
Stockholders' equity	**45,002,824**	42,457,501	40,001,547	38,145,550	36,834,069
For the year					
Net interest income	**$ 15,793,087**	$ 16,287,242	$ 15,317,312	$ 14,698,051	$ 13,560,388
Income before income taxes	**5,217,655**	5,603,985	4,518,226	5,385,595	4,318,698
Net income	**3,875,848**	4,155,019	3,365,337	3,109,840	2,730,368
Cash dividend declared	**1,510,352**	1,512,133	1,314,898	1,117,663	1,667,674
Per share data (restated giving retroactive effect to stock dividends declared)					
Net income	**$2.95**	$3.16	$2.56	$2.35	$2.03
Cash dividend declared	**1.15**	1.15	1.00	0.85	1.24
Book value	**34.73**	32.80	30.67	29.09	27.38
Ratios					
Return on average assets	0.91%	1.08%	0.92%	0.90%	0.85%
Return on average equity	8.61%	9.79%	8.41%	8.15%	7.41%

To our shareholders, customers, and staff:

We, like most of you, are ready to put the year 2020 in the rearview mirror. To say that this has been an unprecedented year would be an understatement. As we began the year, we could have never imagined the pending chaos wrought by the Coronavirus; we are grateful for all of the frontline workers who kept our local economy up and running and we mourn the loss that many have experienced. We pray for a return to some level of normalcy as we proceed with cautious optimism into 2021.

As we reflect on the challenges of this past year, I am pleased to report that our team rose to the highest level of excellence, even in the midst of this pandemic. We delivered by focusing our efforts on how to help our customers and communities first, recognizing that revenues and profits will follow if we simply do the right thing each day. We were rewarded with the second best profit year in our 96-year history, quite a testament.

How were we able to achieve these results? Teamwork. Plain and simple. Our teams across Delmarva stepped up to the plate, delivered millions of dollars in small business loans under the PPP program, helped accommodate those whose businesses had been shut down, and worked as a partner with each and every loan customer we have to ensure their continued viability and success.

The book value of our stock has risen to $34.73 per share. An increase of over 30.37% since 2015 when the book value of our stock was $26.64. Our outstanding capital position allowed us to pay our stockholders a dividend of $1.15 per share, the same dividend paid in 2019. We hope this consistent dividend demonstrates our confidence in the safety and soundness of the institution as well as our ability to deliver stable returns for our stockholders.

Our 2020 net income was $3,875,848 or $2.95 per share. This result compared favorably with last year‘s record profit given all of the challenges that both the national and local economy faced. Our net income before taxes was $5,217,655 with a return on average equity of 8.61%. While this is slightly less than last year‘s record of 9.79%, we are extremely proud of this accomplishment given the compressed net interest rate margins and business shut downs that occurred locally. Net interest income was $15,793,087 a 3.03% percent decrease from last year, reflecting compressed interest margins and the Federal Reserves “cheap money” policy as a result of the pandemic. We expect this trend will continue into 2021.

We experienced a surge of deposits from customers both old and new. Assets rose from $389.48 million in 2019 to $445.55 million at the end of 2020. This figure included a sharp increase in deposits from $298.12 million to $367.74 million. Total assets increased by 14.40%. We recognize that this influx of deposits was largely driven by government stimulus packages and expect to see some run off as the economy reopens and consumer spending increases.

Our Board continued its careful underwriting of loans, which maintained average balances of $321,937,236 compared with $329,341,317 in the previous year. The Bank’s non-performing assets were at a record low despite the economic headwinds faced both nationally and locally. This accomplishment is a tribute to our staff who have been proactive in contacting and working with customers who faced different challenges in 2020.

We have continued to invest in technology that provides us with the flexibility to adapt to an ever-changing environment. I've thought every day about how technology has re-defined the way we create, deliver, and experience banking services. We must never forget to be relevant to a modern customer base but faithful to a nearly one hundred year old brand. No one could have foreseen that the investment in FBW Connect would pay such huge dividends prior to March 20, 2020, when we had to close our branches to in-person traffic. We must be thankful to our creative team, who understood that innovation was vital, and that true innovation only happened with courage. Our team succeeded at focusing their time, energy and resources to FBW's highest priority, our customer experience.

Delivering an exceptional customer experience remains our primary focus. We believe if we get that right, our bank will continue to deliver consistent returns for our shareholders while being true to the principles that the bank was founded upon - serving the needs of the "common man" on Delmarva. We all can be so proud of our Board and staff who have worked tirelessly to deliver an excellent experience for all of our customers.

And now as we move forward, we undoubtedly will face some challenges, but we will be thoroughly prepared. We will move in a direction that says all things are possible with the right people, the right vision, and the right ethical and moral compass to serve our customers each and every day. We will continue to reassess. We will ask ourselves, where have we been? Where are we now? Where do we want to be? We will continue to study the impact we make on our customers and community, for that influence will ultimately benefit you, our loyal stockholders.

As we look forward to 2021 and beyond, I want to take this opportunity to thank our staff for their tireless energy, their enthusiasm, their optimism, and their thoughtful commitment to The Farmers Bank of Willards. I wish you all the very best.

Christopher F. Davis, Pres.

Chris Davis, President

Farmers Bank of Willards

Balance Sheets

	December 31, 2020	December 31, 2019
Assets		
Cash and due from banks	**$ 88,009,871**	$ 13,680,361
Federal funds sold	**-**	363,194
Total cash and cash equivalents	**88,009,871**	14,043,555
Certificates of deposit in other banks	**2,340,000**	3,062,000
Investment securities available for sale	**27,089,181**	23,436,015
Federal Home Loan Bank stock, at cost	**1,540,600**	2,063,100
Loans, less allowance for loan losses of $3,176,328 and $3,222,340	**309,544,222**	331,455,253
Premises and equipment	**6,848,623**	6,946,190
Accrued interest receivable	**1,096,759**	1,318,123
Bank owned life insurance	**4,735,022**	4,611,893
Foreclosed real estate	**3,299,858**	1,579,610
Other assets	**1,046,585**	969,051
	$ 445,550,721	$ 389,484,790
Liabilities and Stockholders' Equity		
Deposits		
Noninterest-bearing	**$ 114,511,522**	$ 78,253,105
Interest-bearing	**253,226,827**	219,865,199
Total deposits	**367,738,349**	298,118,304
Federal funds purchased and other short term debt	**52,284**	3,500,000
Federal Home Loan Bank advances	**28,000,000**	40,585,000
Accrued interest payable	**262,651**	350,076
Cash dividend payable	**1,510,352**	1,512,133
Other liabilities	**2,387,283**	2,299,646
	399,950,919	346,365,159
Stockholders' equity		
Common stock, par value $1 per share, authorized 30,000,000 shares, issued and outstanding 1,313,070 shares in 2020 and 1,314,598 shares in 2019	**1,313,070**	1,314,598
Surplus	**22,652,813**	22,692,357
Undivided profits	**21,344,573**	18,979,077
Accumulated other comprehensive income	**289,346**	133,599
	45,599,802	43,119,631
	$ 445,550,721	$ 389,484,790

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

Statements of Income

	Years Ended December 31,		
	2020	2019	2018
Interest revenue			
Loans, including fees	**$ 18,071,605**	$ 18,858,971	$ 17,569,201
Investment securities	**548,567**	506,898	248,449
Federal funds sold	**3,439**	17,586	45,544
Other	**257,136**	336,598	322,999
Total interest revenue	**18,880,747**	19,720,053	18,186,193
Interest expense			
Deposits	**2,344,693**	2,452,630	2,118,315
Borrowed funds	**742,967**	980,181	750,566
Total interest expense	**3,087,660**	3,432,811	2,868,881
Net interest income	**15,793,087**	16,287,242	15,317,312
Provision for loan losses	**875,000**	1,065,354	1,265,582
Net interest income after provision for loan losses	**14,918,087**	15,221,888	14,051,730
Noninterest revenue			
Card services	**1,022,698**	876,352	794,583
Service charges on deposit accounts	**256,906**	360,153	327,163
Increase in cash surrender value of life insurance	**123,129**	122,211	120,250
Gain (loss) on sale/valuation of foreclosed real estate	**(38,829)**	(182,394)	(231,928)
Gain (loss) on sale/impairment of investment securities	**14,158**	(755)	(1,000)
Gain (loss) on sale of certificates of deposit in other banks	**-**	(1,892)	-
Gain (loss) on other dispositions	**7,510**	18,257	(11,617)
Other noninterest revenue	**95,774**	103,434	89,894
	1,481,346	1,295,366	1,087,345
Noninterest expense			
Salaries	**4,833,366**	4,778,632	4,513,693
Employee benefits	**1,235,329**	1,261,990	1,167,024
Occupancy	**590,783**	557,754	566,582
Furniture and equipment	**498,472**	468,239	392,332
Deposit insurance premiums	**106,212**	88,756	166,316
Data communications and processing costs	**1,139,848**	962,537	958,039
Loan processing and collections	**186,781**	334,712	241,623
Foreclosed real estate holding costs	**156,597**	158,154	157,716
Card services	**780,492**	583,881	519,412
Promotional	**381,783**	418,262	447,354
Other operating	**1,272,115**	1,300,352	1,490,758
	11,181,778	10,913,269	10,620,849
Income before income taxes	**5,217,655**	5,603,985	4,518,226
Income taxes	**1,341,807**	1,448,966	1,152,889
Net income	**$ 3,875,848**	$ 4,155,019	$ 3,365,337
Earnings per common share - basic and diluted	**$ 2.95**	$ 3.16	$ 2.56

