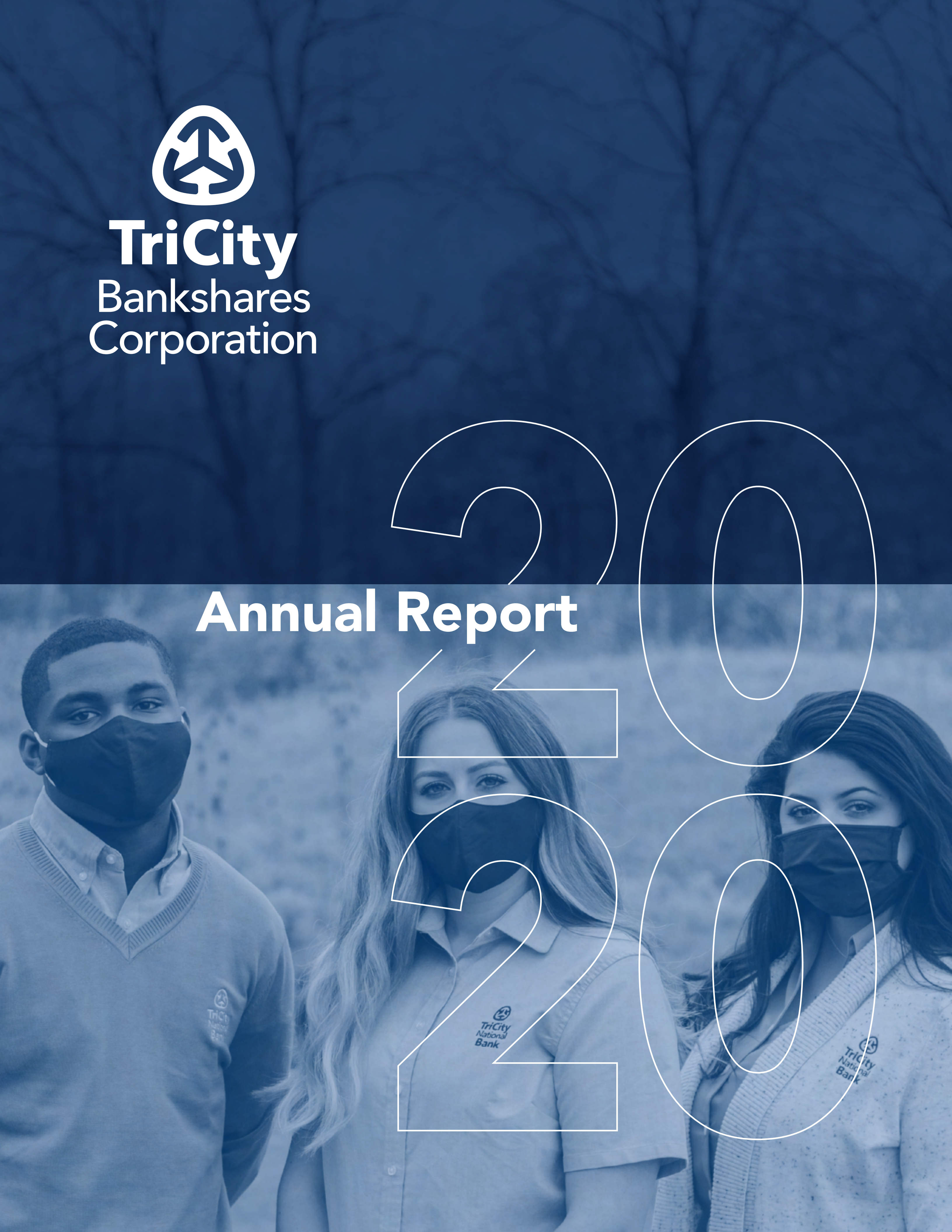
TriCity Bankshares Corporation

Annual Report 2020



TRI CITY IS YOUR SAFE HARBOR.

When the seas are rough, you must chart a new course,
Using experience, determination, and even some force.
A seasoned sailor who's navigated rough waters before,
Can be your partner to help find a safe shore.

Though the challenges were new, choppy waters are not,
Only the best survive when put on the spot.
For decades, your hometown bank has been there with you,
In good times and bad, together, we've navigated through.

We've steered through challenges never dreamt of,
Fought day and night for businesses, our labor of love.
United we've stood, threw our sails to the wind,
Even when the lighthouse glow felt rather dim.

For we'll weather this storm, and the next one, too.
No wave is too high for this hardy crew.
With your shipmate in tow, you have nothing to dread.
We'll batten the hatches, find safe waters ahead.

TriCity National Bank

Learn more at www.tcnb.com | 414.325.1140 Member FDIC NMLS # 433891

Dear Shareholders,

The global coronavirus pandemic dominated every aspect of our bank's existence in 2020. As I wrote last year, our bank implemented plans to safeguard our employees, customers, and communities early in the crisis, before the implementation of any government programs. We did this all while maintaining our focus on programs and initiatives that strengthened our bank, particularly in the digital marketplace. Despite the pandemic's impact, our initiatives in the past year included: a reorganized general ledger to better analyze department financial performance and budget forecasting, a strengthening of our marketing initiatives, the creation of a sales-based customer relationship dashboard, and an improved asset liability risk model. As a result, we now have new tools to focus on income, create efficiencies, and increase our share of the marketplace.

Our bank was tested on many fronts with macroeconomic impacts that were beyond our control. Net interest margins were further compressed to record lows, affecting both our loan and securities investment income. To compensate, we renewed our focus on fee income, Paycheck Protection Program (PPP) loans, and marketing efforts to increase our volume of government-agency, low interest rate retail mortgages. Our team of dedicated bankers effectively pivoted and met these challenges head on in order to capitalize on these unique marketplace opportunities. We worked hard to overcome the uncontrollable macro conditions and provided a safe harbor for our employees while maintaining full-service operations and normal business hours. We did this with wisdom, diligence, and perseverance. And we succeeded.

After years of effort to fine-tune each department to compete in the digital age — with our strong focus on analytics, marketing, and sales — I am confident that our conservative risk model has proven that we can weather any macro storm and continue to invest in our future. We have expanded our relationships with financially strong loan customers, and we have funded our activities with core deposits. As I reflect back on our five decades, and as I applaud our combination of seasoned employees and capable new employees, I am certain we now have the team in place to meet any challenge and prosper.

Your investment in our corporation is in a safe harbor. I hope you are as proud as I am knowing that your investment is creating a safe harbor for many others in our community, as well.

Thank you for your continued support. Please stay safe and healthy.

Sincerely,

Brian T. McGarry

Brian T. McGarry
Chairman of the Board and Chief Executive Officer
Tri City Bankshares Corporation

2020 Management Discussion and Analysis

The year 2020 provided a unique economic and operating environment for the Corporation and our customers. The Covid-19 pandemic took hold in March of 2020, resulting in major changes in the daily activities of consumers, families and businesses throughout the remainder of the year. Economic activity slowed dramatically as health mandated restrictions became a priority, resulting in considerable reductions in business volume, particularly in the hospitality, restaurant and bar, onsite retail and travel industries.

In response to the pandemic, the Federal government implemented a number of programs to support individuals, families and businesses. Two rounds of stimulus funding were provided to individuals and families for their use in meeting financial needs. The Paycheck Protection Program ("PPP"), made SBA guaranteed forgivable loans available to a broad range of businesses. The Corporation provided $62 million in PPP loans to over 1,100 Tri City customers in 2020. The stimulus and PPP programs resulted in increased bank account deposit balances for many of our customers, due to reduced spending and a focus on increased savings. Additional Federal programs were created to provide business tax credits for providing extra child-care and health related time off to employees during the pandemic. The Corporation utilized these programs and provided additional pandemic related benefits in 2020 to provide a safe harbor for our employees who continued to provide essential banking services to our community.

The U.S. Federal Reserve ("Fed Reserve") also made a major reduction in the Federal Funds Rate ("FFR") in response to the pandemic. In March of 2020, the Fed Reserve made two FFR adjustments, reducing the FFR to a target range of 0.00% to 0.25%, from the 1.50% to 1.75% target range in place as of January 1, 2020. The FFR is the basis for the interest rate at which financial institutions earn interest on excess reserve balances on an overnight basis. The FFR also influences the prime lending rate and the rates financial institutions pay on deposit balances. In addition, interest rates dropped across the U.S. Treasury rate yield curve as the pandemic took its toll on the economy. For reference, the 3, 5 and 10 year U.S. Treasury rates were 1.59%, 1.67% and 1.88%, respectively as of January 1, 2020. They dropped to 0.58%, 0.70% and 0.94% as of mid-March, 2020 and 0.17%, 0.36% and 0.93%, respectively as of December 31,2020.

The Corporation worked diligently within these parameters to provide a safe working environment for our employees, maintain full service and normal business hours for our customers, support our business customers with PPP loans and our retail customers with mortgages to refinance existing homes to take advantage of the low interest rate environment, and provide temporary loan modifications for customers.

Financial Highlights

The Corporation's total assets grew by $330 million in 2020 to $1.8 billion as of December 31, 2020, driven by an increase of $303 million in deposits spread across all commercial and personal lines of business.

The Corporation posted after-tax net income of $14.2 million for the year ended December 31, 2020, a decrease of $4.5 million compared to $18.7 million in 2019. The reduction in after-tax net income in 2020 reflects the major impact of reduced interest rates on our loan and security investment portfolios and overnight excess reserve balances, $1.5 million in additions to the provision for loan losses, and a $1.9 million decrease in income associated with death benefits on bank owned life insurance. Earnings per share decreased to $1.60 for the year ended December 31, 2020 compared to $2.10 for 2019.

Total shareholders' equity increased to $191.1 million as of December 31, 2020, comprised of a $9.6 million increase in retained earnings, and a $7.0 million increase in accumulated other comprehensive income based upon an increase in the unrealized market value gain on security investments. The increase in retained earnings was net of $4.6 million in dividends ($0.52 per share) paid to shareholders in 2020.

Balance Sheet

Total assets were $1.80 billion as of December 31, 2020, an increase of $330 million or 22.5% compared to $1.47 billion as of December 31, 2019.

Cash and cash equivalents increased to $195.4 million as of December 31, 2020 compared to $96.5 million as of December 31, 2019. Included in cash and cash equivalents is $161.4 million in overnight funds at the Federal Reserve or with correspondent banks. The Corporation averaged $141.0 million in liquid overnight funds in 2020 compared to $78.4 million in 2019. The increase resulted from the major growth in customer deposits, net of deployment of funds in security investments and loan growth. The Corporation is also maintaining some additional liquidity deemed appropriate for potential deposit decreases and future loan growth pending the anticipated improvement in the economy in 2021.

The security investment portfolio grew substantially from $383.3 million as of December 31, 2019 to $558.5 million as of December 31, 2020. The Corporation focused its 2020 purchases on expanding the portfolio of high credit quality municipal bonds, along with acquiring mortgage-backed securities centered on providing a steady level of cash flows and shorter maturities. The investment portfolio as of December 31, 2020 was comprised of 36.0% in collateralized mortgage obligations, 32.3% in mortgage backed securities and 31.7% in municipal bonds.

