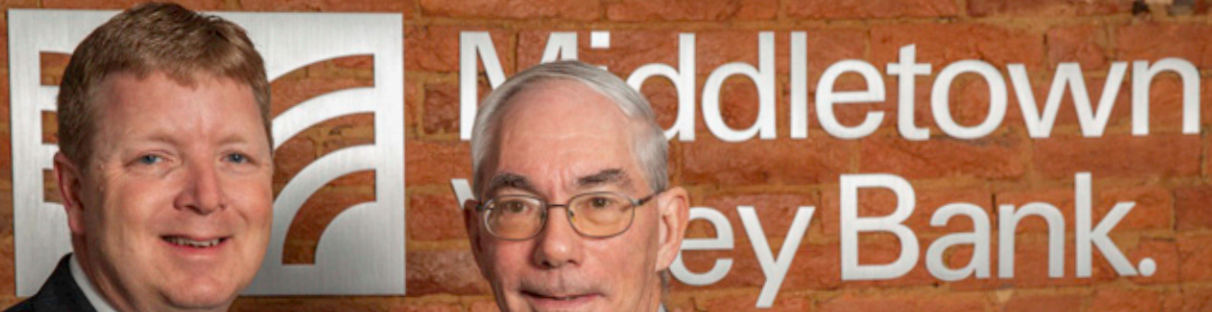


Rooted in Our Communities

2019 ANNUAL REPORT



Community
Heritage
Financial, Inc.



LETTER TO OUR Shareholders

Dear Shareholders,

We are excited to present to you the 2019 annual report of Community Heritage Financial, Inc., the parent company of Middletown Valley Bank (“MVB”) and Millennium Financial Group, Inc. (“Mlend”). The integration of Mlend, a leading mortgage lender, provides the company the opportunity to offer valuable mortgage products to customers throughout central and western Maryland as well as neighboring areas of Pennsylvania, Virginia, West Virginia and the District of Columbia. Not only did we expand our footprint substantially and improve our services, we became well positioned for increased mortgage activity as a result of interest rate declines during the year.

Community Heritage Financial continued to achieve above-average growth during the year. Investments in the communities we serve and putting the customer first were the keys to our record of growth. MVB and Mlend share core values in customer service. Both have local roots and tremendous commitment to the communities that have supported us for many years. Our reputation grows

stronger every day due to our delivering of the Absolutely Exceptional Experience and our community involvement.

During 2019, our employees and directors volunteered over 1,550 hours within our communities. Our team members serve in various volunteer and leadership capacities on more than twenty-five non-profit boards. More than \$150,000 in donations from our company provided much needed fiscal support to local efforts to improve the lives of our neighbors. We have highlighted some of our non-profit partners in this year’s report.

In January 2019, MVB opened a second Hagerstown branch to better serve our growing customer base in Washington County. Total Hagerstown deposits ended 2019 over \$200 million combined. Continued infrastructure investment is being made at a pace to continue the long-term trends of decreasing overhead rates and increasing rates of return.

In March 2019, we opened our 12,000+ square foot operations center in Hagerstown, bringing an initial forty quality jobs to the community. The additional space houses our operations and support services with room for additional growth.

The company was successful in growing assets and increasing earnings in 2019. Total assets grew by more than 18% (\$81.3 million), with total deposit growth of 15% (\$58.2 million). Net loans grew by 20% (\$71.6 million). Net income was \$2.6 million, with earnings per share of \$1.17 for the year ended December 31, 2019, as compared to net income of \$2.0 million and earnings per share of \$0.88 for the same period in 2018. The company issued \$15 million in ten-year subordinated debt notes in October that will allow us to continue with our growth strategy.

Credit quality measures remain strong and continue to improve. The loan portfolio has excellent diversity with no concentration risk and minimal high-risk loans. Our loan portfolio is built on solid relationships as reflected in our deposit growth and in our percentage of C&I loans, which is nearly double our peer group average. The Enterprise Risk Management program continues to demonstrate risk is well controlled and we remain prepared for liquidity or credit stress events.

With the addition of Mlend, the company added a great deal of talent to our organization. MVB also added talent, bringing our total employees to a record 153 at year end. Every member of our team, including our external directors, is an important part of our service to our customers, our communities, and our shareholders. Together we provide the Absolutely Exceptional Experience that has propelled our growth as a company.

We are fortunate to serve such diverse, active communities and to have an exceptional group of individuals within the company who understand the importance of commitment to these communities. On behalf of Community Heritage Financial, Inc., we thank you for trusting us as your community financial partner.



Robert E. (BJ) Goetz, Jr.
President and Chief Executive Officer



James G. Pierre
Chairman of the Board



Built on
Relationships



PUTTING THE Customer First

Financial Highlights

As of and for the years ended December 31
(dollars in thousands, except ratio's and per common share data)

	2019	2018	2017	2016	2015
Earnings Data (\$):					
Net interest income	\$16,602	\$13,646	\$10,695	\$8,573	\$6,559
Provision for (recovery of) loan losses	763	582	637	464	425
Non-interest income	3,826	1,174	1,025	1,095	947
Non-interest expense	16,105	11,569	8,619	7,928	6,645
Net income	2,631	1,968	1,217	893	366

Common Share Data:

Basic earnings per common share	\$1.17	\$0.88	\$0.82	\$0.69	\$0.29
Dividends paid per common share	0.12	0.09	0.08	0.08	0.08
Book value per common share (end of period)	21.60	20.12	19.42	19.54	19.20
Weighted average common shares outstanding	2,250,064	2,233,820	1,481,593	1,285,774	1,265,057

Selected Statistical Data (%):

Net interest margin	3.66%	3.62%	3.59%	3.45%	3.50%
Return on average assets	0.55	0.53	0.39	0.34	0.18
Return on average common equity	5.55	4.74	4.17	3.54	1.52
Efficiency ratio	78.80	78.10	73.50	82.00	88.50

Financial Condition Data (\$):

Total assets	\$516,967	\$435,658	\$361,224	\$282,904	\$238,088
Loans	429,335	357,742	283,233	210,175	162,427
Allowance for loan losses	4,235	3,593	3,051	2,527	2,150
Securities	42,641	47,967	47,457	45,689	47,992
Deposits	446,707	388,544	315,934	250,981	202,956
Borrowings	289	-	-	5,000	9,200
Subordinated Debt	14,574	-	-	-	-
Shareholder's equity	48,635	44,944	43,388	25,124	24,685
Non-performing assets	1,856	3,184	4,030	4,063	3,352

Ratios (%):

Loans to deposits	96.1%	92.1%	89.6%	83.7%	80.0%
Allowance for loan losses to total loans	0.99	1.00	1.08	1.20	1.32
Non-performing Assets/Loans + OREO	0.43	0.89	1.42	1.92	2.10
Non-performing Assets/Total Assets	0.36	0.73	1.12	1.44	1.41
Average shareholders' equity to average total assets	9.88	11.20	9.50	9.60	12.10
Tier 1 capital to risk-weighted assets	14.40	13.50	16.40	13.00	16.00
Total risk-based capital	15.60	14.80	17.70	14.30	17.30

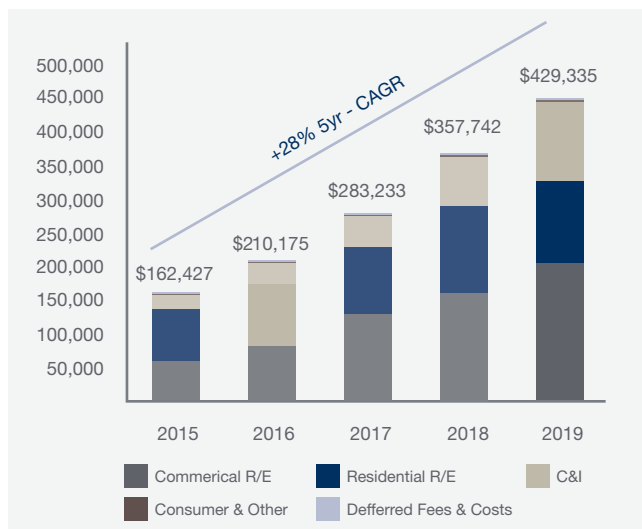
Management's Discussion and Analysis

Total Assets



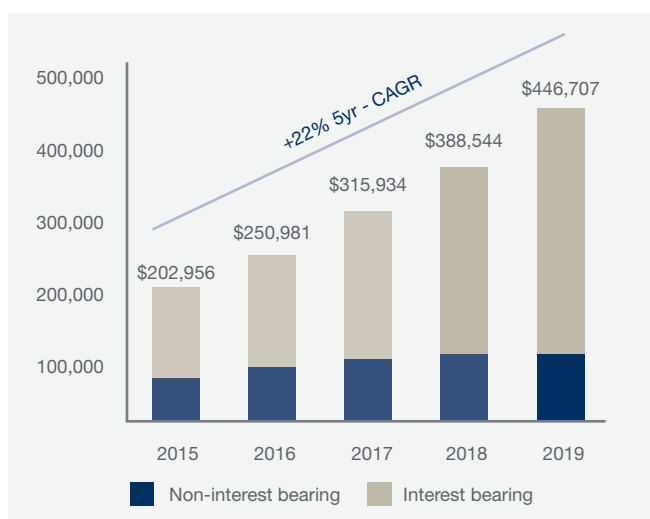
Total assets were \$517 million at December 31, 2019, an increase of \$81.3 million or 19% from year-end 2018. Balance sheet growth was driven by strong loan growth of \$72 million, funded by core deposit growth of \$58 million, net income of \$2.6 million and the addition of \$15 million in subordinated debt. The compounded five year annual growth rate for total assets is 21%.

Loan Totals and Mix



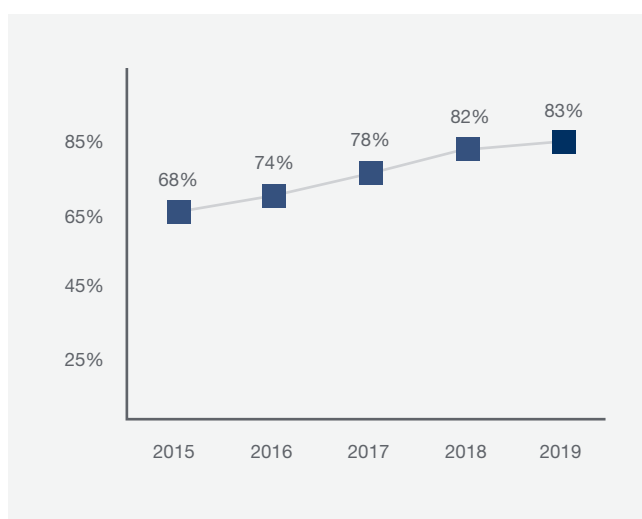
Total loans at December 31, 2019 were \$429 million, comprised of commercial real estate loans of \$203 million (47% of total loans), residential real estate of \$124 million (29% of total loans), commercial and industrial (C&I) of \$99 million (23% of total loans), consumer loans of \$2 million (less than 1% of total loans) and deferred loan fees and costs of \$956 thousand (less than 1% of total loans). During 2019, growth in the commercial real estate (up \$38 million) and C&I (up \$26 million) accounted for 89% of total loan growth. The five year compounded annual growth rate for the loan portfolio is 28%.

Deposit Totals and Mix



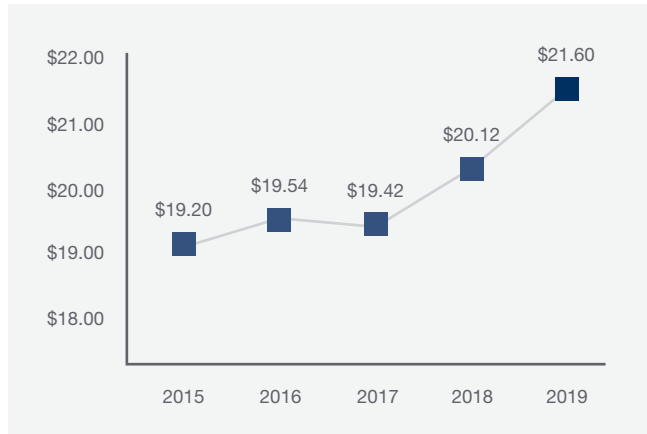
Total deposits were \$447 million at December 31, 2019, an increase of \$58 million or 15% when compared to year-end 2018. Non-interest bearing deposits totaled \$127 million (28% of total deposits) at year-end 2019, up \$19 million for the year. Interest bearing deposits increased \$39 million for the year and ended the year at \$320 million (72% of total deposits). The five year compounded annual growth rate is 22%.

Loans to Assets



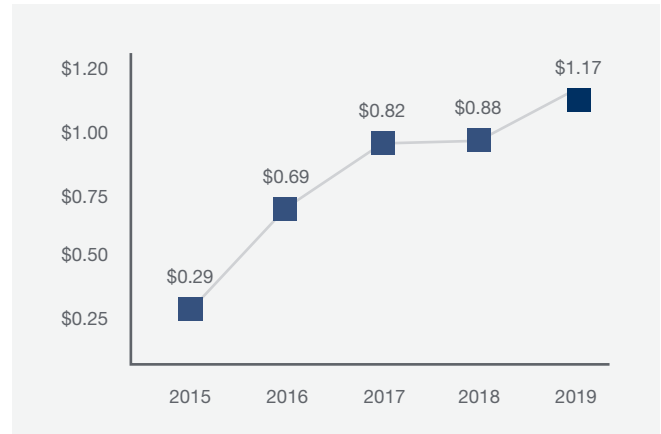
The Company continued to focus on strategic balance sheet growth by increasing the ratio of earning assets to total assets. Loan growth and composition are an integral component of the growth and is reflected in the loans to assets ratio growth over the past 5 years.

