



Community
Heritage
Financial, Inc.



2020 ANNUAL REPORT

Committed
to Our
Communities



LETTER TO OUR

Shareholders

Dear Shareholders,

As we all know, 2020 was full of adversity and challenges. The Community Heritage Financial, Inc. (“CHF” or “the Company”) leadership team thought deeply about those challenges and addressed the pandemic proactively, as many individuals and businesses faced financial difficulties during this unprecedented time. Uncertainty endures around the COVID-19 virus, leaving many questions unanswered; however, one thing is certain, and that is how tremendously proud we are of the response we have received from our remarkable group of employees. They continue to work through the difficulties brought by the pandemic, and have truly made a difference in our communities – doing so with the same consistent smiles and focus that have set us apart for so many years.

It is important to remember that the greatest lessons are often learned in the worst of times. With that, here are a few lessons that the CHF leadership team learned from the year 2020:

Our dedicated team is the greatest asset we have.

It was remarkable to witness how the CHF team rallied together during these unusual circumstances to continue moving our customers and company forward. Our goal, as it has been every year, was to be the best community-focused financial organization for the communities that we serve. Whether it was the first round of Paycheck Protection Program (“PPP”) loans, the mortgage boom, or the need to shift employees and work locations for business continuity, our team members stepped up to assist at varying points throughout the past year to meet the unprecedented volume demands and challenging conditions.

Customers appreciate and depend on our guidance.

The fear that existed for many of our customers was extinguished quickly by each of us. We remained strong, stable, and calm. Whether a customer was concerned about the safety of their deposits, the loss in income their business was experiencing, or the inability to pay their mortgage, we were there for them every step of the way.

We believe our rapid response to the PPP was a testimony to our commitment to our customers and local economies. Our participation in the program helped ensure the continuity of operations for our business customers and helped over 7,500 people in our local communities keep their jobs.

Our communities are better places because of Community Heritage Financial. We remained dedicated to supporting our community partners throughout our footprint. Whether it was giving time to non-profit organizations, supporting many food, hygiene, and clothing drives during the year, providing leadership to non-profit organizations through board and committee work, or continuing to provide financial support as the difficulties of the pandemic impacted our communities, we were steadfast in our commitments.

The Company's financial performance continues to shine. Despite all the challenges 2020 brought, we have been able to achieve the strongest financial performance in the history of the Company. Total assets reached a record high of \$688.2 million, which is a 33% increase over last year. Middletown Valley Bank, our banking subsidiary, reached 34% in total deposit growth and 30% in total loan growth. Millennium Financial Group ("Mlend"), our mortgage lending subsidiary, had a record year with \$251 million in closed loans, which is a 139% increase from 2019. Net income for the Company was \$4.1 million, with earnings per share of \$1.83 for year-end 2020, as compared to net income of \$2.6 million and earnings per share of \$1.17 for the year 2019.

We are proud to say our credit quality remains strong with excellent diversity. The need for dependable community-based financial partners in the last year allowed us to foster many new relationships that supported our loan and deposit growth. Our risk management measures, along with our strength and flexibility, have allowed us to keep loan delinquency below 0.25% for the entire year and to achieve a level of 0% delinquent loans as of December 31, 2020.

There are still many unanswered questions that face this world; however, the CHF team has proven time and time again that we are ready for any test. We have shown what we can do when faced with the greatest of challenges. We will continue to focus on serving our stakeholders – our shareholders, our employees, our customers, and our communities, and on being the premier financial institution for the communities that we serve.



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



James G. Pierre
Chairman of the Board



Financial Highlights

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

Earnings Data (\$):

	2020	2019	2018	2017	2016
Net interest income	19,642	16,602	13,646	10,695	8,573
Provision for loan losses	3,253	763	582	637	464
Non-interest income	8,265	3,826	1,174	1,025	1,095
Non-interest expense	18,946	16,105	11,569	8,619	7,928
Net income	4,127	2,631	1,968	1,217	893

Common Share Data:

Basic earnings per common share	1.83	1.17	0.88	0.82	0.69
Dividends paid per common share	0.16	0.12	0.09	0.08	0.08
Book value per common share (end of period)	23.52	21.60	20.12	19.42	19.54
Tangible book value per common share (end of period)	22.78	20.86	20.12	19.42	19.54
Weighted average common shares outstanding	2,251,320	2,250,064	2,233,820	1,481,593	1,285,774

Selected Statistical Data (%):

Net interest margin	3.68*	3.66	3.62	3.59	3.45
Return on average assets	0.64	0.55	0.53	0.39	0.34
Return on average common equity	8.06	5.55	4.74	4.17	3.54
Efficiency ratio	67.89	78.84	78.10	73.50	82.00

Financial Condition Data (\$):

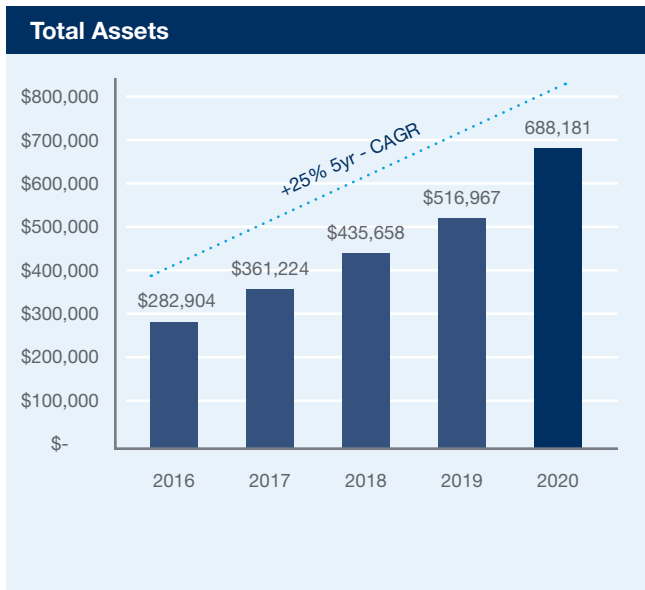
Total assets	688,181	516,967	435,658	361,224	282,904
Loans	558,967	429,335	357,742	283,233	210,175
Allowance for loan losses	7,480	4,235	3,593	3,051	2,527
Securities	72,439	42,641	47,967	47,457	45,689
Deposits	599,560	446,707	388,544	315,934	250,981
Borrowings	8,558	289	-	-	5,000
Subordinated Debt	14,664	14,574	-	-	-
Shareholder's equity	52,960	48,635	44,944	43,388	25,124
Non-performing assets	1,788	1,856	3,184	4,030	4,063

Ratios (%):

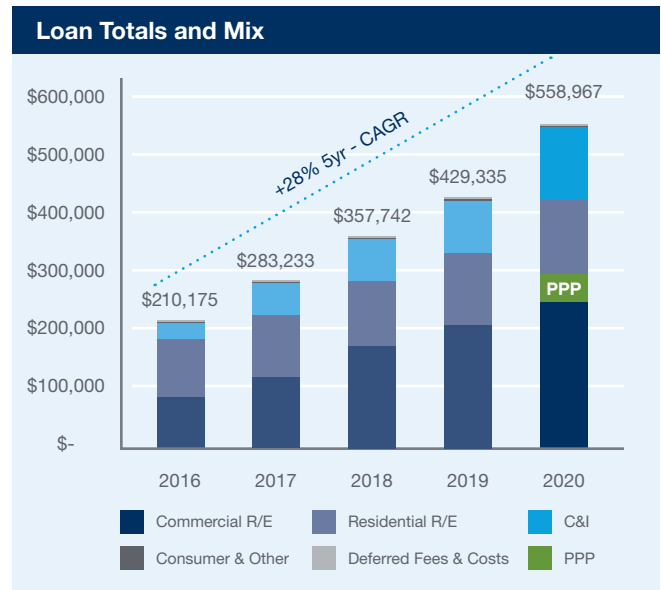
Loans to deposits	93.23	96.11	92.07	89.65	83.74
Allowance for loan losses to total loans	1.34	0.99	1.00	1.08	1.20
Allowance for loan losses to total loans (excl. PPP Loans)	1.47	NA	NA	NA	NA
Non-performing assets/loans + OREO	0.35	0.43	0.89	1.42	1.92
Non-performing assets/total assets	0.26	0.36	0.73	1.12	1.44
Average shareholders' equity to average total assets	7.99	9.88	11.20	9.55	9.60
Tier 1 capital to risk-weighted assets	NA	14.40	13.52	16.40	12.99
Total risk-based capital	NA	15.60	14.77	17.68	14.25
Community Bank Leverage Ratio (CBLR)	9.11	NA	NA	NA	NA

*Normalized margin excludes PPP loans, Fed Reserve balances, and brokered deposits.

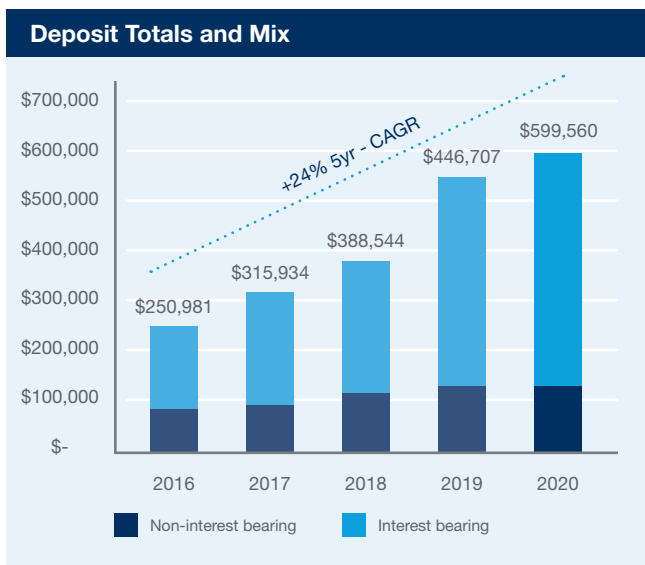
Management's Discussion and Analysis



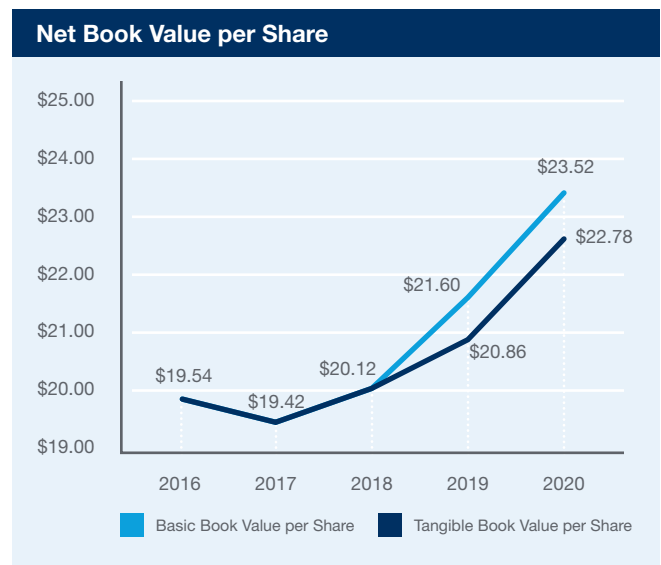
Total assets were \$688 million at December 31, 2020, an increase of \$171.2 million or 33% year over year. Balance sheet growth was driven by strong loan growth of \$129.6 million, which includes \$50 million in Paycheck Protection Program (PPP) loans, all funded by core deposit growth of \$147 million, and net income of \$4.1 million. The compounded five year annual growth rate for total assets is 25%.