Total gross loans were $959.1 million as of December 31, 2020 compared to $902.1 million as of December 31, 2019. The growth includes the impact of PPP loan activity, with $40.1 million of PPP loans outstanding as of December 31, 2020, along with $19.0 million in net organic loan growth. Excluding PPP activity, new loan originations during 2020 totaled a record level of $333 million, but the Corporation also experienced loan payoffs of $165 million, along with regularly scheduled loan maturities and principal payments. The Corporation continues to focus on loan growth while maintaining its core discipline of conservative underwriting to strong credit quality borrowers.

As reflected in the table below, the loan portfolio remains diversified, with a focus and expertise on real estate. The percentage of loans in the commercial and multifamily real estate sectors have increased over the past few years, reflecting the Corporation's effort to expand its relationships with major real estate developers and the evolving demographics in our geographic market creating growth in multifamily developments. The decrease in residential mortgages is in part from an increase in customers refinancing into long term fixed rate loans which were originated and sold to FHLMC in 2020.

Loan Portfolio Composition
$ in thousands

	December 31, 2019		*December 31, 2020*	
	Loan Balance	Percent of Total Loans	Loan Balance	Percent of Total Loans
Commercial & Industrial, including PPP	$ 35,218	3.9%	$ 69,045	7.2%
Real Estate:				
Commercial	506,283	56.1%	520,297	54.2%
Residential	184,557	20.5%	167,612	17.6%
Multifamily	112,250	12.4%	134,715	14.0%
Construction	59,220	6.6%	61,488	6.4%
Installment & Other	4,538	0.5%	5,958	0.6%
Total	$ 902,066	100.0%	$ 959,115	100.0%

As the Corporation has developed expanded relationships with financially strong loan customers over the past several years, and in line with market competition, the Corporation has increased its volume of fixed rate loans with maturities of three to five years, structured with prepayment penalties.

Our asset quality measures remained strong in 2020. Nonaccrual loans totaled $4.9 million or only 0.52% of total loans as of December 31, 2020. Accruing loans that were past due 30 days and over were only $6.2 million or 0.64% as of December 31, 2020. While credit quality and asset quality measures are good, the Corporation did provide $1.5 million in provision for loan losses in 2020, compared to no provision in each of the prior three years, given the current and potential impacts of the pandemic particularly in the hospitality, restaurant and bar and retail sectors in which the Corporation has some exposure. The allowance for loan losses is 1.37% of outstanding loan balances as of December 31, 2020 compared to 1.23% as of December 31, 2019.

Total deposits were $1.57 billion as of December 31, 2020, an increase of $302.8 million or 23.6% compared to $1.27 billion as of December 31, 2019. The growth was across all commercial and personal lines of business from a combination of new account growth, the impacts of Federal government programs and reduced customer spending during the pandemic. Noninterest bearing demand deposits comprised $122.0 million of the increase, interest bearing transaction, savings and money market accounts increased by $183.0 million, and certificate of deposit balances decreased by $2.2 million. The Corporation has historically maintained and utilized its large deposit base and capital to fund its activities, with no third-party borrowings. This is a significant benefit for the Corporation and a continuing focus of Management.

Capital

Total stockholders' equity was $191.1 million as of December 31, 2020, an increase of $16.6 million or 9.5% compared to $174.5 million as of December 31, 2019. The increase in stockholders' equity during 2020 resulted from an increase of $9.6 million in retained earnings net of $4.6 million in shareholder dividend payments, and an increase of $7.0 million in accumulated other comprehensive income associated with an increase in the unrealized gain on security investments as of December 31, 2020.

Total equity to total assets decreased to 10.6% as of December 31, 2020 compared to 11.9% as of December 31, 2019 driven by the increase in total assets as of December 31, 2020. The Corporation's Tier One capital ratio also decreased during the year due to the growth in assets, to 10.2% as of December 31, 2020 compared to 11.8% as of December 31, 2019 based on consolidated year end total assets, but the ratio remains in excess of the regulatory guidelines for well capitalized banks.

The Corporation's Board of Directors firmly believes in maintaining a strong capital base. The Board of Directors will continue to monitor the Corporation's strategy, future earnings, on-going regulatory requirements, the economy, the marketplace and other factors when approving future dividends.

Core Operating Income

Management maintains a focused and committed effort to position the Corporation to generate core operating income. Core operating income represents the pre-tax earnings generated by the core banking business lines and operations of the Corporation. A reconciliation of reported income before taxes to core operating income is presented below:

Core Operating Income
$ in thousands

	For the Year Ended December 31,				
	2016	**2017**	**2018**	**2019**	**2020**
Total Income Before Taxes	$ 16,111	$ 18,186	$ 21,514	$ 22,453	$ 16,735
Acquistion-related purchase accounting income	(1,851)	(907)	(1,667)	(1,066)	(979)
Bank owned life insurance death benefits income	0	0	0	(2,334)	(450)
New market tax credit investment amortization expense	0	0	728	1,069	1,620
Core Operating Income	$ 14,260	$ 17,279	$ 20,575	$ 20,122	$ 16,926

The adjustments for core operating income eliminate matters that are associated with acquisition, life insurance, and tax credit investments outside of the core operations of the Corporation.

As reflected in the reconciliation, Management has worked to increase core operating income since 2016. The increase has included a focused effort in loan growth, while also making significant investments in personnel and IT infrastructure. The Corporation has created and enhanced multiple areas of its banking operations over the past five years, including development and hiring of commercial and retail lenders, the formation of an expanded commercial loan credit department, the creation of a business services team to support our retail merchant customers, the development of a data analytics team, enhancements in our finance team for work across all bank metrics, the expansion of our IT professional team, improvements in our human resource team and training programs, expanding the depth of our compliance and BSA team, and the establishment of a marketing and communications team driving our local market brand and website.

The reduction in core operating income in 2020 compared to 2019 is primarily due to the reduction in the interest rate yield in our loan and investment portfolios and interest earned on overnight funds held at the Fed Reserve and correspondent banks, along with the $1.5 million provision for loan loss expense recognized in 2020.

Income Statement

Net interest income before provision for loan losses was $49.6 million in 2020, a decrease of $1.5 million or 3.0% compared to $51.1 million in 2019. The decrease resulted from a $1.2 million decrease in interest income on loans, interest income on security investments holding consistent and a $1.2 million decrease in interest income on overnight excess reserves invested with the Fed Reserve or correspondent banks, all offset by a $0.9 million decrease in interest paid on deposits. All interest income and expense components were impacted by the major change in the interest rate environment that began in March 2020.

The decrease in interest income on loans was due to a decrease in yield on total loans of approximately 0.44% and the decrease in residential mortgages held by the Corporation. While average security investment holdings increased by $171 million in 2020 compared to 2019, the yield on the security investment portfolio decreased by approximately 0.34%. The decrease in interest income on overnight invested funds was entirely due to the decrease in the FFR, which reduced the overnight interest rate to 0.10% beginning in March of 2020 compared to an average rate of 2.10% in 2019. The decrease in interest expense paid to deposit customers, despite the growth in deposits, was primarily due to lower rates paid on municipal deposits which follow the FFR.

The overall yield on total earning assets was 3.37% and 4.01% in 2020 and 2019, respectively. The Corporation's primary competitive advantage is its strong core deposit base, resulting in the cost of funds being a very low 0.10% and 0.17% in 2020 and 2019, respectively. As a result, the net interest margin decreased to 3.27% in 2020 compared to 3.84% in 2019.

As previously discussed, the Corporation recorded a $1.5 million provision for loan losses in 2020, with no provision recorded in 2019.

Noninterest income was also impacted by the pandemic in 2020. Total noninterest income was $18.4 million in 2020, comparable to the same $18.4 million in 2019, but with some large variations in components. The Corporation's retail mortgage team generated $145 million in new loan originations in 2020, with 70% being mortgages sold to FHLMC. The team generated $2.9 million in gain on sale of loans compared to $0.6 million in 2019. The Corporation retains the servicing rights on the loans, with the off balance sheet servicing portfolio increasing to $262 million as of December 31, 2020. The increase in retail activity was offset by a reduction in NSF and overdraft charges of $1.0 million due to customers' having more funds available on deposit and a $1.9 million reduction in income on death benefits from bank owned life insurance policies. Core noninterest income as a percentage of average assets was 1.06% in 2020 compared to 1.07% in 2019.

Noninterest expense was $49.8 million in 2020, an increase of $2.6 million or 5.6% compared to $47.1 million in 2019. The increase was due in part to a net $1.0 million increase in salary and benefits and a $0.6 million increase in non-core new markets tax credit investment amortization. The increase in salary and benefits is the result of the investments in personnel noted in the Core Operating Income discussion above, and is also net of $1.1 million of PPP loan processing fees recognized as a reduction in salaries and benefits offsetting the cost of PPP loan originations. The Corporation also incurred approximately $0.9 million for temporary pay increases and other employee benefits associated with the pandemic. Core noninterest expense as a percentage of average assets was 2.93% in 2020 compared to 3.19% in 2019.

Income tax expense was $2.5 million in 2020 compared to $3.7 million in 2019. The Corporation's overall effective tax rate was 15.1% in 2020 compared to 16.6% in 2019. The reduction is primarily the result of decreased pretax income and increased tax exempt interest income on the municipal bond securities portfolio. The lower effective tax rate in both 2020 and 2019 benefited from the Tax Cuts and Jobs Act signed into law in December 2017 which reduced federal income tax rates effective in 2018.