Net Book Value per Share



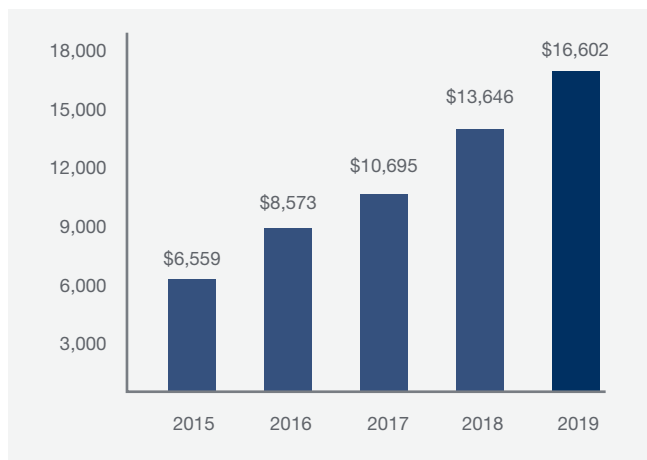
Net book value increased \$1.48 per share in 2019 or 7.4% primarily due to increased retained earnings resulting from net income of \$2.6 million for 2019.

Earnings per Share



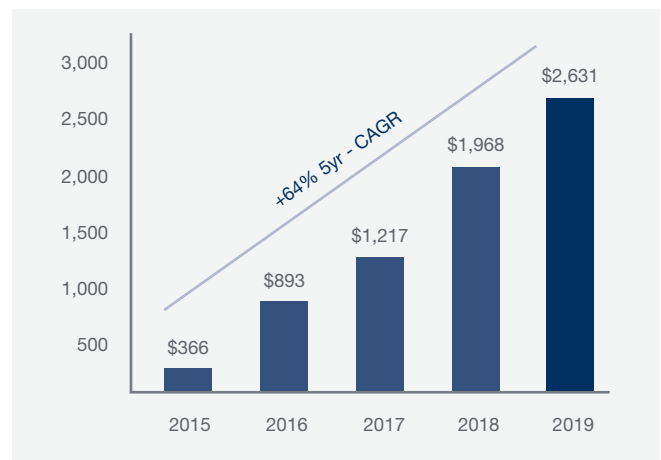
Earnings per share increased by \$0.29 in 2019. The addition of Mlend contributed approximately \$0.15 per share of the \$0.29 increase.

Net Interest Income



Net interest income increased by \$2.96 million in 2019 compared to 2018. Loan growth of \$72 million helped to increase loan interest and fee income by \$4.6 million for the year. Strong deposit growth and a higher cost of funds increased deposit interest expense by \$1.6 million. The net resulted in the positive impact to margin income for the year.

Net Income



Consolidated net income for 2019 was \$2.63 million, an increase of \$663 thousand or 34% compared to 2018. 2019 income was enhanced by the merger of Mlend in February of 2019, which contributed \$350 thousand in after tax income to the consolidated income of CHF. The five year compounded annual growth rate for net income is 64%.

BUILT ON
Tradition





Landon's Library

Promoting Childhood Literacy.

Landon's Library was established in 2006 in memory of our two-year old son, Landon, who passed away from SUDC (sudden unexplained death in childhood). Our mission is to promote childhood literacy and the importance of parents reading to their children. We were the first county-wide effort in the state of Maryland to participate with Dolly Parton's Imagination Library. To date we have distributed over 350,000 children's books in Garrett County, Maryland, which has resulted in higher overall reading scores throughout the county.

Support from organizations like Mlend allow us to continue purchasing books to be distributed to children throughout our county in an effort to promote our literacy goals.

We are always looking for volunteers to assist us in our monthly playdates for children, our youth basketball league and in numerous fundraising events throughout the year.

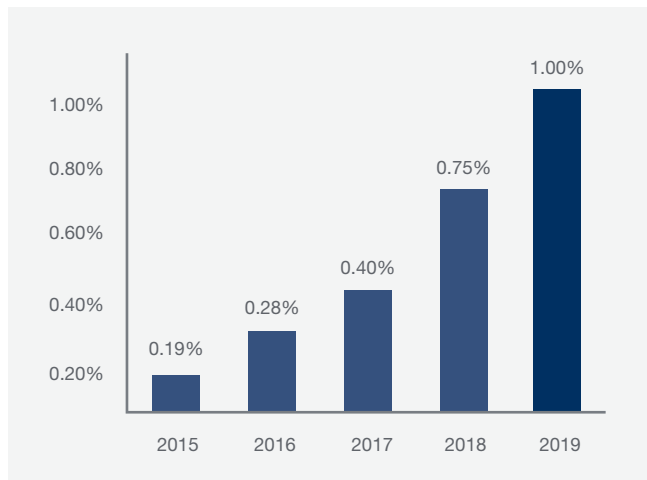
Brian Boal

Founder

Landon's Library

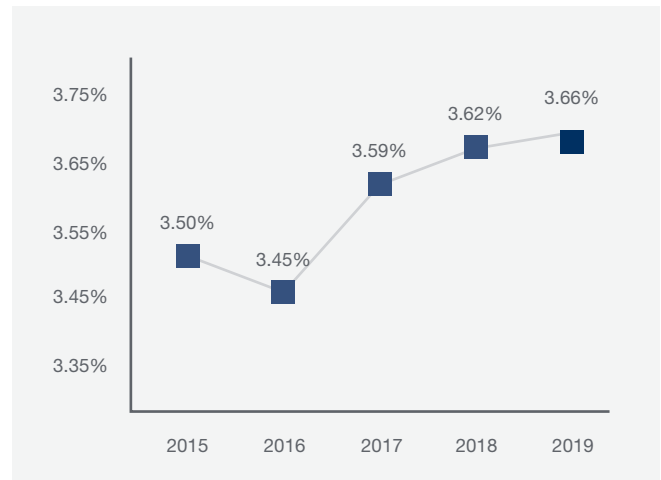
www.landonslibrary.org

Cost of Funds



Cost of funds increased to 1.00% for 2019, up 0.25% from 0.75% in 2018. Bank and credit union competition in the local market kept rates higher than the national average for an extended period during 2019. The Bank also realized a full year of interest expense on two CD promotions initiated in 2018, which were priced during a rising rate environment.

Net Interest Margin



Net interest margin improved by 4 bps in 2019 versus 2018. While the cost of funds increased by 0.25% year-over-year compared to 2018, the yield on earnings assets grew from 4.32%, on average, in 2018 to a level of 4.64% in 2019, an increase of 0.32%. The volume of asset growth and improved yield on earnings assets accounted for the improved margin.



GARRETT COUNTY
Maryland



Girls Inc. Of Washington County

Fostering Development.

Girls Inc. of Washington County inspires all girls to be Strong, Smart, and Bold. We currently serve 3,200+ girls ages 6-18 through after-school programming, summer camp, and outreach. We utilize research-based, hands-on educational programs that foster the development of the whole girl; motivating girls to take risks, value themselves, and discover and develop their inherent strengths. Our program goals are to enhance academic achievement, life skills, and attitudes in order to nurture social and emotional growth and personal well-being of girls and their family. The combination of long-lasting mentoring relationships, a pro-girl environment, and research-based programming equips girls to navigate gender, economic, and social barriers, and grow up healthy, educated, and independent.

Middletown Valley Bank invests in the future of girls in Washington County by supporting Girls Inc. of Washington County all year long. Not only do they support our

programs financially, but the employees volunteer their time, becoming recognizable faces our girls can remember and trust. Whether it is through event support, facilitating a financial literacy class to our girls, planting a garden for Earth Day, or even making Krumpe's Donuts with our team....Middletown Valley Bank is truly a community bank, and we are so very grateful to have them in our corner.

Girls Inc. is always looking for people to join our mission of inspiring all girls to be Strong, Smart and Bold. You can volunteer, donate, advocate for the rights of girls, or just stop in for a visit to learn more about our work!

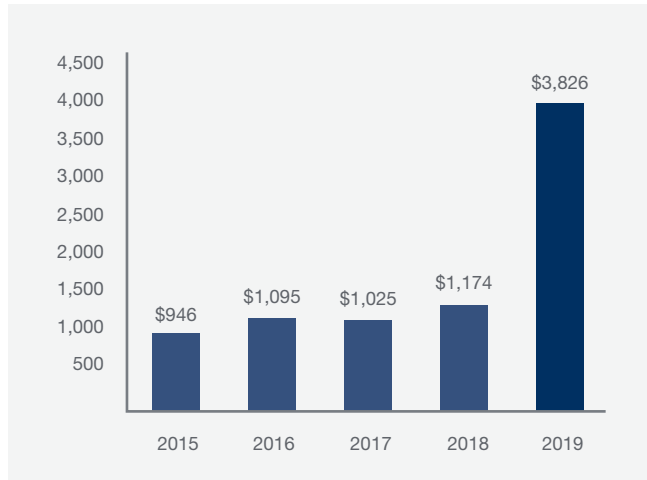
Shana Ruff

Director of Development

Girls Inc. of Washington County

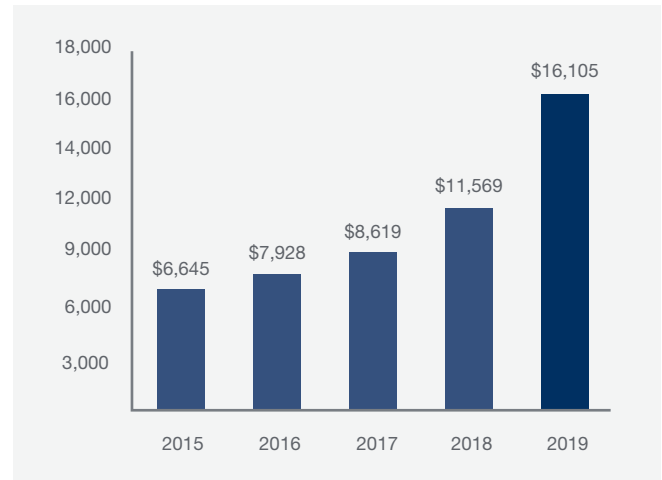
www.girlsinc-md.org

Non-Interest Income



Non-interest income increased \$2.6 million compared to 2018. Most of the increase is attributed to the addition of Mlend, which contributed \$2.5 million in secondary market mortgage sale gains and fee income for the year.

Non-Interest Expense



Non-interest expense increased \$4.5 million in 2019 compared to 2018 expense. 2019 included a full year of operating expenses for the parent company of \$416 thousand and the addition of Mlend operating expenses of \$2.0 million. Operating expenses at the Bank increased by \$2.1 million to support the asset growth of the Company. Additional expenses related to the opening of a new operations center, upgrades to data communications systems and increased salary and benefits related to the addition of key support staff accounted for the increased expense.



FREDERICK COUNTY
Maryland



Myersville Community Library

The Freedom to Invent, Explore & Transform.

The Myersville Community Library is the newest branch in the Frederick County Public Libraries (FCPL) system. FCPL is comprised of two Bookmobiles, and nine branches throughout Frederick County. Last year FCPL saw 2.3 million visits to our branches and circulated 3.15 million materials. Our mission is to facilitate the public's freedom to explore, to invent, and to transform. FCPL seeks to connect people to ideas and to each other, helping to foster individual and community growth.

Middletown Valley Bank supported the inclusion of early literacy learning panels in the new children's library at the Myersville Community Library. This tremendously generous gift turned ordinary shelving into extraordinary learning opportunities. These panels are designed specifically for libraries and to help our littlest library customers learn important skills through play; skills like letter identification, counting and mathematics, social skill development, and more. The library, along with our partners like MVB, is

actively working to increase literacy skill development so our children are ready to read and succeed. Since the library opened this fall, nearly 20,000 people have visited and checked out nearly 33,000 materials. The library has hosted over 217 programs for children and over 5,000 have attended those programs. Thank you for this wonderful gift and for investing in our community, MVB!

We hope that you will visit and enjoy your local library often! We also offer digital resources like ebooks, audiobooks, movies, and music available on any mobile device or tablet. All the library's programs and services are offered at no cost. To learn more about how you can get involved and support your local library visit us online.

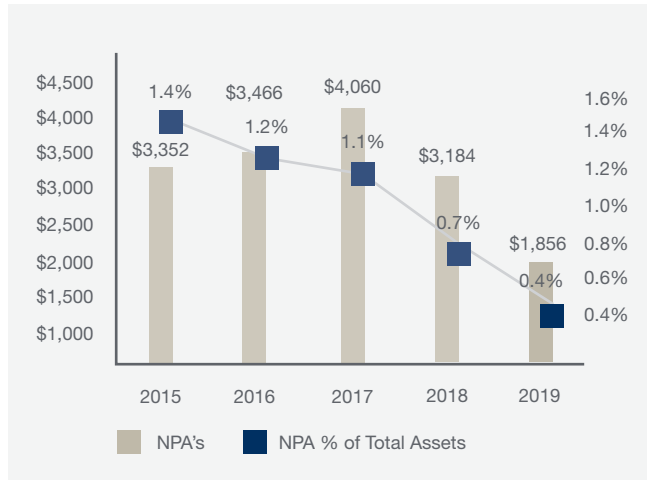
Marian Currens

Branch Administrator

Myersville Community Library

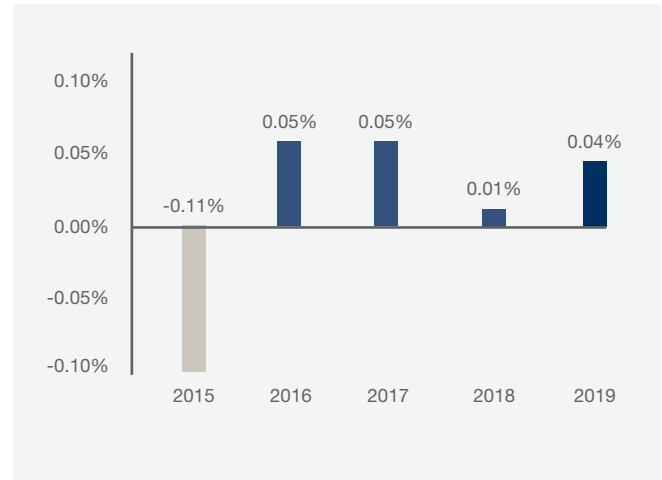
www.fcpl.org

Non-Performing Assets



Non-performing assets (NPA's) improved in 2019 with a reduction of \$1.3 million compared to year-end 2018. As a percent of total assets, NPA's improved from 0.73% in 2018 to 0.36% in 2019. The bank continues to stress credit quality as a major initiative in conjunction with the growth of the loan portfolio.