Total loans at December 31, 2020 were \$559 million, comprised of commercial real estate loans of \$246 million (44% of total loans), residential real estate of \$135 million (24% of total loans), C&I of \$177 million (32% of total loans), including \$50 million in PPP loans, consumer loans of \$791 thousand (less than 1% of total loans), and net deferred costs of \$71 thousand (less than 1% of total loans). During 2020, growth in the commercial real estate (up \$42 million) and C&I (up \$78 million) accounted for 93% of total loan growth of which PPP loans accounted for 28%. The five year compounded annual growth rate for the loan portfolio is 28%.

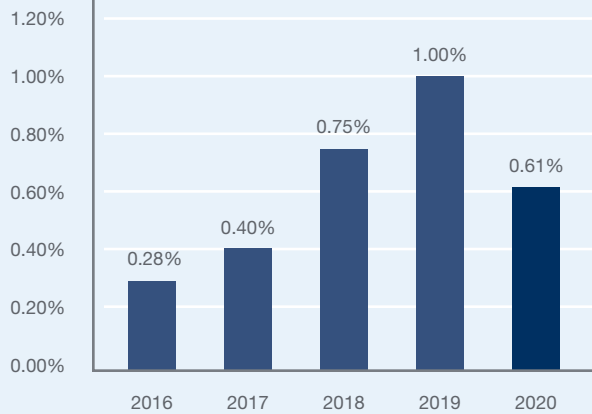


Total deposits were \$600 million at December 31, 2020, an increase of \$153 million or 34% when compared year over year to 2019. Non-interest bearing deposits totaled \$197 million (33% of total deposits) at year-end 2020, up \$71 million for the year. Interest bearing deposits increased \$82 million for the year and ending at \$402 million (67% of total deposits) in total balances. The five year compounded annual growth rate is 24%.



Book value per share and tangible book value per share increased \$1.92 per share in 2020 or 8.9% and 9.2%, respectively. Tangible book value per share excludes goodwill of \$1.7 million (no impairment) and a non-compete net intangible asset of \$9 thousand from the Mlend acquisition in 2019. The increase in common share value is primarily due to increased retained earnings resulting from net income of \$4.1 million for 2020.

Cost of Funds



Cost of funds decreased to 0.61% for 2020, down 39 basis points from 1.00% in 2019. The pandemic and the resulting economic conditions such as high unemployment provided for rates in the local market and nationwide to decrease and remain low in 2020.

Earnings Per Share



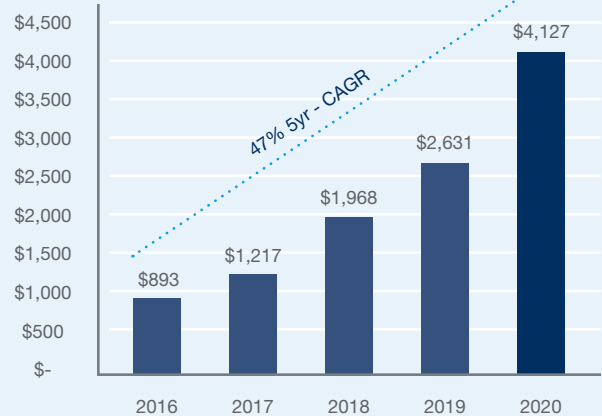
Earnings per share increased by \$0.61 or 56% in 2020. Contributing to the substantial increase in EPS was the increase in loan interest and fee income and revenue from the sale of mortgage loans on the secondary market.

Net Interest Income



Net interest income increased by \$3 million in 2020 compared to 2019. Loan growth of \$129 million (\$50 million in PPP loans) increased loan interest and fee income by \$3.3 million for the year. Cost of funds decreased by 57 basis points to 0.43% in 2020. The net resulted in the positive impact to margin income for the year.

Net Income



Consolidated net income for 2020 was \$4.13 million, an increase of \$1.5 million or 57% compared to 2019. 2020 income was enhanced by PPP loan growth of \$50 million, which contributed \$1.6 million in loan interest and fee income for the year. The five year compounded annual growth rate for net income is 47%.



RIVER CITY
DENTAL



BUSINESS HIGHLIGHTS

Dr. Brenda Paul

River City Dental

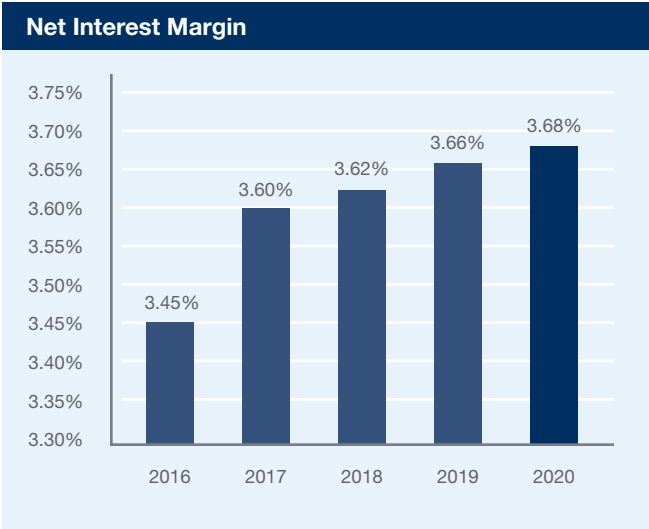
Dr. Brenda Paul has been a practicing dentist for 27 years. She opened River City Dental two years ago, but she has called Williamsport, Maryland her professional home since 1994. Over that time, her practice has grown from one employee to 12 employees. River City Dental is a general dental practice that treats patients of all ages. They perform preventative, restorative, and cosmetic dentistry in a modern and comfortable environment.

River City Dental and Dr. Paul are passionate about supporting young people. Dr. Paul's father, Joseph Paul, was a career dental salesman and, to honor his legacy, she grants a scholarship to a Williamsport High School senior each year to recognize acts of community service. She also awards the Joseph E. Paul Dental Hygiene Instrument Scholarship to a freshman Dental Hygiene student at Allegany College of Maryland each year – a \$2,400 scholarship to help cover the cost of dental

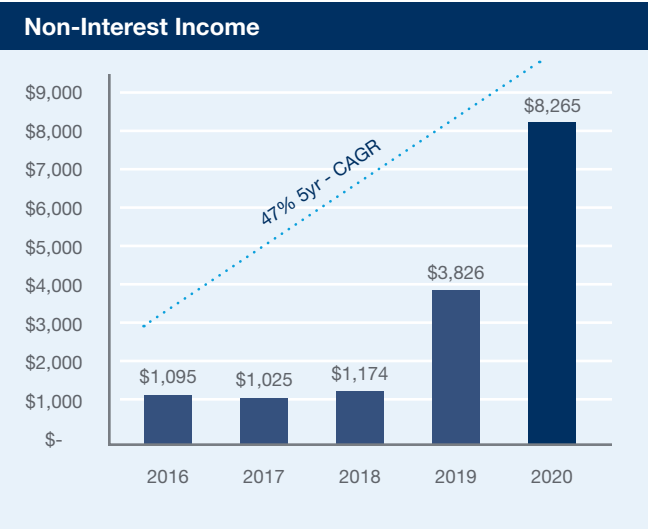
instruments. Additionally, she serves on the Board of Directors at the Discovery Station in Hagerstown.

Dr. Paul's favorite phrase is, "Women are like teabags – they know their real strength when they are in hot water." She was forced to move out of her previous office space three years ago, and she reached out to Middletown Valley Bank to help finance the construction of the facility she now calls home. Faced with uncertainty again when the COVID-19 pandemic occurred in 2020, Dr. Paul contacted Abe Perez to assist her in acquiring a PPP loan to help her practice weather the storm.

Patients return to Dr. Paul's practice year after year because they are treated like family. Similarly, Dr. Paul continues to bank with MVB year after year, stating she is "forever grateful that Middletown Valley Bank has me as part of their family."



Net interest margin normalized (2020 excludes fed reserve balances, PPP loans, and brokered deposits) decreased by 9 basis points in 2020 versus 2019. Loan growth of \$129 million with historical low rates decreased the yield on earning assets down to 3.94% and the loan yield to 4.41%.



Non-interest income increased \$4.4 million compared to 2019. The majority of this increase is due to secondary market mortgage sales gains resulting in \$4.7 million in revenue for the year.





BUSINESS HIGHLIGHTS

Audrey Kennedy, Crystal Deberry & Judy Simson Cherry Hill Assisted Living

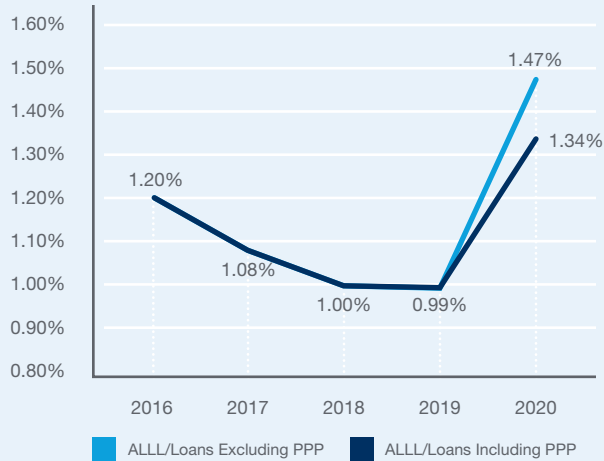
Crystal Deberry, Judy Simson, and Audrey Kennedy came together in 2016 after realizing that they shared the common goal of providing a top notch assisted living facility for their community. Over the course of a year, they planned and sought guidance from an accountant and Middletown Valley Bank's Jeff McCauley, to figure out how they could make their vision a reality. Their plans finally came together in September of 2017 when they took ownership of Cherry Hill Assisted Living in Accident, Maryland.

Cherry Hill Assisted Living is a valuable resource to the community, offering quality care in a home-like environment for people who are no longer able to reside safely in their own homes. They are conscious of providing a facility that does not feel like an institution but, rather, a safe, comfortable space to call home.

Crystal, Judy, and Audrey give their time and resources back to the local community in other ways as well. They are frequent supporters of Hospice, local athletics, the Garrett County Fair, and the Garrett County Sheriff's Office.

The three women see Jeff and Middletown Valley Bank as integral pieces in the opening and ongoing operations of Cherry Hill Assisted Living, stating, "He is highly involved in the advice for our financial decisions and management of our loans. During the pandemic, Jeff and our accountant Brian were responsible for helping us receive the PPP as quickly as possible and continued to guide us through the entire process. Jeff has always gone above and beyond in looking out for our financial success. We could not do it without him!"