Tri City Bankshares Corporation

Selected Financial Data

	For the Year Ended December 31,				
	2016	2017	2018	2019	2020
Results of Operations					
Interest income	$ 44,091,245	$ 47,094,056	$ 51,298,986	$ 53,452,565	$ 51,067,127
Interest expense	1,241,042	1,562,534	1,878,617	2,296,014	1,446,834
Net interest income	42,850,203	45,531,522	49,420,369	51,156,551	49,620,293
Provision for loan losses ("PLL")	900,000	-	-	-	1,500,000
Net interest income after PLL	41,950,203	45,531,522	49,420,369	51,156,551	48,120,293
Core noninterest income	14,379,506	14,992,594	15,721,859	15,430,526	17,341,854
Non-core noninterest income	769,702	329,920	1,106,574	3,002,577	1,029,396
Core noninterest expense	40,988,691	42,668,461	44,006,958	46,067,993	48,136,600
Non-core noninterest expense	-	-	728,278	1,069,131	1,619,796
Income before income taxes	16,110,720	18,185,575	21,513,566	22,452,530	16,735,147
Deferred tax adjustment	-	1,500,190	-	-	-
Income taxes	5,382,714	6,005,916	4,552,500	3,729,500	2,518,795
Net income	$ 10,728,006	$ 10,679,469	$ 16,961,066	$ 18,723,030	$ 14,216,352
Balance Sheet Data					
Assets	$ 1,427,301,200	$ 1,414,721,950	$ 1,406,431,804	$ 1,466,800,227	$ 1,796,413,636
Security investments	440,788,027	444,488,998	371,017,618	383,295,527	558,509,399
Total loans	799,628,467	825,842,074	907,464,082	902,066,127	958,247,553
Allowance for loan losses	(11,256,774)	(10,732,652)	(10,994,385)	(11,072,956)	(13,106,919)
Total loans, net	788,371,693	815,109,422	896,469,697	890,993,171	945,140,634
Deposits	1,284,805,692	1,267,051,615	1,249,302,645	1,271,749,600	1,574,587,154
Borrowings	-	-	-	-	-
Total Tier One capital	139,755,993	146,655,541	159,342,248	173,434,722	183,020,518
Total stockholders' equity	138,186,448	143,865,498	153,014,924	174,466,438	191,103,531
Net loans to deposits	61.36%	64.33%	71.76%	70.06%	60.02%
Per Share Data					
Earnings per share	$ 1.20	$ 1.20	$ 1.90	$ 2.10	$ 1.60
Cash dividends paid	$ 0.48	$ 0.48	$ 0.48	$ 0.52	$ 0.52
Book value per share	$ 15.52	$ 16.16	$ 17.18	$ 19.59	$ 21.46
Shares outstanding	8,904,915	8,904,915	8,904,915	8,904,915	8,904,915
Performance Ratios					
Return on average assets	0.80%	0.76%	1.21%	1.30%	0.87%
Return on average equity	7.89%	7.57%	11.43%	11.43%	7.78%
Interest on earning assets	3.49%	3.57%	3.91%	4.01%	3.37%
Cost of funds	0.10%	0.12%	0.14%	0.17%	0.10%
Net interest margin	3.39%	3.45%	3.77%	3.84%	3.27%
Core noninterest income to average assets	1.07%	1.07%	1.13%	1.07%	1.06%
Core noninterest expense to average assets	3.04%	3.04%	3.15%	3.19%	2.93%
Efficiency Ratio	71.62%	70.50%	67.56%	69.18%	71.89%
Capital Ratios					
Total equity to total assets	9.68%	10.17%	10.88%	11.89%	10.64%
Tier One capital ratio	9.79%	10.37%	11.33%	11.82%	10.19%
Asset Quality Ratios					
Nonaccrual loans to total loans	0.74%	0.56%	0.47%	0.54%	0.52%
Past due loans >30 days to total loans	1.01%	0.80%	0.82%	0.52%	0.65%
Net charge-offs to total loans	0.15%	0.06%	-0.03%	-0.01%	-0.06%
Other real estate owned to total assets	0.03%	0.01%	0.01%	0.00%	0.00%
Allowance for loan losses to total loans	1.41%	1.30%	1.21%	1.23%	1.37%

Independent Auditors' Report

To the Board of Directors and Stockholders of
Tri City Bankshares Corporation

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Tri City Bankshares Corporation and subsidiaries (the Corporation), which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated 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 consolidated 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 control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. 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 consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Corporation as of December 31, 2020 and 2019, 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.

Report on Internal Control Over Financial Reporting

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Corporation's internal control over financial reporting as of December 31, 2020, based on criteria established in *Internal Control-Integrated Framework (2013),* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 24, 2021 expressed an unqualified opinion.

Baker Tilly US, LLP

Milwaukee, Wisconsin
March 24, 2021

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED BALANCE SHEETS

As of December 31, 2020 and 2019

ASSETS

		2020		2019
Cash and due from banks	$	184,345,327	$	84,918,940
Federal funds sold		11,019,722		11,601,051
Total Cash and Cash Equivalents		195,365,049		96,519,991
Securities available for sale, at fair value		558,509,399		383,295,527
Loans, less allowance for loan losses of $13,106,919 and $11,072,956 as of 2020 and 2019, respectively		945,140,634		890,993,171
Premises and equipment - net		16,026,081		16,555,094
Right of use lease asset		15,659,597		16,143,202
Bank owned life insurance		43,312,658		42,931,999
Accrued interest receivable and other assets		22,400,218		20,361,243
TOTAL ASSETS	$	1,796,413,636	$	1,466,800,227

LIABILITIES AND STOCKHOLDERS' EQUITY

		2020		2019
LIABILITIES				
Deposits				
Demand	$	420,974,242	$	298,876,234
Interest bearing		1,096,230,547		913,251,748
Certificates of deposit		57,382,365		59,621,618
Total Deposits		1,574,587,154		1,271,749,600
Lease liability		15,659,597		16,143,202
Accrued interest payable and other liabilities		15,063,354		4,440,987
Total Liabilities		1,605,310,105		1,292,333,789
STOCKHOLDERS' EQUITY				
Cumulative preferred stock, $1 par value 200,000 shares authorized, no shares issued		-		-
Common stock, $1 par value, 15,000,000 shares authorized, 8,904,915 shares issued and outstanding in 2020 and 2019		8,904,915		8,904,915
Additional paid-in-capital		26,543,470		26,543,470
Accumulated other comprehensive income		8,083,013		1,031,716
Retained earnings		147,572,133		137,986,337
Total Stockholders' Equity		191,103,531		174,466,438
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	1,796,413,636	$	1,466,800,227

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

For the Years Ended December 31, 2020 and 2019

	2020	2019
INTEREST INCOME		
Loans	$ 42,721,792	$ 43,921,658
Investment securities		
Taxable	6,499,710	6,987,281
Tax exempt	1,401,511	897,178
Federal funds sold and due from banks	424,789	1,627,122
Other	19,325	19,326
Total Interest Income	51,067,127	53,452,565
INTEREST EXPENSE		
Deposits	1,446,826	2,289,362
Other borrowings	8	6,652
Total Interest Expense	1,446,834	2,296,014
Net Interest Income before Provision for Loan Losses	49,620,293	51,156,551
Provision for loan losses	1,500,000	-
Net Interest Income after Provision for Loan Losses	48,120,293	51,156,551
NONINTEREST INCOME		
Service charges on deposits	3,572,842	4,641,796
Debit card interchange	5,108,086	4,473,591
ATM	911,465	1,282,415
Merchant services	771,158	862,433
Loan servicing income	790,051	598,005
Net gain on sale of loans	2,884,025	554,604
Increase in bank owned life insurance	1,050,659	899,752
Bank owned life insurance death benefits	450,000	2,333,763
Non-accretable loan discount	579,396	668,814
Other income	2,253,568	2,117,930
Total Noninterest Income	18,371,250	18,433,103
NONINTEREST EXPENSES		
Salaries and employee benefits	27,791,365	26,792,477
Net occupancy costs	4,229,818	4,253,503
Furniture and equipment expenses	2,896,063	2,465,444
Data processing and telecommunications expense	5,547,873	5,156,412
Professional fees	1,757,098	1,644,619
Advertising and promotional	911,740	664,543
FDIC and other regulatory assessments	527,222	488,231
New Markets Tax Credits investment amortization	1,619,796	1,069,131
Office supplies	891,900	922,527
Other expense	3,583,521	3,680,237
Total Noninterest Expense	49,756,396	47,137,124
Total Income before Taxes	16,735,147	22,452,530
Less: Income tax expense	2,518,795	3,729,500
NET INCOME	$ 14,216,352	$ 18,723,030

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2020 and 2019

	2020	2019
NET INCOME	$ 14,216,352	$ 18,723,030
Other comprehensive income, net of tax:		
Securities available for sale:		
Net unrealized holding gains arising during the period	9,691,323	10,114,247
Tax effect	(2,640,026)	(2,755,207)
Total Other Comprehensive Income, net of tax:	7,051,297	7,359,040
COMPREHENSIVE INCOME	$ 21,267,649	$ 26,082,070

See accompanying notes to consolidated financial statements.

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the Years Ended December 31, 2020 and 2019

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total
BALANCES - January 1, 2019	$ 8,904,915	$ 26,543,470	$ (6,327,324)	$ 123,893,863	$ 153,014,924
Net income	-	-	-	18,723,030	18,723,030
Total Other Comprehensive Income	-	-	7,359,040	-	7,359,040
Cash dividends - ($0.52 per share)	-	-	-	(4,630,556)	(4,630,556)
BALANCES - December 31, 2019	8,904,915	26,543,470	1,031,716	137,986,337	174,466,438
Net income	-	-	-	14,216,352	14,216,352
Total Other Comprehensive Income	-	-	7,051,297	-	7,051,297
Cash dividends - ($0.52 per share)	-	-	-	(4,630,556)	(4,630,556)
BALANCES - December 31, 2020	$ 8,904,915	$ 26,543,470	$ 8,083,013	$ 147,572,133	$ 191,103,531

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2020 and 2019

	2020	2019
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income	$ 14,216,352	$ 18,723,030
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation	2,057,856	1,949,568
Amortization and accretion of servicing rights, premiums, discounts and PPP processing fees	3,835,966	1,852,926
Net gain on sale of loans	(2,884,025)	(554,604)
Provision for loan losses	1,500,000	-
(Expense) Benefit for deferred income taxes	(461,564)	435,033
Proceeds from sales of loans held for sale	103,198,112	35,779,614
Originations of loans held for sale	(100,787,232)	(36,884,071)
Increase in bank owned life insurance	(1,050,659)	(899,752)
Gain on bank owned life insurance death benefits	(450,000)	(2,333,763)
Gain on sale of other real estate owned	-	(5,500)
Net change in fair value of mortgage servicing rights	180,000	(30,365)
(Loss) Gain on disposal of premises and equipment	(28,705)	598
Right of use lease asset amortization	704,530	747,275
Net change in:		
Accrued interest receivable and other assets	765,473	(5,041,393)
Lease liability	(704,530)	(747,275)
Accrued interest payable and other liabilities	844,969	326,752
Net cash flows from operating activities	20,936,543	13,318,073
CASH FLOWS FROM INVESTING ACTIVITIES		
Activity in available for sale securities:		
Maturities, prepayments and calls	118,942,703	67,942,011
Purchases	(280,424,393)	(72,777,977)
Net (increase) decrease in loans	(55,813,456)	7,938,398
Purchase of premises and equipment	(1,545,637)	(2,772,596)
Purchase of bank owned life insurance	-	(5,000,000)
Proceeds from bank owned life insurance death benefits	-	4,557,315
Investment in FHLB Chicago	(1,503,200)	-
Proceeds from sale of other real estate owned	-	109,900
Proceeds from sales of premises and equipment	45,500	18,043
Net cash (used in) provided by investing activities	(220,298,483)	15,094
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in deposits	302,837,554	22,446,955
Dividends paid	(4,630,556)	(4,630,556)
Net cash flows provided by financing activities	298,206,998	17,816,399
Net change in cash and cash equivalents	98,845,058	31,149,566
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	96,519,991	65,370,425
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 195,365,049	$ 96,519,991

See accompanying notes to consolidated financial statements

TRI CITY BANKSHARES CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2020 and 2019

(continued)

	2020	2019
SUPPLEMENTAL CASH FLOW DISCLOSURES		
Cash paid for interest	$ 1,462,710	$ 2,304,750
Cash paid for income taxes	2,810,000	3,755,000
SUPPLEMENTAL NON-CASH DISCLOSURES		
Mortgage servicing rights resulting from sales of loans	788,095	263,461
Lease liabilities arising from obtaining right of use lease assets	220,925	16,890,477
Security purchases settled in subsequent period	7,598,934	-
Proceeds of bank owned life insurance death benefits received in subsequent period	1,120,000	-

See accompanying notes to consolidated financial statements

NOTE 1 - Summary of Significant Accounting Policies

The consolidated financial statements of Tri City Bankshares Corporation (the "Corporation") include the accounts of its wholly owned subsidiary, Tri City National Bank (the "Bank") (collectively, the "Corporation"). The Bank includes the accounts of its wholly owned subsidiaries, Tri City Capital Corporation, a Nevada investment subsidiary, Title Service of Southeast Wisconsin, Inc., a title company subsidiary, TCNB Whole Health Investment Fund LLC, TCNB Aurora Investment Fund LLC, TCNB Fire Loan Pool IF LLC, TCNB FCI Loan Pool IF LLC and TCNB Notre Dame IF LLC, subsidiaries to facilitate tax credit investments. All significant intercompany accounts and transactions have been eliminated in consolidation.