Net Charge-Offs / Average Loans



Credit quality remains strong as evidenced in the reduction in nonperforming asset balances along with the low percentage of net charge-offs.

WASHINGTON COUNTY Maryland





Hospice of Washington County

Focusing on the Quality of Life.

No one knows when the final season of life will occur, but they can count on Hospice of Washington County (HWC) to make each day the best that it can be. We offer expert medical and personal care, as well as emotional and spiritual support expressly tailored to our patients' specific needs and wishes. Education and support are provided each step of the way for the patient's caregivers, family, and friends as well. Celebrating its 40th Anniversary, HWC is the only licensed provider for hospice care within Washington County. HWC's team of committed professionals understands the importance of ensuring that every individual can live their life to the fullest.

Hospice focuses on quality of life, not quantity. HWC provides care wherever the individual designates as their home. That can be in a private residence, nursing home, or assisted living facility. HWC is a non-profit organization; therefore no one will be denied care due to their inability to pay. Currently HWC has over 150 employees, 200 volunteers, a census average of 230 patients, a large palliative care program with over 225 patients, four locations including our Palliative Care outpatient clinic in Boonsboro, MD and Doey's House (the region's first and only Inpatient Hospice Unit).

Middletown Valley Bank (MVB) has been an excellent community partner and a supporter of Hospice of

Washington County. MVB has donated to a number of our projects, which has grown the HWC endowment and supported the foundation of Doey's House. This vital funding has assured that the mission of HWC will continue. MVB's employees have also played a vital role in helping to spread the word of the benefits of quality hospice care and enabled HWC to reach more community members with important care and grief support. HWC is grateful for the support and partnership of MVB.

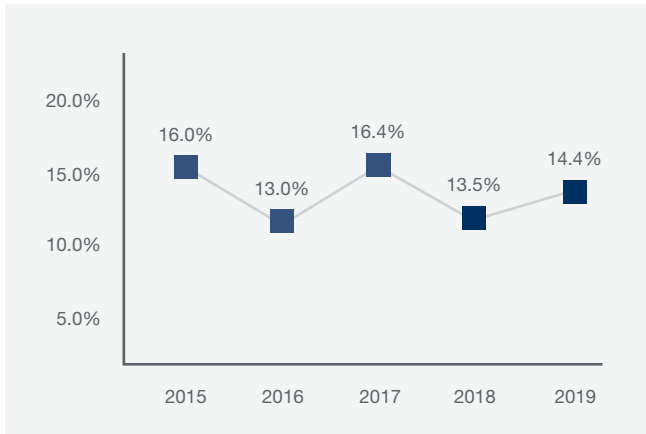
Volunteers play an indispensable role in enabling Hospice of Washington County to offer the best care possible to our patients and their families. No healthcare background or prior experience is needed. Our volunteers are supported in their role by the Volunteer Services Department, and a competent and caring team of doctors, nurses, aides, social workers and chaplains. There are many volunteer opportunities available, which include working directly with patients and families or providing other support to HWC facilities, events, and fundraising efforts. If you are interested in becoming a volunteer, please call our Volunteer Department at 301-791-6360.

Karen M. Giffin

Senior Director Development and Public Relations
Hospice of Washington County, Inc.

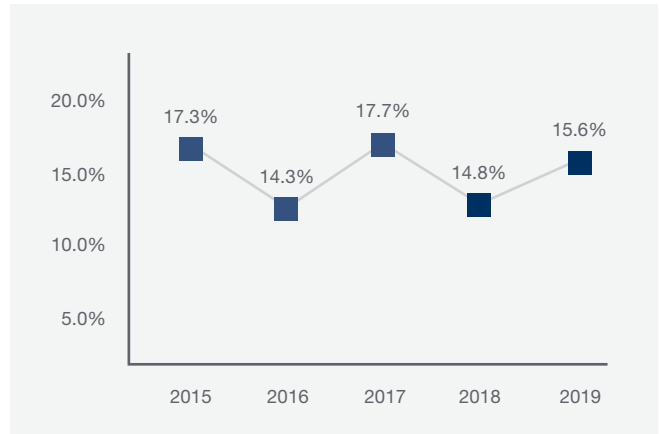
www.hospiceofwc.org

Tier 1 Capital



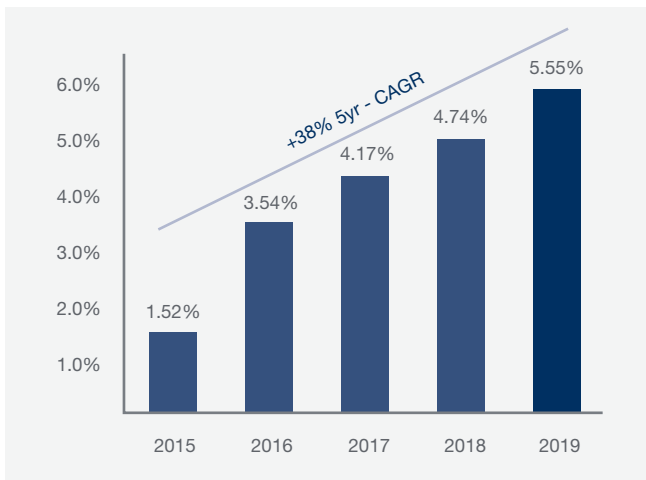
Bank level Tier 1 capital remains in a “well capitalized” position at 14.4% as of December 31, 2019 and increased from 13.5% as of December 31, 2018. In conjunction with a \$15 million subordinated debt offering in October 2019, the Company injected \$13.8 million to the Bank in the form of working capital for future growth and earnings. This had an immediate impact on capital ratios.

Total Risk Based Capital



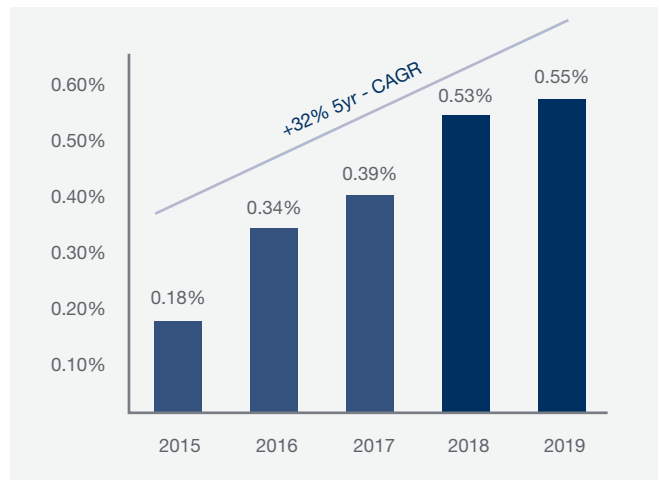
Bank level total risk based capital remained in a “well capitalized” position at 15.6% at year-end 2019, up from 14.8% at end-of-year 2018. The working capital injection, as noted in the Tier 1 capital notes, applies to the overall risk based capital position of the Bank as well.

Return on Equity



Return on equity was 5.55% in 2019, an increase of 0.81% over 2018. The Company continued the upward trend in 2019 of adding shareholder value and return. The addition of Mlend in 2019 added additional revenue and business lines to the corporation to enhance returns. In 2019, the Company issued \$15 million in subordinated debt to be deployed to the subsidiaries in the form of working capital to further the growth of the Company and return to shareholders. The five year compounded annual growth rate for ROE is 38%.

Return on Average Assets



Return on average assets was 0.55% in 2019 compared to 0.53% in 2018. The Company continued to expand with the formation of the holding company late in 2018, the addition of Mlend in early 2019 and the continued strong asset growth at the Bank. The rapid growth resulted in additional expense to build and support the infrastructure to enhance future growth and earnings for the Company and Stockholders. The additional expense and rapid asset growth impacted ROAA on a year-over-year growth basis. The five year compounded annual growth rate for ROAA is 32%.



Independent Auditor's Report

To the Board of Directors and Shareholders
Community Heritage Financial, Inc.
Middletown, Maryland

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Community Heritage Financial, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, 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 control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Heritage Financial, Inc. and Subsidiaries as of December 31, 2019 and 2018, 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.

Yocent, Hyde & Barbour, P.C.

Winchester, Virginia
March 31, 2020

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018

<u>ASSETS</u>	<u>2019</u>	<u>2018</u>
Cash and due from banks	\$ 25,065,743	\$ 15,347,455
Federal funds sold	-	3,198,302
FHLB Stock, at cost	392,200	325,200
Securities available for sale, at fair value	42,640,765	47,966,728
Loans held for sale	3,775,199	-
Loans, net of allowance for loan losses of \$4,235,315 (2019) and \$3,593,161 (2018)	425,099,435	354,149,192
Bank premises and equipment, net	6,815,474	6,285,800
Accrued interest receivable	1,232,624	1,155,631
Deferred income taxes, net	979,581	1,246,329
Income taxes receivable	27,672	83,832
Bank owned life insurance	4,966,843	4,720,042
Goodwill and other Intangibles	1,673,868	-
Other assets	4,297,689	1,179,732
	<hr/>	<hr/>
TOTAL ASSETS	\$ 516,967,093	\$ 435,658,243
	<hr/>	<hr/>
<u>LIABILITIES</u>		
Deposits:		
Demand	\$ 126,449,656	\$ 107,387,981
Interest-bearing demand	171,096,402	136,730,984
Savings	52,039,669	49,810,748
Time and IRA	97,120,784	94,614,527
Total deposits	446,706,511	388,544,240
Subordinated debt, net of unamortized issuance costs	14,573,940	-
Accrued interest payable	279,832	113,379
Other borrowings	289,039	-
Other liabilities	6,482,869	2,056,136
	<hr/>	<hr/>
TOTAL LIABILITIES	468,332,191	390,713,755
	<hr/>	<hr/>
<u>SHAREHOLDERS' EQUITY</u>		
Preferred stock, \$1 par value; 1,000,000 shares authorized; no shares issued and outstanding	-	-
Common Stock, \$.01 par value, 4,000,000 shares authorized; 2,251,320 and 2,233,820 shares issued and outstanding December 31, 2019 and 2018	22,513	22,338
Surplus	28,523,004	28,138,429
Retained earnings	19,866,168	17,505,373
Accumulated other comprehensive income (loss)	223,217	(721,652)
	<hr/>	<hr/>
TOTAL SHAREHOLDERS' EQUITY	48,634,902	44,944,488
	<hr/>	<hr/>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 516,967,093	\$ 435,658,243
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See Notes to Consolidated Financial Statements.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2019 AND 2018

<u>INTEREST INCOME</u>	<u>2019</u>	<u>2018</u>
Interest and fees on loans	\$ 19,681,478	\$ 15,069,426
Interest on investment securities:		
U.S. government	169,808	183,518
Mortgage backed	455,991	494,827
Municipal	283,769	241,651
Other interest	496,974	312,071
	<hr/>	<hr/>
TOTAL INTEREST INCOME	21,088,020	16,301,493
	<hr/>	<hr/>
<u>INTEREST EXPENSE</u>		
Interest on deposits:		
Savings	26,534	25,019
Interest-bearing demand	2,177,644	1,290,782
Time and IRA	2,039,270	1,312,498
Interest on borrowed funds	242,818	27,217
	<hr/>	<hr/>
TOTAL INTEREST EXPENSE	4,486,266	2,655,516
	<hr/>	<hr/>
NET INTEREST INCOME	16,601,754	13,645,977
	<hr/>	<hr/>
<u>PROVISION FOR LOAN LOSSES</u>	763,490	582,349
	<hr/>	<hr/>
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	15,838,264	13,063,628
	<hr/>	<hr/>
<u>NONINTEREST INCOME</u>		
Service charges on deposit accounts	590,534	443,353
VISA check card income	489,999	438,261
Loss on sales and calls of securities available for sale	(636)	-
Gain on sales of loans	2,098,208	132,599
(Loss) on sales of premises and equipment	(5,471)	-
Bank owned life insurance income	109,176	99,335
Other secondary market income	468,147	-
Other operating income	76,003	60,749
	<hr/>	<hr/>
	3,825,960	1,174,297
	<hr/>	<hr/>
<u>NONINTEREST EXPENSES</u>		
Salaries and employee benefits	9,460,012	6,503,339
Occupancy expense	1,395,464	1,091,182
Equipment expense	1,103,277	903,702
(Gain) on sale of other real estate owned	(12,017)	-
Data and other processing expenses	1,399,269	869,529
FDIC Insurance expense	179,323	94,960
Other operating expense	2,580,005	2,105,828
	<hr/>	<hr/>
	16,105,333	11,568,540
	<hr/>	<hr/>
INCOME BEFORE INCOME TAXES	3,558,891	2,669,385
	<hr/>	<hr/>
<u>INCOME TAXES</u>	928,117	701,651
	<hr/>	<hr/>
NET INCOME	\$ 2,630,774	\$ 1,967,734
	<hr/>	<hr/>
Earnings per Common Share, Basic and Diluted	\$ 1.17	\$ 0.88

