CoastalSouth Bancshares, Inc.
and Subsidiary

Report on Consolidated Financial Statements

For the years ended December 31, 2019 and 2018

Contents

Independent Auditor's Report

The Board of Directors
CoastalSouth Bancshares, Inc. and CoastalStates Bank
Hilton Head Island, South Carolina

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of CoastalSouth Bancshares, Inc. and Subsidiary which are comprised of the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of operations, comprehensive income (loss), changes in stockholders' equity and cash flows for the years then ended and the related notes to the 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 consolidated 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 consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls 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 CoastalSouth Bancshares, Inc. and Subsidiary as of December 31, 2019 and 2018, and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Elliott Davis, LLC

Columbia, South Carolina
March 26, 2020

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Balance Sheets

As of December 31, 2019 and 2018

(in thousands of dollars, except share data)	2019	2018
Assets		
Cash and cash equivalents:		
Cash and due from banks	$ 2,033	$ 8,700
Interest-bearing accounts with other banks	2,675	29,844
Federal funds sold	44,565	29,152
Total cash and cash equivalents	49,273	67,696
Investments		
Securities available-for-sale (amortized cost of $60,689 and $60,621, respectively)	61,378	59,870
Equity securities	168	147
Non-marketable equity securities	950	621
Total investments	62,496	60,638
Loans held for sale	81,243	32,641
Loans held for investment	468,326	376,746
Allowance for loan losses	(3,936)	(2,919)
Loans held for investment, net	464,390	373,827
Premises, furniture and equipment, net	14,280	12,047
Bank-owned life insurance	13,534	13,180
Deferred tax asset	10,779	12,154
Goodwill	4,708	4,708
Intangible assets	1,718	1,614
Other real estate owned	1,505	2,117
Other assets	4,563	3,489
Total assets	$ 708,489	$ 584,111
Liabilities		
Deposits		
Non-interest bearing transaction accounts	$ 141,025	$ 116,478
Interest-bearing transaction accounts	90,761	91,056
Savings and money market	203,402	186,237
Time deposits	165,904	119,555
Total deposits	601,092	513,326
Other borrowings	10,000	500
Other liabilities	5,103	2,454
Total liabilities	616,195	516,280
Stockholders' Equity		
Voting common stock, $1 par value at December 31, 2019 and 2018; 50,000,000 shares authorized at December 31, 2019 and 2018; 6,202,746 and 4,950,602 shares issued and outstanding at December 31, 2019 and 2018, respectively	6,203	4,951
Nonvoting common stock, $1 par value at December 31, 2019 and 2018; 10,000,000 shares authorized at December 31, 2019 and 2018; 1,753,507 and 1,449,482 shares issued and outstanding at December 31, 2019 and 2018, respectively	1,754	1,449
Capital surplus	120,756	101,590
Accumulated deficit	(36,966)	(39,569)
Accumulated other comprehensive income (loss)	547	(590)
Total stockholders' equity	92,294	67,831
Total liabilities and stockholders' equity	$ 708,489	$ 584,111

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Operations

For the years ended December 31, 2019 and 2018

(in thousands of dollars, except share data)	2019	2018
Interest income		
Loans, including fees	$ 27,632	$ 19,457
Investments		
Taxable	1,593	1,547
Non-taxable	30	25
Non-marketable equity securities	55	38
Federal funds sold	840	920
Other earning assets from banks	113	133
Total	30,263	22,120
Interest expense		
Interest-bearing deposits	5,192	2,242
Other borrowings	92	77
Total	5,284	2,319
Net interest income	24,979	19,801
Provision for credit losses	1,867	1,694
Net interest income after provision for loan losses	23,112	18,107
Noninterest income		
Gain on sale of government guaranteed loans	1,877	1,222
Income from mortgage originations	1,502	1,287
Interchange income and card fees	770	668
Service charges on deposit accounts	699	705
Securities gains (losses), net	640	(57)
Bank-owned life insurance	354	343
Other noninterest income	658	516
Total noninterest income	6,500	4,684
Noninterest expenses		
Salaries and employee benefits	16,976	13,975
Occupancy and equipment	1,707	1,280
Software and other technology expense	1,406	1,199
Other professional fees	1,296	1,824
Data processing	1,027	937
Loss on other real estate owned, net	399	263
Regulatory assessment	380	428
Other noninterest expense	2,955	3,289
Total noninterest expense	26,146	23,195
Income (loss) before taxes	3,466	(404)
Income tax (benefit) provision	863	(223)
Net income (loss)	$ 2,603	$ (181)
Net income (loss) per common share:		
Basic	$ 0.36	$ (0.03)
Diluted	$ 0.36	$ (0.03)

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2019 and 2018

(In thousands of dollars, except share data)

	2019	2018
Net income (loss)	$ 2,603	$ (181)
Other comprehensive income (loss)		
Unrealized gains (losses) on investment securities available for sale:		
Holding gains (losses) arising during the period, net of taxes of $172 and ($203) for 2019 and 2018, respectively	649	(771)
Reclassification adjustment for realized net gains included in net income (loss), net of taxes of ($131) and ($3) for 2019 and 2018, respectively	488	11
Other comprehensive income (loss), net of tax	1,137	(760)
Comprehensive income (loss)	$ 3,740	$ (941)

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Changes in Stockholders' Equity

For the years ended December 31, 2019 and 2018

(In thousands of dollars, except share data)

	Common Stock						Accumulated Other	
	Voting		Nonvoting		Capital	Accumulated	Comprehensive	
	Shares	Amount	Shares	Amount	Surplus	Income (Deficit)	Income/ (Loss)	Total
Balance as of December 31, 2017	4,254,714	$ 4,255	1,449,482	$ 1,449	$ 90,743	$ (39,478)	$ 170	$57,139
Effect of adoption of ASU 2016-01	-	-	-	-	-	90	-	90
Issuance of common stock for the acquisition of First Citizens Financial Corporation	695,888	696	-	-	10,264	-	-	10,960
Stock based compensation expense	-	-	-	-	583	-	-	583
Net loss	-	-	-	-	-	(181)	-	(181)
Other comprehensive loss, net of tax	-	-	-	-	-	-	(760)	(760)
Balance as of December 31, 2018	4,950,602	$ 4,951	1,449,482	$ 1,449	$101,590	$ (39,569)	$ (590)	$67,831
Issuance of common stock under incentive plan	9,000	9	-	-	(9)	-	-	-
Issuance of common stock under 2019 private placement	1,243,144	1,243	304,025	305	18,266	-	-	19,814
Stock based compensation expense	-	-	-	-	909	-	-	909
Net income	-	-	-	-	-	2,603	-	2,603
Other comprehensive income, net of tax	-	-	-	-	-	-	1,137	1,137
Balance as of December 31, 2019	6,202,746	$ 6,203	1,753,507	$ 1,754	$120,756	$ (36,966)	$ 547	$92,294

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

CoastalSouth Bancshares, Inc. and Subsidiary

Consolidated Statements of Cash Flows

For the years ended December 31, 2019 and 2018

(In thousands of dollars, except share data)	2019	2018
Operating activities		
Net income (loss)	$ 2,603	$ (181)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Provision for loan losses	1,867	1,694
Depreciation expense	695	555
Increase in cash value of bank-owned life insurance	(354)	(343)
Stock-based compensation	909	583
Net gain on sale of securities available-for-sale	(619)	(14)
Amortization of operating lease right-of-use assets	387	-
Impairment of commercial mortgage servicing rights	19	-
(Increase) decrease in fair value of equity securities	(21)	71
Writedown on other real estate owned	398	268
Net gain on sale of premises, furniture and equipment	(12)	(77)
Net loss (gain) on sale of other real estate owned	1	(5)
Net (gain) loss on sale of portfolio loans	-	(64)
Gain on sale of government guaranteed loans, including originations of servicing rights	1,877	1,222
Discount accretion and premium amortization on securities available-for-sale	365	486
Amortization of intangible assets	348	144
Deferred income tax expense (benefit)	786	(181)
Decrease (increase) in loans held for sale	(48,602)	3,692
(Increase) decrease in other assets	(1,176)	1,372
(Decrease) increase in other liabilities	2,649	(502)
Net cash provided (used) by operating activities	(37,880)	8,720
Investing activities		
Purchase of securities available-for-sale	(13,899)	(27,785)
Proceeds from sales of securities available-for-sale	8,079	13,716
Proceeds from paydowns on mortgage backed securities	6,006	7,551
Net sale (purchase) of non-marketable equity securities	(329)	3,095
Net increase in loans	(94,777)	(45,127)
Net purchase of premises, furniture and equipment	(2,916)	(5,309)
Proceeds from sales of other real estate owned	213	1,841
Net cash received from business combination	-	18,670
Net cash used by investing activities	(97,623)	(33,348)
Financing activities		
Net increase in deposits	87,766	51,706
Net proceeds (repayments) of Federal Home Loan Bank advances	10,000	(75,000)
Net decrease in federal funds purchased	-	(30,182)
Proceeds from capital raise, net	19,314	-
Net cash provided (used) by financing activities	117,080	(53,476)
Net decrease in cash and cash equivalents	(18,423)	(78,104)
Cash and cash equivalents, beginning of year	67,696	145,800
Cash and cash equivalents, end of year	$ 49,273	$ 67,696
Cash (received) paid during the year for:		
Interest	$ 4,343	$ 1,993
Income taxes	(38)	32
Noncash investing and financing activities:		
Unrealized gains (losses) on securities available for sale, net	1,137	$ (760)
Transfers of loans to other real estate owned	-	49
Initial recognition of operating lease right-of-use assets	978	-
Initial recognition of operating lease liabilities	998	-
Conversion of subordinated debt to common stock	500	-

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

(In thousands of dollars, except share data)

Note 1. Summary of Significant Accounting Policies

Organization

CoastalSouth Bancshares, Inc. (the "Company"), headquartered in Hilton Head Island, South Carolina, is a registered bank holding company with one banking subsidiary, Coastal States Bank ("CSB"). CSB operates retail banking branches in Beaufort County, South Carolina, Dawson County, Georgia, and Forsyth County, Georgia. CSB also has commercial lending centers in Savannah, Georgia and Atlanta, Georgia, as well as other commercial lines of business that operate on a national platform. The deposits of CSB are insured by the Federal Deposit Insurance Corporation ("FDIC"). CSB has one wholly owned subsidiary, Coastal States Mortgage, Inc. ("CSM"), a mortgage company focused on originating and selling residential mortgages to investors. The Company was organized on September 28, 2003 as a Virginia corporation, with no activity until August 9, 2004. CSB was organized as a South Carolina state-chartered bank on July 30, 2004 and opened on August 9, 2004.

Nature of Business

The Company offers full-service banking services designed to meet the needs of retail and commercial customers in the markets in which it operates. The services offered include transaction and savings deposit accounts, commercial and consumer lending, mortgage banking and other activities related to commercial banking. The Company and CSB are subject to the regulations of certain federal and state agencies and are periodically examined by those regulatory agencies. CSM is an approved mortgage lender with the Federal Housing Administration, Department of Veterans Affairs, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation.

Use of Estimates in the Preparation of Financial Statements

The accounting and reporting policies of the Company and its subsidiaries are in accordance with accounting principles generally accepted in the United States of America ("US GAAP" or "GAAP") and also conform to general industry practices. All intercompany accounts and transactions have been eliminated in consolidation. Assets and liabilities of purchased companies are stated at estimated fair values at the date of acquisition. Results of operations of companies purchased are included from the date of acquisition. Certain reclassifications have been made to prior period amounts to conform to the current period presentation.

Management's Estimates

The preparation of consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the consolidated financial statements and the 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 changes include:

- Determination of the allowance for loan losses ("ALL") and provision for credit losses
- Valuation of real estate acquired in conjunction with foreclosures or in satisfaction of loans
- Income taxes, including tax provisions and realization of deferred tax assets
- Fair value of assets and liabilities, including intangible assets and goodwill

(In thousands of dollars, except share data)

Cash and Due From Banks
The Company is required to maintain cash balances with its correspondent banks to cover all cash letter transactions. At December 31, 2019 and 2018, the requirement was met by the cash balance in the vault and balances on deposit with other banks.