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and conform to general practices within the banking industry.

The Corporation grants commercial, real estate and installment loans and accepts deposits primarily in Southeastern Wisconsin. The Corporation is subject to competition from other financial institutions and nonfinancial institutions providing financial products. Additionally, the Corporation is subject to the regulations of certain regulatory agencies and undergo periodic examination by those regulatory agencies.

Use of Estimates

In preparing consolidated financial statements in conformity with U.S. GAAP, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, deferred taxes, other than temporary impairment of securities and fair values of financial instruments.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash and balances due from banks and federal funds sold, all of which mature within ninety days. The Corporation maintained amounts due from banks that exceeded federally insured limits as of December 31, 2020. The Corporation has not experienced any losses in such accounts.

Securities

Securities are classified as available for sale when the Corporation intends to hold them for an indefinite period of time but not necessarily to maturity. Securities available for sale are accounted for on a trade date basis and carried at fair value, with unrealized holding gains and losses excluded from net income and reported in accumulated other comprehensive income (loss), net of tax. Gains and losses on sales are recorded on the trade date and determined using the specific identification method.

Declines in the fair value of securities below their cost that are other-than-temporary due to credit issues are reflected as "Other than temporary impairment of securities" in the consolidated statements of income. In estimating other-than-temporary losses, management considers: (1) the length of time and extent that fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, and (3) the Corporation's ability and intent to hold the security for a period sufficient to allow for any anticipated recovery in fair value. The difference between the present values of the cash flows expected to be collected and the amortized cost basis is the credit loss. The credit loss is the portion of the other-than-temporary impairment that is recognized in earnings and is a reduction to the cost basis of the security. The portion of other-than-temporary impairment related to all other factors is included in other comprehensive loss, net of tax.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Loans Held for Investment

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at the amount of unpaid principal, reduced by an allowance for loan losses and any deferred fees or costs in originating loans. Interest income is accrued and credited to income on a daily basis based on the unpaid principal balance. Loan origination fees, net of certain direct loan origination costs, are deferred and recognized as an adjustment of the loan yield using an effective interest method. The accrual of interest income on impaired loans is discontinued when, in the opinion of management, there is reasonable doubt as to the borrower's ability to meet payment of interest or principal when they become due. When interest accrual is discontinued, all unpaid accrued interest is reversed. Cash collections on impaired loans are credited to the loan receivable balance and no interest income is recognized on those loans until the principal balance is current. Loans are returned to accrual status when the principal and interest amounts contractually due are brought current and future payments are reasonably assured. Generally, a troubled debt restructuring ("TDR") includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that the Corporation would not otherwise consider except for the borrower's financial difficulties. All TDRs are classified as impaired loans. TDRs may be on accrual or non-accrual status based upon the performance of the borrower and management's assessment of collectability. TDRs deemed non-accrual may return to accrued status based on performance in accordance with terms of the restructuring, generally 6 months.

Consistent with regulatory guidance, charge-offs are taken when specific loans, or portions thereof, are considered uncollectible and of such little value that their continuance as bankable assets is not warranted. The Corporation's policy is to promptly charge these loans off in the period the uncollectible loss amount is reasonably determined. The Corporation promptly charges-off commercial and real estate loans, or portions thereof, when available information confirms that specific loans are uncollectible based on information that includes, but is not limited to, (1) the deteriorating financial condition of the borrower, (2) declining collateral values, and/or (3) legal action, including bankruptcy, that impairs the borrower's ability to adequately meet its obligations. All consumer loans 120 days or more past due and all other loans with principal and interest 180 days or more past due will be reviewed for potential charge-off at least quarterly.

The COVID-19 pandemic has negatively impacted the global and United States economies. In response to the crisis, the Coronavirus Aid, Relief, and Economic Security ("CARES") Act was passed by Congress and signed into law on March 27, 2020. The CARES Act includes provisions to fight the COVID-19 pandemic and stimulate the economy by supporting individuals and businesses through loans, grants, tax changes, and other types of relief. In addition, the Consolidated Appropriations Act ("CAA") was signed into law on December 27, 2020 which in part addressed additional COVID-19 pandemic responses and relief. Some of the CARES Act and CAA provisions applicable to and implemented by the Corporation in 2020 include, but are not limited to:

- Accounting for Loan Modifications – The CARES Act, along with regulatory guidance from federal banking agencies, provides that a financial institution may elect to suspend (1) the requirements under U.S. GAAP for certain loan modifications that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes. Modifications in the scope of the exemption include forbearance agreements, interest rate modifications, repayment plan changes and any other similar arrangements that would delay payments of principal or interest. This relief is allowable on modifications on loans which were not more than 30 days past due as of December 31, 2019, and that occur after March 1, 2020, and before the earlier of January 1, 2022 or 60 days after the date on which the national emergency related to the COVID-19 pandemic is terminated. The suspension is not applicable to any adverse impact on the credit of a borrower that is not related to the pandemic (see Note 5 – Loans).
- Paycheck Protection Program – The CARES Act established the Paycheck Protection Program ("PPP"), an expansion of the Small Business Administration's 7(a) loan program and the Economic Injury Disaster Loan Program ("EIDL"), administrated directly by the Small Business Administration ("SBA") (see Note 5 – Loans).

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Loans Acquired Through Purchase

Loans acquired through the completion of a purchase, including loans that have evidence of deterioration of credit quality since origination and for which it is probable, at acquisition, that the Corporation will be unable to collect all contractually-required payments receivable, are initially recorded at fair value with no valuation allowance. Loans are evaluated individually at the date of acquisition to determine if there is evidence of deterioration of credit quality since origination. Loans where there is evidence of deterioration of credit quality since origination may be aggregated and accounted for as a pool of loans if the loans being aggregated have common risk characteristics. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, a loss accrual or a valuation allowance. Non-accretable discount may be taken to non-interest income if a loan pays-off or if the non-accretable discount is greater than a charge-off taken. Subsequent decreases to the expected cash flows will generally result in a change in the allowance for loan losses. Subsequent increases in cash flows result in a change in the allowance for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount with a positive impact on interest income. The difference between the undiscounted cash flows expected at acquisition and the investment in the loan, or the "accretable yield," is recognized as interest income on a level-yield method over the life of the loan. Increases in expected cash flows subsequent to the initial investment are recognized prospectively through adjustment of the yield on the loan over its remaining life. Decreases in expected cash flows are recognized as a change in the allowance for loan losses. If the Corporation does not have the information necessary to reasonably estimate expected cash flows, it may use the cost recovery method or cash basis method of income recognition. Valuation allowances on these impaired loans reflect only losses incurred after the acquisition (meaning the present value of all cash flows expected at acquisition that ultimately are not to be received).

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or estimated market value in the aggregate. Net unrealized gains or losses are recognized through a valuation allowance by charges to income. All sales are made without recourse. Loans held for sale were $1,080,650 and $1,395,600 as of December 31, 2020 and 2019, respectively.

Allowance for Loan Losses

The allowance for loan losses reflects management's best estimate of the probable and inherent losses on loans and is based on a risk model developed and implemented by management and approved by the Corporation's Board of Directors.

The allowance for loan losses is a valuation allowance for probable and inherent losses incurred in the loan portfolio. Management maintains allowances for loan losses at levels deemed adequate to absorb estimated probable credit losses inherent in the loan portfolio. The adequacy of the allowance is determined based on periodic evaluations of the loan portfolios and other relevant factors. The allowance is comprised of both a specific component and a general component. Even though the entire allowance is available to cover losses on any loan, specific allowances are provided on impaired loans pursuant to accounting standards. The general allowance is based on historical loss experience, adjusted for qualitative and environmental factors.

In determining the general allowance management has segregated the loan portfolio by loan class. For each class of loan, a historical loss factor is computed. In determining the appropriate period of activity to use in computing the historical loss factor management reviews trends in net charge-off ratios. It is management's intention to utilize a period of activity that is most reflective of current experience. Changes in the historical period are made when there is a distinct change in the trend of net charge-off experience. Management adjusts the historical loss factors for the impact of the following qualitative factors: asset quality, changes in volume and terms, policy changes, ability of management, economic trends, industry conditions, changes in credit concentrations and competitive/legal factors. In determining the impact, if any, of an individual qualitative factor, management compares the current underlying facts and circumstances surrounding a particular factor with those in the historical periods, adjusting the historical loss factor in a directionally consistent manner with changes in the qualitative factor. Management separately evaluates both the Corporation's historical portfolio as well as acquired loans that have renewed and are eligible to be considered as part of the general allowance. Management will continue to analyze the qualitative factors on a quarterly basis, adjusting the historical loss factor both up and down, to a factor deemed appropriate for the probable and inherent risk of loss in its portfolio.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Allowance for Loan Losses (continued)

Specific allowances are determined as a result of the impairment process. When a loan is identified as impaired it is evaluated for loss using either the fair value of collateral method or the present value of cash flows method. If the present value of expected cash flows or the fair value of collateral exceeds the Corporation's carrying value of the loan, no loss is anticipated, and no specific reserve is established. However, if the Corporation's carrying value of the loan is greater than the present value of expected cash flows or fair value of collateral, a specific reserve is established. In either situation, loans identified as impaired are excluded from the calculation of the general reserve.

The allowance for loan losses is increased by provisions charged to earnings and reduced by charge-offs, net of recoveries. The adequacy of the allowance for loan losses is reviewed and approved by the Corporation's Board of Directors on a quarterly basis. In addition, various regulatory agencies periodically review the allowance for loan losses. These agencies may suggest additions to the allowance for loan losses based on their judgments of collectability based on information available to them at the time of their examination.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Corporation, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Mortgage Servicing Rights

The Corporation records a mortgage servicing right ("MSR") asset when it continues to service borrower payments and perform maintenance activities on loans sold to secondary market investors. In the period in which the loan is sold to the secondary market investors, the gain on sale of the loan is increased by the value of the initial MSR.