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

Statements of Comprehensive Income

	Years Ended December 31,		
	2020	2019	2018
Net income	**$ 3,875,848**	$ 4,155,019	$ 3,365,337
Other comprehensive income			
Unrealized gain (loss) on investment securities available for sale	**214,874**	216,377	31,631
Reclassify (gain) loss realized on sale of investment securities available for sale	**(14,158)**	755	-
Income tax relating to unrealized gain on investment securities available for sale	**(44,969)**	(58,378)	(8,704)
Other comprehensive income	**155,747**	158,754	22,927
Comprehensive income	**$ 4,031,595**	$ 4,313,773	$ 3,388,264

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

Statements of Changes in Stockholders' Equity

	Common stock				Accumulated other comprehensive income
	Shares	Par value	Surplus	Undivided profits	
Balance, December 31, 2017	**1,314,898**	**$ 1,314,898**	**$ 22,701,057**	**$ 14,285,752**	**$ (48,082)**
Net income	-	-	-	3,365,337	-
Cash dividend, $1.00 per share	-	-	-	(1,314,898)	-
Unrealized gain on investment securities available for sale net of income taxes of $8,704	-	-	-	-	22,927
Balance, December 31, 2018	1,314,898	1,314,898	22,701,057	16,336,191	(25,155)
Net income	-	-	-	4,155,019	-
Cash dividend, $1.15 per share	-	-	-	(1,512,133)	-
Stock repurchased	(300)	(300)	(8,700)	-	-
Unrealized gain on investment securities available for sale net of income taxes of $58,378	-	-	-	-	158,754
Balance, December 31, 2019	1,314,598	1,314,598	22,692,357	18,979,077	133,599
Net income	-	-	-	3,875,848	-
Cash dividend, $1.15 per share	-	-	-	(1,510,352)	-
Stock repurchased	(1,528)	(1,528)	(39,544)	-	-
Unrealized gain on investment securities available for sale net of income taxes of $44,969	-	-	-	-	155,747
Balance, December 31, 2020	**1,313,070**	**$ 1,313,070**	**$ 22,652,813**	**$ 21,344,573**	**$ 289,346**

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

Statements of Cash Flows

	Years Ended December 31,		
	2020	2019	2018
Cash flows from operating activities			
Interest received	**$ 19,235,324**	$ 19,431,698	$ 18,001,784
Fees and commissions received	**1,603,730**	1,415,936	1,687,748
Interest paid	**(3,175,085)**	(3,390,230)	(2,794,802)
Cash paid to suppliers and employees	**(10,519,244)**	(10,300,967)	(10,345,998)
Income taxes paid	**(1,686,394)**	(1,195,604)	(858,541)
	5,458,331	5,960,833	5,690,191
Cash flows from investing activities			
Proceeds from maturities and calls of investment securities held to maturity	**-**	-	436,528
Proceeds from maturities and calls of investment securities available for sale	**15,768,180**	13,910,928	2,241,429
Proceeds from sale of securities available for sale	**968,411**	1,170,060	-
Net redemption (purchase) of Federal Home Loan Bank stock	**522,500**	(410,300)	(245,400)
Proceeds from disposition of premises, equipment and software	**-**	8,000	2,387
Proceeds from sale of foreclosed/repossessed assets	**866,243**	1,467,800	1,176,900
Proceeds from loans held for sale	**-**	881,938	-
Loans advanced, net of principal collected	**18,185,698**	(7,416,557)	(19,723,964)
Proceeds from sale of certificates of deposit	**-**	2,439,108	-
Net redemption (purchase) of certificates of deposit	**722,000**	(248,000)	(4,262,000)
Purchases of investment securities available for sale	**(20,192,213)**	(26,706,132)	(5,091,225)
Investment in foreclosed real estate	**-**	-	(62,550)
Purchases of premises, equipment, and software	**(314,674)**	(731,629)	(1,153,594)
	16,526,145	(15,634,784)	(26,681,489)
Cash flows from financing activities			
Net increase (decrease) in			
Time deposits	**(1,976,431)**	(11,044,602)	5,823,898
Other deposits	**71,596,476**	8,997,435	13,013,086
Proceeds from Federal Home Loan Bank advances, net of repayments	**(12,585,000)**	9,085,000	5,500,000
Proceeds from Federal funds purchased, net of repayments	**(3,500,000)**	3,500,000	-
Stock repurchased	**(41,072)**	(9,000)	-
Dividends paid	**(1,512,133)**	(1,314,898)	(1,117,663)
	51,981,840	9,213,935	23,219,321
Net increase (decrease) in cash and cash equivalents	**73,966,316**	(460,016)	2,228,023
Cash and cash equivalents at beginning of year	**14,043,555**	14,503,571	12,275,548
Cash and cash equivalents at end of year	**$ 88,009,871**	$ 14,043,555	$ 14,503,571

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

Statements of Cash Flows (Continued)

	Years Ended December 31,		
	2020	2019	2018
Reconciliation of net income to net cash provided by operating activities			
Net income	**$ 3,875,848**	$ 4,155,019	$ 3,365,337
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	**445,855**	385,076	326,307
Amortization of computer software	**42,320**	38,534	38,670
Provision for loan losses	**875,000**	1,065,354	1,265,582
Deferred income taxes	**(127,010)**	(117,659)	372,335
Amortization of premiums and (accretion) of discounts, net	**31,489**	(54,928)	47,891
Loss (gain) on sale and writedown of assets			
Foreclosed real estate, net of deferred gain realized	**38,829**	182,394	231,928
Investment securities available for sale	**(14,158)**	755	1,000
Certifcates of deposit in other banks		1,892	-
Premises, equipment and software	**(7,510)**	10,063	11,617
Loans held for sale	**-**	(28,320)	-
Decrease (increase) in			
Cash surrender value of life insurance	**(123,129)**	(122,211)	(120,250)
Accrued interest receivable	**221,364**	(99,636)	(101,197)
Prepaid income taxes net of income taxes payable	**(217,577)**	371,021	(77,987)
Other assets	**70,018**	(17,991)	228,724
Increase (decrease) in			
Deferred origination fees, net	**224,853**	(11,580)	(10,854)
Accrued interest payable	**(87,425)**	42,581	74,079
Other liabilities	**209,564**	160,469	37,009
	$ 5,458,331	$ 5,960,833	$ 5,690,191

Noncash investing activity			
Real estate acquired through foreclosure or deed in lieu of foreclosure	**$ 2,625,320**	$ 545,257	$ 1,071,689
Borrowing for automobile purchase	**52,284**	-	-
	$ 2,677,604	$ 545,257	$ 1,071,689

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

Notes to Financial Statements

1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the financial statements conform to United States generally accepted accounting principles and to general practices within the banking industry. The Farmers Bank of Willards is not considered a public business entity. As such, it is not required to comply with disclosures that pertain only to public companies. For accounting standards issued by the Financial Accounting Standards Board, the Bank is subject to the effective dates applicable to private companies.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions may affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The estimate that is particularly susceptible to significant change is the allowance for loan losses.

Nature of operations

The Farmers Bank of Willards is a financial institution operating primarily in the Maryland counties of Wicomico and Worcester as well as lower Sussex County in Delaware. The Bank does not limit its services to customers in these areas; but it is the Bank's priority to serve the financial needs of those within its community.

The Bank offers deposit services and loans to individuals, small businesses, associations, and government entities. Other services include automatic drafts from accounts, automated teller machine services, safe deposit boxes, debit cards, internet banking with bill pay feature, and digital banking with a lock-it feature. Prior to 2019, the Bank offered credit card loans but sold the portfolio in February, 2019.

Per share data and stock dividends

Earnings per common share and dividends per common share are determined by dividing net income and dividends by the weighted average number of shares outstanding after giving retroactive effect to stock dividends declared. There are no common stock equivalents. The adjusted weighted average number of shares used in the earnings per share calculation was 1,314,315, 1,314,888, and 1,314,898 for the years ended December 31, 2020, 2019, and 2018, respectively.

Stock dividends of 20% or more are recorded at par value while stock dividends of less than 20% are recorded at fair value. This value is determined based on the most recent sale before the dividend. Stock dividends may be funded from earned surplus. As of December 31, 2020, the entire balance of surplus represents paid in surplus with no earned surplus as a result of transfers between the capital accounts.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, demand amounts due from banks, and federal funds sold. Federal funds are purchased and sold for one-day periods. Due from banks includes interest-bearing accounts that are payable on demand.