See Notes to Consolidated Financial Statements.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2019 AND 2018

	2019	2018
NET INCOME	\$ 2,630,774	\$ 1,967,734
Other comprehensive income (loss):		
Unrealized holding gain (loss) on securities available for sale (net of tax of \$(358,584) and 79,748, respectively)	944,408	(210,034)
Reclassification adjustment (net of tax of \$(175)- and \$-, respectively)	461	--
Other comprehensive income (loss), net of tax	944,869	(210,034)
COMPREHENSIVE INCOME	\$ 3,575,643	\$ 1,757,700

See Notes to Consolidated Financial Statements.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Years Ended December 31, 2019 AND 2018

	<u>COMMON STOCK</u>	<u>SURPLUS</u>	<u>RETAINED EARNINGS</u>	<u>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</u>	<u>TOTAL</u>
<u>BALANCE, DECEMBER 31, 2017</u>	<u>\$ 2,233,820</u>	<u>\$ 25,926,947</u>	<u>\$ 15,738,683</u>	<u>\$ (511,618)</u>	<u>\$ 43,387,832</u>
Net Income	-	-	1,967,734	-	1,967,734
Other comprehensive Loss	-	-	-	(210,034)	(210,034)
Reorganization into a holding company structure (par value \$1.00 to \$0.01)	(2,211,482)	2,211,482	-	-	-
Cash dividends (\$0.09 per share)	-	-	(201,044)	-	(201,044)
<u>BALANCE, DECEMBER 31, 2018</u>	<u>\$ 22,338</u>	<u>\$ 28,138,429</u>	<u>\$ 17,505,373</u>	<u>\$ (721,652)</u>	<u>\$ 44,944,488</u>
Net Income	-	-	2,630,774	-	2,630,774
Other comprehensive income	-	-	-	944,869	944,869
Acquisition of Mlend	115	258,635	-	-	258,750
Shares issued for compensation	60	125,940	-	-	126,000
Cash dividends (\$0.12 per share)	-	-	(269,979)	-	(269,979)
<u>BALANCE, DECEMBER 31, 2019</u>	<u>\$ 22,513</u>	<u>\$ 28,523,004</u>	<u>\$ 19,866,168</u>	<u>\$ 223,217</u>	<u>\$ 48,634,902</u>

See Notes to Consolidated Financial Statements.

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2019 AND 2018

<u>CASH FLOWS FROM OPERATING ACTIVITIES</u>	<u>2019</u>	<u>2018</u>
Net income	\$ 2,630,774	\$ 1,967,734
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of premises and equipment	659,990	497,935
Provision for loan losses	763,490	582,349
Gain on sale of other real estate owned	(12,017)	-
Loss on sales and calls of investment securities	636	-
Loss on premises and equipment	5,471	-
Gain on sales of loans	(2,098,208)	(132,599)
Originations of loans held for sale	(88,473,402)	(13,471,474)
Proceeds from sales of loans held for sale	87,726,469	13,843,073
Amortization of intangibles	7,639	-
Amortization of debt issuance cost	21,757	-
Amortization of right-of-use assets	439,559	-
Share-based compensation	126,000	-
Earnings on bank owned life insurance	(109,176)	(99,335)
Deferred tax benefit	(92,011)	(142,374)
Increase in accrued interest receivable	(76,993)	(315,258)
Increase in other assets	(6,256)	(408,829)
Decrease (increase) in income taxes receivable	56,160	(285,708)
Increase in accrued interest payable	166,453	69,830
Increase in other liabilities	339,955	398,747
Amortization of premium and discounts on investment securities, net	271,755	309,458
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>2,348,045</u>	<u>2,813,549</u>
<u>CASH FLOWS FROM INVESTING ACTIVITIES</u>		
Purchases of securities available for sale	(7,978,274)	(10,187,887)
Proceeds from maturities, repayments and calls of securities available for sale	9,587,958	9,079,259
Proceeds from sales of securities available for sale	4,747,516	-
Proceeds from sales of fixed assets	25,000	-
Net (increase) in loans	(71,722,400)	(74,382,270)
Purchase of FHLB stock	(67,000)	(70,500)
Cash paid in acquisition, net of cash received	(949,610)	-
Purchases of fixed assets	(1,190,196)	(1,169,001)
Proceeds from the sale of OREO	20,684	-
Purchases of the bank owned life insurance	(140,540)	-
NET CASH (USED IN) INVESTING ACTIVITIES	<u>(67,666,862)</u>	<u>(76,730,399)</u>

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2019 AND 2018
(CONTINUED)

CASH FLOWS FROM FINANCING ACTIVITIES

Net increase in demand and savings deposits	55,656,014	36,817,765
Net increase in time and IRA deposits	2,506,257	35,792,919
Issuance of subordinated debt, net of issuance costs	14,552,183	-
Net repayment of other borrowings	(605,672)	-
Cash dividends paid	(269,979)	(201,044)

NET CASH PROVIDED BY FINANCING ACTIVITIES	71,838,803	72,409,640
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NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	6,519,986	(1,507,210)
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<u>CASH AND CASH EQUIVALENTS, BEGINNING BALANCE</u>	18,545,757	20,052,967
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<u>CASH AND CASH EQUIVALENTS, ENDING BALANCE</u>	\$ 25,065,743	\$ 18,545,757
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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

Cash paid during the year for:

Interest	\$ 4,298,056	\$ 2,585,686
Income taxes	\$ 1,076,288	\$ 1,129,733

SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES

Transfers of loans to other real estate owned	\$ 116,667	\$ -
Loans made to finance other real estate owned	\$ 108,000	\$ 166,768
Lease Liabilities arising from right-of-use assets	\$ 2,723,499	\$ -
Unrealized gain (loss) on securities available for sale	\$ 1,303,628	\$ (289,782)

See Notes to Consolidated Financial Statements.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations:

Community Heritage Financial, Inc. (“CMHF” or the “Company” on a consolidated basis), the parent company for its wholly-owned subsidiaries, Middletown Valley Bank (the “Bank”) and Millennium Financial Group, Inc. (“Mlend”), was established in November 2018 under the laws of the State of Maryland to serve as the holding company for the Bank. Establishment of the holding company occurred subsequent to an affirmative vote by shareholders and receipt of regulatory approval. Upon formation of the holding company, the Company’s reorganization was completed through a one-for-one share exchange in which the Bank’s shareholders received one share of CMHF’s common stock with a par value of \$0.01 in exchange for each share of their \$1 par value common stock of the Bank. CMHF is regulated under the Bank Holding Company Act of 1956, as amended, and is subject to regulation, supervision, and examination by the Federal Reserve Board.

Middletown Valley Bank is an independent and community-oriented financial institution offering a full range of retail and commercial banking services to individuals and businesses in its market area. Services are primarily provided to customers located in Frederick County and Washington County, Maryland, as well as the surrounding communities through the Bank’s network of seven branch locations. Its primary deposit products are demand, savings, and time deposits, and its primary lending products are real estate mortgages, commercial business loans and installment loans.

Middletown Valley Bank began serving customers in 1908 and is headquartered in Middletown, Maryland. The Bank is a Maryland chartered bank subject to regulation, supervision, and examination by the Maryland Office of Commissioner of Financial Regulation and the Federal Deposit Insurance Corporation (“FDIC”), and our deposits are insured by the FDIC up to \$250,000 per depositor. In addition to two branch offices in Middletown, the Bank also has branches in:

- Jefferson, Maryland,
- Myersville, Maryland,
- Boonsboro, Maryland, and
- Hagerstown, Maryland (2).

CMHF acquired 100% of Millennium Financial Group, Inc. on February 1, 2019, pursuant to a definitive purchase agreement dated November 28, 2018. Millennium Financial Group Inc., (“Mlend”), is a full-service residential mortgage company, headquartered in Middletown, Maryland with additional lending offices located in Crofton, Maryland and Oakland, Maryland. Mlend is licensed in Maryland, Pennsylvania, Virginia, West Virginia and the District of Columbia and offers a full range of residential mortgage products to homebuyers for home purchases, refinancing and construction. Programs include but are not limited to conventional, USDA, VA, FHA and Maryland Mortgage Program loans.

The accounting and reporting policies of the Company conform to generally accepted accounting principles and to general practices of the banking and mortgage industries. The following is a summary of the more significant policies.

Principles of Consolidation:

The consolidated financial statements of Community Heritage Financial, Inc. and its wholly-owned subsidiaries, Middletown Valley Bank and Millennium Financial Group, Inc., include the accounts of all three companies. All material intercompany balances and transactions have been eliminated in consolidation.

Business Segments:

We primarily operate two business segments, commercial banking and mortgage banking. The commercial banking segment includes both commercial and consumer lending and provides customers with products such as commercial loans, real estate loans, other business financing and consumer loans. In addition, this segment provides customers with several choices of deposit products, including demand deposit accounts, savings accounts and certificates of deposit. The mortgage banking segment engages primarily in the origination of residential mortgages for sale into the secondary market. For additional information, refer to Note 4 “Business Segments.”

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Use of Estimates:

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of goodwill and other-than-temporary impairment of securities.

Presentation of Cash Flows:

For the purposes of reporting cash flows, the Company considers cash and cash equivalents as those amounts that are highly liquid instruments with an original maturity of three months or less. They are included in the balance sheet captions, "Cash and due from banks" and "Federal funds sold."

Securities:

Investments in debt securities are classified as either held to maturity, available for sale, or trading. Currently, all debt securities are classified as available for sale. FHLB stock is classified as restricted and carried at cost. Available for sale securities are carried at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (i) the Bank intends to sell the security or (ii) it is more likely than not that the Bank will be required to sell the security before recovery of its amortized cost basis. If, however, the Bank does not intend to sell the security and it is not more-than-likely that the Bank will be required to sell the security before recovery, management must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost of the security exceeds the present value of the cash flows expected to be collected from the security. If there is no credit loss, there is no other-than-temporary impairment. If there is a credit loss, other-than-temporary impairment exists, and the credit loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

Management regularly reviews each security for other-than-temporary impairment based on criteria that include the extent to which costs exceed market price, the duration of that market decline, the financial health of and specific prospects for the issuer, its best estimate of the present value of cash flows expected to be collected from debt securities, its intention with regard to holding the security to maturity and the likelihood that the Bank would be required to sell the security before recovery.

For restricted equity securities, impairment is based on the ultimate recovery of par value. The impairment of a restricted equity security results in a write-down that must be included in income.

Gains or losses on disposition are based on the net proceeds and the adjusted carrying amount of the securities, using the specific identification method.

Loans:

Loans are reported at their recorded investment, which is the principal amount outstanding, as adjusted for net deferred fees or cost of loan originations. The balance of the allowance for loan losses is netted against the recorded investment in loans on the balance sheet. Interest income is accrued on the unpaid principal balance. Loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the yield on the related loans using the interest method. Loans on which the accrual of interest has been discontinued are designated as nonaccrual loans. Accrual of interest on all classes of loans is discontinued either when reasonable doubt exists as to the full, timely collection of interest or principal in accordance with the loan's contractual terms, or when a loan becomes contractually past due by ninety days or more with respect to principal or interest. All interest accrued but not collected for loans placed on nonaccrual or

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

charged off is reversed against interest income. Income on such loans is then recognized only to the extent that cash is received and where the future collection of loan principal is probable. Accruals are resumed on loans only when they are brought fully current with respect to interest and principal and when, in the judgment of management, the loan is estimated to be fully collectible as to both principal and interest. Loans are considered past due when the borrower is not current with their payments in accordance with the contractual terms of their loan agreement.

Loans Held for Sale:

The Company engages in the sale of residential mortgages, with originations initiated through Mlend or the Bank. Loans originated and intended for sale (Loans held for Sale) in the secondary market are carried at the lower of cost or fair value on an individual basis. Gains and losses on loans sold (sales proceeds minus carrying value) are recorded as a component of noninterest income in the consolidated statements of income. Direct loan origination costs and fees are deferred at origination of the loan and are recognized in noninterest income upon the sale of the loan. The servicing of loans held for sale is not retained once the sale is complete.

Allowance for Loan Losses:

An allowance for loan losses is maintained at a level deemed appropriate by management to provide for known and inherent losses that are probable within the loan portfolio. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans, based on evaluations of the collectability of loans and prior loan loss experience. 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 that may affect the borrowers' ability to pay. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available. Loans deemed uncollectible are charged off and deducted from the allowance, while subsequent recoveries are credited to the allowance.

The allowance consists of specific and general components. The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific allowance is established when the present value of expected future cash flows, the observable market price, or the fair value of the collateral, if the loan is collateral dependent, of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical losses adjusted for qualitative factors.

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

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

As the first step in determining the general component of the allowance for loan losses, management calculates the historical loss percentage. The historical loss percentage is calculated based on the Bank's experience as well as the experience of its peers. In instances where the Bank has not experienced losses, peer information will be used. The historical loss percentage calculated is applied to the quarter end balance of each portfolio segment. The historical component is further adjusted by management's evaluation of various conditions per segment including the economy, trends in portfolio volume, concentrations, changes in experience and depth of lending staff, trends in problem loans, and

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

trends in collateral and debt ratio exceptions.