The Corporation initially records servicing rights at the time of the sale of the loans to the secondary market investors. The Corporation uses the amortization method for the subsequent measurement of its MSR assets. Under the amortization method, the Corporation amortizes the value of its MSR assets in proportion to and over the life of the loan on a per loan basis. An impairment analysis is prepared on a quarterly basis by estimating the fair value of the MSR assets and comparing that value to the carrying amount. A valuation allowance is established when the carrying amount exceeds fair value. The fair value of the MSR asset is determined by using a discounted cash flow model, which estimates the present value of the future net cash flows of the servicing portfolio based on various factors, such as servicing costs, expected prepayment speeds and discount rates.

As of December 31, 2020 and 2019, the Corporation services real estate loans for investors in the secondary market, which are not included in the accompanying consolidated balance sheets, of approximately $262 million and $223 million, respectively. The related MSR assets were $1,672,249 and $1,491,001 as of December 31, 2020 and 2019, respectively, and are included in accrued interest receivable and other assets on the consolidated balance sheets. MSR assets as of December 31, 2020 are reported net of a valuation allowance of $180,000. No valuation allowance was required as of December 31, 2019. During 2020, the Corporation complied with mortgage forbearance loan modifications in accordance with CARES Act and CAA provisions.

Premises and Equipment - Net

Land is carried at cost. Depreciable assets are stated at cost less accumulated depreciation. Provisions for depreciation are computed on straight-line methods over the estimated useful lives of the assets, which range from 3 to 10 years for furniture and equipment and 15 to 40 years for buildings and lease-hold improvements. Repairs and maintenance costs are expensed as incurred.

New Markets Tax Credits

As part of its Community Reinvestment Act responsibilities and due to their favorable economics, the Corporation invests in tax credit-motivated projects primarily in the markets it serves. These projects are directed at tax credits issued under the federal New Markets Tax Credits program. As a result of the transactions, the Corporation has several Investment Fund subsidiaries. The Investment Fund subsidiaries are a limited partner in several community development entities ("CDEs"). The Corporation is not the general partner, does not have controlling ownership and is not the primary beneficiary in any of these limited partnerships and thus, the limited partnerships have not been consolidated. These investments are accounted for using the equity method of accounting and are evaluated for impairment at the end of each reporting period (see Note 7 – New Market Tax Credits - Variable Interest Entities).

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Federal Reserve Bank and FHLB Chicago Stocks

The Corporation is required to maintain Federal Reserve Bank ("FRB") and Federal Home Loan Bank of Chicago ("FHLB Chicago") stock as a member of both the FRB and FHLB Chicago, in amounts as required by these institutions. These equity securities are restricted in that they can only be sold back to the respective member institutions or another member institution at par. Therefore, they are less liquid than other investments and their fair value is equal to cost. The Corporation meets the minimum amount required by current regulations and the institutions.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Corporation has entered into off-balance sheet financial instruments consisting of commitments to extend credit, commercial letters of credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded, or related fees are incurred or received.

Derivative Financial Instruments

The Corporation offers interest rate swap products directly to qualified commercial borrowers. The Corporation economically hedges client derivative transactions by entering into offsetting interest rate swap contracts executed with a third party. The derivative contracts have mirror-image terms, which results in the positions' changes in fair value primarily offsetting through earnings each period. The credit risk and risk of non-performance embedded in the fair value calculations is different between the dealer counterparties and the commercial borrowers which may result in a difference in the changes in the fair value of the mirror-image swaps. The Corporation incorporates credit valuation adjustments to appropriately reflect both its own non-performance risk and the counterparty's risk in the fair value measurements. When evaluating the fair value of its derivative contracts for the effects of non-performance and credit risk, the Corporation considered the impact of netting and any applicable credit enhancements such as collateral postings, thresholds and guarantees.

As of December 31, 2020 and 2019, the aggregate amortizing notional value of interest rate swaps with various commercial borrowers was $30.5 million and $13.8 million, respectively. The Corporation receives fixed rates and pays floating rates based upon LIBOR on the swaps with commercial borrowers. Commercial borrower swaps are completed independently with each borrower and are not subject to master netting arrangements. These commercial borrower swaps were reported on the consolidated balance sheets as a derivative asset and liability of $2,783,449 and $1,408,366 in accrued interest receivable and other assets and accrued interest payable and other liabilities as of December 31, 2020 and 2019, respectively. As of December 31, 2020 and 2019, no interest rate swaps were in default and therefore all values for the commercial borrower swaps are recorded on a gross basis on the consolidated balance sheets.

The offsetting interest rate swaps with a third party are collateralized by the pledge of security investments totaling $2,984,419 and $1,483,160 as of December 31, 2020 and 2019, respectively.

Advertising Costs

All advertising costs incurred by the Corporation are expensed in the period in which they are incurred and recorded in noninterest expense.

Income Taxes

The Corporation files a consolidated federal income tax return and combined state income tax returns. Income tax expense is recorded based on the liability method. Deferred income tax assets and liabilities are computed annually for differences between the financial statement and tax bases of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. As changes in tax laws or rates are enacted, deferred tax assets and liabilities are adjusted through income tax expense. The differences relate principally to the allowance for loan losses, mortgage servicing rights, new markets tax credits investments, premises and equipment, and FICA payroll taxes. Valuation allowances are established when necessary to reduce deferred income tax assets to the amount expected to be realized. The Corporation also accounts for the uncertainty in income taxes related to the recognition and measurement of a tax position taken or expected to be taken in an income tax return. The Corporation follows the applicable accounting guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition related to the uncertainty in these income tax positions. It is the Corporation's policy to include interest and penalties in tax expense.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Earnings Per Share

Basic earnings per share is computed based upon the weighted average number of common shares outstanding during each year. The Corporation had no potentially dilutive shares outstanding during the periods ended December 31, 2020 and 2019.

Segment Reporting

The Corporation has determined that it has one reportable segment - community banking. The Corporation offers a range of financial products and services to external customers, including accepting deposits and originating residential, consumer and commercial loans. Revenues for each of these products and services are disclosed in the consolidated statements of income.

Employee Benefit Plan

The Corporation has established a defined contribution 401(k) profit-sharing plan for qualified employees. The Corporation's policy is to fund contributions as accrued.

Bank Owned Life Insurance

The Corporation is the owner and primary beneficiary of life insurance policies on certain employees. Bank owned life insurance is reported at the cash surrender value of the policies. The earnings on the policies are recognized as a component of noninterest income. The policies can be liquidated, if necessary, with tax costs associated. However, the Corporation intends to hold these policies and, accordingly, the Corporation has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Lease Reporting

The Corporation leases various banking facilities under operating lease agreements. The Corporation adopted Accounting Standards Update (ASU) No. 2016-02 "Leases (Topic 842)" and subsequent amendments thereto on January 1, 2019. The Corporation adopted the standard under the modified retrospective approach as of the date of adoption and elected to apply the practical expedient to account for lease and non-lease components in contracts in which the Corporation is a lessee as a single lease component. The Corporation reports right of use lease assets representing our right to use an underlying asset for the lease term, and reports lease liabilities representing our obligation to make lease payments arising from the lease. Adoption of the lease standard resulted in the recognition of a right of use lease asset and lease liability of $15,573,043 as of January 1, 2019.

Lease assets and liabilities are determined based on the present value of remaining minimum lease payments, including all extension options, discounted using the Corporation's incremental borrowing rate as of the date of adoption, and any subsequent lease extensions or commencements. Since the rates inherent in the leases are generally not available, the Corporation uses the FHLB Chicago advance fixed rate for the appropriate lease term as the discount rate. Disclosures regarding the Corporation's leasing activity are presented in Note 14 – Leases.

Reclassifications

Certain 2019 amounts have been reclassified to conform to the 2020 presentation. The reclassifications have no effect on previously reported consolidated net income, basic earnings per share, and consolidated stockholders' equity.

Revenue Recognition

The Corporation generally fully satisfies its performance obligations on its contracts with customers as services are rendered and the transaction prices are typically fixed; charged either on a periodic basis or based on activity. Because performance obligations are satisfied as services are rendered and the transaction prices are fixed, there is little judgment involved in applying Topic 606 that significantly affects the determination of the amount and timing of revenue from contracts with customers. The main types of revenue contracts included in non-interest income within the consolidated statements of operations are as follows:

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Revenue Recognition (continued)

- ***Service charges on deposits*** - Service charges on deposits consist of transaction-based fees, account maintenance fees, and overdraft services fees for various retail and business checking customers. Transaction-based fees, which includes services such as wire transfer fees and statement rendering fees are recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. All deposit liabilities are considered to have one-day terms and therefore related fees are recognized as non-interest income at the time when the services are provided to the customer. Account maintenance fees, which relate primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Corporation satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn directly from the customer's account balance.

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

- ***ATM Income -*** The Corporation earns income on automated teller machine ("ATM") transactions. This income includes fees when noncustomers use the Corporation's ATM network, when the Corporation's customers use other ATM networks and interchange income on transaction activity that occurs on the Corporation's ATM network. Income from these activities are recognized concurrently when the transactions occurs.

- ***Merchant Services Income*** - The Corporation earns merchant services income for selling and servicing merchant card processing to customers. The Corporation uses a third party to process the credit/debit cards at point of sale. The Corporation receives monthly payments for servicing the merchant terminals, which is earned over the course of the month, representing the period over which the Corporation satisfies the performance obligation. A per transaction fee and a percent of the overall transaction amount makes up the monthly merchant service fee collected from each customer. In addition, merchant services sell merchant terminal machines which is recognized at the time of sale.

- ***Gain/Losses on Sale of OREO –*** The Corporation records a gain or loss from the sale of OREO when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Corporation finances the sale of OREO to the buyer, the Corporation assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the OREO asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Corporation adjusts the transaction prices and related gain (loss) on sale if a significant financing component is present.

- ***Other Non-Interest Income*** – The main items in this revenue category are other loan closing related fees, prepayment fees and title fees which are all recognized at the time the transaction is executed as that is the point in time the Corporation fulfills the customer's request. Also included in other income are financial advisory fees which are contractually agreed with each customer and earned over time as the Corporation provides the contracted monthly or quarterly services.

Subsequent Events

Subsequent events were evaluated through March 24, 2021, the date the consolidated financial statements were available to be issued.

The impact of the COVID-19 pandemic continues to evolve. The ultimate extent of the impact of the COVID-19 pandemic on our business, financial condition and results of operations is currently unknown and will depend on various developments and other factors, including the duration and scope of the pandemic, governmental and regulatory responses to the pandemic, and the associated impacts on the economy, financial markets and our customers. On December 27, 2020, the 2021 Consolidated Appropriations Act ("CAA") was signed into law. The CAA included $284 billion in new PPP funding, and the Corporation is assisting its customers in applying for such funding and providing additional PPP loans. As of March 23, 2021, the Corporation has originated 456 new loans under the CAA with a balance of approximately $32 million and an average processing fee of approximately 5.7%. The Corporation is continuing to originate PPP loans under the CAA.