Certificates of deposit in other banks

Certificates of deposit in other banks are recorded at cost.

Federal Home Loan Bank stock

As a member of the Federal Home Loan Bank, the Bank is required to purchase stock based on its total assets. Additional stock is purchased and redeemed based on the outstanding Federal Home Loan Bank advances to the Bank. This investment is carried at cost.

Notes to Financial Statements

1. **Summary of Significant Accounting Policies** (Continued)

Investment securities

As debt securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Declines in the fair value of individual securities below their cost that are other than temporary result in write-downs of the individual securities to their estimated recoverable value. Factors affecting the determination of whether an impairment that is other than temporary has occurred include a downgrading of the security by a rating agency, a significant deterioration in the financial condition of the issuer, or that management would not likely hold a security for a period of time sufficient to allow for any anticipated recovery of fair value. Gains and losses on the disposition of securities are recorded as of the trade date using the specific identification method.

Securities held to meet liquidity needs or which may be sold before maturity are classified as available for sale and carried at fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. Equity securities are recorded at fair value.

Securities that management has the intent and ability to hold to maturity are recorded at amortized cost, which is cost adjusted for amortization of premiums to the bond's first call date and accretion of discounts to maturity. Premiums and discounts of mortgage-backed securities are amortized over the expected lives of the securities. Amortization and accretion are recorded using a method that approximates the level yield method.

Loans held for sale

During 2018, the Bank classified its credit card portfolio as available for sale as a result of a signed agreement to sell its credit card loans. When the loans were sold in February, 2019, the Bank recognized a gain on sale of $28,320. There are no loans held for sale as of December 31, 2019 or 2020.

Loans and allowance for loan losses

Loans are stated at face value adjusted for deferred origination fees, costs, and the allowance for loan losses. Interest on loans is accrued on the principal amounts outstanding. Nonrefundable fees and costs associated with originating loans are recognized as income over the life of the related loans. Generally the accrual of interest is discontinued when any portion of principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full. Loans specifically reviewed for nonaccrual treatment are not considered impaired during periods of "minimal delay" in payment (usually ninety days or less) or if they are both well secured and in the process of collection by an attorney, provided eventual collection of all amounts due is expected.

Payments received on nonaccrual loans are generally accounted for as a reduction in principal with interest recognized after all principal has been collected. Loans are returned to accrual status when all principal and interest amounts contractually due are brought current and future payments are reasonably assured.

<u>**Notes to Financial Statements**</u>

1. **Summary of Significant Accounting Policies** (Continued)

Loans and allowance for loan losses (continued)

Loans are considered impaired when, based on current information, it is probable that the Bank will not collect all principal and interest payments according to contractual terms. Impaired loans include loan relationships where management of the Bank has worked with the borrowers to restructure the original terms of the loan. This may include reducing the payments to interest only for a set period or reducing the interest rate on the loan. Management considers the financial condition of the borrower, cash flows of the loan, and the value of the related collateral. Impaired loans are measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that the Bank will measure impairment based on the fair value of the collateral, if the loan is collateral dependent. For collateral dependent real estate loans, management reviews its current appraisal, obtaining either a new appraisal or making adjustments to the original appraised value based on current trends in the real estate market. For other collateral dependent loans, the Bank uses other estimation methods.

The allowance for loan losses is established through a provision for loan losses charged to expense. Loans are charged against the allowance for loan losses when management believes that the collectability of the principal is unlikely. The allowance, based on evaluations of the collectability of loans, is an amount that management believes will be adequate to absorb probable losses on existing loans that may become uncollectible. The evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, overall portfolio quality, review of specific problem loans, and current economic conditions and trends that may affect the borrowers' ability to pay.

The allowance for loan losses represents an estimation of losses in the loan portfolio. The Bank uses a loan grading system to identify its impaired loans. For the balance of the loan portfolio, management applies a factor to pools of loans with similar characteristics to provide for losses. The pooled loan portions of the allowance reflect management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. These loss allocation factors are general indicators of future loss and include current historic losses, economic conditions, officer experience or unseasoned new products and current delinquency ratios compared to historic ratios. The adequacy of the allowance is determined through careful and continuous evaluation of the loan portfolio, and involves consideration of a number of factors to establish a prudent level.

Management believes it has established the allowance for loan losses in accordance with generally accepted accounting principles and has taken into account the views of its regulators and the current economic environment. There can be no assurance that in the future the Bank's regulators will not require, or the changes in economic environment will not necessitate further increases in the allowance.

Management reports loans as delinquent based on the terms of the promissory note including any modifications.

Premises and equipment

Premises and equipment are recorded at cost less accumulated depreciation. Land is recorded at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets or, if shorter, the expected terms of the leases including lease option periods where exercise is reasonably certain.

<u>**Notes to Financial Statements**</u>

1. Summary of Significant Accounting Policies (Continued)

Bank owned life insurance

The Bank owns five life insurance policies through two carriers on its three current and retired executive officers. The policies are recorded at their cash surrender values.

Foreclosed real estate

Real estate acquired through foreclosure is recorded at the lower of cost or fair value on the date acquired, less estimated cost to sell. In general, cost equals the Bank's investment in the property at the time of foreclosure. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated fair value of the property are included with gains and losses on sales and valuations of foreclosed real estate. Expenses of owning the property are included in noninterest expense.

Loans are transferred to foreclosed real estate once either the sale has been ratified or the Bank receives a deed in lieu of foreclosure from the borrower.

Income taxes

Income tax expense is based on the results of operations, adjusted for permanent differences between items of income or expense reported in the financial statements and those reported for tax purposes. Deferred income taxes are provided for the temporary differences between financial and taxable income. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse.

Subsequent events

The Bank has evaluated events and transactions subsequent to December 31, 2020 through March 9, 2021, the date these financial statements were available to be issued. No significant subsequent events were identified that would affect the presentation of the financial statements.

2. Correspondent Bank Relationships

The Bank normally carries balances with other banks that exceed the federally insured limit. The average balances carried in excess of the limit, including unsecured federal funds sold to the same banks, were approximately $13,999,723 and $5,452,769 for 2020 and 2019, respectively. The balance maintained at the Federal Reserve Bank is excluded from this average.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same ownership category. The combined total is insured up to $250,000.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

Notes to Financial Statements

3. Certificates of Deposit in Other Banks

The certificates mature as follows:

Maturity period	2020	2019
One year or less	$ 947,000	$ 947,000
Over one to two years	470,000	947,000
Over two to three years	449,000	470,000
Over three to four years	249,000	449,000
Over four to five years	225,000	249,000
	$ 2,340,000	$ 3,062,000

All individual certificates of deposit balances are in increments of $250,000 or less to allow for full FDIC insurance coverage.

4. Investment Securities Available for Sale

Investment securities are summarized as follows:

December 31, 2020	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Annual income
U.S. Treasury	$ -	$ -	$ -	$ -	$ 99,952
U.S. government agency	5,213,052	133,950	7,209	5,339,793	132,923
Corporate	1,211,453	83,572	8,853	1,286,172	35,027
State and municipal	9,082,903	166,701	59,970	9,189,634	126,231
Mortgage-backed securities	11,182,578	129,974	38,970	11,273,582	154,434
	$ 26,689,986	$ 514,197	$ 115,002	$ 27,089,181	$ 548,567

December 31, 2019	Amortized cost	Unrealized gains	Unrealized losses	Fair value	Annual income
U.S. Treasury	$ 10,016,352	$ 3,960	$ -	$ 10,020,312	$ 114,366
U.S. government agency	5,079,567	68,164	13,675	5,134,056	122,635
Corporate	717,045	26,363	1,377	742,031	43,848
State and municipal	2,464,759	25,317	42	2,490,034	90,926
Mortgage-backed securities	4,973,972	86,870	11,260	5,049,582	135,123
	$ 23,251,695	$ 210,674	$ 26,354	$ 23,436,015	$ 506,898

The decline in fair values of debt securities is a result of the fluctuations in interest rates. Since no loss is expected on these securities, no impairment has been recorded. During 2020, management sold securities with a book value of $954,253, realizing gross gains of $30,354 and gross losses of $16,196. During 2019, management sold securities with a book value of $1,170,815, realizing gross gains of $5,918 and gross losses of $6,673. Replacement investments were purchased where the increased yield recovered the loss by December 31, 2019. The Bank recognized a $1,000 impairment loss on an equity security in 2018.

Notes to Financial Statements

4. Investment Securities Available for Sale (Continued)

The Bank has pledged investment securities as collateral on certain deposits. The Bank also has a secured line of credit from a correspondent bank that, when drawn, requires pledging of securities.

Contractual maturities and the amount of pledged securities are shown below. Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations. Mortgage-backed securities are due in monthly installments and small business administration securities are payable in quarterly installments.