Allowance for Loan Losses to Total Loans



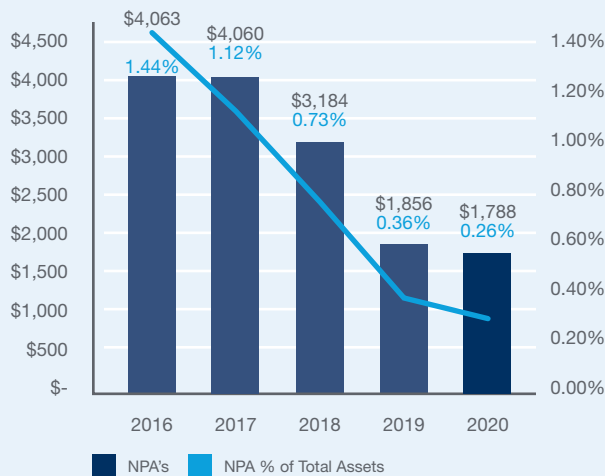
Management considered the effects of the pandemic on the economy, as well as the ability of customers to meet their financial obligations in the determination of the allowance for loan losses at December 31, 2020. As a result, the allowance for loan losses to loans increased 35 basis points to 1.34% for 2020. The year over year increase in provision for loan loss expense was \$2.5 million.

Non-Interest Expense



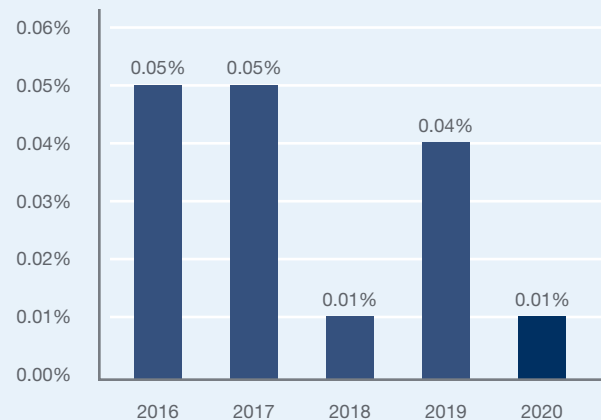
Non-interest expense increased \$2.8 million in 2020 compared to 2019. The majority of the increase is related to salaries and employee benefits which increased \$1.7 million as the Company has grown its workforce to support the expansion of the balance sheet. Data processing expense increased \$585 thousand, also a result of the balance sheet growth. Deposit growth during 2020 and the effects of FDIC credits received in 2019 contributed to the increased FDIC premiums. Combined, the result was higher non-interest expenses during 2020.

Nonperforming Assets



Non-performing assets (NPA's) improved in 2020 with a reduction of \$68 thousand compared to year-end 2019. As a percent of total assets, NPA's improved from 0.36% in 2019 to 0.26% in 2020. The bank continues to stress credit quality as a major initiative in conjunction with the rapid growth of the loan portfolio.

Net Charge-Offs/Average Loans



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



BUSINESS HIGHLIGHTS

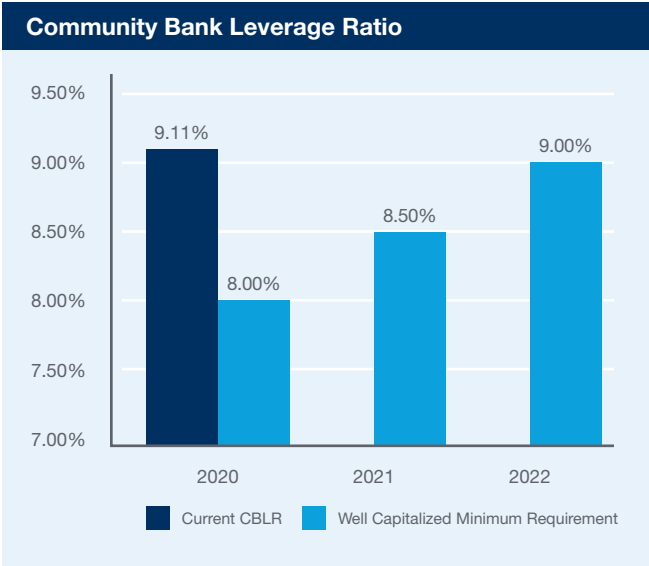
Charlie Delauter

Lee Delauter & Sons (LDS)

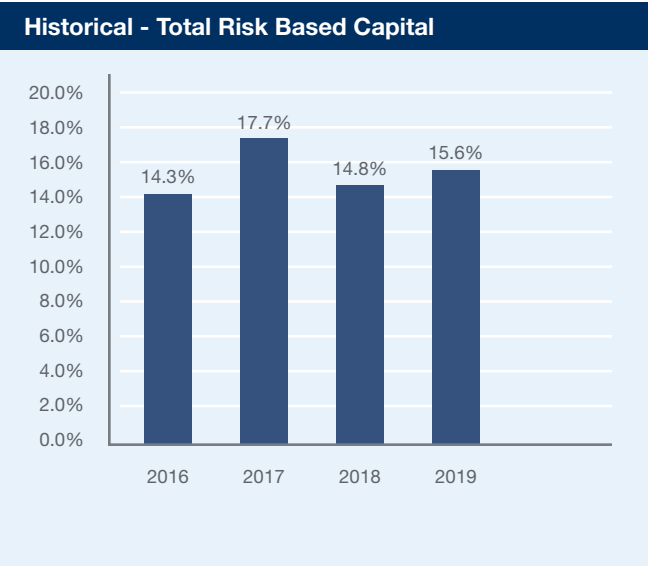
Charlie Delauter's father, Lee, started Lee Delauter & Sons in Wolfsville, Maryland in 1933. The company has grown to include a second location in Middletown since that time. It has remained a family affair since its inception, as they now have a third-generation ownership partner. Both convenience stores offer gasoline, auto repair, and towing service, while the Middletown location also offers a variety of sandwiches, soups, salads, and dinner specials.

Lee Delauter & Sons is actively involved in charitable work through numerous community fund campaigns, as well as school and fire department-related fundraisers and events. They also support The Religious Coalition, which works to provide emergency shelter and basic human needs to the homeless and those most at risk in Frederick County.

According to Charlie, Middletown Valley Bank "has been instrumental in the success of our company over many years, playing a major role in providing funding for our Middletown location." MVB is proud that we could be there for Lee Delauter & Sons during this abnormal and unpredictable year. Charlie adds, "They continue to be a huge partner during the pandemic, providing funds for the challenges our small business has faced. We value the local support and dealing with people that we know."



In 2020, the Bank adopted the Community Bank Leverage Ratio (CBLR) framework as the measurement for capital adequacy (Tier 1 Capital to Total Average Assets). Under the CBLR, the minimum required to be adequately capitalized is 8% for 2020, 8.5% for 2021 and 9% thereafter. The Bank was well capitalized at 9.11% for 2020. The CBLR is discussed in greater detail in the Notes to Consolidated Financial Statements.



Prior year historical capital ratios under BASEL III. Under BASEL III the minimum capital requirement for total risk base capital is 8% to be considered well capitalized. The Company was well capitalized for all periods reflected above.





BUSINESS HIGHLIGHTS

Greg Weaver

Antrim Way Honda

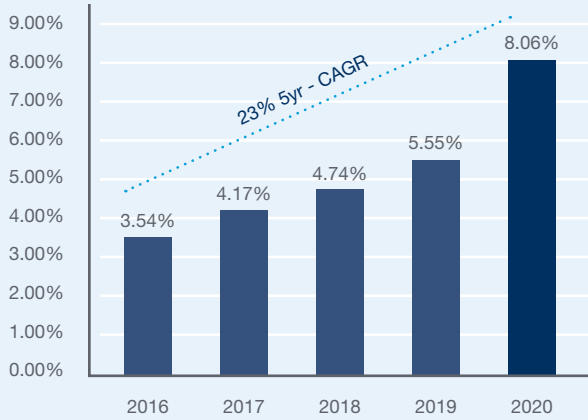
Antrim Way Honda began as Antrim Way Motors when it was founded by Puff Weaver in 1955. At that time, Puff would travel to nearby cities and buy Hondas to resell in Greencastle, Pennsylvania. Antrim Way eventually became an official Honda dealer in 1976.

Today, Antrim Way Honda sells new Hondas and pre-owned vehicles. They service all makes and models and sell Honda retail parts. They pride themselves on offering an exceptional experience for their customers, and one way they do this is by making the dealership feel as comfortable as possible, even adding a gift shop for customers to browse.

The business is involved in various charitable organizations. They are especially passionate about the Greencastle Antrim School District, as they recognize the profound impact of community and education.

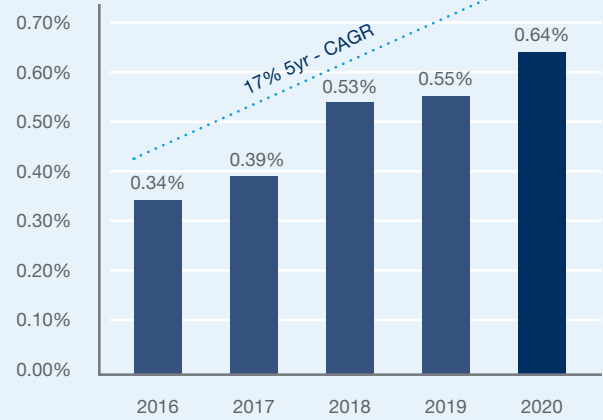
Middletown Valley Bank has helped provide Antrim Way Honda with the financial flexibility needed to implement a unique and progressive floor plan structure. This, in turn, has helped the business experience continued growth. Greg and Cherie Weaver, current owners of Antrim Way, reiterate this point by saying, "It's clear that the MVB team understands and cares about the needs of individual businesses."

Return on Average Equity



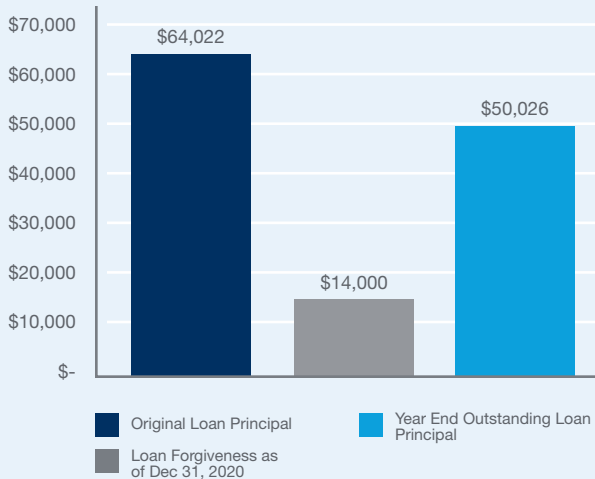
Return on average equity was 8.06% in 2020, an increase of 2.51% over 2019, the Company's strongest in five years. 2020 was a year of record balance sheet growth and record net income. The Company grew by \$172 million (33.4%) when compared to 2019 and net income increased \$1.5 million (56.9%) for 2020.