Debt Securities
The Company classifies debt investment securities into three categories: trading, held-to-maturity and available-for-sale. Management determines the appropriate classification of investment securities at the time of purchase. Debt investment securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the investment securities to maturity. Held-to-maturity investment securities are carried at amortized cost. At December 31, 2019 and 2018, the Company had no investment securities classified as held-to-maturity.

Investment securities classified as trading are held principally for resale in the near term and are recorded at fair value. Gains or losses, either unrealized or realized, are reported in noninterest income. At December 31, 2019 and 2018, the Company had no investment securities classified as trading.

Investment securities not classified as either held-to-maturity or trading are classified as available-for-sale. Investment securities available-for-sale are stated at fair value, with the unrealized gains and losses, net of tax, reported as a separate component of accumulated other comprehensive income (loss) in the Consolidated Statements of Comprehensive Income (Loss).

The amortized cost of debt investment securities classified as either held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts to maturity or call, or in the case of mortgage-backed securities, over the estimated life of the security. Such amortization is considered an adjustment to yield on the security and included in interest income from investments. Interest and dividends are included in interest and dividends on investment securities in the Consolidated Statements of Operations.

Gains and losses realized from the sales of investment securities are determined by specific identification and are included in noninterest income. Available-for-sale and held-to-maturity investment securities are reviewed quarterly for potential impairment. The Company determines whether it has the intent to sell a debt security or whether it is more likely than not it will be required to sell the debt security before the recovery of its amortized cost basis. If either condition is met, the Company will recognize, in earnings, an impairment loss necessary to reduce the carrying value of the debt security to fair value. For all other debt investment securities for which the Company does not expect to recover the entire amortized cost basis of the security and do not meet either condition, an other-than-temporary loss is considered to have occurred and the Company records the credit loss portion of impairment in earnings and the impairment related to all other factors in other comprehensive loss.

Equity Securities
Equity securities are recorded at fair value, with changes in fair value presented in other noninterest income. The fair value of equity securities is based on observable market prices.

(In thousands of dollars, except share data)

Non-Marketable Equity Securities

Equity securities without readily determinable fair values (non-marketable) that are not held for trading purposes includes Federal Home Loan Bank ("FHLB") of Atlanta capital stock and various other non-marketable equity investments. Investment in the FHLB of Atlanta is a condition of borrowing from the FHLB of Atlanta, and the stock is pledged to collateralize such borrowings. At December 31, 2019 and 2018, the Company's investment in FHLB stock was $950 and $609, respectively. Dividends received on non-marketable equity securities are included as a separate component in interest income.

Loans Held for Sale

Loans held for sale ("LHFS") includes loans acquired through the Company's Mortgage Banker Finance ("MBF") line of business that are acquired with the intent to sell. These LHFS are accounted for at the lower of cost or fair value; as of December 31, 2019, and 2018, respectively, there have been no fair value adjustments recorded on this type of LHFS.

LHFS also represents mortgage loans originated by CSM with the intent to sell. Generally, loans originated by CSM with the intent to sell are accounted for at fair value. These loans are initially recorded and carried at fair value, with changes in fair value recognized in income from mortgage originations.

Additionally, the Company may periodically decide to sell other commercial and consumer loans and may reclassify loans from held for investment to held for sale when appropriate. At the time of transfer, the amount by which the amortized cost basis of the LHFS exceeds fair value may be accounted for as a valuation allowance or direct write-down.

Loans Held for Investment

Loans held for investment ("LHFI" or "Loans") are stated at their unpaid principal balance, net of any charge-offs. Interest income on loans is computed based upon the unpaid principal balance. Interest income on loans is recognized in the period earned and is computed using the effective interest method. Bank loan origination and commitment fees and certain direct loan origination costs, as well as purchase premiums and discounts, are deferred and amortized to income over the contractual life of the related loans or commitments, adjusted for prepayments, using a method that approximates a level yield.

Loans are considered past due or delinquent when the contractual principal or interest due in accordance with the terms of the loan agreement or any portion thereof remains unpaid after the due date of the scheduled payment. Loans are placed on non-accrual status when it becomes probable that interest is not fully collectible, generally when the loan becomes 90 days past due. Once loans are placed on non-accrual status, previously accrued but unpaid interest is reversed from interest income, and the accrual of interest income is suspended. Future payments received are applied to the principal balance of the loan. If and when borrowers demonstrate the sustained ability to repay such loans in accordance with the loan's contractual terms, the loan may be returned to accrual status. Loans which become 90 days past due are reviewed for collectability of principal. Principal amounts deemed uncollectible are charged off against the Allowance for Loan Losses ("ALL"), unless such loans are in the process of modification, collection through repossession, or foreclosure. Certain consumer loans are not placed on non-accrual but are monitored and charged-off at 120 days past due.

(In thousands of dollars, except share data)

Acquired Loans
Acquired, non-impaired loans are recorded at their initial fair value and adjusted for subsequent advances, pay downs, amortization, or accretion of any premium or discount on purchase, charge-offs, and additional provision for credit loss that may be required.

Impaired Loans
The Company considers a loan to be impaired when, based upon current information and events, it believes it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Management reviews all impaired loans over $100,000, and certain loans judgmentally identified under this threshold, individually to determine if a specific allowance based upon the borrower's overall financial condition, resources and payment record, support from guarantors and the realizable value of any collateral is necessary. Specific allowances are based upon discounted cash flows using a loan's initial effective interest rate or the net realizable value of the collateral for collateral-dependent loans. If the recorded investment in the impaired loan exceeds its fair value, a valuation allowance is required as a component of the ALL. Interest income on impaired loans is recorded on a cash basis once the loan's principal has been fully recovered.

Troubled Debt Restructurings
A loan is also considered impaired if its terms are modified in a troubled debt restructuring ("TDR"). A restructuring of debt constitutes a TDR if the Company, for economic or legal reasons related to a borrower's financial difficulties, grants a concession to a borrower that it would not otherwise consider. Concessions granted generally involve forgiving or forbearing a portion of interest or principal on any loans or making loans at a rate that is less than prevailing market rates. Prior to modifying a borrower's loan terms, the Company performs an evaluation of the borrower's financial condition and ability to service the debt under the potential modified loan terms. If a loan is accruing at the time of modification, the loan remains on accrual status and is subject to the Company's charge-off and non-accrual policies. If a loan is on non-accrual before it is determined to be a TDR, then the loan remains on non-accrual. TDRs may be returned to accrual status if there has been a sustained period of repayment performance by the borrower.

Allowance for Loan Losses
The ALL represents management's estimate of probable and reasonably estimable credit losses incurred in loans held for investment as of the balance sheet date. The estimate of the ALL is based upon management's evaluation of the loan portfolio including such factors as past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay (including the timing of future payments), the estimated value of any underlying collateral, composition of the loan portfolio, current market and economic conditions, borrower's payment status, internal credit risk ratings and other relevant factors. This evaluation is inherently subjective as it requires material estimates including the amounts and timing of future cash flows expected to be received on impaired loans that may be susceptible to significant changes. Loans are charged off when management believes that the ultimate collectability of the loan is unlikely. Allocation of the ALL may be made for specific loans, but the entire allowance is available for any loan that, in management's judgment, is deemed to be uncollectible. The ALL is increased by provisions charged to expense and decreased by actual charge-offs, net of recoveries.

The ALL adequacy assessment begins with a process of estimating probable and reasonably estimable credit losses

(In thousands of dollars, except share data)

incurred within the loan portfolio. These estimates are established by category and based upon the Company's internal system of credit risk ratings and historical loss data. Periodically, management reassesses certain assumptions in the calculation of allowance for loan losses in order to further refine the estimation methodology, as appropriate. The estimate of probable and reasonably estimable credit losses incurred within the loan portfolio may then be adjusted for management's estimate of additional probable and reasonably estimable credit losses as a result of specific credit exposures, trends in delinquent and nonaccrual loans, as well as other factors such as prevailing economic conditions, lending strategies, and other influencing factors.

Bank-Owned Life Insurance
Bank Owned Life Insurance ("BOLI") is long-term life insurance on the lives of certain employees where the insurance policy benefits and ownership are retained by the employer. To date, the Company has purchased life insurance policies on certain senior officers. BOLI is recorded at the cash surrender value, which can be adjusted for charges due at settlement at the balance sheet date. The cash value accumulation on BOLI is permanently tax deferred if the policy is held until the insured person's death.

Core Deposit Intangible
As a result of business combinations, identifiable intangible assets were recorded representing the estimated value of core deposits assumed. The Company amortizes the intangible assets over their estimated useful lives. Core deposit intangibles are periodically reviewed for reasonableness and are evaluated for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable.

Commercial Mortgage Servicing Rights
The Company's commercial mortgage servicing rights arise from the sale of participating interests in government guaranteed loans to third parties where servicing is retained by the Company. The Company defines its classes of servicing assets relationship to the government guarantor, such as United States Department of Agriculture ("USDA") or Small Business Administration ("SBA") guaranteed loans. The Company initially records servicing assets at fair value at the time the sale is recognized. Subsequently, the Company amortizes these servicing assets over the expected life of the related loan, adjusting for expected prepayments. Periodically, the Company evaluates these assets for impairment. When the carrying value exceeds the fair value of a class of servicing assets, the Company recognizes impairment of the servicing assets.

Goodwill
Goodwill represents the excess of the purchase price over the fair value of net assets acquired in a business combination. Goodwill is not amortized but tested for impairment on an annual basis, or more often, if events or circumstances indicate there may be impairment. Goodwill impairment exists when a reporting unit's carrying value of goodwill exceeds its implied fair value, which is determined through a two-step impairment test.

If the fair value of the reporting unit exceeds its carrying value, no further testing is required. If the carrying value exceeds the fair value, further analysis is required to determine whether an impairment charge must be recorded based upon the implied fair value of goodwill and, if so, the amount of such charge. The Company performs its Goodwill testing at least on an annual basis unless it's determined that conditions exists to indicate impairment.

For the Company's annual goodwill impairment evaluation, management bypassed the qualitative assessment for

(In thousands of dollars, except share data)

each respective reporting unit and performed the quantitative assessment of the goodwill impairment test. The Quantitative assessment of the goodwill impairment test requires a comparison of the fair value of the reporting unit with its carrying amount, including goodwill. Accordingly, management determined the fair value of the reporting unit and compared the fair value to the reporting unit's carrying amount. Management determined that the reporting unit's fair value exceeded its carrying amount and therefore goodwill was not impaired. No events have occurred since the last annual goodwill impairment assessment that would necessitate an interim goodwill impairment assessment.

Liabilities for Representations and Warranties
The Company is exposed to certain liabilities under representations and warranties made to purchasers of mortgage loans and servicing rights that require indemnification or repurchase of loans. At the time it issues a guarantee, the Company is required to recognize an initial liability for the fair value of obligations assumed under the guarantee.

The Company establishes a contingency reserve for its liabilities under representations and warranties provided to purchasers of its mortgage loans. This reserve is maintained at a level considered appropriate by management to provide adequately for known and inherent losses. The reserve is based upon a continuing review of past loss experience, estimates and assumptions of risk elements and future economic conditions. Additions to the reserve are recorded in other expenses.

Management's judgment about the adequacy of the reserve is based upon a number of assumptions about future events which it believes to be reasonable but which may or may not be accurate. There is no assurance that additional increases in the reserve will not be required. The Company may from time-to-time be required to repurchase loans previously sold to investors due to loan nonperformance. At December 31, 2019 and 2018, CSM had a contingency reserve of $152 and $173, respectively, for potential indemnifications to other third-party purchasers.

Premises, Furniture and Equipment
Premises, furniture and equipment are stated at cost, less accumulated depreciation. The provision for depreciation is computed by the straight-line method, based on the estimated useful lives for buildings of 30 to 40 years and software, furniture and equipment of 3 to 10 years. Leasehold improvements are amortized over the life of the respective leases or over the useful life of the asset. The cost of assets sold or otherwise disposed of and the related allowance for depreciation are eliminated from the accounts and the resulting gains or losses are reflected in the Consolidated Statements of Operations when incurred. Routine maintenance and repairs are charged to current expense. The costs of major repairs and improvements are capitalized. Premises and equipment are evaluated for impairment whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable.