Management has an established internally developed methodology to determine the adequacy of the allowance for loan losses that assesses the risks inherent in the loan portfolio. For purposes of determining the allowance for loan losses, management has segmented certain loans in the portfolio by product type. The loan portfolio is segmented based on risk characteristics into the following segments: commercial real estate, residential real estate, commercial, and consumer loans. Particular characteristics associated with each segment are detailed below:

- Loans secured by commercial real estate carry risks associated with the success of the business and the ability to generate a positive cash flow sufficient to service debts. Real estate security diminishes risks only to the extent that a market exists for the subject collateral.
- Residential real estate loans carry risks associated with the continued creditworthiness of the borrower and changes in the value of the collateral.
- Commercial loans not secured by real estate carry risks associated with the successful operation of a business, and the repayments of these loans depend on the profitability and cash flows of the business. Additional risk relates to the value of collateral, if any, where depreciation occurs and the valuation is less precise.
- Consumer loans carry risks associated with the continued creditworthiness of the borrower and the value of the collateral, such as automobiles which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. Consumer loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.

Troubled Debt Restructurings:

In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. At December 31, 2019 and 2018, there were loans in the amount of \$1,015,809 and \$1,335,701, respectively that were modified in troubled debt restructurings. There were no commitments to lend additional funds to these borrowers at December 31, 2019 and 2018.

Transfers of Financial Assets:

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company – put presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Other Real Estate Owned:

Properties acquired by foreclosure, or deed in lieu of foreclosure are initially recorded at fair value less cost to sell and subsequently at the lower of the initially recorded amount and capitalized costs or estimated fair value less cost to sell. Costs of carrying the real estate are charged to expense. As of December 31, 2019 and 2018, the Company had no other real estate owned. At December 31, 2019 and 2018, the Company had no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Premises and Equipment:

Land is carried at cost. Premises and equipment, including construction of major capital additions, are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis. The estimated useful lives for computing depreciation on premises and equipment range from 3 to 50 years in each of these categories. Maintenance and repairs are charged to operating expenses as incurred.

Bank Owned Life Insurance:

The Bank has purchased life insurance policies on certain key executives and other officers. Bank owned life insurance is recorded at the amount that can be realized under the insurance contract at the balance sheet date, which is the cash surrender value. Any increase in the cash surrender value is recorded as noninterest income in the Consolidated Statements of Income. In the event of the death of an individual under these policies, the Bank would receive a death benefit which would also be recorded as noninterest income on the Consolidated Statements of Income.

Earnings Per Common Share:

Basic earnings per common share ("EPS") represent income available to common shareholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution in basic EPS that could occur if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. There were no potentially dilutive shares outstanding during the years ended December 31, 2019 and 2018. Basic and diluted weighted average shares outstanding were 2,250,064 and 2,233,820 for the years ended December 31, 2019 and 2018.

Income Taxes:

Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards. Deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits, if any, in the accompanying balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. Interest and penalties associated with unrecognized tax benefits are classified as additional income taxes in the statement of income. As of December 31, 2019, and 2018, there was no liability recorded for unrecognized tax benefits.

Advertising Costs:

The Company accounts for its advertising costs as a charge to operations as the costs are incurred. Advertising costs were \$137,706 and \$141,110 for the years ended December 31, 2019 and 2018, respectively, and are included in other operating expenses in the Consolidated Statements of Income.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Comprehensive Income (Loss):

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income (loss). All the Company's other comprehensive income (loss) relates to unrealized gains and losses on available for sale securities for the years ended December 31, 2019 and 2018.

Restrictions on Retained Earnings:

According to certain banking regulations, there is a restriction on availability of the Bank's retained earnings for the payment of dividends.

Goodwill and Other Intangible Assets:

Goodwill arises from business combinations and is generally determined as the excess of the fair value of the consideration transferred, plus the fair value of any noncontrolling interests in the acquiree, over the fair value of the net assets acquired and liabilities assumed as of the acquisition date. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized but tested for impairment at least annually or more frequently if events and circumstances exist that indicate that a goodwill impairment test should be performed. The Company performs an annual goodwill impairment test, which is generally conducted in the 4th quarter. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values.

Recent Accounting Pronouncements:

On January 1, 2019, the Company adopted ASU 2016-02 "Leases (Topic 842)" and all subsequent amendments thereto. Adoption of the leasing standard resulted in the recognition of right-of-use assets and lease liabilities of \$2.7 million. Refer to "Note 8 Leases" for further discussion of the standard's adoption and the Company's accounting for its lease agreements.

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public business entities that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer, excluding smaller reporting companies, the standard is effective for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The Company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The Company has formed a committee to address the compliance requirements and has engaged a third-party consultant to aid in modeling, assumptions and testing.

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment." The amendments in this ASU simplify how an entity is required to test goodwill for impairment by eliminating Step 2 from the goodwill impairment test. Step 2 measures a goodwill impairment loss by comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Instead, under the amendments in this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Public business entities that are not SEC filers should adopt the amendments in this ASU for annual or interim goodwill impairment tests in fiscal years beginning after December

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

15, 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The Company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, "Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments." This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various Transition Resource Group (TRG) Meetings. The effective date of each of the amendments depends on the adoption date of ASU 2016-01, ASU 2016-13, and ASU 2017-12. The Company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, "Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief." The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The effective date and transition methodology for the amendments in ASU 2019-05 are the same as in ASU 2016-13. The Company is currently assessing the impact that ASU 2019-05 will have on its consolidated financial statements.

In November 2019, the FASB issued ASU 2019-11, "Codification Improvements to Topic 326, Financial Instruments – Credit Losses." This ASU addresses issues raised by stakeholders during the implementation of ASU No. 2016-13, "Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." Among other narrow-scope improvements, the new ASU clarifies guidance around how to report expected recoveries. "Expected recoveries" describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. While applying the credit losses standard, stakeholders questioned whether expected recoveries were permitted on assets that had already shown credit deterioration at the time of purchase (also known as PCD assets). In response to this question, the ASU permits organizations to record expected recoveries on PCD assets. In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities. The ASU includes effective dates and transition requirements that vary depending on whether or not an entity has already adopted ASU 2016-13. The Company is currently assessing the impact that ASU 2019-11 will have on its consolidated financial statements.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. This ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company is currently assessing the impact that ASU 2019-12 will have on its consolidated financial statements.

In January 2020, the FASB issued ASU 2020-01, "Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321,

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

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Topic 323, and Topic 815.” The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2016-01 made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. For public business entities, the amendments in the ASU are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2020-01 to have a material impact on its consolidated financial statements.

Note 2. Millennium Financial Group, Inc. Acquisition

On February 1, 2019, pursuant to a definitive purchase agreement dated November 28, 2018, for consideration with a total fair value of \$1.68 million, the Company purchased 100% of the stock of Millennium Financial Group, Inc. (“Mlend”), a full-service residential mortgage lender, headquartered in Middletown, Maryland with additional lending offices located in Crofton, Maryland and Oakland, Maryland. The acquisition enhances the Company’s mortgage infrastructure and provides direct access to the secondary mortgage market creating greater potential for noninterest income.

The Company has accounted for the purchase under the acquisition method of accounting in accordance with FASB ASC topic 805, “Business Combinations,” whereby the acquired assets and liabilities were recorded by the Company at their estimated fair values as of their acquisition date. The following table provides the purchase price as of the acquisition date, the identifiable assets acquired and liabilities assumed at their estimated fair values, and the resulting goodwill of \$1.66 million recorded from the acquisition:

Purchase Price Consideration:

Cash consideration	\$ 1,000,000
CMHF stock consideration (11,500 shares @ .01 par value)	258,750
Note Payable (10 yr note - annual payment of \$50,000 discounted at 3.35% rate)	<u>417,894</u>
Total purchase price for Millennium Financial Group, Inc.	\$ 1,676,644
Assets acquired:	
Cash and cash equivalents	\$ 50,390
Loans held for sale	930,058
Equipment	29,939
Non-compete intangible	25,000
Right-of-use assets	822,564
Other assets	<u>2,282</u>
Total assets acquired	\$ 1,860,233
Liabilities assumed:	
Borrowings	\$ 894,711
Lease liabilities	822,564
Other liabilities	<u>122,821</u>
Total liabilities assumed	\$ 1,840,096
Net assets acquired	<u>\$ 20,137</u>
Amount of goodwill resulting from acquisition	<u>\$ 1,656,507</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 3. Goodwill and Other Intangibles

Goodwill and other intangibles were recorded as a result of CMHF’s acquisition of Mlend in 2019. Other intangibles are composed solely of a non-compete agreement entered into as a result of the acquisition, which is being amortized to income over the three year life of the agreement. The following table provides information on the components of goodwill and other intangibles recorded in the Consolidated Balance Sheets at December 31, 2019.

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Goodwill	\$ 1,656,507	\$ -	\$ 1,656,507
Non-compete intangible	<u>25,000</u>	<u>(7,639)</u>	<u>17,361</u>
Total	<u>\$ 1,681,507</u>	<u>\$ (7,639)</u>	<u>\$ 1,673,868</u>

Amortization expense included in other operating expense in the Consolidated Statements of Income was \$7,639 for the year end December 31, 2019.

The following table provides information on the expected future amortization of the non-compete intangible:

2020	\$ 8,333
2021	8,333
2022	<u>695</u>
Total	<u>\$ 17,361</u>

Note 4. Business Segments

Prior to its acquisition of Millennium Financial Group, Inc. the Company had one reportable business segment. Subsequent to the acquisition of Millennium Financial Group, Inc., in 2019, the Company has two reportable business segments: commercial banking and mortgage banking. Revenues from commercial banking operations consist primarily of interest earned on loans and investment securities as well as fees earned on deposit accounts and from other ancillary services provided to our depositors. Mortgage banking operating revenues consist principally of gains on sales of loans in the secondary market, mortgage banking fee income related to loan originations, and interest earned on mortgage loans held for sale.

The results of operations associated with the holding company are comprised primarily of interest expense associated with the Company’s subordinated debt and general corporate expenses. The results of the holding company are not directly associated with the Company’s evaluation of its business lines and are included in “Other” below.

Information about reportable business segments and reconciliation of such information to the consolidated financial statements as of and for the year ended December 31, 2019 was as follows:

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 4. Business Segments (continued)

**Community Heritage Financial
Operating Results by Business Segment
As of and for the Year Ended December 31, 2019**

	Commercial Banking	Mortgage Banking	Other	Eliminations	Consolidated
<u>Revenues:</u>					
Interest income	\$ 21,050,569	\$ 126,655	\$ -	\$ (89,204)	\$ 21,088,020
Gains on sales of loans	-	2,098,208	-	-	2,098,208
Other noninterest income	1,259,605	559,881	-	(91,734)	1,727,752
Total operating income	22,310,174	2,784,744	-	(180,938)	24,913,980
<u>Expenses:</u>					
Provision for loan losses	763,490	-	-	-	763,490
Interest expense	4,243,566	130,459	201,445	(89,204)	4,486,266
Noninterest expenses	13,781,053	1,999,509	416,505	(91,734)	16,105,333
Total operating expenses	18,788,109	2,129,968	617,950	(180,938)	21,355,089
Income (loss) before income taxes	3,522,065	654,776	(617,950)	-	3,558,891
Income tax expense (benefit)	925,301	181,245	(178,429)	-	928,117
Net Income (loss)	\$ 2,596,764	\$ 473,531	\$ (439,521)	\$ -	\$ 2,630,774
Total Assets	\$ 513,019,372	\$ 7,632,125	\$ 63,838,237	\$ (67,522,641)	\$ 516,967,093
Goodwill and other intangibles	-	1,673,868	-	-	\$ 1,673,868
Capital expenditures	1,122,188	61,258	6,750	-	\$ 1,190,196

Note 5. Securities

There were no securities held to maturity as of December 31, 2019 and 2018.

The amortized cost and fair value of securities available for sale as of December 31, 2019 and 2018 were as follows:

<u>December 31, 2019</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available for Sale:				
U.S. Treasuries	\$ 1,999,617	\$ 5,916	\$ (688)	\$ 2,004,845
Federal Government Agencies	9,467,744	156	(2,278)	9,465,622
Mortgage Backed	19,139,726	177,232	(66,455)	19,250,503
Municipals	11,725,707	213,538	(19,450)	11,919,795
	<u>\$ 42,332,794</u>	<u>\$ 396,842</u>	<u>\$ (88,871)</u>	<u>\$ 42,640,765</u>
<u>December 31, 2018</u>	<u>Amortized Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Fair Value</u>
Available for Sale:				
U.S. Treasuries	\$ 1,998,854	\$ 1,876	\$ (14,575)	\$ 1,986,155
Federal Government Agencies	7,470,000	-	(251,911)	7,218,089
Mortgage Backed	26,130,432	41,604	(631,555)	25,540,481
Municipals	13,363,099	32,749	(173,845)	13,222,003
	<u>\$ 48,962,385</u>	<u>\$ 76,229</u>	<u>\$ (1,071,886)</u>	<u>\$ 47,966,728</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 5. Securities (continued)

Securities carried at fair value of \$5,834,646 and \$7,621,756 at December 31, 2019 and 2018, respectively, were pledged to secure public funds and for other purposes as required or permitted by law. In 2019, the Company recognized gross gains of \$22,055 and gross losses of \$(22,691) on the sales of securities. In 2018, the Company sold no securities.