Return on Average Assets



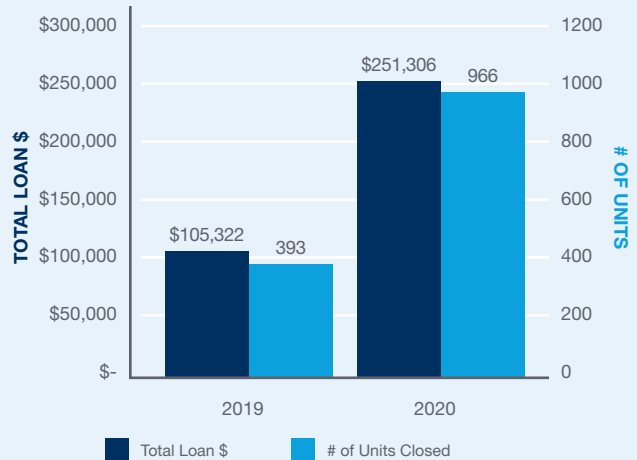
Return on average assets increased 9 basis points to 0.64% in 2020, compared to 0.55% in 2019. The Company experienced rapid growth in 2020 that resulted in the need for additional staffing and upgrades to the infrastructure to support the growth and earnings for the company and stockholders. The five-year compounded annual growth rate for ROAA is 17%.

Paycheck Protection Program



The Company participated in the 2020 SBA Paycheck Protection Program to extend small business loans to community businesses experiencing financial hardships during the pandemic. In doing so, the Company supported the retention of 7,554 jobs in the local community via \$64 million in PPP loans. At year end 2020, \$14 million in PPP loans had been granted forgiveness.

Mlend Production



Mlend's mortgage loan production of 966 units for \$251 million in 2020, increased by 573 (146%) units and \$146 million (139%) from 2019. Mlend contributed \$1.9 million to the Company's consolidated net income for 2020. Though most of these loans were sold on the secondary market, part of this production was retained at the Bank as part of the loans held for investment.



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 its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, 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 its subsidiaries as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Yount, Hyde & Barbour, P.C.

Winchester, Virginia
March 31, 2021

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

	2020	2019
Assets		
Cash and due from banks	\$ 28,785,202	\$ 25,065,743
Securities available-for-sale, at fair value	72,438,845	42,640,765
Restricted equity securities, at cost	462,100	392,200
Loans	558,966,588	429,334,750
Less allowance for loan losses	7,480,190	4,235,315
Loans, net	551,486,398	425,099,435
Loans held for sale	12,626,481	3,775,199
Premises and equipment, net	6,399,918	6,815,474
Right-of-use assets	2,666,896	3,109,423
Accrued interest receivable	2,199,489	1,232,624
Deferred tax assets	2,080,834	979,581
Bank-owned life insurance	5,279,741	4,966,843
Goodwill	1,656,507	1,656,507
Intangible assets	9,028	17,361
Other Assets	2,089,838	1,215,938
Total Assets	\$ 688,181,277	\$ 516,967,093
Liabilities and Shareholders' Equity		
Liabilities		
Deposits:		
Non-interest-bearing demand	\$ 197,297,205	\$ 126,449,656
Interest-bearing	402,262,420	320,256,855
Total Deposits	599,559,625	446,706,511
Subordinated debt, net of una mortized issuance costs	14,663,636	14,573,940
Other borrowings	8,558,178	289,039
Lease liabilities	2,714,979	3,136,351
Accrued interest payable	215,490	279,832
Other liabilities	9,508,874	3,346,518
Total Liabilities	635,220,782	468,332,191
Shareholders' Equity		
Preferred stock, par value \$1; shares authorized 1,000,000; no shares issued and outstanding	-	-
Common stock, par value \$1; shares authorized 10,000,000; 2,251,320 shares issued and outstanding at December 31, 2020 and 2019	22,513	22,513
Surplus	28,523,004	28,523,004
Retained earnings	23,633,375	19,866,168
Accumulated other comprehensive income	781,603	223,217
Total Shareholders' Equity	52,960,495	48,634,902
Total Liabilities and Shareholders' Equity	\$ 688,181,277	\$ 516,967,093

See accompanying notes to the Consolidated Financial Statements

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

	2020	2019
	<u> </u>	<u> </u>
Interest Income		
Loans, including fees	\$ 22,934,974	\$ 19,681,478
Securities	1,073,590	909,568
Fed funds sold and other	152,726	496,974
Total interest income	<u>24,161,290</u>	<u>21,088,020</u>
Interest Expense		
Deposits	3,411,990	4,243,448
Subordinated debt	947,409	201,444
Other borrowings expense	160,301	41,374
Total interest expense	<u>4,519,700</u>	<u>4,486,266</u>
Net interest income	19,641,590	16,601,754
Provision for loan losses	3,252,897	763,490
Net interest income after provision for loan losses	<u>16,388,693</u>	<u>15,838,264</u>
Non-interest income		
Service charges on deposits	648,125	590,534
Earnings bank owned life insurance	144,962	109,176
Gain/(loss) sale of fixed assets	500	(5,471)
Gain/(loss) sale of securities	749,590	(636)
Gain on sale of loans	4,655,892	2,098,208
Other secondary market income	1,017,944	468,147
Other non-interest income	1,047,791	566,002
Total non-interest income	<u>8,264,803</u>	<u>3,825,960</u>
Non-interest expense		
Salaries and employee benefits	11,147,427	9,460,012
Occupancy and equipment	2,738,468	2,498,741
Legal and professional fees	746,435	683,696
Advertising	271,442	137,706
Data processing	1,984,715	1,399,269
FDIC premiums	272,154	179,323
Other intangible amortization	8,333	7,639
(Gain) on sale of other real estate owned	-	(12,017)
Other non-interest expense	1,777,343	1,750,964
Total non-interest expense	<u>18,946,317</u>	<u>16,105,333</u>
Income before taxes	5,707,179	3,558,891
Income tax expense	1,579,761	928,117
Net Income	<u>\$ 4,127,418</u>	<u>\$ 2,630,774</u>
Basic earnings and diluted earnings per share	\$1.83	\$1.17

See accompanying notes to the Consolidated Financial Statements

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Years Ended December 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
Net income	\$ 4,127,418	\$ 2,630,774
Other comprehensive income:		
Unrealized holding gain on securities available for sale (net of tax of \$418,301 and \$84,754, respectively)	1,101,689	944,408
Reclassification adjustment (net of tax of \$(206,287) and \$175, respectively)	<u>(543,303)</u>	<u>461</u>
Other comprehensive income, net of tax	<u>558,386</u>	<u>944,869</u>
Comprehensive net income	<u>\$ 4,685,804</u>	<u>\$ 3,575,643</u>

See accompanying notes to the Consolidated Financial Statements

COMMUNITY HERITAGE FINANCIAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
For the Years Ended December 31, 2020 and 2019

	COMMON STOCK	SURPLUS	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL
<u>BALANCE, DECEMBER 31, 2018</u>	\$ 22,338	\$ 28,138,429	\$ 17,505,373	\$ (721,652)	\$ 44,944,488
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>	\$ 22,513	\$ 28,523,004	\$ 19,866,168	\$ 223,217	\$ 48,634,902
Net Income	-	-	4,127,418	-	4,127,418
Other comprehensive income	-	-	-	558,386	558,386
Cash dividends (\$0.16 per share)	-	-	(360,211)	-	(360,211)
<u>BALANCE, DECEMBER 31, 2020</u>	\$ 22,513	\$ 28,523,004	\$ 23,633,375	\$ 781,603	\$ 52,960,495

See accompanying notes to the Consolidated Financial Statements

COMMUNITY HERITAGE FINANCIAL, INC. and SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

<u>CASH FLOWS FROM OPERATING ACTIVITIES:</u>	<u>For the Years Ended December 31,</u>	
	2020	2019
Net Income	\$ 4,127,418	\$ 2,630,774
Adjustments to reconcile net income to cash (used in) provided by operating activities:		
Depreciation and amortization of premises and equipment	737,873	659,990
Provision for loan losses	3,252,897	763,490
Gain on sale of other real estate owned	-	(12,017)
(Gain) loss on sales and calls of investment securities	(749,590)	636
(Gain) loss on premises and equipment	(500)	5,471
Gain on sales of loans held for sale	(4,655,892)	(2,098,208)
Originations of loans held for sale	(203,067,019)	(88,473,402)
Proceeds from sales of loans held for sale	198,871,629	87,726,469
Amortization of intangibles	8,333	7,639
Amortization of debt issuance cost	89,696	21,757
Amortization of right-of-use assets	442,527	439,559
Share-based compensation	-	126,000
Earnings on bank owned life insurance	(144,962)	(109,176)
Deferred tax benefit	(1,313,267)	(92,011)
Increase in accrued interest receivable	(966,865)	(76,993)
(Increase) decrease in other assets	(873,900)	49,904
(Decrease) increase in accrued interest payable	(64,342)	166,453
Increase in other liabilities	2,152,390	339,955
Amortization of premium and discounts on investment securities, net	427,085	271,755
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	(1,726,489)	2,348,045
<u>CASH FLOWS FROM INVESTING ACTIVITIES:</u>		
Purchases of securities available for sale	(77,195,621)	(7,978,274)
Proceeds from maturities, repayments and calls of securities available for sale	20,614,931	9,587,958
Proceeds from sales of securities available for sale	31,464,109	4,747,516
Proceeds from sales of fixed assets	500	25,000
Net (increase) in loans	(129,639,860)	(71,722,400)
Purchase of FHLB stock	(69,900)	(67,000)
Cash paid in acquisition, net of cash received	-	(949,610)
Purchases of fixed assets	(322,317)	(1,190,196)
Proceeds from the sale of OREO	-	20,684
Purchases of the bank owned life insurance	(167,936)	(140,540)
NET CASH (USED IN) INVESTING ACTIVITIES	(155,316,094)	(67,666,862)
<u>CASH FLOWS FROM FINANCING ACTIVITIES:</u>		
Net increase in non-interest bearing deposits	70,847,549	19,061,675
Net increase in interest bearing deposits	82,005,565	39,100,596
Issuance of subordinated debt, net of issuance costs	-	14,552,183
Net proceeds from (repayment of) other borrowings	8,269,139	(605,672)
Cash dividends paid	(360,211)	(269,979)
NET CASH PROVIDED BY FINANCING ACTIVITIES	160,762,042	71,838,803
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,719,459	6,519,986
<u>CASH AND CASH EQUIVALENTS, BEGINNING BALANCE</u>	25,065,743	18,545,757
<u>CASH AND CASH EQUIVALENTS, ENDING BALANCE</u>	\$ 28,785,202	\$ 25,065,743
<u>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</u>		
Cash paid during the year for:		
Interest	\$ 4,417,854	\$ 4,298,056
Income taxes	\$ 1,770,047	\$ 1,076,288
<u>SUPPLEMENTAL DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES</u>		
Transfers of loans to other real estate owned	\$ -	\$ 116,667
Loans made to finance other real estate owned	\$ -	\$ 108,000
Lease Liabilities arising from right-of-use assets	\$ -	\$ 2,723,499
Unrealized gain on securities available for sale	\$ 770,400	\$ 1,303,628
Unsettled purchases of securities available-for-sale	\$ 3,588,594	\$ -

See accompanying notes to the 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 eight branch locations and one expected to open spring of 2021. 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 is parent company to the wholly owned subsidiary Millennium Financial Group, Inc. 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.”