Other Real Estate Owned
Other real estate owned ("OREO") includes assets that have been acquired in satisfaction of debt through foreclosure. OREO is recorded at the lower of cost or fair value, minus estimated costs to sell. Subsequent to foreclosure, losses resulting from the periodic revaluation of the property are charged to loss on other real estate owned, net and a new carrying value is established. Any gains or losses realized at the time of disposal or

(In thousands of dollars, except share data)

subsequent write-downs are reflected in the Consolidated Statements of Operations. Expenses to maintain such assets are included in net cost of operation of other real estate owned.

Other Borrowings
The Federal Home Loan Bank ("FHLB") allows the Company to obtain advances through its credit program. These advances are secured by securities owned by the Company and held in safekeeping by the FHLB, FHLB stock owned by the Company, and certain qualifying loans secured by real estate, including residential mortgage loans, home equity lines of credit and commercial real estate loans. FHLB stock is carried at cost, classified as a restricted security, and periodically evaluated for impairment based on ultimate recovery of par value. Both cash and stock dividends are reported as income.

Income Taxes
Income tax expense is based upon income before income taxes and generally differs from income taxes paid due to deferred income taxes and benefits arising from income and expenses being recognized in different periods for financial and income tax reporting purposes, as well as permanent differences. The Company uses the asset and liability method to account for deferred income taxes. The objective of the asset and liability method is to establish deferred tax assets and liabilities for the temporary differences between the financial reporting basis and the income tax basis of the Company's assets and liabilities at the effective rates expected to be in effect when such amounts are realized or settled. The Company evaluates the realization of deferred tax assets based upon all positive and negative evidence available at the balance sheet date. Realization of deferred tax assets is based upon the Company's judgments, including taxable income within any applicable carryback periods, future projected taxable income, reversal of taxable temporary differences and other tax-planning strategies to maximize realization of the deferred tax assets. A valuation allowance is recognized for a deferred tax asset if, based upon the weight of available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. In computing the income tax provision or benefit, the Company evaluates the technical merits of its income tax positions based upon current legislative, judicial and regulatory guidance.

The Company continually monitors and evaluates the potential impact of current events on the estimates used to establish income tax expense and income tax liabilities. The Company and its Subsidiary file a consolidated federal income tax return and separate state income tax returns based upon current tax law, positions taken by various tax auditors within the jurisdictions that the Company is required to file income tax returns, as well as potential or pending audits or assessments by such tax auditors. If the Company incurs interest and/or penalties related to income tax matters it will report them as a part of income tax expense.

The Company believes that its income tax filing positions taken or expected to be taken in its tax returns will more likely than not be sustained upon audit by the taxing authorities and does not anticipate any adjustments that will result in a material adverse impact on the Company's financial condition, results of operations, or cash flow. Therefore, no reserves for uncertain income tax positions have been recorded.

Retirement Plan
The Company has a 401(k) profit sharing plan (the "Plan"), which provides retirement benefits to officers and employees who meet certain age and service requirements. The Plan includes a salary reduction feature pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended (the "Code"). At its discretion, the Bank makes matching contributions to the Plan. Employer contributions for the 401(k) profit sharing plan were $376 and $292 in 2019 and

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2018, respectively, and are included in salaries and employee benefits.

Net Income (Loss) Per Common Share
Basic net income (loss) per common share represents income (loss) available to stockholders divided by the weighted-average number of common shares outstanding during the period. Dilutive income (loss) per share reflects additional common shares that would have been outstanding if dilutive potential common shares had been issued. Potential common shares that may be issued by the Company relate solely to outstanding options, warrants and restricted stock units are determined using the treasury stock method. Potential common shares are not included in the denominator of the diluted per share computation when inclusion would be anti-dilutive.

Comprehensive Income (Loss)
Other comprehensive income (loss) is defined as the change in stockholders' equity during the period from transactions and other events and circumstances from nonowner sources. Accumulated other comprehensive income (loss) includes the reclassification for realized gains and losses from investment securities sales during the period and the unrealized holding gains and losses from investment securities available-for-sale.

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

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

Stock-Based Compensation
The Company grants stock options, restricted stock units, and other equity awards to purchase its common stock to certain key officers/employees and directors. Stock options are for a fixed number of shares with an exercise price equal to the fair value of the shares at the grant date. The fair value of stock options is determined using the Black-Scholes model. The fair value of restricted stock units when granted is the fair value of the stock on the grant date. Stock-based compensation expense is recognized in the Consolidated Statements of Operations on a straight-line basis over the vesting period. In addition, the Company estimates the number of awards for which vesting is probable and adjusts compensation cost accordingly. For nonqualified stock options, as compensation expense is recognized, a deferred tax asset is recorded that represents an estimate of the future tax deduction from exercise. At the time that stock-based awards are exercised, cancelled, or expire, the Company may be required to recognize an adjustment to income tax expense. For incentive stock options, the Company does not recognize an income tax benefit related to compensation expense in the period incurred or when exercised, unless there is a disqualifying disposition.

Fair Value
US GAAP requires the use of fair values in determining the carrying values of certain assets and liabilities, as well as

for specific disclosures. Fair value is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between willing market participants at the measurement date. When determining the fair value measurements for assets and liabilities, the Company considers the principal or most advantageous market in which those assets or liabilities are sold and considers assumptions that market participants would use when pricing those assets or liabilities.

Individual fair value estimates are classified on a three-tiered scale based upon the relative reliability of the inputs used in the valuation. Fair values determined using Level 1 inputs rely on active and observable markets to price identical assets or liabilities. In situations where identical assets and liabilities are not traded in active markets, fair values may be determined based upon Level 2 inputs, which are used when observable data exists for similar assets and liabilities. Fair values for assets and liabilities that are not actively traded in observable markets are based upon Level 3 inputs, which are considered to be unobservable.

Business Combinations
The Company applies the acquisition method of accounting for all business combinations. The acquirer is the entity that obtains control of one or more businesses in the business combination and the acquisition date is the date the acquirer achieved control. The acquirer recognizes the fair value of assets acquired, liabilities assumed and any non-controlling interest in the acquiree at the acquisition date. If the fair value of assets purchased exceeded the fair value of liabilities assumed, it results in a gain on acquisition. If the consideration given exceeds the fair value of the net assets received, goodwill is recognized. Generally, fair values are subject to refinement for up to one year after the closing date of an acquisition as information relative to closing date fair values becomes available (the "measurement period"). During the measurement period, the Company may recognize adjustments to the initial amounts recorded as if the accounting for the business combination had been completed at the acquisition date. Adjustments are typically recorded as a result of new information received after the acquisition date that is necessary to identify and measure identifiable assets acquired and liabilities assumed. In many cases, the determination of acquisition-date fair values requires management to make estimates about discount rates, future expected cash flows, market conditions, and other future events that are subjective in nature and subject to change.

The following is a description of the methods used to determine the fair values of significant assets and liabilities acquired:

Cash and Due from Banks
The carrying amount of these assets is expected to reasonably approximate fair value given the short-term nature of the assets.

Investment Securities Available-for-sale
The fair value of investment securities is determined by quoted market prices at the time of acquisition.

Loans
The fair value of acquired loans is based upon a discounted cash flow methodology that considered factors including the type of loans and related collateral, classification status, fixed or variable interest rate, loan term, whether or not the loan was amortizing, and a market discount rate reflecting risks inherent in the acquired loans, including potential prepayments. The fair value of acquired loans includes both a rate-based

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valuation mark, representing the carrying value of discount required to establish the appropriate effective yield for acquired loans, as well as a credit-based valuation mark representing the valuation adjustment applied to acquired loans related to credit loss assumptions.

Other Real Estate Owned
The fair value of other real estate owned is estimated based upon the value that management expects to receive when the property is sold, net of related costs of disposal.

Core Deposit Intangibles
The fair value of core deposit intangibles is estimated based upon a discounted cash flow methodology that gives consideration to expected customer attrition rates, cost of the deposit base, and the net maintenance cost attributable to customer deposits.

Premises and Equipment
The fair value of premises and equipment is estimated based upon independent appraisals or broker price opinions.

Other Assets
Other assets generally include accrued interest that has been earned on borrowers' loans or investment securities not yet received and prepaid expenses. The carrying value of these assets is expected to reasonably approximate fair value.

Deposits
The fair values used for the noninterest-bearing deposits that comprise the transactions accounts acquired closely approximate the amount payable on demand at the acquisition date and thus reasonably approximate fair value. The fair value of interest-bearing deposits is estimated based upon a discounted cash flow methodology. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Deferred Tax Assets and Liabilities
Deferred tax assets and liabilities are temporary differences between the carrying amount of an asset or a liability recognized in the Consolidated Balance Sheets and the related tax basis for the asset or liability using enacted tax rates in effect for the year in which the differences are expected to be recovered.

Other Liabilities
Other liabilities generally include accrued interest on deposit accounts, accrued expenses, and additional accounts held in escrow. The carrying value of these liabilities is expected to reasonably approximate fair value.

Operating Segments
Accounting Standards require that information be reported about a company's operating segments using a "management approach." Reportable segments are identified in these standards as those revenue producing components for which separate financial information is produced internally and which are subject to evaluation

(In thousands of dollars, except share data)

by the chief operating decision maker. While the chief operating decision maker monitors the revenue streams of the various products and services, operations are managed, and financial performance is evaluated on a Company-wide basis. Accordingly, all of the financial service operations are considered by management to be aggregated in one reportable segment.

Reclassifications
Certain captions and amounts in the 2018 consolidated financial statements were reclassified to conform with the 2019 presentation. These reclassifications had no effect on the net results of operations or stockholders' equity.

Recently Issued Accounting Pronouncements
The Company is registered with OTCQX, and as a result, the Company is classified as a public business entity for the purposes of adopting new accounting pronouncements. The following table summarizes Accounting Standard Updates ("ASUs") which update various topics of the Accounting Standards Codification ("ASC") recently issued by the Financial Accounting Standards Board ("FASB") that could have a material effect on the Company's financial statements:

Standards Adopted in 2019			
Standard	**Description**	**Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2016-02, *Leases*	The ASU creates ASC Topic 842, *Leases*, which supersedes ASC Topic 840, *Leases*. ASC Topic 842 requires lessees to recognize right-of-use assets and associated liabilities that arise from leases, with the exception of short-term leases. The ASU does not make significant changes to lessor accounting; however, there were certain improvements made to align lessor accounting with the lessee accounting model and ASC Topic 606, *Revenue from Contracts with Customers*. There are several new qualitative and quantitative disclosures required. Upon transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach.	January 1, 2019	The Company adopted the standard on January 1, 2019, using the modified retrospective transition approach as of the date of adoption. As a result of the adoption of ASU 2016-02, the Company initially recognized an operating lease right-of-use ("ROU") asset of $978 and an operating lease liability of $998, with no significant impact on the Company's consolidated financial statements or equity and related disclosures. See Note 12. *Leases* for more details.
ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*	This ASU amends ASC Topic 350, Intangibles – Goodwill and Other, to simplify the subsequent measurement of goodwill, by eliminating Step 2 from the goodwill impairment test. The amendments require an entity to perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. This ASU requires an entity to recognize an impairment charge for the amount by which a reporting unit's carrying amount exceeds its fair value, with the loss limited to the total amount of goodwill allocated to that reporting unit. The ASU must be applied on a prospective basis.	October 1, 2019	The Company adopted the standard on October 1, 2019, and the adoption did not have a significant impact on the Company's consolidated financial statements and related disclosures.