The amortized cost and fair value of debt securities at December 31, 2019, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 6,997,361	\$ 7,002,745
Due after one year through five years	7,133,155	7,138,039
Due after five years through ten years	8,285,433	8,379,870
Due after ten years	19,916,845	20,120,111
	<u>\$ 42,332,794</u>	<u>\$ 42,640,765</u>

The following table shows the investments' gross unrealized losses and estimated fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at:

	December 31, 2019					
	Less than 12 months		12 months or more		Total	
	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
U.S. Treasuries	\$ -	\$ -	\$ 999,185	\$ 688	\$ 999,185	\$ 688
Federal Government						
Agencies	-	-	467,722	2,278	467,722	2,278
Mortgage backed	207,449	90	6,513,093	66,365	6,720,542	66,455
Municipals	3,705,690	19,450	-	-	3,705,690	19,450
	<u>\$ 3,913,139</u>	<u>\$ 19,540</u>	<u>\$ 7,980,000</u>	<u>\$ 69,331</u>	<u>\$ 11,893,139</u>	<u>\$ 88,871</u>
	December 31, 2018					
	Less than 12 months		12 months or more		Total	
	Fair Value	Loss	Fair Value	Loss	Fair Value	Loss
U.S. Treasuries	\$ -	\$ -	\$ 984,945	\$ 14,575	\$ 984,945	\$ 14,575
Federal Government						
Agencies	-	-	7,218,089	251,911	7,218,089	251,911
Mortgage backed	2,083,611	1,803	19,933,765	629,752	22,017,376	631,555
Municipals	3,715,256	15,658	5,710,293	158,187	9,425,549	173,845
	<u>\$ 5,798,867</u>	<u>\$ 17,461</u>	<u>\$ 33,847,092</u>	<u>\$ 1,054,425</u>	<u>\$ 39,645,959</u>	<u>\$ 1,071,886</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 5. Securities (continued)

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. At December 31, 2019, securities with unrealized losses consisted of two U.S. Treasuries, two Federal Government agencies, thirteen mortgage backed securities, and five municipals. The unrealized losses on debt securities are reflective of interest rate fluctuations and are not a reflection of credit deterioration. Because the Bank does not intend to sell these investments and it is more likely than not that the Bank will not be required to sell these investments before recovery of the amortized cost basis, which may be maturity, the Bank does not consider these investments to be other-than-temporarily impaired at December 31, 2019.

Note 6. Loans

Loans consist of the following at December 31:

	<u>2019</u>	<u>2018</u>
Commercial real estate	\$ 203,161,108	\$ 165,437,915
Residential real estate	123,927,619	116,390,967
Commercial	99,323,981	73,803,627
Consumer	1,966,480	1,442,295
	<u>\$ 428,379,188</u>	<u>\$ 357,074,804</u>
Less:		
Net deferred loan fees and (costs)	(955,562)	(667,549)
Allowance for loan losses	4,235,315	3,593,161
	<u>\$ 425,099,435</u>	<u>\$ 354,149,192</u>

Overdraft deposit accounts totaling \$161,410 and \$29,976 were reclassified as loans at December 31, 2019 and 2018, respectively.

A summary of transactions in the allowance for loan losses is as follows for the years ended December 31, 2019 and 2018, by portfolio segment:

	<u>Commercial Real Estate</u>	<u>Residential Real Estate</u>	<u>Commercial</u>	<u>Consumer</u>	<u>Total</u>
Allowance for Loan Losses:					
Balance, December 31, 2018	\$ 1,400,893	\$ 1,023,613	\$ 1,142,632	\$ 26,023	\$ 3,593,161
Provision for loan losses	451,188	117,327	160,739	34,236	763,490
Charge-offs	-	(98,030)	-	(35,806)	(133,836)
Recoveries	-	-	-	12,500	12,500
Balance, December 31, 2019	<u>\$ 1,852,081</u>	<u>\$ 1,042,910</u>	<u>\$ 1,303,371</u>	<u>\$ 36,953</u>	<u>\$ 4,235,315</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ 29,638</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 29,638</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,852,081</u>	<u>\$ 1,013,272</u>	<u>\$ 1,303,371</u>	<u>\$ 36,953</u>	<u>\$ 4,205,677</u>
Loans Receivable:					
Balance, December 31, 2019	<u>\$ 203,161,108</u>	<u>\$ 123,927,619</u>	<u>\$ 99,323,981</u>	<u>\$ 1,966,480</u>	<u>\$ 428,379,188</u>
Ending balance: individually evaluated for impairment	<u>\$ 270,399</u>	<u>\$ 1,807,599</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,077,998</u>
Ending balance: collectively evaluated for impairment	<u>\$ 202,890,709</u>	<u>\$ 122,120,020</u>	<u>\$ 99,323,981</u>	<u>\$ 1,966,480</u>	<u>\$ 426,301,190</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 6. Loans (Continued)

	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for Loan Losses:					
Balance, December 31, 2017	\$ 1,211,604	\$ 935,583	\$ 883,534	\$ 19,971	\$ 3,050,692
Provision for loan losses	189,289	88,030	289,621	15,409	582,349
Charge-offs	-	(46,927)	(30,523)	(14,476)	(91,926)
Recoveries	-	46,927	-	5,119	52,046
Balance, December 31, 2018	<u>\$ 1,400,893</u>	<u>\$ 1,023,613</u>	<u>\$ 1,142,632</u>	<u>\$ 26,023</u>	<u>\$ 3,593,161</u>
Ending balance: individually evaluated for impairment	<u>\$ -</u>	<u>\$ 67,426</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 67,426</u>
Ending balance: collectively evaluated for impairment	<u>\$ 1,400,893</u>	<u>\$ 956,187</u>	<u>\$ 1,142,632</u>	<u>\$ 26,023</u>	<u>\$ 3,525,735</u>
Loans Receivable:					
Balance, December 31, 2018	<u>\$ 165,437,915</u>	<u>\$ 116,390,967</u>	<u>\$ 73,803,627</u>	<u>\$ 1,442,295</u>	<u>\$ 357,074,804</u>
Ending balance: individually evaluated for impairment	<u>\$ 352,170</u>	<u>\$ 2,397,462</u>	<u>\$ 662,281</u>	<u>\$ -</u>	<u>\$ 3,411,913</u>
Ending balance: collectively evaluated for impairment	<u>\$ 165,085,745</u>	<u>\$ 113,993,505</u>	<u>\$ 73,141,346</u>	<u>\$ 1,442,295</u>	<u>\$ 353,662,891</u>

Management evaluates the credit quality of all loans based on an internal grading system that estimates the capability of the borrower to repay the contractual terms of their loan agreement as scheduled or at all. The Bank's internal risk grading is based on experiences with similarly graded loans. This analysis is performed on an ongoing basis as new information is obtained. The Bank uses the following definitions for adverse risk ratings:

- **Special Mention** - Loans classified as special mention have a potential weakness that deserve 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 possibility that the institution will sustain some loss if the deficiencies are not corrected.
- **Doubtful** - A loan classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 6. Loans (Continued)

The following table represents the credit quality of loans by class at:

<u>December 31, 2019</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial Real Estate:					
Construction and					
Land Development	\$ 32,941,646	\$ -	\$ -	\$ -	\$ 32,941,646
Multifamily	9,829,303	-	-	-	9,829,303
Other	160,119,760	-	270,399	-	160,390,159
Residential Real Estate	121,800,302	-	2,127,317	-	123,927,619
Commercial	93,510,986	5,135,677	677,318	-	99,323,981
Consumer	1,966,480	-	-	-	1,966,480
	<u>\$ 420,168,477</u>	<u>\$ 5,135,677</u>	<u>\$ 3,075,034</u>	<u>\$ -</u>	<u>\$ 428,379,188</u>

<u>December 31, 2018</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Substandard</u>	<u>Doubtful</u>	<u>Total</u>
Commercial Real Estate:					
Construction and					
Land Development	\$ 20,693,608	\$ -	\$ -	\$ -	\$ 20,693,608
Multifamily	8,014,431	-	-	-	8,014,431
Other	136,377,706	-	352,170	-	136,729,876
Residential Real Estate	113,860,377	-	2,530,590	-	116,390,967
Commercial	71,902,394	477,186	1,424,047	-	73,803,627
Consumer	1,442,295	-	-	-	1,442,295
	<u>\$ 352,290,811</u>	<u>\$ 477,186</u>	<u>\$ 4,306,807</u>	<u>\$ -</u>	<u>\$ 357,074,804</u>

Past due and nonaccrual loans presented by loan class were as follows at:

<u>December 31, 2019</u>	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 or More Days Past Due</u>	<u>Total Past Due Loans</u>	<u>Over 90 Days Past Due and Still Accruing</u>	<u>Nonaccrual</u>
Commercial Real Estate:						
Construction and						
Land Development	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-	-
Other	-	-	-	-	-	270,399
Residential Real Estate	465,581	-	244,692	710,273	-	884,959
Commercial	8,969	-	-	8,969	-	-
Consumer	-	-	-	-	-	-
	<u>\$ 474,550</u>	<u>\$ -</u>	<u>\$ 244,692</u>	<u>\$ 719,242</u>	<u>\$ -</u>	<u>\$ 1,155,358</u>

<u>December 31, 2018</u>	<u>30-59 Days Past Due</u>	<u>60-89 Days Past Due</u>	<u>90 or More Days Past Due</u>	<u>Total Past Due Loans</u>	<u>Over 90 Days Past Due and Still Accruing</u>	<u>Nonaccrual</u>
Commercial Real Estate:						
Construction and						
Land Development	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-	-
Other	-	-	-	-	-	352,171
Residential Real Estate	1,075,250	-	497,115	1,572,365	-	1,438,642
Commercial	-	48,150	-	48,150	-	662,281
Consumer	-	-	-	-	-	-
	<u>\$ 1,075,250</u>	<u>\$ 48,150</u>	<u>\$ 497,115</u>	<u>\$ 1,620,515</u>	<u>\$ -</u>	<u>\$ 2,453,094</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 6. Loans (Continued)

Information relating to individually impaired loans, including TDRs and presented by class of loans, was as follows as of and for the years ended:

<u>December 31, 2019</u>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With No Related Allowance Recorded:					
Commercial Real Estate:					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	654,763	270,399	-	310,285	-
Residential Real Estate	1,899,249	1,627,107	-	1,692,886	38,346
Commercial	-	-	-	-	-
Consumer	-	-	-	-	-
	<u>\$ 2,554,012</u>	<u>\$ 1,897,506</u>	<u>\$ -</u>	<u>\$ 2,003,171</u>	<u>\$ 38,346</u>
With an Allowance Recorded:					
Commercial Real Estate:					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	-	-	-	-	-
Residential Real Estate	180,492	180,492	29,638	186,851	-
Commercial	-	-	-	-	-
Consumer	-	-	-	-	-
	<u>\$ 180,492</u>	<u>\$ 180,492</u>	<u>\$ 29,638</u>	<u>\$ 186,851</u>	<u>\$ -</u>
<u>December 31, 2018</u>	<u>Unpaid Principal Balance</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With No Related Allowance Recorded:					
Commercial Real Estate:					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	690,326	352,170	-	287,759	-
Residential Real Estate	2,070,024	1,847,901	-	1,910,999	44,705
Commercial	762,325	662,281	-	888,553	-
Consumer	-	-	-	-	-
	<u>\$ 3,522,675</u>	<u>\$ 2,862,352</u>	<u>\$ -</u>	<u>\$ 3,087,311</u>	<u>\$ 44,705</u>
With an Allowance Recorded:					
Commercial Real Estate:					
Construction and Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	-	-	-	-	-
Residential Real Estate	566,162	549,561	67,426	566,245	10,535
Commercial	-	-	-	-	-
Consumer	-	-	-	-	-
	<u>\$ 566,162</u>	<u>\$ 549,561</u>	<u>\$ 67,426</u>	<u>\$ 566,245</u>	<u>\$ 10,535</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 6. Loans (Continued)

There were no loans modified in a troubled debt restructuring (TDR) during the years ended December 31, 2019 and 2018 and there were no TDRs that defaulted during the years ended December 31, 2019 and 2018 that were modified within 12 months prior to default. For the purposes of this disclosure, a troubled debt restructuring payment default occurs when, within twelve months of the original modification, the loan reaches more than 90 days past due, is charged-off or foreclosed upon. TDRs are individually evaluated for impairment and included in the impaired loan tables.

Note 7. Premises and Equipment

Investments in premises and equipment are as follows at December 31:

	2019	2018
Premises and land	\$ 8,443,796	\$ 8,016,527
Furniture and equipment	3,796,810	2,963,065
	12,240,606	10,979,592
Less: accumulated depreciation	5,425,132	4,693,792
	\$ 6,815,474	\$ 6,285,800

Depreciation and amortization expense amounted to \$659,990 and \$497,935 during the years ended December 31, 2019 and 2018, respectively.

Note 8: Leases

On January 1, 2019, the Company adopted ASU No. 2016-02 *“Leases (Topic 842)”* and all subsequent ASUs that modified Topic 842. The Company elected the prospective application approach provided by ASU 2018-11 and did not adjust prior periods for ASC 842. The Company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. As stated in the Company’s 2018 annual report, the implementation of the new standard resulted in recognition of right-of-use assets and lease liabilities of \$2.7 million at the date of adoption, which were related to the Bank’s lease of premises used in operations. Additional right-of-use assets and lease liabilities totaling \$823 thousand were recognized upon the acquisition of Mlend on February 1, 2019, and were related to Mlend’s lease of premises used in operations. The right-of-use assets and lease liabilities detailed below include four locations used by the Bank and three locations used by Mlend at December 31, 2019. Short-term leases, including those with initial terms of 12 months or less, are not included in these balances. Lease payments for short-term leases are recognized as lease expense on a straight-line basis over the lease term, or for variable lease payments, in the period in which the obligation was incurred. Right-of-use assets and lease liabilities are included in other assets and other liabilities, respectively, in the Consolidated Balance Sheets.