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.

COVID-19:

Beginning in March 2020 and through the end of the year, the COVID-19 pandemic had a significant impact on our communities, customers, and operations. COVID-19 continues to have an impact in 2021, however, the duration and extent of its effects over the longer term are dependent on future developments and cannot be reasonably estimated at this time. Risks arising from the pandemic may impact the future earnings, cash flows, and financial condition of the Company. These risks which are inherently uncertain, primarily include: the financial impact of the pandemic on our customers, the ability of those customers to fulfill their financial obligations to the Company, potential operational disruptions, the Company's ability to generate demand for its products and services, and adverse changes in the valuation of collateral or other assets which may result in impairment charges. Accordingly, estimates used in the preparation of our financial statements may be subject to significant adjustments in future periods due to the unprecedented and evolving nature of the pandemic. The greater the duration and severity of the pandemic, the more likely that estimates will be materially impacted by its effects.

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".

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 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 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, 2020 and 2019, there were loans in the amount of \$1.04 million and \$1.02 million, respectively that were modified in troubled debt restructurings. There were no commitments to lend additional funds to these borrowers at December 31, 2020 and 2019.

During 2020, the Bank approved payment deferrals for customers experiencing hardships related to COVID-19. These deferrals were for no more than six months in duration and for loans that were not more than 30 days past due as of December 31, 2019. As such, they were not considered TDRs based on the relief provisions of the Coronavirus Aid, Relief and Economic Security ("CARES") Act and recent interagency regulatory guidance.

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, 2020, and 2019, the Company had no other real estate owned. At December 31, 2020, and 2019, the Company had no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process.

Paycheck Protection Program:

Beginning in April 2020, the Bank originated loans under the Paycheck Protection Program (PPP) of the Small Business Administration (SBA). PPP loans are fully guaranteed by the SBA, and in some cases, borrowers may be eligible to obtain forgiveness of the loans, in which case loans would be repaid by the SBA. As repayment of the PPP loans is guaranteed by the SBA, the Bank does not recognize a reserve for PPP loans in its allowance for loan losses. The Bank received fees from the SBA of one percent to five percent of the principal amount of each loan originated under the PPP. Fees received from the SBA are recognized net of direct origination costs in interest income over the life of the related loans. Recognition of fees related to PPP loans is dependent upon the timing of ultimate repayment or forgiveness. Aggregate fees from the SBA of \$2.4 million, net of direct costs, are being recognized in interest income over the life of the loans. There were \$1.2 million in net fees which remained unrecognized as of December 31, 2020.

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, 2020 and 2019. Basic and diluted weighted average shares outstanding were 2,251,320 and 2,250,064 for the years ended December 31, 2020 and 2019, respectively.

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 Consolidated Statements of Income. As of December 31, 2020, and 2019, 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 \$271 thousand and \$138 thousand for the years ended December 31, 2020 and 2019, respectively, and are included in other non-interest expenses in the Consolidated Statements of Income.

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 relates to unrealized gains and losses on available for sale securities for the years ended December 31, 2020 and 2019.

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 fourth quarter. As of December 31, 2020, and 2019 there was no impairment to goodwill. Intangible assets with definite useful lives are amortized over their estimated useful lives to their estimated residual values. Intangible amortization expense for the years ended December 31, 2020, and 2019 was \$8,333 and \$7,639, respectively.

Recent Accounting Pronouncements:

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 was 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 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 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 March 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-04 “Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting.” These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. Subsequently, in January

2021, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2021-01 "Reference Rate Reform (Topic 848): Scope." This ASU clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The ASU also amends the expedients and exceptions in Topic 848 to capture the incremental consequences of the scope clarification and to tailor the existing guidance to derivative instruments affected by the discounting transition. An entity may elect to apply ASU No. 2021-01 on contract modifications that change the interest rate used for margining, discounting, or contract price alignment retrospectively as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications from any date within the interim period that includes or is subsequent to January 7, 2021, up to the date that financial statements are available to be issued. An entity may elect to apply ASU No. 2021-01 to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020. The Company has identified and is in the process of modifying loans that are directly or indirectly influenced by LIBOR. The Company is assessing ASU 2020-04 and its impact on the transition away from LIBOR for loans and other financial instruments.

In October 2020, the FASB issued ASU 2020-08, "Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable fees and Other Costs." This ASU clarifies that an entity should reevaluate whether a callable debt security is within the scope of ASC paragraph 310-20-35-33 for each reporting period. For public business entities, the ASU is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is not permitted. All entities should apply ASU No. 2020-08 on a prospective basis as of the beginning of the period of adoption for existing or newly purchased callable debt securities. The Company does not expect the adoption of ASU 2020-08 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. In connection with the acquisition in 2019, the Company incurred \$77,596 in merger related expenses. These expenses are included in the other non-interest expense line item of the Consolidated Statements of Income. There were no merger expenses in 2020.

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)		417,894
Total purchase price for Millennium Financial Group, Inc.	\$	<u>1,676,644</u>
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		2,282
Total assets acquired	\$	<u>1,860,233</u>
Liabilities assumed:		
Borrowings	\$	894,711
Lease liabilities		822,564
Other liabilities		122,821
Total liabilities assumed	\$	<u>1,840,096</u>
Net assets acquired	\$	<u>20,137</u>
Amount of goodwill resulting from acquisition	\$	<u>1,656,507</u>

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, 2020 and 2019:

Goodwill and Intangibles Amortization

	As of December 31,	
	2020	2019
Non-compete intangible:		
Cost	\$ 25,000	\$ 25,000
Accumulated amortization	(15,972)	(7,639)
Non-compete intangible, net	<u>\$ 9,028</u>	<u>\$ 17,361</u>
Carrying value of goodwill:	\$ 1,656,507	\$ 1,656,507

Amortization expense included in other operating expense in the Consolidated Statements of Income as of December 31, 2020, and 2019 was \$8,333 and \$7,639, respectively.

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

Years ending December 31,		
2021	\$	8,333
2022		<u>695</u>
Total	\$	<u>9,028</u>

Note 4. Business Segments

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 primarily 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 years ended December 31, 2020 and 2019 are as follows:

OPERATING RESULTS BY BUSINESS SEGMENTS

As of and for the Year Ended December 31, 2020

	Commercial Banking	Mortgage Banking	Other	Eliminations	Consolidated
Revenues:					
Interest Income	\$ 24,023,741	\$ 259,450	\$ -	\$ (121,901)	\$ 24,161,290
Gain on Sales of loans	-	4,655,892	-	-	4,655,892
Other secondary market income	-	1,209,784	-	(191,840)	1,017,944
Other non-interest income	2,125,041	465,926	-	-	2,590,967
Total operating income	<u>26,148,782</u>	<u>6,591,052</u>	<u>-</u>	<u>(313,741)</u>	<u>32,426,093</u>
Expenses					
Provision for loan losses	3,252,897	-	-	-	3,252,897
Interest expense	3,460,947	233,245	947,409	(121,901)	4,519,700
Non-interest expense	15,616,056	3,179,395	342,706	(191,840)	18,946,317
Total operating expenses	<u>22,329,900</u>	<u>3,412,640</u>	<u>1,290,115</u>	<u>(313,741)</u>	<u>26,718,914</u>
Income (loss) before taxes	3,818,882	3,178,412	(1,290,115)	-	5,707,179
Income tax expense (benefit)	955,353	874,699	(250,291)	-	1,579,761
Net income (loss)	<u>\$ 2,863,529</u>	<u>\$ 2,303,713</u>	<u>\$ (1,039,824)</u>	<u>\$ -</u>	<u>\$ 4,127,418</u>
Total Assets	\$ 673,880,679	\$ 18,504,066	\$ 68,093,987	\$ (73,297,455)	\$ 687,181,277
Goodwill and other intangible	-	1,665,535	-	-	1,665,535
Capital expenditures	288,175	34,142	-	-	322,317

As of and for the Year Ended December 31, 2019

	Commercial Banking	Mortgage Banking	Other	Eliminations	Consolidated
Revenues:					
Interest Income	\$ 21,050,569	\$ 126,655	\$ -	\$ (89,204)	\$ 21,088,020
Gain on Sales of loans	-	2,098,208	-	-	2,098,208
Other secondary market income	-	559,881	-	(91,734)	468,147
Other non-interest income	1,259,605	-	-	-	1,259,605
Total operating income	<u>22,310,174</u>	<u>2,784,744</u>	<u>-</u>	<u>(180,938)</u>	<u>24,913,980</u>
Expenses					
Provision for loan losses	763,490	-	-	-	763,490
Interest expense	4,243,566	130,459	201,445	(89,204)	4,486,266
Non-interest expense	13,781,053	1,999,509	416,505	(91,734)	16,105,333
Total operating expenses	<u>18,788,109</u>	<u>2,129,968</u>	<u>617,950</u>	<u>(180,938)</u>	<u>21,355,089</u>
Income (loss) before 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)	<u>\$ 2,596,764</u>	<u>\$ 473,531</u>	<u>\$ (439,521)</u>	<u>\$ -</u>	<u>\$ 2,630,774</u>
Total Assets	\$ 513,019,372	\$ 7,632,125	\$ 63,838,237	\$ (67,522,641)	\$ 516,967,093
Goodwill and other intangible	-	1,673,868	-	-	1,673,868
Capital expenditures	1,122,188	61,258	6,750	-	1,190,196

Note 5. Investment Securities

There were no securities held to maturity as of December 31, 2020 and 2019.

The amortized cost and estimated fair value of securities available for sale, with gross unrealized gains and losses as of December 31, 2020 and 2019 were as follows:

As of December 31, 2020	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasuries	\$ 999,916	\$ 1,564	\$ -	\$ 1,001,480
Mortgage Backed	37,007,159	498,342	(4,590)	37,500,911
Municipals	22,790,334	408,083	(12,118)	23,186,299
Corporates	10,563,065	198,620	(11,530)	10,750,155
Total	<u>\$ 71,360,474</u>	<u>\$ 1,106,609</u>	<u>\$ (28,238)</u>	<u>\$ 72,438,845</u>
As of December 31, 2019	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. Treasuries	\$ 1,999,617	\$ 5,916	\$ (688)	\$ 2,004,845
U.S Government Agency	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
Total	<u>\$ 42,332,794</u>	<u>\$ 396,842</u>	<u>\$ (88,871)</u>	<u>\$ 42,640,765</u>

Securities carried at estimated fair value of \$13.37 million and \$5.84 million at December 31, 2020 and 2019 respectively, were pledged to secure public funds and for other purposes as required or permitted by law. In 2020, the Company recognized gross gains of \$754 thousand and gross losses of \$4 thousand on the sales of securities. In 2019, the Company recognized gross gains of \$22 thousand and gross losses of \$23 thousand on the sales of securities.