(In thousands of dollars, except share data)

Standards Not Yet Adopted			
Standard	**Description**	**Required Date of Adoption**	**Effect on the Financial Statements or Other Significant Matters**
ASU 2016-13, *Measurement of Credit Losses on Financial Instruments, as amended*	The ASU amends ASC Topic 326, Financial Instruments- Credit Losses, to replace the incurred loss impairment methodology with a current expected credit loss ("CECL") methodology for financial instruments measured at amortized cost and other commitments to extend credit. For this purpose, expected credit losses reflect losses over the remaining contractual life of an asset, considering the effect of voluntary prepayments and considering available information about the collectability of cash flows, including information about past events, current conditions, and reasonable and supportable forecasts. The resulting allowance for credit losses reflects the portion of the amortized cost basis that the entity does not expect to collect. Additional quantitative and qualitative disclosures are required upon adoption. The CECL model does not apply to AFS debt securities; however, the ASU requires entities to record an allowance when recognizing credit losses for AFS securities, rather than recording a direct write-down of the carrying amount.	January 1, 2023 Early adoption is permitted.	The Company is evaluating the impact that this ASU will have on its consolidated financial statements and related disclosures, and the Company currently anticipates that an increase to the allowance for credit losses will be recognized upon adoption to provide for the expected credit losses over the estimated life of the financial assets. In addition to our allowance for loan losses, we may also be required to record an allowance for credit losses on debt securities instead of applying the impairment model currently utilized. However, since the magnitude of the anticipated increase in the allowance for credit losses will be impacted by economic conditions and trends in the Company's portfolio at the time of adoption, the quantitative impact cannot yet be reasonably estimated.

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

Note 2. Business Combinations

First Citizens Financial Corporation

On July 17, 2018, the Company acquired 100% of the outstanding shares of First Citizens Financial Corporation ("FCFC"), the parent company of Georgia state-chartered Foothills Community Bank ("FCB"), headquartered in Dawsonville, Georgia. Upon consummation of the acquisition, FCFC was merged with and into the Company, with the Company as the surviving entity in the merger; concurrently, FCB was merged with and into CSB. Through the acquisition, the Company entered the North Georgia market and expanded its deposit base to fund planned future growth. FCB operated two retail bank branches located in Dawsonville, Georgia and Cumming, Georgia, respectively.

Under the terms of the acquisition, FCFC's accredited common shareholders received 0.033 shares of the Company's common stock in exchange for each share of FCFC common stock. $12,524 of total consideration transferred was comprised of 695,888 shares of the Company's voting common stock issued at $15.75 per share, and $1,564 of cash. The fair value of the common shares issued as part of the consideration paid for FCFC was determined in the basis of the closing price of the Company's common shares on the acquisition date.

Goodwill of $4,708 arising from the acquisition consisted of synergies resulting from the combining of the operation of the companies, and it is not deductible for tax purposes. Acquisition-related costs of $235 were included in other noninterest expense in the Company's Consolidated Statements of Operations the year ended December 31, 2018.

(In thousands of dollars, except share data)

The following table summarizes the consideration paid for FCFC and the amounts of the assets and liabilities acquired and assumed, respectively, recognized at the acquisition date:

	Carrying Value Acquired	Purchase Adjustments	As Recorded by CSB
Assets			
Cash and due from banks	$ 20,234	$ -	$ 20,234
Investment securitues	131	-	131
Loans, net	70,881	(945)	69,936
Property, plant and equipment	6,268	(226)	6,042
Intangible assets	87	1,431	1,518
Bank owned life insurance	1,608	-	1,608
Deferred tax asset	-	1,863	1,863
Other assets	1,979	(64)	1,915
Total assets acquired	101,188	2,059	103,247
Liabilities			
Deposits			
Noninterest-bearing	16,073	-	16,073
Interesting-bearing	78,118	231	78,349
Total deposits	94,191	231	94,422
Other liabilities	1,009	-	1,009
Total liabilities assumed	95,200	231	95,431
Net identifiable assets acquired	$ 5,988	$ 1,828	$ 7,816
Consideration			
Voting common stock			$ 10,960
Cash			1,564
Total consideration transferred to FCFC			12,524
Goodwill			$ 4,708

The loans acquired had gross contractual amounts receivable of $92,483. At the acquisition date CSB's current estimate of expected cash flows to be collected was $89,529. Acquired loans were evaluated to determine if they were purchased credit-impaired (PCI). PCI loans are loans with evidence of deterioration of credit quality since origination for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable. No PCI loans were identified as part of this business combination.

(In thousands of dollars, except share data)

Note 3. Investment Securities

The amortized cost and estimated fair values of securities available-for-sale at December 31, 2019 and 2018 are shown in the tables below:

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$ 46,146	$ 432	$ 247	$ 46,331
Government-sponsored agencies	422	-	1	421
Obligations of corporations	7,000	102	-	7,102
Municipal obligations	7,121	427	24	7,524
Total securities available-for-sale	$ 60,689	$ 961	$ 272	$ 61,378

	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Mortgage backed securities	$ 44,204	$ 14	$ 815	$ 43,403
Government-sponsored agencies	3,525	4	25	3,504
Obligations of corporations	4,000	12	14	3,998
Municipal obligations	8,892	149	76	8,965
Total securities available-for-sale	$ 60,621	$ 179	$ 930	$ 59,870

Proceeds from sales of securities available-for-sale during 2019 and 2018 were $8,079 and $13,716, respectively, resulting in gross realized gains of $619 and $14, respectively. There were no gross realized losses in either of the reporting periods.

The following is a summary of maturities of securities available-for-sale as of December 31, 2019. The amortized cost and estimated fair values are based on the contractual maturity dates. Actual maturities may differ from contractual maturities because borrowers may have the right to call or repay obligations with or without penalty. Mortgaged-backed securities are not presented by maturity date because pay-downs are expected before contractual maturity dates.

(In thousands of dollars, except share data)

	Amortized Cost	Estimated Fair Value
Due after one year but within five years	$ 6,423	$ 6,507
Due after five years but within ten years	4,020	4,301
Due after ten years	4,100	4,239
Mortgage backed securities	46,146	46,331
Total	$ 60,689	$ 61,378

The following table shows gross unrealized losses and fair value of securities available for sale, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2019.

	Less than Twelve months		Twelve months or more		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Mortgage backed securities	$ 12,738	$ 143	$ 7,037	$ 104	$ 19,775	$ 247
Government-sponsored agencies	127	-	294	1	421	1
Municipal obligations	2,976	24	-	-	2,976	24
	$ 15,841	$ 167	$ 7,331	$ 105	$ 23,172	$ 272

The following table shows gross unrealized losses and fair value of securities available for sale, aggregated by investment category, and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2018.

	Less than Twelve months		Twelve months or more		Total	
	Fair Value	Unrealized losses	Fair Value	Unrealized losses	Fair Value	Unrealized losses
Mortgage backed securities	$ 12,511	$ 256	$ 28,862	$ 559	$ 41,373	$ 815
Government-sponsored agencies	-	-	2,408	25	2,408	25
Obligations of corporations	1,486	14	-	-	1,486	14
Municipal obligations	492	3	2,911	73	3,403	76
	$ 14,489	$ 273	$ 34,181	$ 657	$ 48,670	$ 930

Securities classified as available-for sale are recorded at fair market value. Of the securities in an unrealized loss position at December 31, 2019, eighteen securities were in a continuous loss position for twelve months or more. The Company believes, based on industry analyst reports and credit ratings, that the deterioration in value is attributable to changes in market interest rates and is not in the credit quality of the issuer and therefore, these losses are not considered other-than-temporary.

The Company evaluates securities available-for-sale for other-than-temporary impairment on an annual basis and more frequently when economic conditions warrant. In performing this evaluation at December 31, 2019, the length of time and the extent to which the fair value has been less than cost, the fact that the Company's securities are primarily issued by U.S. Government agencies and the cause of the decline in value are considered. In addition, the Company does not intend to sell, and it is not more likely than not that we will be required to sell, these securities before maturity. As a result of this evaluation, the Company has determined that the declines summarized in the tables above are not deemed to be other-than-temporary. There can be no assurance that the Company will not conclude in future periods that conditions existing at that time indicate some or all of these securities may be sold or are other than temporarily impaired, which would require a charge to earnings in such periods.

During 2019 and 2018, the Company recognized a net gain (loss) on changes in market value of $21 and ($71), respectively, to reflect the change in fair value of equity securities.

At December 31, 2019 and 2018, investment securities with a book value of $38,568 and $47,825, respectively, and a market value of $38,849 and $47,594, respectively, were pledged to secure federal funds lines of credit and Federal Home Loan Bank borrowings.

Note 4. Loans and Allowance for Loan Losses

Composition of Loan Portfolio

The Company engages in a full complement of lending activities, including real estate-related loans, construction loans, commercial and industrial loans, and consumer purpose loans. While risk of loss in the Company's portfolio is primarily tied to the credit quality of the various borrowers, risk of loss may increase due to factors beyond the Company's control, such as local, regional and/or national economic downturns. General conditions in the real estate market may also impact the relative risk in the real estate portfolio.

Construction and land loans include loans for the development of residential neighborhoods, construction of one-to-four family residential construction loans to builders, commercial real estate construction loans, primarily for owner-occupied properties, and other loans for land investment. Construction loans generally carry a higher degree of risk than long-term financing of existing properties because repayment depends upon the ultimate completion of the project and usually on the subsequent lease-up and/or sale of the property. The Company limits its construction lending risk through adherence to established underwriting procedures.

Commercial real estate loans include loans secured by owner-occupied commercial buildings for office, storage, retail, farmland, and warehouse space. They also include non-owner occupied commercial buildings such as leased retail and office space, multi-family properties, and senior housing developments. The primary risk associated with loans secured with income-producing property is the inability of that property to produce adequate cash flow to service the debt. High unemployment, generally weak economic conditions and/or an oversupply in the market may result in our customers having difficulty achieving adequate occupancy rates. Payments on such loans are often dependent on successful operation or management of the properties.

(In thousands of dollars, except share data)

Commercial and industrial loans include both secured and unsecured loans for working capital, expansion, and other business purposes. Short-term working capital loans may be secured by non-real estate collateral such as accounts receivable, inventory, and/or equipment. The Company evaluates the financial strength, cash flow, management, credit history of the borrower and the quality of the collateral securing the loan. Repayment is primarily dependent on the ability of the borrower to achieve business results consistent with those projected at loan origination resulting in cash flow sufficient to service the debt. To the extent that a borrower's business results are significantly unfavorable versus the original projections, the ability for the loan to be serviced on a basis consistent with the contractual terms may be at risk. The Company often requires personal guarantees and secondary sources of repayment on commercial and industrial loans.

Residential real estate loans include permanent mortgage financing, construction loans to individual consumers, and home equity lines of credit. These loans are secured by residential properties. Significant and rapid declines in real estate values can result in residential mortgage loan borrowers having debt levels in excess of the current market value of the collateral.

Consumer purpose loans primarily includes purchased student loans and purchased consumer unsecured loans. Consumer loans may carry greater risks than other loans, as these loans are generally unsecured.

Loans held for sale are comprised of loans acquired through mortgage warehouse lending activities and mortgage banking activities. The Company serves as a warehouse lender by purchasing loans originated by third-party mortgage originators and selling these loans to other third-party investors. The Company also originates mortgage loans with customers through CSM and sells these loans to third-party investors.

Following is a summary of the composition of the loan portfolio at December 31, 2019 and 2018:

	2019	2018
Commercial loans:		
Construction and land	$ 42,708	$ 30,609
Commercial real estate	240,525	162,509
Commercial and industrial	78,485	56,247
Consumer loans:		
Residential real estate	63,836	70,387
Other consumer [1]	42,772	56,994
Total gross LHFI	468,326	376,746
Less allowance for loan losses	(3,936)	(2,919)
LHFI, net	$ 464,390	$ 373,827
LHFS [2]	$ 81,243	$ 32,641

[1] Includes $26,541 and $36,627 of student loans acquired from Laurel Road Bank, and $13,144 and $17,219 of marine loans acquired from Radius Bank as of December 31, 2019 and 2018, respectively.

[2] Includes $81,243 and $32,641 in loans acquired through MBF as of December 31, 2019 and 2018, respectively.