NOTE 1 - Summary of Significant Accounting Policies (cont.)

Accounting Pronouncements Effective in 2020

Reference Rate Reform

In March 2020, the Financial Accounting Standards Board ("FASB") issued ASU 2020-04, *Reference Rate Reform (Topic 848).* The ASU provides temporary optional guidance to ease the potential burden in accounting for reference rate reform. The new guidance provides optional expedients and exceptions for applying U.S. GAAP principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. The ASU is intended to help stakeholders during the global market-wide reference rate transition period. Therefore, it will be in effect for a limited time through December 31, 2022. The Corporation has evaluated the impact of the ASU and it did not have a material impact on the operating results or financial position of the Corporation.

Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13*, Fair Value Measurement (Topic 820).* This ASU modifies disclosure requirements on fair value measurements. The following disclosure requirements were removed: (1) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, (2) the policy for timing of transfers between levels, (3) the valuation processes for Level 3 fair value measurements and (4) for nonpublic entities, the changes in unrealized gains and losses for the period included in earnings for recurring Level 3 fair value measurements held at the end of the reporting period. The following disclosure requirements were modified: (1) in lieu of a rollforward for Level 3 fair value measurements, a nonpublic entity is required to disclose transfers into and out of Level 3 of the fair value hierarchy and purchases and issues of Level 3 assets and liabilities, (2) for investments in certain entities that calculate net asset value, an entity is required to disclose the timing of liquidation of an investee's assets and the date when restrictions from redemption might lapse only if the investee has communicated the timing to the entity or announced the timing publicly, and (3) the amendments clarify that the measurement uncertainty disclosure is to communicate information about the uncertainty in measurement as of the reporting date. The Corporation adopted this guidance in 2020 and it had no material impact on the financial statement disclosures.

Accounting Pronouncements for Future Adoption

Financial Instruments – Credit Losses – Measurement of Credit Losses on Financial Instruments

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments – Credit Losses (Topic 326) Measurement of Credit Losses on Financial Instruments*. ASU 2016-13 requires credit losses on most financial assets measured at amortized cost and certain other instruments to be measured using an expected credit loss model (referred to as the current expected credit loss model). Under this model, entities will estimate credit losses over the entire contractual term of the instrument (considering estimated prepayments, but not expected extensions or modifications unless reasonable expectation of a troubled debt restructuring exists) from the date of initial recognition of that instrument. The ASU also replaces the current accounting model for purchased credit impaired loans and debt securities. The allowance for credit losses for purchased financial assets with a more-than insignificant amount of credit deterioration since origination ("PCD assets"), should be determined in a similar manner to other financial assets measured on an amortized cost basis. However, upon initial recognition, the allowance for credit losses is added to the purchase price ("gross up approach") to determine the initial amortized cost basis. The subsequent accounting for PCD financial assets is the same expected loss model described above. Further, the ASU made certain targeted amendments to the existing impairment model for available-for-sale (AFS) debt securities. For an AFS debt security for which there is neither the intent nor a more-likely-than-not requirement to sell, an entity will record credit losses as an allowance rather than a write-down of the amortized cost basis. In November 2019, the FASB issued ASU 2019-10 which amends the effective date of ASU 2016–13. The Corporation must adopt this guidance in 2023. Management has engaged a third-party vendor to assist in the implementation of the standard and is in the process of analyzing loan level data for modeling purposes. Management is currently evaluating the impact of adoption of the new standard on the consolidated operations, financial position and cash flows of the Corporation.

Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs

In October 2020, the FASB issued ASU 2020-08, *Codification Improvements to Subtopic 310-20, Receivables – Nonrefundable Fees and Other Costs.* This amendment clarifies that an entity should re-evaluate whether a callable debt security is within the scope of paragraph 310-20-35-33 for each reporting period. The amendments are effective for fiscal years beginning after December 15, 2020. Management is evaluating the impact of the amendment, but believes it will not have a material impact on the operating results or financial position of the Corporation.

NOTE 2 - Fair Value of Financial Instruments

The accounting guidance for fair value measurements and disclosures establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy favors the transparency of inputs to the valuation of an asset or liability as of the measurement date and thereby favors use of Level 1 if appropriate information is available, otherwise Level 2, and finally Level 3 if a Level 2 input is not available. The three levels are defined as follows.

- Level 1 — Fair value is based upon quoted prices (unadjusted) for identical assets or liabilities in active markets in which the Corporation can participate.
- Level 2 — Fair value is based upon quoted prices for similar (i.e., not identical) assets and liabilities in active markets, and other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- Level 3 — Fair value is based upon financial models using primarily unobservable inputs.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input within the valuation hierarchy that is significant to the fair value measurement.

Securities available for sale - The fair value of securities available for sale is determined by obtaining market price quotes from independent third parties wherever such quotes are available. Where such quotes are not available, management utilizes independent third-party valuation analysis to support these estimates and judgments in determining fair value. The subsequent table presents, for the periods noted, the Corporation's fair value of securities available for sale in accordance with the fair value hierarchy described above.

Impaired loans - The Corporation does not record loans held for investment at fair value on a recurring basis. However, from time to time, a particular loan may be considered impaired and an allowance for loan losses 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 agreement are considered impaired. Once a loan is identified as individually impaired, management measures impairment in accordance with relevant accounting guidance. The fair value of impaired loans is estimated using either the fair value of collateral method or the present value of cash flows method. Those impaired loans requiring an allowance represent loans for which the fair value of the expected repayments or collateral does not exceed the recorded investments in such loans. For individually evaluated impaired loans, the significant unobservable inputs include the present value of expected future cash flows discounted at the loans effective interest rate, the underlying collateral for collateral-dependent loans, or the estimated liquidity of the note, resulting in an average discount of approximately 22.5% as of December 31, 2020 and 20.8% as of December 31, 2019 for those impaired loans requiring an allowance. The Corporation records these impaired loans as nonrecurring level 3 in the fair value hierarchy. On December 31, 2020 and 2019, all of the impaired loans were evaluated based on the fair value of the collateral.

Mortgage servicing rights - The fair value of MSRs is estimated using third-party information for selected asset price tables for servicing cost and servicing fees applied to the Corporation's portfolio of serviced loans and is categorized as level 2 in the fair value hierarchy.

Interest rate swaps – Values of these instruments are obtained through an independent pricing source utilizing information which may include market observed quotations for swaps, LIBOR rates, forward rates and rate volatility and are categorized as level 2 in the fair value hierarchy.

The methods described above may produce a fair value estimate that may not be indicative of net realizable value or reflective of future fair values. Further, while the Corporation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in different estimates of fair values of the same financial instruments as of the reporting date.

NOTE 2 - Fair Value of Financial Instruments (cont.)

Financial instruments measured at fair value on a recurring basis for 2020 and 2019 are summarized below:

Assets	Balance at 12/31/2020	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of state and political subdivision	$ 176,979,539	$ -	$ 176,979,539	$ -
Collateralized mortgage obligations	201,239,076	-	201,239,076	-
Mortgage-backed securities	180,290,784	-	180,290,784	-
Total securities available for sale	$ 558,509,399	$ -	$ 558,509,399	$ -
Interest rate swaps - other assets	$ 2,783,449	$ -	$ 2,783,449	$ -
Liabilities				
Interest rate swaps - other liabilities	$ 2,783,449	$ -	$ 2,783,449	$ -

Assets	Balance at 12/31/2019	Level 1	Level 2	Level 3
Securities available for sale				
Obligations of state and political subdivision	$ 51,247,038	$ -	$ 51,247,038	$ -
Collateralized mortgage obligations	194,208,525	-	194,208,525	-
Mortgage-backed securities	137,839,964	-	137,839,964	-
Total securities available for sale	$ 383,295,527	$ -	$ 383,295,527	$ -
Interest rate swaps - other assets	$ 1,408,366	$ -	$ 1,408,366	$ -
Liabilities				
Interest rate swaps - other liabilities	$ 1,408,366	$ -	$ 1,408,366	$ -

Financial instruments measured at fair value on a non-recurring basis for 2020 and 2019 are summarized below:

	Balance at 12/31/2020	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 5,717,400	$ -	$ -	$ 5,717,400
Mortgage servicing rights	1,628,633	-	1,628,633	-
Totals	$ 7,346,033	$ -	$ 1,628,633	$ 5,717,400

	Balance at 12/31/2019	Level 1	Level 2	Level 3
Impaired loans with a related allowance, net	$ 7,486,899	$ -	$ -	$ 7,486,899
Mortgage servicing rights	1,767,518	-	1,767,518	-
Totals	$ 9,254,417	$ -	$ 1,767,518	$ 7,486,899

NOTE 2 - Fair Value of Financial Instruments (cont.)

The estimated fair values of financial instruments as of December 31,

		2020		2019	
	Fair Value Hierarchy	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FINANCIAL ASSETS					
Cash and due from banks	1	$ 184,345,327	$ 184,345,327	$ 84,918,940	$ 84,918,940
Federal funds sold	2	11,019,722	11,019,722	11,601,051	11,601,051
Available for sale securities	2	558,509,399	558,509,399	383,295,527	383,295,527
Federal reserve stock	2	322,100	322,100	322,100	322,100
Loans held for investment	3	945,140,634	948,993,634	890,993,171	898,937,000
Bank owned life insurance	2	43,312,658	43,312,658	42,931,999	42,931,999
Mortgage servicing rights, net	2	1,672,249	1,628,633	1,491,001	1,767,518
Interest rate swaps	2	2,783,449	2,783,449	1,408,366	1,408,366
Accrued interest receivable	2	4,735,605	4,735,605	3,643,328	3,643,328
FINANCIAL LIABILITIES					
Deposits	2	$ 1,574,587,154	$ 1,574,758,154	$ 1,271,749,600	$ 1,271,153,600
Interest rate swaps	2	2,783,449	2,783,449	1,408,366	1,408,366
Accrued interest payable	2	58,125	58,125	74,001	74,001

The estimated fair value of fee income on letters of credit outstanding as of December 31, 2020 and December 31, 2019 is insignificant. Loan commitments on which the committed interest rate is less than the current market rate are also insignificant at December 31, 2020 and December 31, 2019.

NOTE 3 - Cash and Due from Banks

The Corporation is required to maintain vault cash and reserve balances with the FRB based upon a percentage of deposits. There was no reserve requirement as of December 31, 2020 and a reserve requirement of $4,340,000 as of December 31, 2019.