	December 31, 2020		December 31, 2019	
Maturity period	Amortized cost	Fair value	Amortized cost	Fair value
One year or less	$ 695,937	$ 707,335	$ 10,141,918	$ 10,146,496
One through five years	2,224,943	2,272,215	2,770,944	2,800,342
Five through ten years	3,866,084	3,994,952	2,768,740	2,798,744
After ten years	6,551,976	6,567,645	388,360	388,607
Mortgage-backed securities	11,182,578	11,273,582	4,973,972	5,049,582
Small business administration agencies	2,168,468	2,273,452	2,207,761	2,252,244
	$ 26,689,986	$ 27,089,181	$ 23,251,695	$ 23,436,015
Pledged securities	$ 3,559,873	$ 3,637,426	$ 2,459,259	$ 2,481,081

Investment securities with unrealized losses for continuous periods of less than twelve months and twelve months or longer are as follows:

	Less than 12 months		12 months or longer		Total	
December 31, 2020	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. government agency	$ 1,542,864	$ 5,401	$ 47,565	$ 1,808	$ 1,590,429	$ 7,209
Corporate	216,147	38,970	-	-	216,147	8,853
State and municipal	2,995,590	59,970	-	-	2,995,590	59,970
Mortgage-backed securities	5,445,536	8,853	-	-	5,445,536	38,970
	$ 10,200,137	$ 113,194	$ 47,565	$ 1,808	$ 10,247,702	$ 115,002

	Less than 12 months		12 months or longer		Total	
December 31, 2019	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
U.S. Treasury	$ -	$ -	$ -	$ -	$ -	$ -
U.S. government agency	1,856,436	11,742	86,091	1,933	1,942,527	13,675
Corporate	223,623	1,377	-	-	223,623	1,377
State and municipal	250,638	42	-	-	250,638	42
Mortgage-backed securities	809,685	6,623	512,082	4,637	1,321,767	11,260
	$ 3,140,382	$ 19,784	$ 598,173	$ 6,570	$ 3,738,555	$ 26,354

Notes to Financial Statements

5. Loans

Major classifications of loans are as follows:

December 31,	2020	2019
Mortgage		
Residential	$ 148,626,792	$ 157,263,524
Commercial	76,541,316	81,450,268
Farm	17,134,015	21,247,501
Construction	23,272,350	31,921,665
Commercial and agricultural	38,650,459	34,760,217
Consumer	8,495,618	8,034,418
	312,720,550	334,677,593
Allowance for loan losses	3,176,328	3,222,340
Loans, net	$ 309,544,222	$ 331,455,253

Loans are reported after adding the balances of the deferred costs net of deferred origination fees and unearned interest recorded as a result of restoring loans to accrual status. The total adjustment for net fees and unearned interest was $394,650 and $169,799 as of December 31, 2020 and 2019, respectively.

Nonaccrual loans are as follows:

December 31,	2020	2019
Mortgage		
Residential	$ 121,036	$ 303,485
Commercial	-	2,651,561
Farm	-	-
Construction	367,906	459,385
Commercial and agricultural	98,915	45,898
Consumer	7,580	19,033
	$ 595,437	$ 3,479,362
Interest not accrued	$ 125,633	$ 369,019

An analysis of past due loans as of December 31, 2020 follows:

	Loans 30-89 days past due	Loans 90 or more days past due	Total past due loans	Current loans	Total loans	Accruing Loans 90 or more days past due
Mortgage						
Residential	$ 196,559	$ -	$ 196,559	$ 148,430,233	$ 148,626,792	$ -
Commercial	-	-	-	76,541,316	76,541,316	-
Farm	-	-	-	17,134,015	17,134,015	-
Construction	-	367,906	367,906	22,904,444	23,272,350	-
Commercial and agricultural	74,559	98,915	173,474	38,476,985	38,650,459	-
Consumer	52,828	4,156	56,984	8,438,634	8,495,618	4,156
	$ 323,946	$ 470,977	$ 794,923	$ 311,925,627	$ 312,720,550	$ 4,156

Notes to Financial Statements

5. **Loans** (Continued)

An analysis of past due loans as of December 31, 2019 follows:

	Loans 30-89 days past due	Loans 90 or more days past due	Total past due loans	Current loans	Total loans	Accruing Loans 90 or more days past due
Mortgage						
Residential	$ 753,700	$ 1,629,097	$ 2,382,797	$ 154,880,727	$ 157,263,524	$ 1,325,612
Commercial	-	2,651,561	2,651,561	78,798,707	81,450,268	-
Farm	-	-	-	21,247,501	21,247,501	-
Construction	157,435	1,470,465	1,627,900	30,293,765	31,921,665	1,011,080
Commercial and agricultural	154,073	-	154,073	34,606,144	34,760,217	-
Consumer	129,774	3,078	132,852	7,901,566	8,034,418	3,078
	$ 1,194,982	$ 5,754,201	$ 6,949,183	$ 327,728,410	$ 334,677,593	$ 2,339,770

Information regarding impaired loans as of and for the year ending December 31, 2020 is as follows:

	Unpaid contractual principal balance	Recorded investment	Related allowance	Average recorded investment	Interest income recognized
With no related allowance					
Mortgage					
Residential	$ 289,652	$ 289,652	$ -	$ 290,999	$ 17,900
Commercial	748,353	367,906	-	432,094	-
Farm	500,000	500,000	-	589,289	32,795
Construction	-	-	-	-	-
Commercial and agricultural	-	-	-	-	-
Consumer	14,601	7,579	-	13,034	-
	1,552,606	1,165,137	-	1,325,416	50,695
With related allowance					
Mortgage					
Residential	670,071	656,152	131,755	670,531	18,292
Commercial	144,826	144,826	10,151	145,798	7,510
Farm	-	-	-	-	-
Construction	154,389	115,472	2,761	123,378	7,922
Commercial and agricultural	314,672	246,296	87,487	260,289	7,968
Consumer	46,968	46,417	11,036	49,808	1,773
	1,330,926	1,209,163	243,190	1,249,804	43,465
Totals					
Mortgage					
Residential	959,723	945,804	131,755	961,530	36,192
Commercial	893,179	512,732	10,151	577,892	7,510
Farm	500,000	500,000	-	589,289	32,795
Construction	154,389	115,472	2,761	123,378	7,922
Commercial and agricultural	314,672	246,296	87,487	260,289	7,968
Consumer	61,569	53,996	11,036	62,842	1,773
	$ 2,883,532	$ 2,374,300	$ 243,190	$ 2,575,220	$ 94,160

Notes to Financial Statements

5. **Loans** (Continued)

Information regarding impaired loans as of and for the year ending December 31, 2019 is as follows:

	Unpaid contractual principal balance	Recorded investment	Related allowance	Average recorded investment	Interest income recognized
With no related allowance					
Mortgage					
Residential	$ 272,160	$ 272,160	$ -	$ 273,909	$ 7,465
Commercial	1,902,804	1,445,860	-	1,446,134	22,665
Farm	-	-	-	-	-
Construction	552,973	261,385	-	294,824	-
Commercial and agricultural	42,058	37,276	-	40,145	-
Consumer	38,855	33,349	-	23,614	1,040
	2,808,850	2,050,030	-	2,078,626	31,170
With related allowance					
Mortgage					
Residential	2,138,857	2,086,898	313,345	2,092,238	105,931
Commercial	2,196,120	2,183,186	348,983	2,186,462	14,003
Farm	648,815	648,815	100,000	648,815	69,794
Construction	286,859	198,000	25,950	216,972	-
Commercial and agricultural	154,683	153,344	33,767	156,270	5,425
Consumer	63,472	63,472	22,073	65,865	3,263
	5,488,806	5,333,715	844,118	5,366,622	198,416
Totals					
Mortgage					
Residential	2,411,017	2,359,058	313,345	2,366,147	113,396
Commercial	4,098,924	3,629,046	348,983	3,632,596	36,668
Farm	648,815	648,815	100,000	648,815	69,794
Construction	839,832	459,385	25,950	511,796	-
Commercial and agricultural	196,741	190,620	33,767	196,415	5,425
Consumer	102,327	96,821	22,073	89,479	4,303
	$ 8,297,656	$ 7,383,745	$ 844,118	$ 7,445,248	$ 229,586

Outstanding loan balances based on allowance impairment analysis are as follows:

	December 31, 2020		December 31, 2019	
	Individually evaluated	Collectively evaluated	Individually evaluated	Collectively evaluated
Mortgage				
Residential	$ 945,804	$ 147,680,988	$ 2,359,058	$ 154,904,466
Commercial	512,732	76,028,584	3,629,046	77,821,222
Farm	500,000	16,634,015	648,815	20,598,686
Construction	115,472	23,156,878	459,385	31,462,280
Commercial and agricultural	246,296	38,404,163	190,620	34,569,597
Consumer	53,996	8,441,622	96,821	7,937,597
	$ 2,374,300	$ 310,346,250	$ 7,383,745	$ 327,293,848