The amortized cost and estimated fair value of debt securities at December 31, 2020, 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:

As of December 31, 2020	Amortized Cost	Estimated Fair Value
Due in one year or less	\$ 2,137,840	\$ 2,144,376
Due after one year through five years	2,725,882	2,811,288
Due after five years through ten years	14,105,242	14,354,545
Due after ten years	52,391,510	53,128,636
	\$ 71,360,474	\$ 72,438,845

The following tables show the securities available-for-sale with 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 as of December 31, 2020 and 2019:

As of December 31, 2020	Number of Securities	Less than twelve months		Twelve Months or Greater		Total	
		Gross		Gross		Gross	
		Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
Mortgage backed	2	\$ 1,628,939	\$ (4,591)	-	-	\$ 1,628,939	\$ (4,591)
Municipals	2	1,639,495	(12,117)	-	-	1,639,495	(12,117)
Corporates	5	2,738,470	(11,530)	-	-	2,738,470	(11,530)
Total	9	\$ 6,006,904	\$ (28,238)	-	-	\$ 6,006,904	\$ (28,238)

As of December 31, 2019	Number of Securities	Less than twelve months		Twelve Months or Greater		Total	
		Gross		Gross		Gross	
		Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss	Estimated Fair Value	Unrealized Loss
U.S. Treasuries	2	-	-	\$ 999,185	\$ 688	\$ 999,185	\$ (688)
U.S Government Agency	2	-	-	467,722	2,278	467,722	(2,278)
Mortgage backed	13	207,449	90	6,513,093	66,365	6,720,542	(66,455)
Municipals	5	3,705,690	19,450	-	-	3,705,690	(19,450)
Total	22	\$ 3,913,139	\$ (19,540)	\$ 7,980,000	\$ -69,331	\$ 11,893,139	\$ (88,871)

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. 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, 2020.

Note 6. Loans and Allowance for Loan Losses

Loans outstanding as of December 31, 2020 and 2019, are categorized as follows:

	As of December 31,			
	2020		2019	
	Amount	Percent	Amount	Percent
Commercial real estate	\$ 245,561,346	44.0%	\$ 203,161,108	47.4%
Residential real estate	135,352,754	24.2%	123,927,619	28.9%
Commercial	177,190,311	31.7%	99,323,981	23.2%
Consumer	791,325	0.1%	1,966,480	0.5%
Total gross loans	\$ 558,895,736	100.0%	\$ 428,379,188	100.0%
Net deferred loan costs	70,852		955,562	
Allowance for loan losses	(7,480,190)		(4,235,315)	
Total net loans	\$ 551,486,398		\$ 425,099,435	

As of December 31, 2020 and 2019, overdraft deposits reclassified as loans totaled \$33 thousand and \$161 thousand, respectively.

The following tables summarize the activity in the allowance for loan losses by loan class for the years ended December 31, 2020 and 2019:

As of and for the year ended December 31, 2020	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Beginning balance	\$ 1,852,081	\$ 1,042,910	\$ 1,303,371	\$ 36,953	\$ 4,235,315
Provision for loan losses	1,755,069	301,743	1,197,907	(1,822)	3,252,897
Charge-offs	-	-	-	(13,710)	(13,710)
Recoveries	-	-	-	5,688	5,688
Ending Balance	\$ 3,607,150	\$ 1,344,653	\$ 2,501,278	\$ 27,109	\$ 7,480,190
Allowance for credit losses:					
Individually evaluated for impairment in accordance with ASC-310-10					
	\$ -	\$ -	\$ 33,323	\$ -	\$ 33,323
Collectively evaluated for impairment	3,607,150	1,344,653	2,467,955	27,109	7,446,867
Ending Balance	\$ 3,607,150	\$ 1,344,653	\$ 2,501,278	\$ 27,109	\$ 7,480,190

As of and for the year ended December 31, 2019	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Allowance for loan losses:					
Beginning balance	\$ 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
Ending Balance	<u>\$ 1,852,081</u>	<u>\$ 1,042,910</u>	<u>\$ 1,303,371</u>	<u>\$ 36,953</u>	<u>\$ 4,235,315</u>
Allowance for credit losses:					
Individually evaluated for impairment	\$ -	\$ 29,638	\$ -	\$ -	\$ 29,638
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>
Ending Balance	<u>\$ 1,852,081</u>	<u>\$ 1,042,910</u>	<u>\$ 1,303,371</u>	<u>\$ 36,953</u>	<u>\$ 4,235,315</u>

The following tables summarize the recorded investments in loans as of December 31, 2020 and 2019, related to each balance in the allowance for loan losses by the portfolio segment and disaggregated based on the Bank's impairment methodology:

As of December 31, 2020	Commercial Real Estate	Residential Real Estate	Commercial	Consumer	Total
Recorded investment in loans:					
Individually evaluated for impairment	\$ 201,583	\$ 522,928	\$ 315,646	\$ -	\$ 1,040,157
Collectively evaluated for impairment	<u>245,359,763</u>	<u>134,829,826</u>	<u>176,874,665</u>	<u>791,325</u>	<u>557,855,579</u>
Ending Balance	<u>\$ 245,561,346</u>	<u>\$ 135,352,754</u>	<u>\$ 177,190,311</u>	<u>\$ 791,325</u>	<u>\$ 558,895,736</u>
As of December 31, 2019					
Recorded investment in loans:					
Individually evaluated for impairment	\$ 270,399	\$ 1,807,599	\$ -	\$ -	\$ 2,077,998
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>
Ending Balance	<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>

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.

The following tables present the classes of the loan portfolio summarized by the aggregate pass rating and the classified ratings of special mention, substandard, and doubtful within the Bank's internal risk rating system as of December 31, 2020 and 2019:

As of December 31, 2020	Pass	Special Mention	Substandard	Doubtful	Total
Commercial Real Estate:					
Construction and					
Land Development	\$ 58,058	\$ -	\$ -	\$ -	\$ 58,058
Multifamily	12,725	-	-	-	12,725
Other	173,608	968	202	-	174,777
Residential Real Estate	133,354	98	1,900	-	135,353
Commercial	169,799	1,992	5,399	-	177,190
Consumer, primarily home equity lines	791	-	-	-	791
Total gross loans	<u>\$ 548,336</u>	<u>\$ 3,059</u>	<u>\$ 7,501</u>	<u>\$ -</u>	<u>\$ 558,896</u>

As of December 31, 2019	Pass	Special Mention	Substandard	Doubtful	Total
Commercial Real Estate:					
Construction and					
Land Development	\$ 32,942	\$ -	\$ -	\$ -	\$ 32,942
Multifamily	9,829	-	-	-	9,829
Other	160,120	-	270	-	160,390
Residential Real Estate	121,800	-	2,127	-	123,928
Commercial	93,511	5,136	677	-	99,324
Consumer, primarily home equity lines	1,966	-	-	-	1,966
Total gross loans	<u>\$ 420,168</u>	<u>\$ 5,136</u>	<u>\$ 3,075</u>	<u>\$ -</u>	<u>\$ 428,379</u>

The following tables reflect past due and nonaccrual loans as of December 31, 2020 and 2019:

As of December 31, 2020	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Current Loans	Total	Nonaccrual Loans
Commercial Real Estate:						
Construction and						
Land Development	\$ -	\$ -	\$ -	\$ 58,058,471	\$ 58,058,471	\$ -
Multifamily	-	-	-	12,725,410	12,725,410	-
Other	-	-	-	174,777,465	174,777,465	201,583
Residential Real Estate	-	-	53,335	135,299,419	135,352,754	522,928
Commercial	-	-	-	177,190,311	177,190,311	282,323
Consumer	-	-	-	791,325	791,325	-
Total gross loans	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 53,335</u>	<u>\$ 558,842,401</u>	<u>\$ 558,895,736</u>	<u>\$ 1,006,834</u>

As of December 31, 2019	30-59 Days Past Due	60-89 Days Past Due	90 or More Days Past Due	Current Loans	Total	Nonaccrual Loans
Commercial Real Estate:						
Construction and						
Land Development	\$ -	\$ -	\$ -	\$ 32,941,646	\$ 32,941,646	\$ -
Multifamily	-	-	-	9,829,303	9,829,303	-
Other	-	-	-	160,390,159	160,390,159	270,399
Residential Real Estate	465,581	-	-	123,462,038	123,927,619	884,959
Commercial	8,969	-	-	99,315,012	99,323,981	-
Consumer	-	-	-	1,966,480	1,966,480	-
Total gross loans	<u>\$ 474,550</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 427,904,638</u>	<u>\$ 428,379,188</u>	<u>\$ 1,155,358</u>

There were no loans 90 days or more past due and still accruing as of December 31, 2020 and 2019.

The following tables summarize information regarding impaired loans, including TDRs, presented by class of loans as of December 31, 2020 and 2019:

December 31, 2020	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
With No Related Allowance Recorded:					
Commercial Real Estate:					
Construction and					
Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	628,707	201,583	-	235,991	-
Residential Real Estate	738,291	522,928	-	554,365	-
Commercial	291,332	282,323	-	330,014	9,009
Consumer	-	-	-	-	-
	<u>\$ 1,658,330</u>	<u>\$ 1,006,834</u>	<u>\$ -</u>	<u>\$ 1,120,370</u>	<u>\$ 9,009</u>
With an Allowance Recorded:					
Commercial Real Estate:					
Construction and					
Land Development	\$ -	\$ -	\$ -	\$ -	\$ -
Multifamily	-	-	-	-	-
Other	-	-	-	-	-
Residential Real Estate	-	-	-	-	-
Commercial	33,323	33,323	33,323	33,430	-
Consumer	-	-	-	-	-
	<u>\$ 33,323</u>	<u>\$ 33,323</u>	<u>\$ 33,323</u>	<u>\$ 33,430</u>	<u>\$ -</u>
December 31, 2019	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
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>

The Bank identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower’s financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions and negative trends may result in a payment default in the near future.

There was one new residential loan modified in a TDR during the year ended December 31, 2020 for a total of \$102 thousand. The modification included a reduction in the interest rate and an extension of the maturity. There were no new modifications during the year ended December 31, 2019. There were no TDRs that subsequently defaulted within 12 months of their modification during the years ended December 31, 2020 and 2019.