(In thousands of dollars, except share data)

Credit Quality Indicators

The Company monitors the credit quality of its commercial loan portfolio using internal credit risk ratings. These credit risk ratings are based upon established regulatory guidance and are assigned upon initial approval of credit to borrowers. Credit risk ratings are updated periodically after the initial assignment or whenever management becomes aware of information affecting the borrowers' ability to fulfill their obligations. The Company utilizes the following categories of credit grades to evaluate its commercial loan portfolio:

Pass - Loans classified as pass are higher quality loans that do not fit any of the other categories below.

Special Mention - Loans classified as special mention have a potential weakness that deserves management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan or of the Company's credit position at some future date.

Substandard - Loans classified as substandard are inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans so classified have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

Doubtful - Loans classified as doubtful have all the weaknesses inherent in those classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The possibility of loss is high, but because of certain important and reasonably specific pending factors that may work to the advantage and strengthening of the credit quality of the loan, its classification as an estimated loss is deferred until its more exact status may be determined. Pending factors include proposed merger, acquisition, or liquidation procedures, capital injection, perfecting liens on additional collateral and refinancing plans.

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio as of December 31, 2019:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Total
Pass	$ 42,554	$ 233,771	$ 76,244	$ 352,569
Special mention	100	2,067	1,890	4,057
Substandard	54	4,687	351	5,092
Doubtful	-	-	-	-
Total	$ 42,708	$ 240,525	$ 78,485	$ 361,718

(In thousands of dollars, except share data)

The following table shows the credit quality indicators associated with the Company's commercial loan portfolio as of December 31, 2018:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Total
Pass	$ 29,390	$ 157,958	$ 54,310	$ 241,658
Special mention	1,219	2,063	1,157	4,439
Substandard	-	2,488	780	3,268
Doubtful	-	-	-	-
Total	$ 30,609	$ 162,509	$ 56,247	$ 249,365

The Company monitors the credit quality of its consumer portfolio based primarily on payment activity and credit scores. Payment activity is the primary factor considered in determining whether a consumer loan should be classified as nonperforming.

The following table shows the credit quality indicators associated with the Company's consumer loan portfolio as of December 31, 2019:

	Residential Real Estate	Other Consumer	Total
Performing	$ 61,940	$ 42,772	$104,712
Nonperforming	1,896	-	1,896
Total	$ 63,836	$ 42,772	$106,608

The following table shows the credit quality indicators associated with the Company's consumer loan portfolio as of December 31, 2018:

	Residential Real Estate	Other Consumer	Total
Performing	$ 67,051	$ 56,994	$124,045
Nonperforming	3,336	-	3,336
Total	$ 70,387	$ 56,994	$127,381

(In thousands of dollars, except share data)

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2019:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Other Consumer	Total
Allowance for loan losses:						
Beginning balance:	$ 164	$ 435	$ 536	$ 1,182	$ 602	$ 2,919
Charge-offs	-	-	(579)	(659)	(196)	(1,434)
Recoveries	-	309	134	129	12	584
Provision (Release)	167	943	1,167	(167)	(243)	1,867
Ending balance	$ 331	$ 1,687	$ 1,258	$ 485	$ 175	$ 3,936
Ending balances:						
Individually evaluated for impairment	$ -	$ 350	$ 227	$ 127	$ -	$ 704
Collectively evaluated for impairment	$ 331	$ 1,337	$ 1,031	$ 358	$ 175	$ 3,232
Loans receivable:						
Ending balance - total	$ 42,708	$ 240,525	$ 78,485	$ 63,836	$ 42,772	$ 468,326
Ending balances:						
Individually evaluated for impairment	$ -	$ 3,282	$ 227	$ 2,722	$ -	$ 6,231
Collectively evaluated for impairment	$ 42,708	$ 237,243	$ 78,258	$ 61,114	$ 42,772	$ 462,095

(In thousands of dollars, except share data)

The following is a summary of information pertaining to our allowance for loan losses at December 31, 2018:

	Construction and Land	Commercial Real Estate	Commercial and Industrial	Residential Real Estate	Other Consumer	Total
Allowance for loan losses:						
Beginning balance:	$ 202	$ 817	$ 411	$ 1,091	$ 1,394	$ 3,915
Charge-offs	(112)	(541)	(46)	(484)	(2,407)	(3,590)
Recoveries	8	5	50	314	523	900
Provision	66	154	121	261	1,092	1,694
Ending balance	$ 164	$ 435	$ 536	$ 1,182	$ 602	$ 2,919
Ending balances:						
Individually evaluated for impairment	$ -	$ -	$ 66	$ 714	$ -	$ 780
Collectively evaluated for impairment	$ 164	$ 435	$ 470	$ 468	$ 602	$ 2,139
Loans receivable:						
Ending balance - total	$ 30,609	$ 162,509	$ 56,247	$ 70,387	$ 56,994	$ 376,746
Ending balances:						
Individually evaluated for impairment	$ -	$ 2,534	$ 134	$ 4,742	$ 15	$ 7,425
Collectively evaluated for impairment	$ 30,609	$ 159,975	$ 56,113	$ 65,645	$ 56,979	$ 369,321

(In thousands of dollars, except share data)

The following summarizes the Company's impaired loans at December 31, 2019:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	2,051	2,508	-	3,048	17
Commercial and industrial	-	-	-	-	-
Residential real estate	2,034	2,458	-	2,578	13
Other consumer	-	-	-	-	-
Ending balance	$ 4,085	$ 4,966	$ -	$ 5,626	$ 30
With an allowance recorded:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	1,231	1,248	350	1,269	42
Commercial and industrial	227	227	227	210	8
Residential real estate	688	688	127	700	-
Other consumer	-	-	-	-	-
Ending balance	$ 2,146	$ 2,163	$ 704	$ 2,179	$ 50
Total:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	3,282	3,756	350	4,317	59
Commercial and industrial	227	227	227	210	8
Residential real estate	2,722	3,146	127	3,278	13
Other consumer	-	-	-	-	-
Ending balance	$ 6,231	$ 7,129	$ 704	$ 7,805	$ 80

(In thousands of dollars, except share data)

The following summarizes the Company's impaired loans at December 31, 2018:

	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance needed:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	2,534	2,840	-	2,805	22
Commercial and industrial	1	1	-	3	-
Residential real estate	2,433	2,657	-	2,563	89
Other consumer	15	15	-	16	1
Ending balance	$ 4,983	$ 5,513	$ -	$ 5,387	$ 112
With an allowance recorded:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-
Commercial and industrial	133	136	66	148	4
Residential real estate	2,309	2,329	714	2,332	106
Other consumer	-	-	-	-	-
Ending balance	$ 2,442	$ 2,465	$ 780	$ 2,480	$ 110
Total:					
Construction and land	$ -	$ -	$ -	$ -	$ -
Commercial real estate	2,534	2,840	-	2,805	22
Commercial and industrial	134	137	66	151	4
Residential real estate	4,742	4,986	714	4,895	195
Other consumer	15	15	-	16	1
Ending balance	$ 7,425	$ 7,978	$ 780	$ 7,867	$ 222

The following is a summary of past due and nonaccrual loans as of December 31, 2019:

	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Construction and land	$ 78	$ -	$ -	$ -	$ 78	$ 42,630	$ 42,708
Commercial real estate	286	-	-	3,296	3,582	236,943	240,525
Commercial and industrial	60	-	-	227	287	78,198	78,485
Residential real estate	492	-	-	1,896	2,388	61,448	63,836
Other consumer	37	11	-	-	48	42,724	42,772
	$ 953	$ 11	$ -	$ 5,419	$ 6,383	$ 461,943	$ 468,326

(In thousands of dollars, except share data)

The following is a summary of past due and nonaccrual loans as of December 31, 2018:

	30-59 Days Past Due	60-89 Days Past Due	Over 90 Days and Accruing	Nonaccrual	Total Past Due and Nonaccrual	Current	Total Loans Receivable
Construction and land	$ 25	$ -	$ -	$ -	$ 25	$ 30,584	$ 30,609
Commercial real estate	-	-	-	2,488	2,488	160,021	162,509
Commercial and industrial	10	3	-	133	146	56,101	56,247
Residential real estate	287	-	-	3,336	3,623	66,764	70,387
Other consumer	2	83	-	-	85	56,909	56,994
	$ 324	$ 86	$ -	$ 5,957	$ 6,367	$ 370,379	$ 376,746

Troubled Debt Restructurings

The following table summarizes the carrying balance of troubled debt restructurings ("TDRs") as of December 31, 2019 and 2018:

	2019	2018
Performing TDRs	$ 875	$ 1,468
Nonperforming TDRs	783	1,309
Total TDRs	$ 1,658	$ 2,777

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

There were no TDRs identified during the year ended December 31, 2019 or 2018. There were no TDRs that were restructured in the previous twelve months which re-defaulted during the years ended December 31, 2019 and 2018.

There were no TDRs identified during the years ended December 31, 2019 and 2018.

(In thousands of dollars, except share data)

Note 5. Premises, Furniture and Equipment

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

	2019	2018
Buildings and improvements	$ 9,450	$ 7,880
Land	4,023	3,451
Furniture and equipment	3,459	3,272
Leasehold and land improvements	2,399	2,392
Software	1,124	1,073
Vehicles	39	39
Construction in progress	507	-
Total	21,001	18,107
Less: accumulated depreciation and amortization	(6,721)	(6,060)
Premises, furniture and equipment, net	$ 14,280	$ 12,047

Depreciation expense for the years ended December 31, 2019 and 2018 was $695 and $555, respectively.

Note 6. Other Assets

Other assets consisted of the following as of December 31:

	2019	2018
Accrued interest receivable	$ 2,167	$ 1,922
Prepaid expense	875	819
Right of use assets	591	-
Accounts receivable	190	143
Current income tax receivable	57	194
Other	683	411
Total	$ 4,563	$ 3,489

(In thousands of dollars, except share data)

Note 7. Other Real Estate Owned

The following summarizes the activity in the other real estate owned for the years ended December 31:

	2019	2018
Balance, beginning of year	$ 2,117	$ 4,172
Additions - foreclosures	-	49
Sales	(214)	(1,836)
Writedowns	(398)	(268)
Balance, end of year	$ 1,505	$ 2,117

A net (loss)/gain of ($1) and $5 were recognized on the sale of other real estate owned for the years ended December 31, 2019 and 2018, respectively, and are included in the net cost of operation of other real estate owned in the Consolidated Statements of Operations. Other real estate expenses for the years ended December 31, 2019 and 2018 were $181 and $275, respectively, and are included in other operating expenses.

There were no repossessed assets at December 31, 2019 and 2018, respectively. There were no repossessed asset write-downs for the years ended December 31, 2019 and 2018.

There were $653 and $1,417 of residential real estate loans in the process of foreclosure at December 31, 2019 and 2018, respectively.

Note 8. Goodwill and Intangible Assets

The Company's carrying amount of goodwill at December 31, 2019, and 2018 and changes to the goodwill are summarized as follows:

	2019	2018
Beginning of year	$ 4,708	$ -
Acquired goodwill	-	4,708
Impairment	-	-
End of year	$ 4,708	$ 4,708

Goodwill was recognized as a result of the Company's acquisition of First Citizens Financial Corporation in 2018. In the fourth quarter of 2019, the Company performed its annual goodwill impairment evaluation and the management bypassed the qualitative assessment for each respective reporting unit and performed the quantitative assessment of the goodwill impairment test. The Quantitative assessment of the goodwill impairment test requires a comparison of the fair value of our reporting unit with its carrying amount, including goodwill. Accordingly, the Company determined the fair value of our reporting unit and compared the fair value to the reporting unit's carrying amount and determined that our reporting unit's fair value exceeded its carrying amount. Therefore, the Company concluded

(In thousands of dollars, except share data)

that our goodwill was not impaired. There are no events that have occurred since the last annual goodwill impairment assessment that would necessitate an interim goodwill impairment assessment. For additional information on goodwill, see *Note 2: Business Combinations*, to the consolidated financial statements.