Notes to Financial Statements

5. Loans (Continued)

Composition of the allowance for loan losses, by loan classification and based on impairment analysis, is as follows:

	December 31, 2020		December 31, 2019	
	Individually evaluated	Collectively evaluated	Individually evaluated	Collectively evaluated
Mortgage				
Residential	$ 131,755	$ 734,967	$ 313,345	$ 662,867
Commercial	10,151	925,871	348,983	238,932
Farm	-	234,572	100,000	107,846
Construction	2,761	351,453	25,950	617,494
Commercial and agricultural	87,487	445,634	33,767	486,020
Consumer	11,036	47,724	22,073	35,063
Unallocated	-	192,917	-	230,000
	$ 243,190	$ 2,933,138	$ 844,118	$ 2,378,222

Transactions in the allowance for loan losses, by loan classification, are as follows:

December 31, 2020	Beginning balance	Provision for loan losses	Charge-offs	Recoveries	Ending balance
Mortgage					
Residential	$ 976,212	$ (125,117)	$ 110,695	$ 126,322	$ 866,722
Commercial	587,915	889,434	587,827	46,500	936,022
Farm	207,846	345,094	349,503	31,135	234,572
Construction	643,444	(289,230)	-	-	354,214
Commercial and agricultural	519,787	86,708	125,655	52,281	533,121
Consumer	57,136	5,194	73,808	70,238	58,760
Unallocated	230,000	(37,083)	-	-	192,917
	$ 3,222,340	$ 875,000	$ 1,247,488	$ 326,476	$ 3,176,328

December 31, 2019	Beginning balance	Provision for loan losses	Charge-offs	Recoveries	Ending balance
Mortgage					
Residential	$ 883,572	$ 660,019	$ 620,394	$ 53,015	$ 976,212
Commercial	514,026	73,889	-	-	587,915
Farm	133,415	103,231	28,800	-	207,846
Construction	939,993	(97,501)	206,872	7,824	643,444
Commercial and agricultural	655,710	198,004	413,605	79,678	519,787
Consumer	71,295	(2,288)	89,171	77,300	57,136
Unallocated	100,000	130,000	-	-	230,000
	$ 3,298,011	$ 1,065,354	$ 1,358,842	$ 217,817	$ 3,222,340

The Bank makes loans to customers primarily located in the Delmarva region. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

Notes to Financial Statements

5. Loans (Continued)

Credit quality indicators

Management has developed a loan risk grading system to help monitor the overall credit quality of its loan portfolio. Each loan is assigned a risk grade at origination. Large credits, regardless of performance, are reviewed annually to determine the risk grade is still suitable. Loan grades are changed as borrowers' circumstances change and either develop credit weaknesses or improved conditions and performance are noted.

Special mention

A special mention loan has potential weaknesses in the credit that require management's close attention. Generally, special mention credits have a weakness that can be corrected in a relatively short period of time. Poor liquidity or fault in collateral title can result in a special mention grade. If left uncorrected, these potential credit weaknesses may result in deterioration of repayment prospects. Special mention loans do not expose the Bank to sufficient risk to warrant an adverse classification.

Substandard

A substandard loan has a well-defined weakness or weaknesses that jeopardize the ultimate repayment of the loan and require more intense supervision by Bank management. The weaknesses in the collateral value, cash flows or borrower's/project's performance would likely result in some loss to the Bank if the deficiencies are not corrected. Borrowers may exhibit recent or unexpected losses, and inadequate debt service coverage ratio, or marginal liquidity and capitalization. Loans that are classified as troubled debt restructured loans are generally graded substandard until the borrower shows the ability to perform under the modified terms of the restructure.

Doubtful

A loan classified as doubtful has all the weaknesses of a substandard loan with the added characteristic that the weaknesses in the credit make collection or liquidation in full, highly improbable.

Loss

Rarely does the Bank use this category. If a credit is deemed loss, management generally records a charge-off unless there are extenuating circumstances.

Summarized below is the credit risk profile of the loan portfolio as of December 31, 2020:

	Pass credits	Special Mention	Substandard	Doubtful	Loss
Mortgage					
Residential	$ 148,347,316	$ 158,440	$ 121,036	$ -	$ -
Commercial	76,541,316	-	-	-	-
Farm	17,134,015	-	-	-	-
Construction	22,904,444	-	367,906	-	-
Commercial and agricultural	38,551,544	-	98,915	-	-
Consumer	8,480,920	-	14,698	-	-
	$ 311,959,555	$ 158,440	$ 602,555	$ -	$ -

During the year ended December 31, 2020, the Bank provided short-term deferrals of loan principal payments up to 90 days for borrowers who were affected by the COVID-19 pandemic. These borrowers were required to meet certain criteria, such as being in good standing and not more than 30 days past due prior to the pandemic. As of December 31, 2020, four borrowers had $578,018 outstanding under this program and three additional borrowers with balances totaling $26,888 received a second 90-day concession.

Notes to Financial Statements

5. Loans (Continued)

Summarized below is the credit risk profile of the loan portfolio as of December 31, 2019:

	Pass credits	Special Mention	Substandard	Doubtful	Loss
Mortgage					
Residential	$ 155,825,796	$ 1,134,243	$ 303,485	$ -	$ -
Commercial	78,798,707	-	2,651,561	-	-
Farm	20,598,686	-	648,815	-	-
Construction	30,293,765	1,168,515	459,385	-	-
Commercial and agricultural	34,714,318	-	45,899	-	-
Consumer	7,978,745	29,793	25,880	-	-
	$ 328,210,017	$ 2,332,551	$ 4,135,025	$ -	$ -

The restructuring of a loan is considered a "troubled debt restructuring" if both (i) the borrower is experiencing financial difficulties and (ii) the creditor has granted a concession. These concessions typically result from the Bank's loss mitigation activities and may include interest rate reductions or below market interest rates, principal forgiveness, restructuring amortization schedules, forbearance and other actions intended to minimize potential losses and to avoid foreclosure or repossession of collateral.

The Bank works with customers to restructure loans by changing the interest rate, modifying the payment term, and writing off accrued interest.

The Bank has outstanding troubled debt restructured (TDR) loans as follows:

	December 31, 2020			December 31, 2019		
	Count	Contract balance	Modified balance	Count	Contract balance	Modified balance
Performing						
Mortgage						
Residential	6	$ 673,845	$ 673,845	9	$ 1,209,170	$ 1,190,231
Commercial	-	-	-	5	990,419	977,484
Farm	1	500,000	500,000	-	-	-
Construction	1	154,390	150,066	1	157,858	153,535
Commercial and agricultural	2	165,757	164,108	1	162,256	162,256
Consumer	1	39,850	39,850	1	44,732	44,732
	11	1,533,842	1,527,869	17	2,564,435	2,528,238
Nonperforming						
Mortgage						
Residential	1	127,437	121,036	-	-	-
Commercial	-	-	-	-	-	-
Farm	-	-	-	-	-	-
Construction	2	552,972	261,385	2	552,972	261,385
Commercial and agricultural	-	-	-	1	9,961	8,622
Consumer	-	-	-	-	-	-
	3	680,409	382,421	3	562,933	270,007
Total	14	$ 2,214,251	$ 1,910,290	20	$ 3,127,368	$ 2,798,245

Notes to Financial Statements

5. Loans (Continued)

As of December 31, 2020 and 2019, there were no delinquent TDR loans more than ninety days and still accruing interest. During 2020 the Bank transferred a restructured residential mortgage with a balance of $323,122 into foreclosed properties. The Bank also recorded charge-offs on restructured loans of $37,827 for commercial mortgages while recording recoveries of $11,034 for residential mortgages. During 2019 the Bank recorded charge-offs on restructured loans of $120,013 for construction loans while recording recoveries of $7,824 for construction loans and $11,034 for residential mortgages.

During 2020, the Bank restructured one residential mortgage loan with a total outstanding balance of $128,485 and one farm loan with a total outstanding balance of $500,000. There were no new troubled debt restructurings in 2019.

The Bank has the following loan commitments outstanding:

December 31,	2020	2019
Construction loans	$ 8,020,050	$ 9,303,623
Home equity and revolving residential lines	5,407,525	4,144,452
Other lines of credit	17,902,599	12,036,836
Standby letters of credit	1,172,359	1,631,060
Payment letters of credit	-	5,000
	$ 32,502,533	$ 27,120,971

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have interest fixed at current market rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank's exposure to loss in the event of nonperformance by the borrower is represented by the contract amount of the commitment. Management is not aware of any accounting loss the Bank will incur by the funding of these commitments.