Note 7. Premises and Equipment

The components of premises and equipment at December 31, 2020 and 2019 are as follows:

	December 31,	
	2020	2019
Premises and land	\$ 7,812,337	\$ 7,804,552
Leasehold improvements	675,580	639,245
Furniture and fixtures	892,123	970,507
Equipment and software	<u>3,095,352</u>	<u>2,826,302</u>
Total cost	12,475,392	12,240,606
Accumulated depreciation	<u>(6,075,475)</u>	<u>(5,425,133)</u>
Premises and equipment, net	<u>\$ 6,399,918</u>	<u>\$ 6,815,474</u>

Depreciation expense amounted to \$738 thousand and \$660 thousand during the years ended December 31, 2020 and 2019, 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. 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 Mends’ 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, 2020 and 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.

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.

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

	As of December 31, 2020		
	Bank	Mlend	Consolidated
Lease liabilities	\$ 2,056,249	\$ 658,729	\$ 2,714,979
Right-of-use assets	\$ 2,015,558	\$ 651,338	\$ 2,666,896
Weighted average remaining lease term	7.1 years	8.1 years	7.4 years
Weighted average discount rate	3.15 %	3.28 %	3.18 %

	For the Year Ended December 31, 2020		
	Bank	Mlend	Consolidated
Operating lease cost	\$ 431,239	\$ 118,949	\$ 550,188
Short-term lease cost	1,488		1,488
Total lease cost	\$ 432,727	\$ 118,949	\$ 551,677

Cash paid for amounts included in the measurement of lease liabilities	\$ 413,587	\$ 88,150	\$ 501,737
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	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 at December 31, 2020, was as follows:

Lease payments due	As of December 31, 2020		
	Bank	Mlend	Consolidated
Year ended December 31, 2021	\$ 417,342	\$ 87,600	\$ 504,942
Year ended December 31, 2022	385,108	87,600	472,708
Year ended December 31, 2023	387,614	87,600	475,214
Year ended December 31, 2024	386,673	94,475	481,148
Year ended December 31, 2025	200,340	95,730	296,070
Thereafter	538,093	298,265	836,358
Total undiscounted cash flows	2,315,170	751,270	3,066,440
Discount	(258,920)	(92,541)	(351,461)
Lease liabilities	\$ 2,056,249	\$ 658,729	\$ 2,714,979

Note 9. Deposits

The components of deposits for the years ending December 31, 2020 and 2019 were as follows:

	December 31,	
	2020	2019
Non-interest bearing deposits	\$ 197,297,205	\$ 126,449,656
Interest bearing deposits		
NOW accounts	72,889,183	53,150,363
Money market accounts	159,851,012	117,746,498
Savings accounts	67,106,504	52,239,210
Time deposit accounts	102,415,721	97,120,784
Total interest bearing deposits	402,262,420	320,256,855
Total deposits	\$ 599,559,625	\$ 446,706,511

The following is a schedule of the future maturities of time deposits as of December 31, 2020:

For the Years Ending December 31:	
2021	\$ 51,493,952
2022	20,899,018
2023	25,083,292
2024	2,931,016
2025	2,008,443
	\$ 102,415,721

Time deposits in denominations of \$250,000 or more amounted to \$43.1 million and \$30.7 million, respectively, at December 31, 2020 and 2019. Included in total deposits at December 31, 2020 and 2019 were insured cash sweep (ICS) and CDARS deposits in the amount of \$55.5 million and \$42.3 million, respectively. Other brokered deposits included in total deposits at December 31, 2020 and 2019 were \$8.8 million and \$232 thousand, respectively.

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 2017.

The following table reflects the provision for income taxes charged (credited) to operations for the years ending December 31, 2020 and 2019:

	For the Years Ended December 31,	
	2020	2019
Current tax expense	\$ 2,893,028	\$ 1,020,128
Deferred tax benefit	(1,313,267)	(92,011)
Total income tax	\$ <u>1,579,761</u>	\$ <u>928,117</u>

A reconciliation of the federal statutory income tax rate on pre-tax income to the provision for income taxes was as follows for the years ending December 31, 2020 and 2019:

	For the Years Ending December 31,	
	2020	2019
Federal tax statutory rate	21.00%	21.00%
Federal tax at statutory rate	\$ 1,198,508	\$ 747,367
Increase (decrease) resulting from the following:		
State income taxes, net of federal tax benefit	357,996	228,182
Tax-exempt interest income	(81,363)	(46,569)
Bank owned life insurance income	(30,442)	(22,927)
Non-deductible interest expense	4,524	3,733
Other non-deductible expenses	18,512	24,303
Other, net	112,026	(5,972)
Total income tax expense	\$ <u>1,579,761</u>	\$ <u>928,117</u>

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and deferred tax liabilities at December 31, 2020 and 2019 were as follows:

	As of December 31,	
	2020	2019
Deferred Tax Assets		
Allowance for loan losses	\$ 1,999,688	\$ 1,080,481
Lease Liabilities	747,162	863,124
Supplemental benefits expense	150,969	153,130
Deferred compensation liability	47,122	27,355
Allowance for off-balance sheet credit exposures	266,120	201,735
Non-accrual interest	183,309	188,358
Other	87,407	55,613
Total deferred tax assets	\$ <u>3,481,777</u>	\$ <u>2,569,796</u>
Deferred Tax Liabilities		
Right of use assets	(733,930)	(855,713)
Unrealized gain on available for sale securities	(296,769)	(84,755)
Deferred loan costs, net	(19,498)	(262,971)
Depreciation	(350,746)	(386,776)
Total deferred tax liabilities	<u>(1,400,943)</u>	<u>(1,590,215)</u>
Net deferred tax assets	\$ <u>2,080,834</u>	\$ <u>979,581</u>

Note 11. Borrowings

At December 31, 2020, 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 \$9.8 million in short-term borrowing capacity from the Federal Reserve Discount Window with an interest rate equal to 0.75%. 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, 2020 and 2019, the Bank had no outstanding borrowings with the FHLB. Total credit availability with the FHLBA at December 31, 2020 was \$165.1 million. Advances under this line of credit are secured by a portion of the Bank's loan portfolio, which at December 31, 2020, would have allowed the Bank to access up to \$89.7 million of credit without pledging additional loans as collateral.

The Bank also had a \$1.0 million letter of credit at December 31, 2020 with another financial institution for contingency funding purposes.

Other borrowings of \$8.6 million and \$289 thousand at December 31, 2020 and 2019, respectively, consisted of Mends' draws on warehouse lines of credit maintained at other financial institutions. Draws on the warehouse lines of credit are collateralized by the specific mortgage loans held for sale which are funded by advances on the lines. The total warehouse lines of credit were \$11 million and \$5 million, with a remaining credit availability of \$2.4 million and \$4.7 million at December 31, 2020 and 2019, respectively.

Note 12. Related Party Transactions

The Company has, and may be expected to have in the future, banking transactions in the ordinary course of business with its executive officers, directors, principal stock holders, their immediate families, and affiliated companies (collectively referred to as "Related Parties"). These transactions are executed on the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other customers.

The following schedule presents the activity of loans with the Company's Related Parties for the years ended December 31, 2020 and 2019:

	December 31,	
	2020	2019
Beginning balance	\$ 740,450	129,952
Effect of changes in the composition of related parties	(107,689)	571,094
Advances	935,827	533,182
Principal curtailments	(412,758)	(493,778)
Ending balance	\$ <u>1,155,830</u>	\$ <u>740,450</u>

The aggregate amount of deposits of executive officers, directors, and their related interests was \$4.6 million and \$7.3 million at December 31, 2020 and 2019, 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 \$659 thousand and \$728 thousand at December 31, 2020 and 2019, respectively.

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.

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, 2020 and 2019 are as follows:

	2020	2019
Commitments to extend credit	\$ 162,134,000	\$ 136,403,319
Standby letters of credit and financial guarantees written	3,945,689	1,399,611

Commitments to extend credit are agreements to lend to a customer if 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, 2020 and 2019, the Company, primarily through Mlend, had interest rate lock commitments to originate mortgage loans totaling \$30.9 million and \$5.3 million, respectively. The Company enters into corresponding commitments with third-party investors to sell each of these loans that close on a best-efforts basis.

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 other financial institutions. At December 31, 2020, there was \$1.98 million of cash balances outstanding in excess of the FDIC insurance levels.

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 \$158 thousand and \$129 thousand to the plan during the years ended December 31, 2020 and 2019, respectively.

Mlend 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 \$33 thousand and \$8 thousand to the plan for the years ended December 31, 2020 and 2019, respectively.

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, 2020 and 2019 was \$44 thousand and \$45 thousand, respectively. The related liability balance at December 31, 2020 and 2019 was \$549 thousand and \$556 thousand, 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, at 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 net deferred compensation liability recorded in other liabilities on the Consolidated Balance Sheets was \$169 thousand and \$99 thousand at December 31, 2020 and 2019, respectively. 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.

In 2020, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework, ("CBLR framework"), for qualifying community banks, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was adopted by the Bank as of December 31, 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to section 4012 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, and a second interim final rule that provides a graduated increase in the CBLR ratio requirement after the expiration of temporary changes implemented pursuant to section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying institutions to calculate and report risk-based capital but rather only requires a Tier 1 to average assets (leverage) ratio. Qualifying banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than the required minimums will be considered to have satisfied the generally applicable risk based and leverage capital requirements in the agencies' capital rules (generally applicable rule) and, if applicable, will be considered to have met the well capitalized ratio requirements for purposes of section 38 of the Federal Deposit Insurance Act. Under the interim final rule, the CBLR minimum requirement is 8% as of December 31, 2020, 8.5% for calendar year 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the bank maintains a leverage ratio of 7% as of December 31, 2020, 7.5% for calendar year 2021 and 8% for 2022 and beyond.

Under the final rule, an eligible bank can opt out of the CBLR framework and revert back to risk-weighting framework without restriction. As of December 31, 2020, the Bank was a qualifying CBLR organization as defined by the federal banking agencies and elected to measure capital adequacy under the CBLR framework.

As of December 31, 2020, 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 the minimum ratios as set forth in the following tables. During the year ended December 31, 2020 the Bank adopted the CBLR framework, to be used for measuring the regulatory capital of the Bank, in place of the risk-based capital ratios. Under the CBLR regulatory minimum capital requirement of 8% the bank maintained its well capitalized level for the year ended December 31, 2020.

Management believes, as of December 31, 2020 and 2019 the Bank met all capital adequacy requirements to which it was subject.

The actual and required capital amounts and ratios as of December 31, 2020 and 2019 are presented below:

As of December 31, 2020	Actual		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions (CBLR Framework)	
	Amount	Ratio	Amount	Ratio
Community bank leverage ratio (Tier 1 capital to average assets)	\$ 61,673	9.11%	\$ 54,146	8.00%

As of December 31, 2019	Actual		Minimum Capital Requirement		Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk weighted assets)	\$ 64,374	15.57%	\$ 26,962	8.00%	\$ 41,345	10.00%
Tier 1 capital (to risk weighted assets)	\$ 59,406	14.37%	\$ 20,222	6.00%	\$ 33,080	8.00%
Common equity tier 1 capital (to risk weighted assets)	\$ 59,406	14.37%	\$ 15,166	4.50%	\$ 26,878	6.50%
Tier 1 leverage (to average assets)	\$ 59,406	11.76%	\$ 17,137	4.00%	\$ 25,256	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, 2020 and 2019, Mlend met these requirements.