NOTE 4 - Available for Sale Securities

The following table presents the amortized costs and fair values of available for sale securities as of December 31,

	2020			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 173,590,169	$ 3,732,228	$ (342,858)	$ 176,979,539
Collateralized mortgage obligations	197,291,097	4,137,130	(189,152)	201,239,075
Mortgage-backed securities	176,518,843	3,861,279	(89,337)	180,290,785
Totals	$ 547,400,109	$ 11,730,637	$ (621,347)	$ 558,509,399

	2019			
	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Obligations of states and political subdivisions	$ 50,505,249	$ 758,370	$ (16,581)	$ 51,247,038
Collateralized mortgage obligations	193,931,978	719,148	(442,601)	194,208,525
Mortgage-backed securities	137,440,333	769,861	(370,230)	137,839,964
Totals	$ 381,877,560	$ 2,247,379	$ (829,412)	$ 383,295,527

The amortized cost and fair value of available for sale securities as of December 31, 2020, by contractual maturity are shown below. Expected maturities will differ from contractual maturities for collateralized mortgage obligations and mortgage backed securities because borrowers or issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

	2020	
	Amortized Cost	Fair Value
Due within one year or less	$ 5,066,771	$ 5,082,621
Due after one year but less than 5 years	10,354,296	10,556,377
Due after 5 years but less than 10 years	53,256,686	54,551,591
Due over 10 years	104,912,416	106,788,950
	173,590,169	176,979,539
Collateralized mortgage obligations	197,291,097	201,239,075
Mortgage backed securities	176,518,843	180,290,785
Totals	$ 547,400,109	$ 558,509,399

NOTE 4 - Available for Sale Securities (cont.)

Available for sale securities with an amortized cost of $169,131,059 and $166,733,594 at December 31, 2020 and December 31, 2019, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

The following table presents the portion of the Corporation's available for sale securities portfolio which has gross unrealized losses, reflecting the length of time that individual securities have been in a continuous unrealized loss position as of December 31:

	2020					
	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 21,879,571	$ (342,858)	$ -	$ -	$ 21,879,571	$ (342,858)
Collateralized mortgage obligations	37,551,255	(189,152)	-	-	37,551,255	(189,152)
Mortgage-backed securities	28,101,248	(89,337)	-	-	28,101,248	(89,337)
Totals	$ 87,532,074	$ (621,347)	$ -	$ -	$ 87,532,074	$ (621,347)

	2019					
	Continuous unrealized losses existing for 12 months or less		Continuous unrealized losses existing for greater than 12 months		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Obligations of states and political subdivisions	$ 1,214,397	$ (11,668)	$ 2,500,841	$ (4,913)	$ 3,715,238	$ (16,581)
Collateralized mortgage obligations	70,009,307	(371,716)	6,093,130	(70,885)	76,102,437	(442,601)
Mortgage-backed securities	58,748,499	(370,230)	-	-	58,748,499	(370,230)
Totals	$ 129,972,203	$ (753,614)	$ 8,593,971	$ (75,798)	$ 138,566,174	$ (829,412)

Management does not believe any individual unrealized loss as of December 31, 2020 represents other than temporary impairment. The Corporation held no investment securities as of December 31, 2020 that had unrealized losses existing for greater than 12 months. The Corporation held nine investment securities as of December 31, 2019 that had unrealized losses existing for greater than 12 months, which consisted of three collateralized mortgage obligations, no mortgage-backed securities and six obligations of states and political subdivisions. Management believes the temporary impairment in fair value was caused by market fluctuation in interest rates. Management does not believe that the Corporation will experience any losses on these investments.

NOTE 5 – Loans

Major classifications of loans are as follows as of December 31:

	2020	2019
Commercial	$ 69,044,920	$ 35,218,336
Real Estate		
Construction	61,488,562	59,219,938
Commercial	520,296,973	506,283,528
Residential	167,611,820	184,556,612
Multifamily	134,715,011	112,249,983
Installment and other	5,958,080	4,537,730
	959,115,366	902,066,127
Less:		
Deferred PPP loan fees	(867,813)	-
Allowance for loan losses	(13,106,919)	(11,072,956)
Net loans	$ 945,140,634	$ 890,993,171

The Corporation participated extensively in the CARES Act PPP loan program administered by the SBA. The Corporation originated 1,121 PPP loans to customers totaling $62.2 million in 2020. The SBA will guarantee 100% of the PPP loans made to eligible borrowers. The entire principal amount of the borrower's PPP loan, including any accrued interest, is eligible to be reduced by loan forgiveness from the SBA so long as certain criteria are met. PPP loans have a two year or up to five year maturity and an interest rate of 1% throughout the term of the loan, with payments deferred until forgiveness proceeds are received from the SBA or ten months after the end of the covered period. As of December 31, 2020, 152 PPP loans totaling $22.1 million had been forgiven and repaid by the SBA. The remaining PPP customer loans outstanding of $40.1 million as of December 31, 2020 are classified as Commercial loans. No allowance for loan loss was allocated to the PPP loan portfolio due to the Corporation complying with the lender obligations that ensure SBA guarantee.

The Corporation received a processing fee from the SBA ranging from 1% to 5% depending on the size of the PPP loan. The Corporation generated $2,768,140 in gross processing fees from the SBA for the PPP loan originations during the year ended December 31, 2020. These processing fees were deferred, net of PPP loan origination costs of $1,069,501 which are recognized as a reduction in salaries and employee benefits on the consolidated statements of income, during the year ended December 31, 2020. A total of $830,826 of the net deferred PPP origination fees were recognized in loan interest income on the consolidated statements of income during the year ended December 31, 2020. The unamortized net deferred PPP origination fees were $867,813 as of December 31, 2020 and will be recognized through loan interest income over the life of the related PPP loans or until the PPP loans are forgiven or repaid.

NOTE 5 – Loans (cont.)

The following table presents the contractual aging of the recorded investment in loans as of December 31:

	2020					
	Current	Days Past Due				Total
	Loans	30-59	60-89	Over 90	Total	Loans
Commercial	$ 69,044,920	$ -	$ -	$ -	$ -	$ 69,044,920
Real Estate						
Construction	61,479,178	9,384	-	-	9,384	61,488,562
Commercial	515,996,073	3,402,146	822,495	76,259	4,300,900	520,296,973
Residential	165,698,063	1,460,834	30,835	422,088	1,913,757	167,611,820
Multifamily	134,715,011	-	-	-	-	134,715,011
Installment and other	5,936,833	16,317	4,930	0	21,247	5,958,080
Total loans	952,870,078	4,888,681	858,260	498,347	6,245,288	959,115,366
Purchase credit-impaired loans	(3,213,711)	(50,991)	(30,835)	(1,215)	(83,041)	(3,296,752)
Total loans, excluding purchase credit-impaired Loans	$ 949,656,367	$ 4,837,690	$ 827,425	$ 497,132	$ 6,162,247	$ 955,818,614

	2019					
	Current	Days Past Due				Total
	Loans	30-59	60-89	Over 90	Total	Loans
Commercial	$ 35,218,336	$ -	$ -	$ -	$ -	$ 35,218,336
Real Estate						
Construction	59,208,999	10,939	-	-	10,939	59,219,938
Commercial	504,734,447	1,368,339	129,084	51,658	1,549,081	506,283,528
Residential	181,634,713	2,434,975	293,763	193,161	2,921,899	184,556,612
Multifamily	112,249,983	-	-	-	-	112,249,983
Installment and other	4,350,969	35,571	0	151,190	186,761	4,537,730
Total loans	897,397,447	3,849,824	422,847	396,009	4,668,680	902,066,127
Purchase credit-impaired loans	(4,008,759)	(216,299)	0	-	(216,299)	(4,225,058)
Total loans, excluding purchase credit-impaired Loans	$ 893,388,688	$ 3,633,525	$ 422,847	$ 396,009	$ 4,452,381	$ 897,841,069

Commercial loans deemed to be inadequately collateralized and past due 90 days or more for principal or interest are placed in a non-accrual status. Residential real estate loans are not subject to these guidelines if well-secured, as deemed by the Senior Loan Committee, and in the process of collection.

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in nonaccrual loans and loans past due ninety days or more and still accruing by class of loans as of December 31:

	2020	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ -	$ -
Real Estate		
Construction	-	-
Commercial	2,811,189	-
Residential	2,127,459	-
Multifamily	-	-
Installment and other	6,109	-
Total Loans	4,944,757	-
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	-	-
Residential	(44,650)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(44,650)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,900,107	$ -

	2019	
	Nonaccrual	Past due 90 days or More and accruing
Commercial	$ -	$ -
Real Estate		
Construction	-	-
Commercial	2,643,614	-
Residential	2,196,733	-
Multifamily	-	-
Installment and other	12,698	146,196
Total Loans	4,853,045	146,196
Purchase Credit Impaired Loans:		
Commercial	-	-
Real Estate		
Construction	-	-
Commercial	-	-
Residential	(78,154)	-
Multifamily	-	-
Installment and other	-	-
Total Purchased Credit-Impaired Loans	(78,154)	-
Total Loans, excluding Purchase Credit Impaired Loans	$ 4,774,891	$ 146,196

NOTE 5 – Loans (cont.)

Management uses an internal asset classification system as a means of identifying problem and potential problem assets. A Special Mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loan at a future date. An asset is classified Substandard if it is inadequately protected by the current net worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard assets include those characterized by the distinct possibility that the Corporation will sustain some loss if the deficiencies are not corrected. Assets classified as Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Assets that do not currently expose the Corporation to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses that may or may not be within the control of the customer are classified as "Pass." Residential Real Estate and Installment and Other loans are not rated and are included in groups of homogeneous loans with similar risk and loss characteristics and are not included in the table below. The following tables present the risk category of loans by class of loans based on the most recent analysis performed and the contractual aging as of December 31:

	2020				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 68,914,767	$ -	$ 130,153	$ -	$ 69,044,920
Real Estate					
Construction	61,488,562	-	-	-	61,488,562
Commercial	494,687,135	295,771	25,314,067	-	520,296,973
Multifamily	134,577,015	-	137,996	-	134,715,011
Total	$ 759,667,479	$ 295,771	$ 25,582,216	$ -	$ 785,545,466
Current	$ 759,603,799	$ 295,771	$ 21,335,612	$ -	$ 781,235,182
30-59	63,680	-	3,347,850	-	3,411,530
60-89	-	-	822,495	-	822,495
Over 90	-	-	76,259	-	76,259
Total	$ 759,667,479	$ 295,771	$ 25,582,216	$ -	$ 785,545,466

	2019				
	Pass	Special Mention	Substandard	Doubtful	Total
Commercial	$ 35,112,117	$ 88,324	$ 17,895	$ -	$ 35,218,336
Real Estate					
Construction	58,527,188	-	692,750	-	59,219,938
Commercial	486,458,088	9,566,420	10,259,020	-	506,283,528
Multifamily	112,101,685	-	148,298	-	112,249,983
Total	$ 692,199,078	$ 9,654,744	$ 11,117,963	$ -	$ 712,971,785
Current	$ 690,871,882	$ 9,654,744	$ 10,885,139	$ -	$ 711,411,765
30-59	1,198,112	-	181,166	-	1,379,278
60-89	129,084	-	-	-	129,084
Over 90	-	-	51,658	-	51,658
Total	$ 692,199,078	$ 9,654,744	$ 11,117,963	$ -	$ 712,971,785

NOTE 5 – Loans (cont.)