6. Lease Commitments

The Bank has entered into agreements to lease branch premises at the following locations:

Location	Branch	Lease expiration	Renewals
Ocean City, Maryland	West OC	April 30, 2030	Two 5-year terms
Ocean City, Maryland	North OC	December 31, 2025	One 5-year term
Ocean City, Maryland	Talbot St.	May 31, 2021	none
Millsboro, Delaware	Millsboro	April 15, 2037	Three 10-year terms

Rent expense for 2020, 2019, and 2018 was $174,406, $137,805, and $136,331, respectively. The Bank is also required to pay certain executory costs including insurance, real estate taxes, and common area maintenance.

Notes to Financial Statements

6. Lease Commitments (Continued)

Lease obligations, including renewal periods management is reasonably certain will be exercised, will require minimum payments as follows:

Period	Amount
2021	$ 195,077
2022	196,814
2023	198,501
2024	188,989
2025	129,422
Remaining years	743,696
	$ 1,652,499

7. Premises and Equipment

A summary of premises and equipment and the related depreciation follows:

	Useful life	2020	2019
Land		$2,091,716	$2,091,716
Buildings and improvements	10-40 years	3,753,379	3,740,804
Leasehold improvements	10-40 years	1,822,192	1,820,483
Furniture and equipment	5-10 years	3,927,939	3,711,339
Automobiles	4-5 years	74,284	49,010
		11,669,510	11,413,352
Accumulated depreciation and amortization		4,820,887	4,467,162
Net premises and equipment		$6,848,623	$6,946,190
Depreciation and amortization expense		$ 445,855	$ 385,076

Included in other assets at December 31, 2020 and 2019, is computer software carried at an amortized cost of $101,769 and $117,909, respectively. Software amortization expense was $42,320 and $38,534 in 2020 and 2019, respectively.

8. Foreclosed Real Estate

Transactions in foreclosed real estate are as follows:

	2020	2019	2018
Beginning of year balance	$ 1,579,610	$ 2,720,960	$ 2,995,549
Additions and improvements	2,625,320	545,257	1,134,239
Sale deferred (recognized)	(55,016)	(524,730)	(2,505)
Sales proceeds	(811,227)	(943,070)	(1,174,395)
Writedowns and losses	(38,829)	(218,807)	(231,928)
End of year balance	$ 3,299,858	$ 1,579,610	$ 2,720,960

Notes to Financial Statements

8. Foreclosed Real Estate (Continued)

The Bank has financed some of the sales of its foreclosed real estate properties. If the down payments on these sales are less than required by accounting standards for sales treatment, the financed properties remain in foreclosed real estate until payments made on the loans plus the original down payments exceed thresholds for required down payment. Any gains on these sales are also deferred. Gains of $160 and $36,413 were recognized on loans transferred out of foreclosed real estate in 2020 and 2019, respectively. Financed properties reported as foreclosed real estate as of December 31, 2020, 2019, and 2018 totaled $271,152, $326,168, and $677,918, respectively.

There were no loans in the process of foreclosure as of December 31, 2020. Six loans, totaling $1,370,336 were in the process of foreclosure as of December 31, 2019. As of December 31, 2018, two outstanding loans totaling $177,128 were in the process of foreclosure.

9. Deposits

Major classifications of interest-bearing deposits are as follows:

December 31,	2020	2019
Money market and NOW	$ 67,086,136	$ 47,588,879
Savings	59,302,680	43,461,878
Certificates of deposit over $250,000	19,718,403	17,325,979
Other time	107,119,608	111,488,463
	$ 253,226,827	$ 219,865,199

The maturity and repricing distributions of time deposits as of December 31, 2020 follows:

Time deposits	Over $250,000	Other	Maturity Total
One year or less	$ 11,762,845	$ 66,909,674	$ 78,672,519
Over one to two years	3,945,411	14,407,608	18,353,019
Over two to three years	2,245,840	9,144,675	11,390,515
Over three to four years	772,823	7,790,291	8,563,114
Over four to five years	991,484	8,867,360	9,858,844
	$ 19,718,403	$ 107,119,608	$ 126,838,011

Certain certificates are issued with a step-up feature that provides the owner a one-time opportunity to increase the certificate of deposit rate to the current rate of newly issued certificates of the same term at the date the option is exercised. Once a certificate of deposit step-up feature has been exercised, the deposit becomes fixed rate.

Demand deposits and interest-bearing escrow accounts, in an overdraft status, totaling $38,268 and $67,655, as of December 31, 2020 and 2019, respectively have been reclassified as loans.

Notes to Financial Statements

10. Lines of Credit and Federal Home Loan Bank Advances

The Bank has an available line of credit of $12,000,000 in overnight federal funds from a correspondent bank. $6,000,000 of this line is unsecured while the balance of the line of credit is collateralized with pledged investment securities. The entire line was available as of December 31, 2020. As of December 31, 2019, there was an overnight advance of $3,500,000 outstanding under this line of credit, with an interest rate of 1.975%. As of December 31, 2019, $8,500,000 of this line was available.

The Bank also has a line of credit with the Federal Home Loan Bank (FHLB) which allows total outstanding advances of twenty five percent of total assets. Because the Bank has pledged as collateral its portfolio of first mortgages on residential properties, the total available advances is limited by this portfolio. Based on this collateral, the total remaining credit available with the FHLB as of December 31, 2020 and 2019 was $32,846,171 and $22,806,260, respectively. In addition to the first residential mortgage portfolio, the FHLB has placed a blanket lien on all of the loans of the Bank with the exception of the nonmortgage consumer and commercial loans.

The nonmortgage consumer and commercial loan portfolios are pledged as collateral on a line of credit from the Federal Reserve Bank. The total available under this line of credit as of December 31, 2020 and 2019 was $20,168,101 and $29,979,554, respectively.

A summary of outstanding FHLB advances is as follows:

		December 31,		
Description	Rate	2020	2019	Maturity
One year advance	1.7875%		10,385,000	August 21, 2020
One year line	variable		2,200,000	September 8,2020
Three year advance	2.3360%		8,000,000	January 15, 2021
Five year advance	2.0600%		5,000,000	June 9, 2022
Five year advance	3.0435%		15,000,000	June 8, 2023
Five year advance	1.4900%	8,000,000		March 13, 2025
Six year advance	1.7900%	5,000,000		March 13, 2026
Seven year advance	2.3930%	15,000,000		March 13, 2027
		$ 28,000,000	$ 40,585,000	

The interest rates on the closed end advances are fixed. The interest rate on the revolving line of credit is variable each day with the FHLB's published daily rate. In March of 2020, the Bank refinanced $28 million outstanding advances at lower rates and extended the maturities of the advances. There were no fees associated with the refinances.

11. Employment Contract

The Bank is party to a ten-year employment agreement, dated September 2002, with an executive that provides for compensation and certain other benefits. The agreement had one ten-year extension, which extended the agreement through 2022. The contract provides severance payments of three years of compensation under certain circumstances.

Notes to Financial Statements

12. Retirement Plans

The Bank sponsors a profit sharing plan that covers all employees with one year of service who have attained age twenty-one. Contributions are determined annually by the Board of Directors. During 2020, 2019, and 2018 the Board made safe harbor contributions which matched 100% of the first 3% of employee compensation and 50% of the next 2% of employee compensation for a maximum match of 4%, resulting in total of contributions of $142,000, $130,950, and $125,163, respectively.

The Bank has adopted a supplemental executive retirement plan for three of its executive officers. The plan provides fixed annual benefits to each participant at normal retirement or disability date. The benefits vest over the period from adoption to normal retirement age. The Bank recorded expenses, including interest, of $189,979, $186,883, and $148,158 for the years ended December 31, 2020, 2019, and 2018, respectively. These plans are funded by five life insurance contracts, with a face value of $3,000,000, which are owned by the Bank. During 2019, one of the three executives retired. He is receiving annual benefits in accordance with terms of the plan.

13. Related Party Transactions

Officers, directors and employees are depositors of the Bank. They receive the same deposit rates and terms as other customers with similar deposits. As of December 31, 2020 and 2019, the deposits of executive officers and directors were $10,926,394 and $8,584,374, respectively.

Executive officers and directors of the Bank enter into loan transactions with the Bank in the ordinary course of business. The terms of these transactions are similar to the terms provided to other borrowers entering into similar loan transactions.

A summary of the activity in these loans is as follows:

	2020	2019
Beginning balance	$ 11,932,096	$ 12,120,186
Advances	2,954,019	6,038,303
Change in officers	-	238,281
Repayments	(2,312,547)	(6,464,674)
Ending balance	$ 12,573,568	$ 11,932,096

In 2005 the Bank entered into an agreement to lease a branch from a company owned by the Chairman of the Board of Directors. Rent paid to this company in 2020, 2019, and 2018 totaled $48,735, $48,322, and $46,349, respectively with additional executory costs of $172, $95, and $126 in 2020, 2019, and 2018, respectively. During 2020, 2019, and 2018 the Bank also purchased supplies totaling $182, $167, and $284, respectively, from a store owned by this director.