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-820, 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).

Interest rate lock commitments: The Company recognizes interest rate lock commitments at fair value based on the price of the underlying loans obtained from an investor for loans that will be delivered on a best-efforts basis while taking into consideration the probability (pull-through) that the rate lock commitments will close (Level 3). The pull-through rate is considered a level 3 input which at December 31, 2020, ranged from (70% - 90%), with a weighted average of (87%) based on the relative fair values of these assets. The fair value of interest rate lock commitments was considered immaterial at December 31, 2019.

For financial assets measured at fair value on a recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows for the years ending December 31, 2020 and 2019:

As of December 31, 2020	Quoted Prices in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Assets:				
Securities available-for-sale:				
U.S. Treasuries	\$ -	\$ 1,001,480	\$ -	\$ 1,001,480
Mortgage Backed	-	37,500,911	-	37,500,911
Municipals	-	23,186,299	-	23,186,299
Corporates	-	10,750,155	-	10,750,155
Other Assets:				
Interest rate lock commitments	-	-	465,926	465,926
Total assets measured on a recurring basis	<u>\$ -</u>	<u>\$ 72,438,845</u>	<u>\$ 465,926</u>	<u>\$ 72,904,771</u>
Liabilities:				
Other Liabilities				
Interest rate lock commitments	\$ -	\$ -	\$ 7,890	\$ 7,890
Total liabilities measured in a recurring basis	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 7,890</u>	<u>\$ 7,890</u>

As of December 31, 2019	Quoted Prices in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Securities available-for-sale:				
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
Total assets measured on a recurring basis	<u>\$ -</u>	<u>\$ 42,640,765</u>	<u>\$ -</u>	<u>\$ 42,640,765</u>

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, 2020 and 2019.

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).

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. No impaired loans were carried at fair value at December 31, 2020. Impaired loans at fair value as of December 31, 2019 are shown in the table below.

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 Company had no other real estate owned at December 31, 2020 and 2019.

For financial assets measured at fair value on a non-recurring basis, the fair value measurements by level within the fair value hierarchy used are as follows.

As of December 31, 2019	Quoted Prices in Active Markets for identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Impaired loans:				
Residential Real Estate	\$ -	\$ -	\$ 150,854	\$ 150,854
Total assets measured on a non-recurring basis	\$ -	\$ -	\$ 150,854	\$ 150,854

The following table presents information about Level 3 fair value measurements for December 31, 2019:

As of December 31, 2019	Fair Value	Valuation Technique	Unobservable Inputs	Range (Weighted Average)
Impaired loans:				
Residential Real Estate	\$ 150,854	Discounted appraised/ invoiced value	Selling expenses and discount for lack of marketability	10-18% (12%)

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.

The estimated fair value of the Company's financial instruments is summarized as follows as of December 31, 2020 and 2019:

	Level in Fair Value Hierarchy	December 31,			
		2020		2019	
		Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets:					
Cash and due from banks	Level 1	\$ 28,785,202	\$ 28,785,202	\$ 25,065,743	\$ 25,065,743
FHLB Stock	Level 2	462,100	462,100	392,200	392,200
Securities	Level 2	72,438,845	72,438,845	42,640,765	42,640,765
Loans held for sale	Level 2	12,626,481	12,626,481	3,775,199	3,775,199
Loans, net	Level 3	551,486,398	551,667,546	425,099,435	428,143,188
Accrued interest receivable	Level 2	2,199,489	2,199,489	1,232,624	1,232,624
Bank owned life insurance	Level 2	5,279,741	5,279,741	4,966,843	4,966,843
Interest rate lock commitments	Level 3	465,926	465,926	-	-
Financial liabilities:					
Time Deposits	Level 3	\$ 102,415,721	\$ 104,361,721	\$ 97,120,784	\$ 97,934,784
Other Deposits	Level 2	497,143,904	497,143,904	349,585,727	349,585,727
Accrued interest payable	Level 2	215,490	215,490	279,832	279,832
Subordinated Debt	Level 3	14,663,636	14,950,299	14,573,940	15,007,082
Other Borrowings	Level 3	8,558,178	8,558,178	289,039	289,039
Interest rate lock commitments	Level 3	7,890	7,890	-	-

Note 20. Derivatives

We maintain and account for derivatives, in the form of interest-rate lock commitments (“IRLCs”), in accordance with the FASB guidance on accounting for derivative instruments and hedging activities. We recognize gains and losses on IRLCs on the mortgage loan pipeline through non-interest income and non-interest expense in the Consolidated Statements of Income. IRLCs on mortgage loans that we intend to sell in the secondary market are considered derivatives. We are exposed to price risk from the time a mortgage loan closes until the time the loan is sold. The period between issuance of a loan commitment and closing and sale of the loan generally ranges from 14 days to 60 days with a limited number of IRLC’s of up to 90 days. At December 31, 2020, the derivative assets and liabilities are included in the Consolidated Balance Sheets in other assets and other liabilities, respectively.

Information pertaining to the notional amounts and fair values of the Company’s derivative financial instruments are as follows:

As of December 31, 2020:	Notional Amount	Fair Value
Asset - IRLCs	\$ 28,820,112	\$ 465,926
Liability - IRLCs	2,124,000	7,890

Note 21. Subordinated Debt

The Company issued long-term private placement subordinated fixed-to-floating rate debt (“Notes”) for \$15 million in October 2019 to multiple investors in the form of Subordinated Note Purchase Agreements 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% for 5 years and will bear a floating rate equal to three-month LIBOR plus 439.5 basis points thereafter. The notes are carried at their principal amount, less unamortized issuance costs and are structured to qualify as Tier 2 capital. The initial debt issuance costs were \$448 thousand. As of December 31, 2020 and 2019, the unamortized issuance costs were \$336 thousand and \$426 thousand, respectively.

Note 22. Common Stock

As of December 31, 2020 and 2019, there were 2,251,320 shares of common stock outstanding. On October 16, 2020, the board of directors voted and approved an increase in the total authorized capital stock of the Company from 5,000,000 shares to 11,000,000 shares, designated as 10,000,000 shares of common stock and 1,000,000 shares of preferred stock. At December 31, 2020, there were 7,748,680 shares of common stock and 1,000,000 shares of preferred stock available to be issued.

Note 23. Other Non-interest Expenses

The following table describes the significant components of other non-interest expenses included in the Consolidated Statements of Income for the years ended December 31, 2020 and 2019:

	For the Years Ending December 31,	
	2020	2019
Public Relations and charitable contributions	\$ 488,659	\$ 255,513
ATM and check card expenses	338,572	338,124
Director fees	186,525	208,500
Other miscellaneous expenses	763,587	948,827
Total other non-interest expenses	\$ 1,777,343	\$ 1,750,964

Note 24. Revenue from Contracts with Customers

Substantially all the Company's revenue from contracts with customers that is within the scope of ASC 606, "Revenue from Contracts with Customers" is reported within non-interest income. Certain other in-scope items such as gains and losses on OREO are recorded in non-interest expense. The recognition of interest income and certain sources of non-interest income (e.g. gains on security transactions, bank owned life insurance income, gains on loans held for sale, etc.) are governed by other areas of U.S. GAAP. Significant revenue streams that are within scope of ASC 606 and included in non-interest income are discussed in the following paragraphs.

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 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, 2020 and 2019:

	For the Years Ending December 31,	
	2020	2019
In-scope of ASC topic 606:		
Service charges on deposit accounts:		
Monthly service and other activity charges	\$ 581,778	\$ 550,981
ATM fees	66,347	78,085
VISA check card income	546,626	489,999
Gain (loss) premises and equipment	500	(5,471)
Other non-interest income	35,239	37,472
Total non-interest income within the scope of ASC-606	1,230,490	1,151,066
Out-of-scope of ASC 606	(1) 7,034,313	2,674,894
	<u>\$ 8,264,803</u>	<u>\$ 3,825,960</u>

(1) Includes bank owned life insurance, gain on sale of loans, other mortgage banking income, gain on IRLC's, and gain on sale 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, 2020 and 2019, the Company did not have any significant contract balances.

Note 25. 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, 2021, the date financial statements were available to be issued.

The Company is in the process of opening a new branch in Waynesboro, Pennsylvania. The target opening of the new branch is mid-2021. There are various expenses such as leasehold improvements, furniture, and equipment along with staffing expense that will have a material impact on the balance sheet and earnings of the company during the year 2021. The opening of the Waynesboro branch will enhance the Company's presence in the state of Pennsylvania which will add to the earnings potential and balance sheet growth potential. With the addition of the Waynesboro branch the Company will have a total of 8 full-service branches.



Executive Management

Robert E. Goetz, Jr.

President & Chief Executive Officer

J. Michael Hill

Executive Vice President & Chief Risk Officer

Robert Wolfe, Jr.

Executive Vice President & Chief Financial 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*

Dustin Watson

*Senior Vice President & Senior Credit
Officer*

Brenda McComas

*Senior Vice President, Director of
Operations, Middletown Valley Bank*

Dawn R. Woods

Corporate Secretary

Michelle Lease

Assistant Corporate Secretary

Board of Directors

COMMUNITY HERITAGE FINANCIAL, INC. AND MIDDLETOWN VALLEY BANK

James G. Pierne

*Chairman of the Board
Assistant Professor of Business
& Management, Hagerstown
Community College*

Todd M. Snook

*Vice Chairman of the Board
Owner & President, Valley
Storage Company*

James H. Clapp

Retired Attorney

Beth Dellaposta

*Chief Financial Officer,
Doing Better Business*

Robert E. Goetz, Jr.

*President & Chief Executive
Officer, CHF & MVB*

Richard L. Kefauver

Retired Businessman

A. Dennis Remsburg

*District Manager, Catoctin & Frederick
Soil Conservation Districts*

J. Thomas Routzahn, Jr.

Retired Businessman

John T. Routzahn, III

*Marketing Representative,
Mutual Benefit Group*

Board of Directors

MILLENNIUM FINANCIAL GROUP, INC.

James G. Pierne

*Chairman of the Board
Assistant Professor of Business
& Management, Hagerstown
Community College*

Robert E. Goetz, Jr.

*Vice Chairman of the Board
President & Chief Executive
Officer, CHF & MVB*

William H. Poffenbarger, Jr.

*President & Chief Executive Officer,
Millennium Financial Group, Inc.*

Richard L. Kefauver

Retired Businessman



Committed to Our Communities

2020 ANNUAL REPORT

General Information

Community Heritage Financial, Inc.
24 West Main Street
P.O. Box 75
Middletown, MD 21769

1.844.533.9211
chinvestorrelations@mvpbank.com
www.communityheritageinc.com

Registrar, Transfer Agent and Change of Address:

American Stock Transfer & Trust Company, LLC.
6201 15th Avenue
Brooklyn, NY 11219

help@astfinancial.com

Market: OTC Pink Marketplace
Trading symbol: CMHF



Community
Heritage
Financial, Inc.