The Company also has other intangible assets at December 31, 2019 and 2018, presented in the following table:

	2019			2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
Definite-lived intangible assets:						
Core deposit intangibles	$ 1,240	$ 325	$ 915	$ 1,240	$ 101	$ 1,139
Commercial mortgage servicing rights	989	186	803	518	43	475
Total	$ 2,229	$ 511	$ 1,718	$ 1,758	$ 144	$ 1,614

Core deposit intangibles are amortized over their estimated useful lives, which the Company determined is ten years. Amortization expense of $224 and $101 at December 31, 2019 and 2018, respectively, was recognized in other noninterest expense.

Commercial mortgage servicing rights arise from the sale of participating interests in government guaranteed loans to third parties where servicing is retained by the Company. These assets are amortized over the expected remaining life of the related loan. Amortization expense of $143 and $43 at December 31, 2019 and 2018, respectively, was recognized in other noninterest income related to these intangible assets.

The Company's estimated future amortization of intangible assets at December 31, 2019 is presented in the following table:

2020	$ 315
2021	276
2022	239
2023	203
2024	168
Thereafter	517
Total expected amortization	$ 1,718

Contractually specified servicing fees related to commercial mortgage servicing rights of $353 and $84 was recognized in other noninterest income during the years ended December 31, 2019 and 2018, respectively. The principal balance of loans serviced for third parties was $49,404 and $26,240 at December 31, 2019 and 2018, respectively.

(In thousands of dollars, except share data)

A rollforward of each class of commercial mortgage servicing rights is presented as follows:

	For the years ended December 31,							
	2019				2018			
	SBA		USDA		SBA		USDA	
Beginning carrying value, net	$	343	$	132	$	-	$	-
Amortization		(102)		(22)		(38)		(5)
Servicing rights originated		246		225		104		137
Servicing rights purchased		-		-		277		-
Servicing rights sold		-		-		-		-
Other-than-temporary impairment		(19)		-		-		-
Ending carrying value, net	$	468	$	335	$	343	$	132

The fair value of the commercial mortgage servicing rights approximated carrying value at December 31, 2019 and 2018.

Note 9. Deposits

At December 31, 2019, the scheduled maturities of certificates of deposit were as follows:

Maturing In	Amount	
2020	$	107,103
2021		51,694
2022		5,959
2023		549
2024 and thereafter		599
Total	$	165,904

The Company had $36,700 and $18,393 in brokered deposits at December 31, 2019 and 2018, respectively. Of these brokered deposits, $15,756 and $18,393 were reciprocal deposits at December 31, 2019 and 2018.

Time deposits that meet or exceed the FDIC Insurance limit of $250 at December 31, 2019 and 2018 were $30,145 and $18,809, respectively.

(In thousands of dollars, except share data)

Note 10. Other Borrowings

The Company has the following other borrowings at December 31, 2019 and 2018:

	2019	2018
Federal Home Loan Bank advance	$ 10,000	$ -
Subordinated debt	-	500
Total	$ 10,000	$ 500

At December 31, 2019, the Company had $10,000 of FHLB advances, which are structured as ten-year fixed rate advances with a call option every three months. If the call option is not exercised, the advances will mature on November 20, 2029. The interest rate of the FHLB advances is 0.8175%.

The Company had pledged investment securities at December 31, 2019 and 2018, totaling $35,252 and $40,221, respectively, as collateral for the FHLB advances. The Company's FHLB stock is also pledged to secure the borrowings. In addition, the Company has pledged blanket liens on its first mortgages 1-4 family residential loans, second mortgages 1-4 family residential loans, including open-ended loans and closed-end 1-4 family residential properties, and commercial real estate loans. The aggregate balance of identified pledgable loans totaled $51,978 and $29,764 at December 31, 2019 and 2018, respectively. Certain advances are subject to prepayment penalties.

The Company had pledged investment securities at December 31, 2019 and 2018, totaling $3,597 and $7,374, respectively, as collateral for federal funds purchased.

On July 27, 2017, the Company issued a 9% fixed rate subordinated note payable for $500 to KR Four, LLC. The subordinated note was scheduled to mature on July 27, 2027 and had a fixed rate of interest of 9% per annum, payable on May 1 and November 1 of each year. Beginning July 27, 2022 and thereafter, the Company may have, at its option redeem the subordinated note due in whole or in part at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, subject to prior approval by the Board of Governors of the Federal Reserve System. The subordinated note was unsecured and was an obligation of the Company only and not guaranteed by its subsidiary, CSB. The Company incurred $21 and $45 of interest expense for the year ended December 31, 2019 and 2018, respectively. The Company did not have a subordinated note payable as of December 31, 2019, and $500 at December 31, 2018. In June 2019, the Company concluded a private placement of common stock for a capital raise whereby the $500 subordinated note payable outstanding was converted into common shares.

(In thousands of dollars, except share data)

Note 11. Income Taxes

Income tax expense (benefit) for the years ended December 31, 2019 and 2018 is summarized as follows:

	2019	2018
Current portion:		
Federal	$ 71	$ (42)
State	6	-
	77	(42)
Deferred income tax expense (benefit)	786	(181)
Total tax (benefit) expense	$ 863	$ (223)

A reconciliation between the income tax expense and the amount computed by applying the Federal statutory rate of 21% to income before income taxes follows:

	2019	2018
Tax at U.S. Statutory Rate	$ 728	$ (85)
Increase (decrease) resulting from:		
Equity based compensation	125	78
State income tax, net of federal income tax effect	79	(79)
Tax exempt income	(41)	(55)
Life insurance	(74)	(69)
Other items, net	46	(13)
Total tax (benefit) expense	$ 863	$ (223)

(In thousands of dollars, except share data)

The gross amounts of deferred tax assets and deferred tax liabilities at December 31, 2019 and 2018 are as follows:

	2019	2018
Deferred tax assets		
Net operating loss carryforward	$ 8,911	$ 10,254
Allowance for loan losses	904	679
Depreciation	324	322
Accrued expenses	313	159
Other real estate owned	190	229
ASC 842 lease liability	126	-
Origination costs and fees	104	86
Stock based compensation	102	58
Nonaccrual loan interest	36	37
Tax credits	14	73
Purchase accounting adjustments	6	71
Unrealized losses on securities available for sale	-	158
Other	108	119
Total deferred tax asset	11,138	12,245
Deferred tax liabilities		
Prepaid expenses	(28)	(28)
ASC 842 right of use asset	(130)	-
Unrealized gain on securities available for sale	(145)	-
Other	(56)	(63)
Total deferred tax liabilities	(359)	(91)
Net deferred tax asset	$ 10,779	$ 12,154

Deferred tax assets represent the future benefit of deductible differences and, if it is more likely than not that a tax asset will not be realized, a valuation allowance is required to reduce the recorded deferred tax assets to net realizable value. After review of all positive and negative factors and potential tax planning strategies, as of December 31, 2019 and 2018, management has determined that a valuation allowance is not necessary. Management has determined that it is more likely than not that the remaining deferred tax asset at December 31, 2019 will be realized, and accordingly, has not established a valuation allowance.

The Company has federal net operating losses of $37,891 and $43,800 at December 31, 2019 and 2018, respectively. These net operating losses expire at various times from 2028 through 2038. The Company's ability to benefit from the use of these net operating loss carryforwards is limited annually under Section 382 of the Internal Revenue Code. The Company has state net operating losses of $25,719 and $28,087 at December 31, 2019 and 2018, respectively. These net operating losses expire at various times from 2028 through 2038.

(In thousands of dollars, except share data)

The Company has analyzed the tax positions taken or expected to be taken in its tax returns and concluded it has no liability related to uncertain tax positions in accordance with applicable regulations.

Tax returns for 2016 and subsequent years are subject to examination by taxing authorities.

Note 12. Leases

The Company has entered into several operating leases for properties relating to its branch banking and mortgage obligations. The leases have various initial terms and expire on various dates. The lease agreements generally provide that the Bank is responsible for ongoing repairs and maintenance, insurance and real estate taxes. The leases also provide for renewal options and certain scheduled increases in monthly lease payments.

Leases with an initial term of 12 months or less are not recorded on the balance sheet. For these short-term leases, lease expense is recognized on a straight-line basis over the lease term. At December 31, 2019, the Company had no leases classified as finance leases.

At December 31, 2019, the Company had an operating lease ROU asset of $591 and an operating lease liability of $577. The ROU asset and operating lease liability are recorded in other assets and other liabilities, respectively, in the Consolidated Balance Sheets.

Rental expenses recorded under leases for the years ended December 31, 2019 and 2018 were $507 and $420 respectively.

The weighted-average remaining lease term and the weighted-average discount rate for operating leases were 1.75 years and 2.90%, respectively, at December 31, 2019.

During 2019, future lease commitments were reduced as the Company purchased a building that was under a lease commitment at December 31, 2018. At December 31, 2019, future maturities of the Company's operating lease liabilities are summarized as follows:

2020	$	392
2021		194
2022		39
2023		-
2024		-
Thereafter		-
Total lease payments	$	625

(In thousands of dollars, except share data)

Note 13. Other Noninterest Expense

A summary of the components of other noninterest expense is as follows for the years ended December 31:

	2019	2018
General and administrative expense	$ 555	$ 440
Marketing and business development	423	345
Travel related expenses	373	369
Other loan expense	304	1,040
Amortization expense	290	165
Board of director compensation	195	209
Net cost of operation of OREO	100	195
Other	715	526
	$ 2,955	$ 3,289

Note 14. Related Party Transactions

Certain parties (principally certain directors and executive officers of the Company, their immediate families and business interests) were loan customers of and had other transactions in the normal course of business with the Company. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. Related party loans totaled $2,572 and $3,043 as of December 31, 2019 and 2018, respectively. At December 31, 2019 and 2018, total deposits held by related parties were $5,855 and $5,427, respectively.

The Company had leases with a limited liability company that is owned by certain directors of the Company. The expenses associated with the leases totaled $0 and $32 for the years ended December 31, 2019 and 2018, respectively. During 2018, the Company purchased the properties associated with these leases.

Note 15. Commitments and Contingencies

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

Note 16. Stock-Based Compensation

In 2017, the stockholders of the Company approved the CoastalSouth Bancshares, Inc. 2017 Incentive Plan ("2017 Plan") to motivate, attract and retain the services of employees, officers, and directors. The 2017 Plan originally provided 627,450 shares to be available for stock-based awards, including options, stock appreciation rights, restricted stock, restricted stock units, deferred stock units, or any other right or interest related to stock or cash

(In thousands of dollars, except share data)

granted to a participant. In 2019, the number of shares available under the plan increased to 704,000, following the acquisition of FCFC. The terms of each stock-based award are indicated in an award certificate. At December 31, 2019, there were 94,000 remaining shares available to be awarded under the 2017 Plan.

The Company granted stock options in 2018 and 2019 which vest 25% each year on the anniversary date of the grant date over four years of continuous service. The terms of the options are for ten years expiring on the tenth anniversary of the grant date. A summary of stock option activity for the years ended December 31, 2019 and 2018 is below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	382,500	$ 13.00	$ 4.91
Granted	115,000	15.75	5.06
Exercised	-	-	-
Forfeited or Expired	(30,000)	14.38	4.77
Outstanding at December 31, 2018	467,500	$ 13.59	$ 4.96
Granted	138,500	13.98	4.59
Exercised	-	-	-
Forfeited or Expired	(60,000)	13.85	4.77
Outstanding at December 31, 2019	546,000	$ 13.66	$ 4.89

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Award Value (1)
Exercisable at December 31, 2018	91,875	$ 13.00		
Exercisable at December 31, 2019	187,500	$ 13.31	7.84	$ -
Vested at December 31, 2018	91,875	$ 13.00		
Vested at December 31, 2019	187,500	$ 13.31	7.84	$ -

(1) *Presented in thousands and considering a $12.55 market value at December 31, 2019.*

The weighted average remaining contractual life of options outstanding at December 31, 2019 is 8.26 years.

The grant date fair value of stock options is determined using the Black-Scholes model. Volatility is based on a peer group of similar community banks in the southeast. The risk-free rate is the treasury rate that most closely relates to the expected life on the grant date.