The Bank built a branch in Millsboro, Delaware upon land owned by a director. The Bank paid rent on the lease of this land totaling $44,991, $43,597, and $42,123 for 2020, 2019, and 2018, respectively. This director owns an auto body shop that performed $2,045 in repairs on the Bank automobile in 2020. During 2020 the Bank foreclosed on property that included land, buildings, and equipment. At the November 2020 auction of this property, this director purchased most of the equipment at a price of $825,000. The Bank has agreed to rent him the buildings in which the large production equipment is located at $1,000 per month.

A director owned a furniture store. During 2018, the Bank paid $20,177 to this store for the purchase of furniture and window treatments.

Notes to Financial Statements

14. Income Taxes

A reconciliation of the statutory federal income tax rates to the effective income tax rates follows:

	2020	2019	2018
Statutory federal income tax rate	21.0 %	21.0 %	21.0 %
Increase (decrease) in tax rate resulting from:			
Tax-exempt income	(1.0)	(1.0)	(1.3)
State tax, net of federal tax benefit	5.9	5.8	5.6
Other, net	(0.1)	0.1	0.2
Income tax expense	25.8 %	25.9 %	25.5 %

The components of income tax expense (benefits) are as follows:

	2020	2019	2018
Current			
Federal	$ 1,060,030	$ 1,097,320	$ 558,677
State	408,787	469,305	221,877
	1,468,817	1,566,625	780,554
Deferred	(127,010)	(117,659)	372,335
	$ 1,341,807	$ 1,448,966	$ 1,152,889

The Bank does not have material uncertain tax positions and did not recognize any adjustment for unrecognized tax benefits. The Bank remains subject to examination of income tax returns for the years ending after December 31, 2016.

The components of the deferred taxes are as follows:

	2020	2019	2018
Provision for loan losses	$ (175,551)	$ (160,324)	$ 149,198
Writedowns of foreclosed real estate	8,612	2,350	230,295
Deferred gain on foreclosed property sales	44	8,603	-
Supplemental executive retirement plan	(37,803)	(40,253)	(40,770)
Interest on nonaccrual loans	66,974	(40,165)	(7,750)
Writedown of equity securties	-	-	11,062
Depreciation	10,714	112,130	30,300
	$ (127,010)	$ (117,659)	$ 372,335

Notes to Financial Statements

14. Income Taxes (Continued)

The components of the net deferred tax asset are as follows:

	2020	2019	2018
Deferred tax assets			
Allowance for loan and letter of credit losses	$ 487,959	$ 312,408	$ 152,084
Foreclosed real estate writedowns	74,396	83,008	85,358
Deferred gain on foreclosed property sales	2,793	2,837	11,440
Supplemental executive retirement plan	424,867	387,064	346,811
Interest on nonaccrual loans	34,571	101,545	61,380
Unrealized loss on securities available for sale	-	-	9,550
	1,024,586	886,862	666,623
Deferred tax liability			
Unrealized gain on securities available for sale	109,848	50,720	-
Depreciation	472,876	462,162	350,032
	582,724	512,882	350,032
	$ 441,862	$ 373,980	$ 316,591

15. Capital Standards

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

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). With the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital.

Common Equity Tier 1 capital consists of common stock, surplus, and undivided profits less disallowed deferred tax assets. Tier 1 capital includes Common Equity Tier 1 capital components with adjustments for certain investments and other items in which the Bank does not participate. Consequently, the Bank’s Common Equity Tier 1 capital and Tier 1 capital are the same.

Total capital includes the allowance for loan losses, as limited based on total risk-weighted assets. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items.

Failure to meet the capital requirements could affect the Bank's ability to pay dividends and accept deposits and may significantly affect the operations of the Bank. Effective in 2016, a capital conservation buffer was phased in over four years, at the rate of .625% per annum, until it reached 2.5% of risk-weighted assets in 2019. The capital conservation buffer is not applied to the leverage, or Tier 1 capital to average assets, ratio. The buffer provides additional capital the Bank must hold to make the Bank more resilient during downturns in the economic cycle. If the Bank fails to meet the buffer, its ability to pay out dividends, buy back stock and pay discretionary bonuses will be limited.

Notes to Financial Statements

15. Capital Standards (Continued)

As of its most recent regulatory examination, the Bank was considered well capitalized. Management knows of no conditions or events since the last regulatory examination that would change this classification.

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute to be categorized as well capitalized under the regulatory framework for prompt corrective action.

The following table presents actual and required capital ratios as of December 31, 2020, and December 31, 2019, for the Bank under the Basel III Capital Rules.

(Dollars in thousands)	Actual		Minimum capital adequacy		To be well capitalized	
December 31, 2020	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 48,505	17.97%	$ 21,591	8.00%	$ 26,989	10.00%
Tier 1 capital (to risk-weighted assets)	$ 45,311	16.79%	$ 16,193	6.00%	$ 21,591	8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 45,311	16.79%	$ 12,145	4.50%	$ 17,543	6.50%
Capital conservation buffer	$ 26,914	9.97%	$ 6,747	2.50%		
Tier 1 capital (to average assets)	$ 45,311	10.15%	$ 17,859	4.00%	$ 22,324	5.00%
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 46,226	15.82%	$ 23,373	8.00%	$ 29,216	10.00%
Tier 1 capital (to risk-weighted assets)	$ 42,986	14.71%	$ 17,350	6.00%	$ 23,373	8.00%
Common equity tier 1 capital (to risk-weighted assets)	$ 42,986	14.71%	$ 13,147	4.50%	$ 18,991	6.50%
Capital conservation buffer	$ 22,853	7.82%	$ 7,304	2.50%		
Tier 1 capital (to average assets)	$ 42,986	11.03%	$ 15,586	4.00%	$ 19,483	5.00%

16. Fair Value Measures

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced liquidation. The Financial Accounting Standards Board (FASB) defines fair value and establishes a framework for measuring fair value. Its guidance also establishes a hierarchy for determining fair value measurements. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities.

Level one uses inputs of quoted prices, unadjusted, for identical assets or liabilities in active markets. Level two inputs to the valuation method include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. Level three assumes inputs to the valuation method that are unobservable and significant to the fair value measurement.

Debt securities classified as available for sale are measured at fair value on a recurring basis. The fair value of municipal bonds classified as available for sale are estimated by applying spreads to curve using the municipal yield curve provided daily by market makers. The fair value of U.S. Treasury, U.S. Agency, mortgage-backed securities, and corporate bonds are calculated from a yield curve derived daily using various market makers. The values are generated by applying spreads to this curve. The Bank does not measure the fair value of any of its other financial assets or liabilities on a recurring basis.

Notes to Financial Statements

16. Fair Value Measures (Continued)

The assets measured at fair value on a recurring basis are as follows:

		Fair value measurements using:		
December 31, 2020	Total	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Investment securities available for sale				
U.S. government agency	$ 5,339,793	$ -	$ 5,339,793	$ -
Corporate	1,286,172	-	1,286,172	-
State and municipal	9,189,634	-	9,189,634	-
Mortgage-backed	11,273,582	-	11,273,582	-
	$ 27,089,181	$ -	$ 27,089,181	$ -
December 31, 2019				
Investment securities available for sale				
U.S. treasury	$ 10,020,312	$ -	$ 10,020,312	$ -
U.S. government agency	5,134,056	-	5,134,056	-
Corporate	742,031	-	742,031	-
State and municipal	2,490,034	-	2,490,034	-
Mortgage-backed	5,049,582	-	5,049,582	-
	$ 23,436,015	$ -	$ 23,436,015	$ -

Impaired loans are generally measured based on the fair value of the loan's collateral on a nonrecurring basis. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values. As of December 31, 2020 and 2019, the fair values of impaired loans are estimated to be $2,131,110 and $6,539,627, respectively. As of December 31, 2020 and 2019, the fair values of these loans consist of recorded investment in loan balances of $2,374,300 and $7,383,745, net of valuation allowances of $243,190 and $844,118, respectively.

The Bank measures its foreclosed real estate, on a nonrecurring basis at fair value less costs to sell. As of December 31, 2020 and 2019, the fair value was estimated to be $3,299,858 and $1,579,610, respectively. The fair value of foreclosed real estate was based on offers and/or appraisals. Cost to sell the real estate was based on standard market factors. The Bank has categorized its foreclosed real estate as Level 3. The lack of an active local real estate market makes these fair values "best estimates" only. There is no assurance that the Bank will realize the recorded fair value of these properties as they are sold.