Lease liabilities represent the Company’s obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the Company’s incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the Company’s right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The Company’s long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the Company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably certain of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 8: Leases (continued)

The following tables present information about the Company's leases:

	As of December 31, 2019		
	Bank	Mlend	Consolidated
Lease liabilities	\$ 2,400,281	\$ 736,070	\$ 3,136,351
Right-of-use assets	\$ 2,377,521	\$ 731,902	\$ 3,109,423
Weighted average remaining lease term	7.8 years	9.0 years	8.1 years
Weighted average discount rate	3.13 %	3.28 %	3.16 %

	For the Year Ended December 31, 2019		
	Bank	Mlend	Consolidated
Operating lease cost	\$ 431,239	\$ 111,326	\$ 542,565
Short-term lease cost	2,147	-	2,147
Total lease cost	\$ 433,386	\$ 111,326	\$ 544,712

Cash paid for amounts included in the measurement of lease liabilities	\$ 408,180	\$ 107,157	\$ 515,337
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A maturity analysis of the Company's operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows:

	As of December 31, 2019		
Lease payments due	Bank	Mlend	Consolidated
Year ended December 31, 2020	\$ 413,307	\$ 96,687	\$ 509,994
Year ended December 31, 2021	417,342	88,200	505,542
Year ended December 31, 2022	385,108	88,200	473,308
Year ended December 31, 2023	387,614	88,310	475,924
Year ended December 31, 2024	386,673	96,395	483,068
Thereafter	738,433	393,745	1,132,178
Total undiscounted cash flows	\$ 2,728,477	\$ 851,537	\$ 3,580,014
Discount	(328,196)	(115,467)	(443,663)
Lease liabilities	\$ 2,400,281	\$ 736,070	\$ 3,136,351

Note 9. Deposits

The following is a schedule of the future maturities of time and IRA deposits as of December 31, 2019:

<u>Year Ending December 31:</u>	
2020	\$ 48,980,827
2021	21,578,613
2022	13,900,736
2023	9,905,288
2024	2,755,320
	<u>\$ 97,120,784</u>

Time deposits in denominations of \$250,000 or more amounted to \$30,722,692 and \$24,620,978, respectively at December 31, 2019 and 2018. Included in total deposits at December 31, 2019 and 2018 were Insured Cash Sweep (ICS) and CDARS deposits in the amount of \$42,280,269 and \$35,996,449, respectively. Other brokered deposits included in total deposits at December 31, 2019 and 2018 were \$231,948 and \$7,020,307, respectively.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 10. Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction and the state of Maryland. With few exceptions, the Company is no longer subject to U.S. federal and state income tax examination by tax authorities for years prior to 2016.

Components of the provision for income taxes are as follows:

	<u>2019</u>	<u>2018</u>
Current income tax expense	\$ 1,020,128	\$ 844,025
Deferred income tax benefit	<u>(92,011)</u>	<u>(142,374)</u>
 Total income tax expense	 <u>\$ 928,117</u>	 <u>\$ 701,651</u>

A reconciliation of the federal statutory income tax rate on pre-tax income to the provision for income taxes is as follows:

	<u>2019</u>	<u>2018</u>
Federal tax at statutory rate	\$ 747,367	\$ 560,571
Increase (decrease) resulting from the following:		
State income taxes, net of federal tax benefit	228,182	167,314
Tax-exempt interest income	(46,569)	(49,271)
Bank owned life insurance income	(22,927)	(20,860)
Non-deductible interest expense	3,733	3,233
Other non-deductible expenses	24,303	10,371
Other, net	<u>(5,972)</u>	<u>30,293</u>
Total income tax expense	<u>\$ 928,117</u>	<u>\$ 701,651</u>

The tax effects of temporary differences between the financial reporting basis and income tax basis of assets and liabilities that are included in the net deferred tax asset at December 31 relate to the following:

	<u>2019</u>	<u>2018</u>
Deferred tax assets:		
Allowance for loan losses	\$ 1,080,481	\$ 904,753
Lease liabilities	863,124	-
Supplemental benefits expense	153,130	154,480
Deferred Compensation Liability	27,355	-
Allowance for off-balance sheet credit exposures	201,735	164,007
Nonaccrual interest	188,358	195,909
Unrealized loss on available for sale securities	-	274,004
Other	<u>55,613</u>	<u>39,424</u>
Total deferred tax assets	<u>2,569,796</u>	<u>1,732,577</u>
 Deferred tax liabilities:		
Right-of-use assets	(855,713)	-
Unrealized gain on available for sale securities	(84,755)	-
Deferred loan costs, net	(262,971)	(183,709)
Depreciation	<u>(386,776)</u>	<u>(302,539)</u>
Total deferred tax liabilities	<u>(1,590,215)</u>	<u>(486,248)</u>
Net deferred tax assets	<u>\$ 979,581</u>	<u>\$ 1,246,329</u>

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 11. Borrowings

At December 31, 2019, the Bank had \$5 million in available secured borrowings and \$5.5 million available in unsecured borrowings with other financial institutions with interest rates on these agreements equal to the prevailing federal funds rate. In addition, the Bank had access to \$2.7 million in short-term borrowing capacity from the Federal Reserve Discount Window with an interest rate equal to 2.75%. The Bank also has access to a credit line with The Federal Home Loan Bank of Atlanta (FHLBA) that may be utilized for short and long-term borrowings. At December 31, 2019 and 2018, the Bank had no outstanding borrowings with the FHLB. Total credit availability with the FHLBA at December 31, 2019 was \$128.3 million. Advances under this line of credit are secured by a portion of the Bank's residential mortgage portfolio, which at December 31, 2019, would have allowed the Bank to access up to \$31.1 million of credit without pledging additional loans as collateral.

The Bank also had a \$1.0 million letter of credit at December 31, 2019 with another financial institution for contingency funding purposes.

Other borrowings of \$289,039 at December 31, 2019, consisted of Mlend's draws on a warehouse line of credit maintained at another financial institution. Draws on the warehouse line of credit are collateralized by the specific mortgage loans held for sale funded by advances on the line up to 100% of the note amount of the specific mortgages. The line of credit carries a rate of interest at the prevailing Prime rate, renewed annually with no stated maturity. The line requires a minimum \$50 thousand remain on deposit at the financial institution at all times. The total warehouse line of credit was \$5 million at December 31, 2019, with a remaining credit availability of \$4.7 million.

Note 12. Related Party Transactions

The aggregate activity of loans made to executive officers, directors, and their related interests during the year ending December 31, 2019, was as follows:

	<u>2019</u>
Beginning Balance	\$ 129,952
Effect of change in the composition of related parties	571,094
Advances	533,182
Principal curtailments	<u>(493,778)</u>
Ending Balance	<u>\$ 740,450</u>

In management's opinion, such loans were made in the ordinary course of business with substantially the same terms (including interest rates and collateral) as those prevailing at the time for comparable transactions with other persons. They do not involve more than normal risk of collectability or present other unfavorable features.

The aggregate amount of deposits of executive officers, directors, and their related interests was \$7,282,209 and \$3,436,148 at December 31, 2019 and 2018, respectively.

Mlend leases its Middletown, Maryland location from Fordham Holdings, LLC, and leases its Oakland, Maryland location from Dry Dock Plaza, LLC. Fordham and Dry Dock are legal entities owned by a member of executive management. The related lease liabilities included in the total of lease liabilities disclosed in Note 8. – Leases, was \$728 thousand at December 31, 2019.

Note 13. Commitments and Contingencies

The Company is subject to legal proceedings which are incidental to the ordinary course of business. In the opinion of the management of the Company, there are no material pending legal proceedings to which the Company is a party to or which involve any of its property.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 14. Financial Instruments with Off-Balance-Sheet Risk

The Bank is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financial needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet. The contract amounts of those instruments reflect the extent of involvement the Bank has in particular classes of financial instruments.

The Bank's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

The contract amounts of these financial instruments at December 31 are as follows:

	<u>2019</u>	<u>2018</u>
Commitments to extend credit	\$ 136,403,319	\$ 93,102,341
Standby letters of credit and financial guarantees written	1,399,611	972,060

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. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, by the Bank upon extension of credit is based on management's credit evaluation of the customer. Collateral held varies but may include accounts receivable, inventory, real estate, equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. The Bank holds collateral supporting those commitments when deemed necessary by management.

At December 31, 2019, the Company, primarily through Mlend, had interest rate lock commitments to originate mortgage loans totaling \$5,276,831. The Company enters into corresponding commitments with third-party investors to sell each of these loans that close.

Note 15. Concentrations of Credit Risk

The Bank extends credit for real estate construction; land development, commercial and residential loans to customers throughout its market area. Although the Bank has a diversified loan portfolio, a substantial portion of its customers' ability to honor their contracts is dependent upon the real estate economic sector.

The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary, by the Bank upon the extension of credit, is based on management's credit evaluation of the customer. Collateral held varies but generally includes equipment and real estate.

The Bank has concentrations of deposits with certain large, national financial institutions. There was \$2,085,052 of additional cash balances outstanding at December 31, 2019 in excess of the FDIC insurance levels.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 16. Profit Sharing Plans

The Bank has a deferred compensation (401(k)) profit sharing plan and trust for all employees who are 21 years of age or older and who have completed 90 days of employment. The plan permits eligible participants to contribute the maximum percentage allowable by law. At its discretion, the Bank may make matching and/or profit sharing plan contributions. The Bank made discretionary contributions of \$129,019 and \$98,024 to the plan during the years ended December 31, 2019 and 2018 respectively.

Millennium Financial Group, Inc. also has a deferred compensation (401(k)) profit sharing plan and trust, which is separate and distinct from the Bank plan. All employees who are 21 years of age or older and who have completed one month of employment are eligible to participate. The plan permits eligible participants to contribute the maximum percentage allowable by law. At its discretion, Mlend may make matching and/or profit sharing plan contributions. Mlend made discretionary contributions of \$7,825 to the plan for the year ended December 31, 2019.

Note 17. Other Benefit Plans

The Bank adopted a defined benefit SERP for certain Executive Officers. The defined benefit SERP on the Executive Officers includes a vesting schedule. The supplemental benefit expense for the years ended December 31, 2019 and 2018 was \$45,094 and \$34,608, respectively. The related liability balance at December 31, 2019 and 2018 was \$556,432 and \$561,338, respectively. The plans are unfunded; however, life insurance has been acquired on the life of the employees in amounts sufficient to help meet the costs of the obligations.

In 2018, the Bank established a nonqualified deferred compensation plan which allows certain key employees to defer a portion of their compensation and provide for supplemental retirement benefits. The plan is unfunded; however, such deferrals accumulate gains and losses based on certain deemed investment options. The Bank may also, in its discretion, make matching contributions to participant accounts. All such contributions vest over a three-year period from the end of the year in which the contributions are made. Plan participation began in 2019, and the deferred compensation liability recorded in other liabilities on the Consolidated Balance Sheets was \$99,402 at December 31, 2019. The Bank made no matching contributions in 2019. The Bank has purchased bank owned life insurance to economically hedge changes in the nonqualified deferred compensation liability.

Note 18. Regulatory Matters

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 possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amount and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. banks (Basel III rules) became effective on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As part of the requirements, the Common Equity Tier I Capital ratio is calculated and utilized in the assessment of capital for all institutions. In addition, a capital conservation buffer must be maintained in excess of the minimum capital requirements to allow an institution to avoid restrictions on dividend payments, share repurchase transactions, and discretionary bonus payments. The capital conservation buffer requirement began its phase-in on January 1, 2016, at 0.625% of risk-weighted assets, and increased by the same percentage in each successive year until fully implemented at 2.5% on January 1, 2019. The capital conservation buffer is applicable to all ratios with the exception of the Tier 1 leverage ratio. At December 31, 2019, the Bank's institution specific capital conservation buffer in excess of the required minimums was 7.57%.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 18. Regulatory Matters (Continued)

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of total common equity tier 1, tier I capital to risk-weighted assets, total capital to risk weighted assets and of Tier I capital to average assets. Management believes, as of December 31, 2019 and 2018, that the Bank met all capital adequacy requirements to which it was subject.

As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based capital, Common Equity Tier 1 capital, Tier 1 risk-based capital, and Tier 1 leverage ratios as set forth in the following tables. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Bank's required and actual capital amounts and ratios are set forth in the following table:

	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<u>As of December 31, 2019:</u>			(Dollars in Thousands)			
Total Capital (to Risk Weighted Assets)	\$ 64,374	15.57%	\$ 33,080	8.00%	\$ 41,345	10.00%
Tier 1 Capital (to Risk Weighted Assets)	\$ 59,406	14.37%	\$ 24,810	6.00%	\$ 33,080	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 59,406	14.37%	\$ 18,608	4.50%	\$ 26,878	6.50%
Tier 1 Leverage (to Average Assets)	\$ 59,406	11.76%	\$ 20,205	4.00%	\$ 25,256	5.00%
<u>As of December 31, 2018:</u>			(Dollars in Thousands)			
Total Capital (to Risk Weighted Assets)	\$ 49,769	14.77%	\$ 26,962	8.00%	\$ 33,703	10.00%
Tier 1 Capital (to Risk Weighted Assets)	\$ 45,580	13.52%	\$ 20,222	6.00%	\$ 26,962	8.00%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	\$ 45,580	13.52%	\$ 15,166	4.50%	\$ 21,907	6.50%
Tier 1 Leverage (to Average Assets)	\$ 45,580	10.64%	\$ 17,137	4.00%	\$ 21,421	5.00%

As a FHA-approved mortgagee, Mlend must maintain a minimum adjusted net worth of \$1,000,000 plus 1% of the total volume in excess of \$25,000,000 of FHA single family mortgages originated, underwritten, serviced, and/or purchased during the prior fiscal year, up to a maximum required adjusted net worth of \$2,500,000. Mlend must also maintain liquid assets of at least 20% of its required adjusted net worth. Adjusted net worth is defined as shareholders' equity, less certain unacceptable assets. At December 31, 2019, Mlend met this requirement.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 19. Fair Value Measurements

The Company uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with the "Fair Value Measurements and Disclosures" topic of FASB ASC, the fair value of an instrument is the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market and in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances, there are no quoted market prices for the Company's various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. U.S. GAAP requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under current market conditions depends on the facts and circumstances and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under current market conditions.