(In thousands of dollars, except share data)

A summary of assumptions used in the valuation for stock options granted during the years ended December 31, 2019 and 2018 is below:

	2019 Black-Scholes Inputs	2018 Black-Scholes Inputs
Expected dividend yield	0.00%	0.00%
Expected volatility	32.30%	21.4% - 33.5%
Risk-free interest rate	1.91% - 2.41%	2.83% - 2.97%
Expected life (in years)	6.25	6.25

The Company also awarded restricted stock units in 2017 which vest over four years of continuous service, with 50% vesting on the third anniversary of the grant date and the remaining 50% vesting on the fourth anniversary of the grant date. In 2019, 9,000 restricted stock units with a one-year vesting period were granted to members of the Board of Directors.

A summary of restricted stock unit activity for the years ended December 31, 2019 and 2018 is below:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2017	68,000	$ 13.00
Granted	-	-
Delivered	-	-
Forfeited	-	-
Outstanding at December 31, 2018	68,000	$ 13.00
Granted	9,000	15.75
Delivered	(9,000)	15.75
Forfeited	(13,000)	13.00
Outstanding at December 31, 2019	55,000	$ 13.00

Stock-based awards are recognized over the vesting period and reflected as salaries and employee benefits within the Consolidated Statements of Operations, which was $909 and $583 for the years ended December 31, 2019 and 2018, respectively. Total unrecognized compensation cost associated with outstanding awards at December 31, 2019 is $1,963.

Note 17. Stock Warrants

In conjunction with the July 28, 2017 capital raise, the Company issued stock warrants in conjunction with the issuance of voting common stock and preferred stock. At the time of the capital raise, insufficient shares of stock were authorized to permit classification of the warrants as equity, and $1,335 was recorded as a liability to reflect

(In thousands of dollars, except share data)

the fair value of warrants on July 28, 2017. Following the authorization of the nonvoting common stock class at the Company's shareholder meeting on September 22, 2017, the fair value of the warrants was reclassified to equity. The warrants vested immediately upon issuance and are outstanding for five years. Under the warrants, there are 385,202 shares of nonvoting common stock permitted for purchase with an exercise price of $13 per share. At December 31, 2019 and 2018, none of the warrants had been exercised. At December 31, 2019, all warrants are considered out-of-the-money.

Note 18. Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding. Diluted income (loss) per share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding and dilutive common share equivalents using the treasury stock method. Dilutive common share equivalents include common shares issuable upon exercise of outstanding in-the-money stock warrants, options and restricted stock units. Potential common shares are not included in the denominator of the diluted per share computation when inclusion would be anti-dilutive. As of December 31, 2019, and 2018, there were 213,500 and 27,000, potential common shares that were not included in the potentially dilutive stock options, restricted stock units and warrants, respectively.

Income (losses) per common share were calculated as follows:

	2019	2018
Net income (loss) per share - basic computation:		
Net income (loss) available to common stockholders	$ 2,603	$ (181)
Average common shares outstanding - basic	7,230,893	6,022,589
Basic net income (loss) per share	$ 0.36	$ (0.03)
Diluted net income (loss) per share computation:		
Net income (loss) available to common stockholders	$ 2,603	$ (181)
Average common shares outstanding - basic	7,230,893	6,022,589
Incremental shares from assumed conversions		
Restricted stock units	22,165	13,182
Stock warrants	4,104	33,992
Average common shares outstanding - diluted	7,257,162	6,069,763
Diluted net income (loss) per share	$ 0.36	$ (0.03)

Note 19. Regulatory Matters

CSB 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 adverse material effect on the Company's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, CSB must meet specific capital guidelines that involve quantitative measures of the CSB's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The CSB's capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

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

CSB is also required to maintain capital at a minimum level based on total assets, which is known as the leverage ratio. Only the strongest banks are allowed to maintain capital at the minimum requirement of 3%. All others are subject to maintaining ratios 1% to 2% above the minimum.

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

In order to avoid restrictions on capital distributions or discretionary bonus payments to executives, CSB is required to maintain a "capital conservation buffer" in addition to its minimum risk-based capital requirements. This buffer is required to consist solely of CET1, but the buffer applies to all three risk-based measurements (CET1, Tier 1 and total capital). The capital conservation buffer was phased in incrementally over time, beginning January 1, 2016 at 0.625% and became fully effective on January 1, 2019, and ultimately consists of an additional amount of Tier 1 capital equal to 2.5% of risk-weighted assets. The capital conservation buffer in effect for the year ended December 31, 2019 was 4.37%.

Prompt Corrective Action - In July 2013, the final rules implementing Basel III capital guidelines increased regulatory capital requirements of U.S. banking organizations in a manner that more closely reflected risk exposures and brought the regulatory capital framework into compliance with Basel III. The final rules revised the level at which the Bank becomes subject to corrective action. The federal banking agencies have broad powers with which to require companies to take prompt corrective action to resolve problems of insured depository institutions that do not meet minimum capital requirements. The law establishes five capital categories for this purpose: (i) well-capitalized; (ii) adequately capitalized; (iii) undercapitalized; (iv) significantly undercapitalized; and (v) critically undercapitalized. The final rules amended the thresholds in the prompt corrective action framework to reflect the higher capital ratios required.

(In thousands of dollars, except share data)

Even though the prompt corrective action rules apply to banks and not bank holding companies, the FRB is authorized to take actions at the holding company level. Failure to meet applicable capital standards could subject the bank holding company or the financial institution to a variety of enforcement remedies available to the federal regulatory authorities. These include limitations on the ability to pay dividends, the issuance by the regulatory authorities of a capital directive to increase capital, and the termination of deposit insurance by the FDIC. CoastalSouth Bancshares, Inc. is not subject to the provisions of prompt corrective action.

The following table summarizes the capital amounts and ratios of CSB and the regulatory minimum requirements at December 31, 2019 and 2018:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Promp Corrective Action Provisions	
December 31, 2019	**Amount**	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Coastal States Bank						
Total capital (to risk-weighted assets)	$ 75,432	12.37%	$ 48,770	8.00%	$ 60,962	10.00%
Tier 1 capital (to risk-weighted assets)	71,496	11.73%	36,577	6.00%	48,770	8.00%
Tier 1 capital (to average assets)	71,496	10.32%	27,709	4.00%	34,637	5.00%
Common Equity Tier 1 Capital (to risk weighted-assets)	71,496	11.73%	27,433	4.50%	39,626	6.50%
December 31, 2018						
Coastal States Bank						
Total capital (to risk-weighted assets)	$ 54,417	11.75%	$ 37,053	8.00%	$ 46,316	10.00%
Tier 1 capital (to risk-weighted assets)	51,498	11.12%	27,790	6.00%	37,053	8.00%
Tier 1 capital (to average assets)	51,498	9.32%	22,093	4.00%	27,617	5.00%
Common Equity Tier 1 Capital (to risk weighted-assets)	51,498	11.12%	20,842	4.50%	30,106	6.50%

The Bank’s regulatory capital ratios are currently well in excess of the minimum standards and continue to be in the "well capitalized" regulatory classification.

Note 20. Lines of Credit

As of December 31, 2019, and 2018, the Company had unused lines of credit to purchase federal funds from unrelated banks totaling $42,500, on both dates, a portion of which is secured by investment securities. These lines of credit are available on a one-day basis for general corporate purposes. As of December 31, 2019, and 2018, the Company had no outstanding balances at both dates.

CSB had the ability to borrow an additional $63,420 and $62,150 at December 31, 2019 and 2018, respectively, from the Federal Home Loan Bank (“FHLB”) secured by a blanket lien on one-to-four family first mortgage loans, multifamily residential loans, and revolving, open-end loans, marketable securities or cash. FHLB has approved borrowings up to 20% of CSB's total assets less advances outstanding. The borrowings are available by pledging collateral and purchasing additional stock in the FHLB. All of the lines discussed above can be revoked at the

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lender's discretion.

Note 21. Stockholders' Equity

Voting Common Stock – On July 17, 2018, the Company acquired First Citizens Financial Corporation and issued 695,888 shares of voting common stock at $15.75 per share, resulting in gross proceeds of $10,960. Following the issuance of these shares, and at December 31, 2018, there were 4,950,602 shares of $1.00 par value voting common stock outstanding. On June 18, 2019, the Company issued 1,205,409 shares of voting common stock at $13.25 per share for gross proceeds of approximately $15,972. On the same date, the Company also converted its outstanding subordinated note to 37,735 shares of voting common stock. The Company issued 9,000 shares of voting common stock for vested restricted stock units ("RSU's") in 2019. At December 31, 2019, there were 6,202,746 shares of $1.00 par value voting common stock outstanding.

Nonvoting Common Stock – On June 18, 2019, the Company concluded a private placement of common stock for gross proceeds of approximately $4,028 and an issuance of 304,025 nonvoting common stock. At December 31, 2019, there were 1,753,507 shares of $1.00 par value nonvoting common stock outstanding.

Dividends – The ability of the Company to pay cash dividends to stockholders is dependent upon receiving cash in the form of dividends from its banking subsidiary. However, certain restrictions exist regarding the ability of the subsidiary to transfer funds in the form of cash dividends to the Company. South Carolina banking regulators restrict the amount of dividends that can be paid to stockholders. All of CSB's dividends to the Company are payable only from the undivided profits of CSB. At December 31, 2019, CSB had an accumulated deficit of $36,966.

As a State chartered bank under South Carolina law, the Bank is authorized to pay cash dividends up to 100% of net income in any calendar year without obtaining the prior approval of the South Carolina State Board of Financial Institutions ("State Board") or the Commissioner of Banking provided that the Bank received a composite rating of one or two at the last examination conducted by the State or Federal regulatory authority. Otherwise, the Bank must file an income and expense report and obtain the specific approval of the State Board. Under Federal Reserve Board regulations, the amount of loans or advances from the banking subsidiary to the parent company are also restricted.

Note 22. Financial Instruments with Off-Balance-Sheet Risk

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

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instruments. Letters of credit are conditional commitments issued to guarantee a customer's performance to a third party and have essentially the same credit risk as other lending facilities. Collateral held for commitments to extend credit and letters of credit varies but may include accounts receivable, inventory, property, plant, equipment and income-producing commercial properties.

The following table summarizes the Bank's off-balance-sheet financial instruments at December 31, 2019 and 2018 whose contract amounts represent credit risk:

	2019	2018
Commitments to extend credit	$ 121,295	$ 81,322
Letters of credit	642	753
Total	$ 121,937	$ 82,075

Note 23. Fair Value of Financial Instruments

US GAAP provides a framework for measuring and disclosing fair value which requires disclosures about the fair value of assets and liabilities recognized in the balance sheet, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans).

Fair value is defined as the exchange in price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. US GAAP also establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

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

Fair Value Hierarchy

The Company groups assets and liabilities 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 the fair value. These levels are:

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

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

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Level 3 Valuation is generated from model-based techniques that use at least one significant assumption not observable in the market. These unobservable assumptions reflect estimates of assumptions that market participants would use in pricing the asset or liability. Valuation techniques include the use of option pricing models, discounted cash flow models and similar techniques.

Following is a description of valuation methodologies used for assets and liabilities recorded at fair value.

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

Equity Securities – Equity securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted prices.

Loans Held for Sale - Loans held for sale are comprised of loans originated for sale in the ordinary course of business. The fair value of loans originated for sale in the secondary market is based on purchase commitments or quoted prices for the same or similar loans and are classified as recurring Level 2. There were no loans held for sale requiring fair value adjustments during 2019 and 2018.

Impaired Loans - The Company does not record loans at fair value on a recurring basis, however, from time to time, a loan is considered impaired and an allowance for loan loss is established. Loans for which it is probable that payment of interest and principal will not be made in accordance with the contractual terms of the loan are considered impaired. Once a loan is identified as individually impaired, management measures impairment. The fair value of impaired loans is estimated using one of several methods, including the collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Those impaired loans not requiring a specific allowance represents loans for which the fair value of expected repayments or collateral exceed the recorded investment in such loans. At December 31, 2019 and 2018, substantially all of the impaired loans were evaluated based upon the fair value of the collateral. Impaired loans where an allowance is established based on the fair value of collateral require classification in the fair value hierarchy. When the fair value of the collateral is based on an observable market price or a current appraised value, the Company records the loan as nonrecurring Level 2. When an appraised value is not available or management determines the fair value of the collateral is further impaired below the appraised value and there is no observable market price, the Company records the loan as nonrecurring Level 3.