ROWLES
& Company, LLP
Certified Public Accountants

The Board of Directors and Stockholders
The Farmers Bank of Willards
Willards, Maryland

Report of Independent Auditors

Report on the Financial Statements

We have audited the accompanying financial statements of The Farmers Bank of Willards, which comprise the balance sheets as of December 31, 2020 and 2019, the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years ended December 31, 2020, 2019, and 2018, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 Bank'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 Bank's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The Farmers Bank of Willards as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years ended December 31, 2020, 2019, and 2018, in accordance with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

Baltimore, Maryland
March 9, 2021

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443-725-5395 Fax 443-725-5074
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Average Balances, Interest, and Yields (unaudited)

	For the Year Ended December 31, 2020			For the Year Ended December 31, 2019		
	Average balance	Interest	Yield	Average balance	Interest	Yield
Assets						
Federal funds sold	$ 2,245,486	$ 3,439	0.15%	$ 918,584	$ 17,586	1.91%
Interest bearing deposits	52,220,408	160,402	0.31%	11,439,207	223,081	1.95%
Investment securities						
U.S. treasury	5,810,444	106,921	1.84%	6,162,729	122,339	1.99%
U. S. agency and MBS	12,320,453	296,074	2.40%	8,880,972	266,308	3.00%
State and municipal	5,684,974	142,174	2.50%	3,388,639	107,901	3.18%
Corporate	1,145,749	35,027	3.06%	994,233	43,848	4.41%
Total investment securities	24,961,620	580,196	2.32%	19,426,573	540,396	2.78%
Bank stock	1,883,928	107,476	5.70%	1,959,785	123,516	6.30%
Loans						
Commercial	43,353,166	2,459,528	5.67%	31,367,605	1,997,176	6.37%
Mortgage	274,043,621	14,935,923	5.45%	293,498,141	16,190,542	5.52%
Consumer	7,956,598	699,770	8.79%	7,804,711	696,478	8.92%
Total loans	325,353,385	18,095,221	5.56%	332,670,457	18,884,196	5.68%
Allowance for loan losses	3,416,149			3,329,140		
Total loans, net of allowance	321,937,236	18,095,221	5.62%	329,341,317	18,884,196	5.73%
Total interest-earning assets	403,248,678	18,946,734	4.70%	363,085,466	19,788,775	5.45%
Noninterest-bearing cash	6,150,485	-		6,984,162	-	
Premises and equipment	6,744,861	-		6,937,698	-	
Other assets	8,984,830	-		9,039,688	-	
Total assets	$ 425,128,854	$ 18,946,734		$ 386,047,014	$ 19,788,775	
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
Savings and NOW deposits	$ 76,428,385	$ 198,490	0.26%	$ 60,514,629	$ 150,907	0.25%
Money market	31,854,121	111,386	0.35%	28,305,361	83,610	0.30%
Other time deposits	130,353,861	2,034,817	1.56%	137,325,213	2,218,113	1.62%
Total interest-bearing deposits	238,636,367	2,344,693	0.98%	226,145,203	2,452,630	1.08%
Borrowed funds	35,117,788	742,967	2.12%	38,133,165	980,181	2.57%
Total interest-bearing liabilities	273,754,155	3,087,660	1.13%	264,278,368	3,432,811	1.30%
Noninterest-bearing deposits	103,514,854	-		76,564,780	-	
	377,269,009	3,087,660		340,843,148	3,432,811	
Other liabilities	2,857,021	-		2,746,365	-	
Stockholders' equity	45,002,824	-		42,457,501	-	
Total liabilities and stockholders' equity	$ 425,128,854	$ 3,087,660		$ 386,047,014	$ 3,432,811	
Net interest spread			3.57%			4.15%
Net interest income		$ 15,859,074			$ 16,355,964	
Net margin on interest-earning assets			3.93%			4.50%

Interest on tax-exempt securities and loans is reported on a fully taxable equivalent basis.

The Greg Rittershoffer Technology center

Willards Branch

Photos taken before covid 19

North Ocean City

West Ocean City

Photos taken before covid 19

Main Office Willards

Milford Street

Photos taken before covid 19

Salisbury Branch

Millsboro

Photos taken before covid 19

Administration

Chris Davis President

Photos taken before covid 19

Ice Cream Day

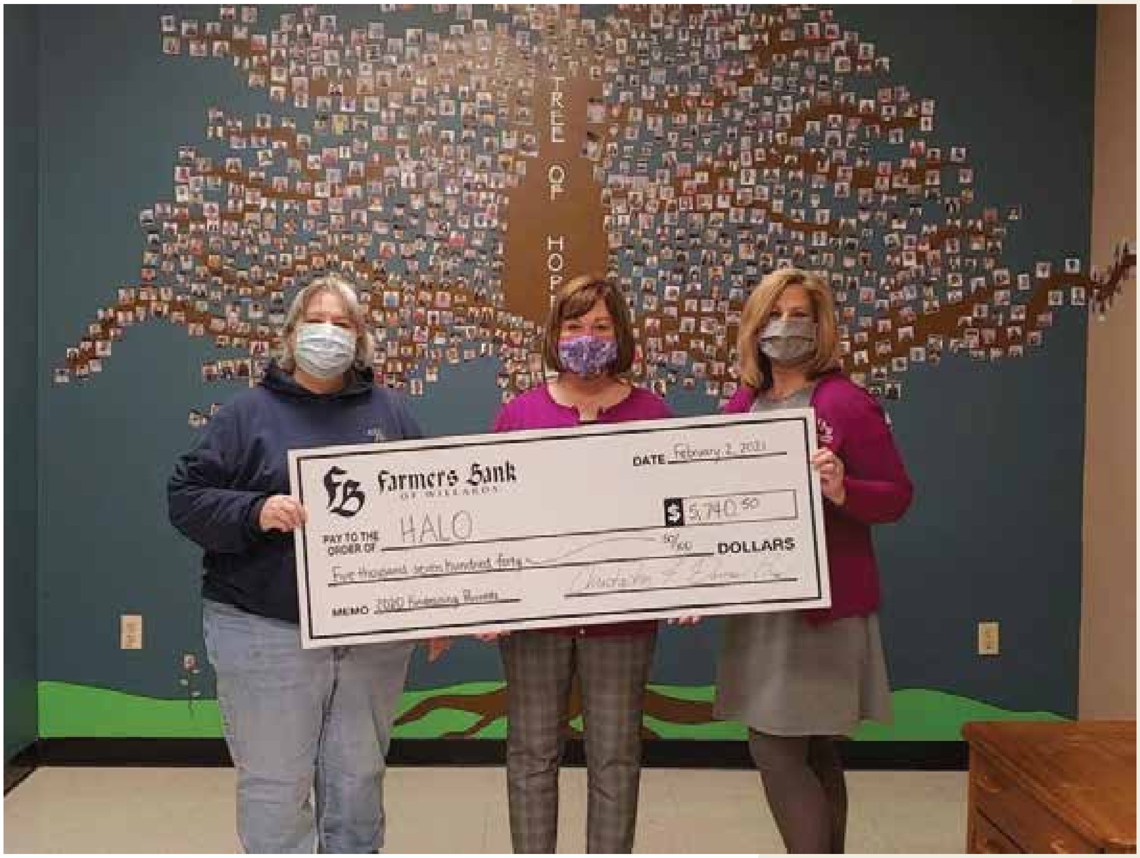

HOPE · FIGHT · CURE


BREAST


We love you
Wendy, Dee
& Linda!


Support the Fighters
Admire the Survivors
Honor the Taken
Never give up Hope
Fight like a girl

The Farmers Bank of Willards gave back this year by making packed lunches for hospital workers and first responders.



EXECUTIVE and SENIOR OFFICERS

CHRISTOPHER F. DAVIS
President

WILLIAM S. TURNER
Executive Vice President

RENEE M. LOVELL
Chief Financial Officer

MARY K. O'CONNELL
Chief Operations Officer

TERRY B. SPARROW
Vice President of Information Systems

MATTHEW PETTERSON
IT Administration and IT Security

CELESTE M. RAYNE
Vice President of Worcester County Operations

JUSTIN M. GRAY
Vice President of Business Development

GEORGE BURBAGE
Vice President, Loan Officer

OTHER MANAGEMENT STAFF

NATALIE BINDER
Treasurer

KRIS N. DERICKSON
Assistant Vice President, Director of Human Resources and Talent Management

TINA SMACK
Assistant Vice President

MATTHEW DAVIS
Assistant Vice President, Loan Officer

KIMBERLY BENTON
Assistant Vice President, Loan Officer

HEATHER MARINE
Assistant Vice President Retail Operations

MARY DRYDEN
Assistant Vice President Special Assets

VICKIE DAVIS
Compliance, Bank Secrecy Act & Security Officer

IRINA POTAPENKO
Internal Auditor

KELLY A. DREXEL
CRA Officer

Notes

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Manager: Jennie Rice

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Manager: Jennie Rice

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Select option 2 from menu
5:00am - 8:00pm Monday - Thursday
6:00am - 8:00pm Friday
9:00am - 2pm Saturday

The Farmers Bank of Willards

Directors

R. Furman Richardson, advisory
Chairman of the Board

Christopher F. Davis
President

Lois A. Sirman
1st Vice Chairman

Elaine W. Perdue
2nd Vice Chairman

Donald B. Bounds

Frank A. Davis, advisory

James E. Lewis, II

James E. Lewis, III

Kimmerly A. Messick

Ezra A. Rickards

H. Wayne Tull

Crawford A. Rayne, emeritus