In accordance with this guidance, the Company groups its assets and liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value. The three levels of the fair value hierarchy based on these two types of inputs are as follows:

Level 1 – Valuation is based on quoted prices in active markets for identical assets and liabilities.

Level 2 – Valuation is based on observable inputs including quoted prices in active markets for similar assets and liabilities, quoted prices for identical or similar assets and liabilities in less active markets, and model-based valuation techniques for which significant assumptions can be derived primarily from or corroborated by observable data in the market.

Level 3 – Valuation is based on model-based techniques that use one or more significant inputs or assumptions that are unobservable in the market.

The following describes the valuation techniques used by the Bank to measure certain assets and liabilities recorded at fair value on a recurring basis in the financial statements:

Securities available for sale: Securities available for sale are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 19. Fair Value Measurements (Continued)

The following table presents the balances of assets measured at fair value on a recurring basis as of December 31:

Description	Balance	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Assets:				
U.S. Treasuries	\$ 2,004,845	\$ -	\$ 2,004,845	\$ -
Federal Government Agencies	9,465,622	-	9,465,622	-
Mortgage Backed	19,250,503	-	19,250,503	-
Municipals	11,919,795	-	11,919,795	-
December 31, 2018				
Assets:				
U.S. Treasuries	\$ 1,986,155	\$ -	\$ 1,986,155	\$ -
Federal Government Agencies	7,218,089	-	7,218,089	-
Mortgage Backed	25,540,481	-	25,540,481	-
Municipals	13,222,003	-	13,222,003	-

Certain assets are measured at fair value on a nonrecurring basis in accordance with GAAP. Adjustments to the fair value of these assets usually result from the application of lower-of-cost-or-market accounting or write-downs of individual assets.

The following describes the valuation techniques used by the Company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Loans Held for Sale: Loans held for sale are carried at the lower of cost or estimated fair value. These loans currently consist of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the Company records any fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale at December 31, 2019 and 2018.

Impaired Loans: Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts due according to the contractual terms of the loan agreements will not be collected. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the Company's collateral is real estate. The value of real estate collateral is determined utilizing a market valuation approach based on an appraisal, of one year or less, conducted by an independent, licensed appraiser using observable market data (Level 2). However, if the collateral is a house or building in the process of construction or if an appraisal of the property is more than one year old and not solely based on observable market comparable or management determines the fair value of the collateral is further impaired below the appraised value, then a Level 3 valuation is considered to measure the fair value. The value of business equipment is based upon an outside appraisal, of one year or less, if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivable collateral are based on financial statement balances or aging reports (Level 3).

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 19. Fair Value Measurements (Continued)

Impaired Loans (Continued):

Impaired loans allocated to the allowance for loan losses are measured at fair value on a nonrecurring basis. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the Consolidated Statements of Income.

Other Real Estate Owned: OREO is measured at fair value in the same manner as described for impaired loans. Any initial fair value adjustment is charged against the allowance for loan losses. Subsequent fair value adjustments are recorded in the period incurred and included in noninterest expense on the Consolidated Statements of Income.

The following table presents the balances of assets measured at fair value on a nonrecurring basis as of December 31:

Description	Balance	Fair Value Measurements Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Assets:				
Impaired loans, net of valuation allowance	\$ 150,854	\$ -	\$ -	\$ 150,854
December 31, 2018				
Assets:				
Impaired loans, net of valuation allowance	\$ 482,135	\$ -	\$ -	\$ 482,135

The following table presents information about Level 3 fair value measurements for December 31:

2019				
Description	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	\$ 150,854	Discounted appraised/ invoiced value	Selling expenses and discount for lack of marketability	19% (19%)
2018				
Description	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans	\$ 482,135	Discounted appraised/ invoiced value	Selling expenses and discount for lack of marketability	10-18% (12%)

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 19. Fair Value Measurements (Continued)

FASB ASC 825, Financials Instruments, requires disclosure about fair value of financial instruments, including those financial assets and financial liabilities that are not required to be measured and reported at fair value on a recurring or nonrecurring basis. ASC 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented may not necessarily represent the underlying fair value of the Company. The carrying amounts and estimated fair values of the Company's financial instruments are presented in the following tables whether or not recognized on the Consolidated Balance Sheets at fair value. Fair values for December 31, 2019 and 2018 were estimated using an exit price notion.

The estimated fair value of financial instruments is summarized as follows at December 31:

	December 31, 2019			
	Carrying Amount	Fair Value		
		Level 1	Level 2	Level 3
Financial assets:				
Cash and due from banks	\$ 25,065,743	\$ 25,065,743	\$ -	\$ -
Federal funds sold	-	-	-	-
FHLB Stock	392,200	-	392,200	-
Securities	42,640,765	-	42,640,765	-
Loans held for sale	3,775,199	-	3,775,199	-
Loans, net	424,773,331	-	-	428,143,188
Accrued interest receivable	1,232,624	-	1,232,624	-
Bank owned life insurance	4,966,843	-	4,966,843	-
Financial liabilities:				
Deposits	446,706,511	-	349,585,727	97,934,784
Accrued interest payable	278,832	-	278,832	-
Subordinated Debt	14,573,940	-	-	15,007,082
Other Borrowings	289,039	-	-	289,039
December 31, 2018				
	Carrying Amount	Level 1	Level 2	Level 3
Financial assets:				
Cash and due from banks	\$ 15,347,455	\$ 15,347,455	\$ -	\$ -
Federal funds sold	3,198,302	3,198,302	-	-
FHLB Stock	325,200	-	325,200	-
Securities	47,966,728	-	47,966,728	-
Loans, net	354,149,192	-	-	353,238,353
Accrued interest receivable	1,155,631	-	1,155,631	-
Bank owned life insurance	4,720,042	-	4,720,042	-
Financial liabilities:				
Deposits	388,544,240	-	293,929,713	93,867,527
Accrued interest payable	113,379	-	113,379	-

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 20. Subordinated Debt

The Company completed a private placement of \$15.0 million of fixed-to-floating subordinated notes on October 17, 2019. Subject to limited exceptions permitting earlier redemption, the notes may be redeemed on or after October 24, 2024. Unless redeemed earlier, the notes will mature on October 30, 2029. The notes bear a fixed rate of 5.75% to but excluding October 30, 2024 and will bear a floating rate equal to three-month LIBOR plus 4.395% thereafter. The notes are carried at their principal amount, less unamortized issuance costs. The balance was \$14,573,940 at December 31, 2019. The initial debt issuance costs were \$447,817, of which \$21,757 were amortized to interest expense in 2019.

Note 21. Common Stock

As of December 31, 2019, there were 2,251,320 shares of common stock outstanding. In 2019, 11,500 shares were issued as consideration in the acquisition of Mlend. There were also 6,000 shares of common stock issued as a stock bonus in January of 2019. At December 31, 2019, there were 1,748,680 shares of common stock and 1,000,000 shares of preferred stock available to be issued.

As of December 31, 2018, there were 2,233,820 shares of common stock outstanding. At December 31, 2018, there were 1,766,180 shares of common stock and 1,000,000 shares of preferred stock available to be issued.

Note 22. Other Operating Expenses

The following table describes the significant components of other operating expenses included in the Consolidated Statements of Income for the years ended December 31:

	<u>2019</u>	<u>2018</u>
Professional fees	\$ 648,668	\$ 535,074
ATM and card related	338,124	273,051
Public relations and charitable contributions	255,513	241,449
Director fees	208,500	174,250
Advertising	137,706	141,110
Other miscellaneous operating expenses	991,494	740,894
Total other operating expenses	<u>\$ 2,580,005</u>	<u>\$ 2,105,828</u>

Note 23. Revenue from Contracts with Customers

On January 1, 2018, the company adopted ASU No. 2014-09, "Revenue from Contracts with Customers: Topic 606", and all subsequent amendments to ASU No. 2014-09 using the modified retrospective method. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue, and as such, a cumulative-effect adjustment to retained earnings was not deemed necessary. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on investment securities and other sales of financial instruments are similarly excluded from the scope. Using Topic 606 guidelines, the Company concluded that Topic 606 applies to certain revenue streams included in noninterest income as well as gains or losses on other real estate owned that have been historically reported in noninterest expense. Significant categories of in-scope revenue are described and disaggregated below.

Service Charges on Deposit Accounts

A significant portion of noninterest income is derived from short-term contracts associated with services provided for deposit account holders. These revenue streams are principally comprised of overdrawn account charges, account maintenance charges, ATM fees, and monthly account fees. The Bank's performance obligations on revenue generated

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 23. Revenue from Contracts with Customers (continued)

from deposit accounts are generally satisfied immediately, when the transaction occurs, or by month-end. Typically, the duration of a contract does not extend beyond the services performed. Due to the short duration of most customer contracts which generate these sources of noninterest income, no significant judgments must be made in the determination of the amount and timing of revenue recognized.

VISA Check Card Income

The Bank earns interchange fees from debit cardholder transactions conducted through the VISA payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Gains and Losses on the Sale of Other Real Estate Owned

The Company records a gain or loss from the sale of other real estate owned ("OREO") when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of OREO to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer.

The following table describes the In-scope and out-of-scope noninterest income elements related to ASC Topic 606 for the years ended December 31:

	Years Ended December 31,	
	2019	2018
In-scope of ASC Topic 606:		
Service charges on deposit accounts:		
Monthly service and other activity charges	\$ 512,449	\$ 376,673
ATM fees	78,085	66,680
VISA check card income	489,999	438,261
Loss on premises and equipment	(5,471)	-
Other operating income	76,003	60,749
Total noninterest income within the scope of ASC 606	1,151,065	942,363
Out-of-scope of ASC 606 (1)	2,674,895	231,934
Total noninterest income	\$ 3,825,960	\$ 1,174,297

(1) Includes bank owned life insurance income, gains on sales of mortgage loans and related fees, and losses on sales and calls of securities.

Contract Balances

The Company's in-scope non-interest revenue streams are largely based on transactional activity. Consideration is often received immediately or shortly after the Company satisfied its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2019 and 2018, the Company did not have any significant contract balances.

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Note 24. Subsequent Events

The Company evaluates subsequent events that have occurred after the balance sheet date, but before the financial statements are issued. There are two types of subsequent events (1) recognized, or those 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, and (2) non-recognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

Subsequent events have been considered through March 31, 2020, the date financial statements were available to be issued.

The impact of the COVID-19 outbreak, which became widespread beginning in February of 2020, had immediate impact on the stock market, consumer confidence and interest rates. The full impact on the US and global economy has yet to be determined but signs are that it will have a significant impact on 2020 GDP and overall financial performance of US corporations, including the banking sector. While management has and will continue to actively take steps to mitigate the impact of the recent market conditions on the balance sheet and earnings of the Company, it should be noted that fair values, rates, yields, balance sheet composition and earnings could be altered by the event. Additionally, it is reasonably possible that estimates made in the financial statements have been, or will be, materially and adversely impacted in the near term as a result of these conditions, including the allowance for loan losses, the valuation of goodwill and intangibles, and other-than-temporary impairment of investment securities.



2019 Executive Officers

Robert E. Goetz, Jr.

President & Chief Executive Officer

J. Michael Hill

Executive Vice President & Chief Risk Officer

Angela M. Thompson

Executive Vice President & Chief Operating Officer

William H. Poffenbarger, Jr.

Executive Vice President: President & Chief Executive Officer, Millennium Financial Group, Inc.

Ryan Lampton

Executive Vice President & Chief Revenue Officer, Middletown Valley Bank

Dawn Lowe

Senior Vice President & Director of Human Resources

Robert Wolfe, Jr.

Senior Vice President & Controller

Dawn R. Woods

Corporate Secretary

Michelle Kelbaugh

Assistant Corporate Secretary

Board of Directors

Community Heritage Financial, Inc. and Middletown Valley Bank

James G. Pierre – Chairman of the Board

Assistant Professor of Business & Management, Hagerstown Community College. Former President and Chief Executive Officer, Susquehanna Bank

A. Dennis Remsburg – Vice Chairman of the Board

District Manager, Catocin & Frederick Soil Conversation Districts

James H. Clapp

Retired Attorney, Former Partner, Shoemaker, Horman & Clapp

Robert E. Goetz, Jr. – President & Chief Executive Officer, CHF & MVB

Richard L. Kefauver

Retired, Former Owner, Fountaindale Exxon Service Center

J. Thomas Routzahn, Jr.

Retired, Former Director and Principal, Grangers Mutual Insurance Company

John T. Routzahn, III

Marketing Representative, Mutual Benefit Group

John J. Rudy

Retired, Co-Owner / Operator, The Model Garage, Inc.

Todd M. Snook

Owner & President, Valley Storage Company

Board of Directors

Millennium Financial Group, Inc.

James G. Pierre – Chairman of the Board

Assistant Professor of Business & Management, Hagerstown Community College. Former President and Chief Executive Officer, Susquehanna Bank

Robert E. Goetz, Jr. – President & Chief Executive Officer, CHF & MVB

William H. Poffenbarger, Jr. – President & Chief Executive Officer, Mlend

Richard L. Kefauver

Retired, Former Owner, Fountaindale Exxon Service Center

Angela M. Thompson – Executive Vice President & Chief Operating Officer, CHF & MVB

Rooted in Our Communities

2019 ANNUAL REPORT

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Market: OTC Pink Marketplace
Trading symbol: CMHF



Community
Heritage
Financial, Inc.