OREO - Foreclosed assets are adjusted to fair value upon transfer of the loans to OREO. Real estate acquired in settlement of loans is recorded initially at estimated fair value of the property less estimated selling costs at the date of foreclosure. The initial recorded value may be subsequently reduced by additional allowances, which are charges to earnings if the estimated fair value of the property less estimated selling costs declines below the initial recorded value. OREO presented as measured on a non-recurring basis includes only those properties that had

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changes in valuation. Fair value is based upon independent market prices, appraised values of the collateral or management's estimation of the value of the collateral.

The table below presents the balances of assets and liabilities measured at fair value on a recurring basis by level within the hierarchy at December 31, 2019 and 2018:

	December 31, 2019			
	Total	Level 1	Level 2	Level 3
Mortgage backed securities	$ 46,331	$ -	$ 46,331	$ -
Government-sponsored agencies	421	-	421	-
Obligations of corporations	7,102	-	6,602	500
Municipal obligations	7,524	-	7,524	-
Equity securities	168	168	-	-
Total	$ 61,546	$ 168	$ 60,878	$ 500

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Mortgage backed securities	$ 43,403	$ -	$ 43,403	$ -
Government-sponsored agencies	3,504	-	3,504	-
Obligations of corporations	3,998	-	3,498	500
Municipal obligations	8,965	-	8,965	-
Equity securities	147	147	-	-
Total	$ 60,017	$ 147	$ 59,370	$ 500

(In thousands of dollars, except share data)

The changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

	Obligations of Corporations
Balance at December 31, 2017	$ 500
Total net gains (losses) included in:	
Net income (loss)	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	-
Transfers into/out of Level 3	-
Balance at December 31, 2018	500
Total net gains (losses) included in:	
Net income (loss)	-
Other comprehensive income	-
Purchases, sales, issuances and settlements, net	-
Transfers into/out of Level 3	-
Balance at December 31, 2019	$ 500

Certain assets and liabilities are measured at fair value on a nonrecurring basis; that is, the instruments are not measured at fair value on an ongoing basis but are subject to fair value adjustments in certain circumstances (for example, when there is evidence of impairment). The following table presents the assets and liabilities carried on the balance sheet by caption and by level within the valuation hierarchy (as described above) for which a nonrecurring change in fair value has been recorded during the years ended December 31, 2019 and 2018.

	December 31, 2019			
	Total	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 1,206	$ -	$ -	$ 1,206
Impaired loans, net	5,527			5,527
Total	$ 6,733	$ -	$ -	$ 6,733

	December 31, 2018			
	Total	**Level 1**	**Level 2**	**Level 3**
Other real estate owned	$ 933	$ -	$ -	$ 933
Impaired loans, net	6,645			6,645
Total	$ 7,578	$ -	$ -	$ 7,578

(In thousands of dollars, except share data)

There were no liabilities measured at fair value on a nonrecurring basis at December 31, 2019 and 2018.

The following tables provide information describing the unobservable inputs used in Level 3 fair value measurements at December 31, 2019 and 2018:

December 31, 2019				
Financial Instrument	**Net Carrying Value**	**Valuation Technique**	**Unobservable Input**	**Range of Inputs**
Other real estate owned	$ 1,206	Third party appraisal or broker's price opinion	Management discount for costs to sell	10%
Impaired loans, net	$ 5,527	Non-collateral dependent - Discounted cash flow analysis	Discount rate	4.25% - 6.75%
		Collateral dependent - Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%

December 31, 2018				
Financial Instrument	**Net Carrying Value**	**Valuation Technique**	**Unobservable Input**	**Range of Inputs**
Other real estate owned	$ 933	Third party appraisal or broker's price opinion	Management discount for costs to sell	10%
Impaired loans, net	$ 6,645	Non-collateral dependent - Discounted cash flow analysis	Discount rate	3.32% - 3.75%
		Collateral dependent - Third party appraisal or broker's price opinion	Management discount for costs to sell	0% -10%

Fair Value of Financial Instruments

The following table includes the estimated fair value of the Company’s financial assets and financial liabilities. The methodologies for estimating the fair value of financial assets and financial liabilities measured on a recurring and nonrecurring basis are discussed above. The methodologies for estimating the fair value for other financial assets and financial liabilities are discussed below. The estimated fair value amounts have been determined by the Company using available market information and appropriate valuation methodologies. However, considerable judgement is required to interpret market data in order to develop the estimates of fair value. Accordingly, the estimates presented below are not necessarily indicative of the amounts the Company could realize in a current market exchange. The use of different market assumptions and/or estimation techniques may have a material effect on the estimated fair value amounts at December 31, 2019.

(In thousands of dollars, except share data)

	2019		2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 49,273	$ 49,273	$ 67,696	$ 67,696
Securities available-for-sale	61,378	61,378	59,870	59,870
Loans held for sale	81,243	81,243	32,641	32,641
Loans held for investment, net	464,390	463,585	373,827	363,193
Non-marketable equity securities	1,118	1,118	768	768
Deposits	601,092	569,164	513,326	455,383
Other borrowings	10,000	10,000	500	500

Cash and cash equivalents
The carrying amount approximates fair value for these instruments.

Securities available-for-sale
The fair value of investment securities is generally determined using widely accepted valuation techniques including matrix pricing and broker-quote-based applications.

Loans held for sale
Loans held for sale are carried at the lower of cost or fair value. These loans currently consist of one-to-four family residential real estate loans originated for sale to qualified third parties. Fair value is based upon the contractual price to be received from these third parties, which may be different than cost.

Loans held for investment
Fair values are estimated for portfolios of loans with similar financial characteristics if collateral-dependent. Loans are segregated by type. The fair value of performing loans is calculated by discounting scheduled cash flows through the estimated maturity using estimated market discount rates that reflect observable market information incorporating the credit, liquidity, yield and other risks inherent in the loan. The estimate of maturity is based upon the Company's historical experience with repayments for each loan classification, modified, as required, by an estimate of the effect of the current economic and lending conditions. Fair value for significant non-performing loans is generally based upon recent external appraisals. If appraisals are not available, estimated cash flows are discounted using a rate commensurate with the risk associated with the estimated cash flows. Assumptions regarding credit risk, cash flows and discounted rates are judgmentally determined using available market information and specific borrower information.

Non-marketable equity securities
Non-marketable equity securities are carried at original cost basis, as cost approximates fair value and there is no ready market for such investments.

(In thousands of dollars, except share data)

Deposits
The fair value of deposits with no stated maturity date, such as noninterest-bearing demand deposits, savings and money market and checking accounts, is based on the discounted value of estimated cash flows. The fair value of time deposits is based upon the discounted value of contractual cash flows. The discount rate is estimated using the rates currently offered for deposits of similar remaining maturities.

Other borrowings
The fair value of the Company's FHLB advances is estimated based upon the discounted value of contractual cash flows. The fair value of investment securities sold under agreements to repurchase approximates the carrying amount because of the short maturity of these borrowings. The discount rate is estimated using rates quoted for the same or similar issues or the current rates offered to the Company for debt of the same remaining maturities.

Note 24. Revenue Recognition

The Company adopted ASC 606, *Revenue from Contracts with Customers,* on January 1, 2018. The Company's sources of revenue are generated from both interest and noninterest revenue streams. According to the standard, revenue streams generated by fees and interest from financial instruments, investments, and transfers and servicing of these assets are excluded from the scope of the standard.

The Company has certain revenue streams within the scope of ASC 606 contained within noninterest income. The Company's contracts with customers generally do not contain terms that require significant judgement to determine the amount of revenue to recognize.

The table below presents the revenue streams within the scope of the standard and is followed by a description of each noninterest income revenue stream for the years ended December 31, 2019 and 2018:

	December 31, 2019		
	Within Scope	Out of Scope	Total
Noninterest income:			
Gain on sale of government guaranteed loans	$ -	$ 1,877	$ 1,877
Income from mortgage originations	-	1,502	1,502
Interchange income and card fees	770	-	770
Service charges on deposit accounts	699	-	699
Securities gains (losses), net	-	640	640
Bank-owned life insurance	-	354	354
Other noninterest income	269	389	658
Total noninterest income	$ 1,738	$ 4,762	$ 6,500

(In thousands of dollars, except share data)

	December 31, 2018		
	Within Scope	Out of Scope	Total
Noninterest income:			
Income from mortgage originations	$ -	$ 1,287	$ 1,287
Gain on sale of government guaranteed loans	-	1,222	1,222
Service charges on deposit accounts	705	-	705
Interchange income and card fees	668	-	668
Bank-owned life insurance	-	343	343
Securities gains (losses), net	-	(57)	(57)
Other noninterest income	74	442	516
Total noninterest income	$ 1,447	$ 3,237	$ 4,684

Income from mortgage originations
The Company earns mortgage production income which is comprised primarily of activity related to the sale of consumer mortgage loans as well as loan origination fees such as closing charges, document review fees, application fees, other loan origination fees, and loan processing fees.

Gain on sale of government guaranteed loans
The Company records a gain from the sale of government guaranteed loans to third parties at the time the transfer is complete. The gain on sale is recognized as a result of the recognition of mortgage servicing rights and premiums paid by the buyer for the purchase of the loan.

Service charges on deposit accounts
The Company earns fees from its deposit customers for transaction-based, account maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees and stop payment charges, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer's request. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges are withdrawn from the customer's account balance.

Interchange income and card fees
The Company earns interchange fees from debit cardholder transactions conducted through a payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are earned daily.

Bank-owned life insurance
The Company's income from bank-owned life insurance primarily represents changes in the cash surrender value of such life insurance policies held on certain key employees, for which the Company is the owner and beneficiary. Revenue is recognized in each period based on the change in cash surrender value during the period.

(In thousands of dollars, except share data)

Securities gains (losses)
The Company recognizes realized gains or losses from the sale of its available-for-sale securities at the trade date and recognizes periodic mark-to-market adjustments on equity securities resulting from changes in fair value.

Other noninterest income
Other noninterest income consists primarily of loan fees, which are out of the scope of ASC Topic 606. The items within scope of the standard primarily relate to contracts with third parties for miscellaneous referral or broker income.

Contract Balances
A contract asset balance typically occurs when an entity performs a service for a customer before the customer payment of consideration, creating a contract receivable, or before payment is due, creating a contract asset. In contrast, a contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment of consideration from the customer. The Company's noninterest revenue streams that are within the scope of ASC 606 are largely based on transactional activity which typically occurs at a point in time immediately after the performance obligations have been satisfied. Consideration is often received immediately or shortly after the Company satisfies its performance obligation and revenue is recognized. The Company does not typically enter into long-term revenue contracts with customers. Therefore, the Company does not experience significant contract balances. As of December 31, 2019 and 2018, the Company did not have any significant contract balances.

Note 25. Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date.

The 2019 novel coronavirus (or "COVID-19") has adversely affected, and may continue to adversely affect economic activity globally, nationally and locally. Following the COVID-19 outbreak in December 2019 in Wuhan, China, and subsequently around the globe including United States of America ("USA") in 2020, market interest rates have declined significantly, with the 10-year Treasury bond falling below 1.00% on March 3, 2020 for the first time. Such events may adversely affect business and consumer confidence, generally, and the Company and its customers. On March 3, 2020, the Federal Open Market Committee ("FOMC") reduced the target federal funds rate by 50 basis points to 1.00% to 1.25%. Subsequently, on March 16, 2020, the FOMC further reduced the target federal funds rate by an additional 100 basis points to 0.00% to 0.25%. These reductions in interest rates and other effects of the COVID-19 outbreak may affect the Company's financial condition and results of operations.

The Company evaluated subsequent events through the date its financial statements were issued, and no other subsequent events were noted through March 26, 2020.