The following table presents the recorded investment in residential real estate and installment and other loan classes based on payment activity as of December 31:

	2020		
	Performing	Nonperforming	Total
Residential Real Estate	$ 165,545,260	$ 2,127,459	$ 167,672,719
Installment & Other	5,951,971	6,109	5,958,080
Totals	$ 171,497,231	$ 2,133,568	$ 173,630,799

	2019		
	Performing	Nonperforming	Total
Residential Real Estate	$ 182,359,879	$ 2,196,733	$ 184,556,612
Installment & Other	4,378,836	158,894	4,537,730
Totals	$ 186,738,715	$ 2,355,627	$ 189,094,342

As of December 31, 2020, the Corporation has identified $15.4 million of loans as impaired, including $10.4 million of performing TDRs. As of December 31, 2019, the Corporation has identified $18.2 million of loans as impaired, including $13.4 million of performing TDRs. The Corporation evaluates loans placed on the watch list for impairment. A loan is identified as impaired when, based on current information and events, it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. A performing TDR consists of loans that have been modified and are performing in accordance with the modified terms for a sufficient length of time, generally six months, or loans that were modified on a proactive basis. A summary of the details regarding impaired loans as of December 31 follows:

	2020	2019
Loans for which there was a related allowance for loan loss	$ 7,375,186	$ 9,448,472
Impaired loans with no related allowance	8,005,054	8,760,147
Total Impaired Loans	$ 15,380,240	$ 18,208,619
Average quarterly balance of impaired loans	$ 16,932,396	$ 18,057,261
Related allowance for loan losses	1,657,786	1,961,573
Interest income recognized while impaired	492,865	629,427

As of December 31, 2020 and 2019, the Corporation had residential real estate loans in foreclosure with a carrying value of $209,440 and $262,298, respectively.

NOTE 5 – Loans (cont.)

The following table presents loans individually evaluated for impairment by class of loans as of December 31:

	2020			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 8,808	$ -	$ 8,808	$ -
Real Estate				
Construction	9,484	-	9,484	-
Commercial	1,907,283	142,088	1,765,195	-
Residential	6,444,002	240,834	6,203,168	-
Multifamily	-	-	-	-
Installment and other	20,426	2,027	18,399	-
Total	8,390,003	384,949	8,005,054	-
Loans with a related allowance recorded:				
Commercial	-	-	-	-
Real Estate				
Construction	614,471	-	614,471	247,471
Commercial	3,079,196	128,223	2,950,973	1,133,773
Residential	3,882,036	73,472	3,808,563	275,363
Multifamily	-	-	-	-
Installment and other	4,501	3,323	1,179	1,179
Total	7,580,204	205,018	7,375,186	1,657,786
Total Impaired Loans	$ 15,970,207	$ 589,967	$ 15,380,240	$ 1,657,786

	2019			
	Unpaid Principal Balance	Partial Charge-offs	Recorded Investment	Allowance For Loan Losses Allocation
Loans with no related allowance recorded:				
Commercial	$ 33	$ 33	$ -	$ -
Real Estate				
Construction	12,050	-	12,050	-
Commercial	1,926,290	105,155	1,821,135	-
Residential	7,102,565	251,589	6,850,976	-
Multifamily	-	-	-	-
Installment and other	80,275	4,289	75,986	-
Total	9,121,213	361,066	8,760,147	-
Loans with a related allowance recorded:				
Commercial	24,278	-	24,278	19,278
Real Estate				
Construction	678,764	-	678,764	254,764
Commercial	3,197,127	8,830	3,188,297	1,287,298
Residential	5,600,057	42,924	5,557,133	400,233
Multifamily	-	-	-	-
Installment and other	-	-	-	-
Total	9,500,226	51,754	9,448,472	1,961,573
Total Impaired Loans	$ 18,621,439	$ 412,820	$ 18,208,619	$ 1,961,573

NOTE 5 – Loans (cont.)

The following table presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio class and based on impairment method as of December 31:

2020	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 246,512	$ 918,196	$ 7,685,735	$ 1,862,506	$ 274,764	$ 85,243	$ 11,072,956
Charge-offs	-	-	(5,021)	(169,900)	-	(47,472)	(222,393)
Recoveries	28,448	-	360,137	359,831	-	7,940	756,356
Provision and re-allocations	(112,801)	(57,483)	1,734,395	(537,299)	428,121	45,067	1,500,000
Ending Balance	$ 162,159	$ 860,713	$ 9,775,246	$ 1,515,138	$ 702,885	$ 90,778	$ 13,106,919
Loans:							
Recorded Investment	$ 69,044,920	$ 61,488,562	$ 520,296,973	$ 167,611,820	$ 134,715,011	$ 5,958,080	$ 959,115,366
Allowance for loan losses:							
Individually evaluated for impairment	-	247,471	1,133,773	275,363	-	1,179	1,657,786
Collectively evaluated for impairment	162,159	613,242	8,641,473	1,239,775	702,885	89,599	11,449,133
Total allowance for loan losses	162,159	860,713	9,775,246	1,515,138	702,885	90,778	13,106,919
Ending Balance	$ 68,882,761	$ 60,627,849	$ 510,521,727	$ 166,096,682	$ 134,012,126	$ 5,867,302	$ 946,008,447
Ending Balance:							
Individually evaluated for impairment	$ 8,808	$ 623,955	$ 4,716,168	$ 8,451,564	$ -	$ 19,578	$ 13,820,073
Collectively evaluated for impairment	69,036,112	60,855,223	515,271,773	156,181,920	134,715,011	5,938,502	941,998,541
Purchase credit-impaired:							
Individually evaluated for impairment	-	-	-	1,560,167	-	-	1,560,167
Collectively evaluated for impairment	-	9,384	309,032	1,418,169	-	-	1,736,585
Total ending balance	$ 69,044,920	$ 61,488,562	$ 520,296,973	$ 167,611,820	$ 134,715,011	$ 5,958,080	$ 959,115,366

2019	Commercial	Construction Real Estate	Commercial Real Estate	Residential Real Estate	Multifamily Real Estate	Installment & Other	Total
Allowance for loan losses:							
Beginning Balance	$ 551,883	$ 901,354	$ 5,648,984	$ 3,538,749	$ 189,417	$ 163,998	$ 10,994,385
Charge-offs	(13,126)	-	(137,313)	(88,436)	-	(3,306)	(242,181)
Recoveries	10,707	-	111,949	191,118	-	6,978	320,752
Provision and re-allocations	(302,952)	16,842	2,062,115	(1,778,925)	85,347	(82,427)	-
Ending Balance	$ 246,512	$ 918,196	$ 7,685,735	$ 1,862,506	$ 274,764	$ 85,243	$ 11,072,956
Loans:							
Recorded Investment	$ 35,218,336	$ 59,219,938	$ 506,283,528	$ 184,556,612	$ 112,249,983	$ 4,537,730	$ 902,066,127
Allowance for loan losses:							
Individually evaluated for impairment	19,278	254,764	1,287,298	400,233	-	-	1,961,573
Collectively evaluated for impairment	227,234	663,432	6,398,437	1,462,273	274,764	85,243	9,111,383
Total allowance for loan losses	246,512	918,196	7,685,735	1,862,506	274,764	85,243	11,072,956
Ending Balance	$ 34,971,824	$ 58,301,742	$ 498,597,793	$ 182,694,106	$ 111,975,219	$ 4,452,487	$ 890,993,171
Ending Balance:							
Individually evaluated for impairment	$ 24,278	$ 690,814	$ 5,009,432	$ 10,359,439	$ -	$ 75,986	$ 16,159,949
Collectively evaluated for impairment	35,194,058	58,482,103	500,930,640	170,362,592	112,249,983	4,461,744	881,681,120
Purchase credit-impaired							
Individually evaluated for impairment	-	-	-	2,048,670	-	-	2,048,670
Collectively evaluated for impairment	-	47,021	343,456	1,785,911	-	-	2,176,388
Total ending balance	$ 35,218,336	$ 59,219,938	$ 506,283,528	$ 184,556,612	$ 112,249,983	$ 4,537,730	$ 902,066,127

NOTE 5 – Loans (cont.)

The Corporation continues to evaluate purchased loans for impairment in accordance with U.S. GAAP. The purchased loans were considered impaired at the acquisition date if there was evidence of deterioration since origination and if it was probable that not all contractually required principal and interest payments would be collected. The following table reflects the carrying value of all purchased loans as of December 31:

	2020		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	39,814	-	9,384
Commercial	746,908	116,193	405,367
Residential	6,223,394	12,126,615	13,996,006
Multifamily	-	-	-
Installment and other	-	-	-
Total	$ 7,010,116	$ 12,242,808	$ 14,410,757

	2019		
	Contractually Required Payments Receivable		
	Credit Impaired	Non-Credit Impaired	Carrying Value of Purchased Loans
Loans with no related allowance recorded:			
Commercial	$ -	$ -	$ -
Real Estate			
Construction	112,389	-	47,021
Commercial	781,332	128,238	433,504
Residential	7,875,874	14,680,307	17,131,107
Multifamily	-	-	-
Installment and other	-	25,002	14,642
Total	$ 8,769,595	$ 14,833,547	$ 17,626,274

As of December 31, 2020, the estimated contractually required payments receivable on credit impaired and non-credit impaired loans was $7.0 million and $12.2 million, respectively. The cash flows expected to be collected related to principal as of December 31, 2020 on all purchased loans is $14.4 million. As a result, there is $4.8 million of remaining discount on the purchased loans. These amounts are based upon the estimated fair values of the underlying collateral or discounted cash flows as of December 31, 2020. The difference between the contractually required payments at acquisition and the cash flow expected to be collected at acquisition is referred to as the non-accretable difference. Subsequent decreases to the expected cash flows will generally result in a change to the allowance for loan losses. Subsequent increases in cash flows will result in a change in the allowance for loan losses to the extent of prior charges or a reclassification of the difference from non-accretable discount to accretable discount, with a positive impact on interest income. Further, any excess of cash flows expected over the estimated fair value is referred to as the accretable yield and is recognized in interest income over the remaining life of the loan when there is a reasonable expectation about the amount and timing of such cash flows.

NOTE 5 – Loans (cont.)

The change in the carrying amount of accretable yield for purchased loans was as follows for the years ended December 31:

	For the Year Ended December 31, 2020	For the Year Ended December 31, 2019
Beginning Balance	$ 1,432,330	$ 1,778,132
Additions	96,860	51,656
Accretion (1)	(400,387)	(397,458)
Ending Balance	$ 1,128,803	$ 1,432,330

(1) Accretable yield is recognized in interest income as the purchased loans pay down, mature, renew or pay off.

Contractual maturities of loans with accretable yield range from 1 year to 30 years. Actual maturities may differ from contractual maturities because borrowers have the right to prepay or renew their loan prior to maturity or the loan may be charged off.

Certain directors and executive officers of the Corporation, and their related interests, had loans outstanding in the aggregate amounts of $5.9 million and $7.6 million as of December 31, 2020 and 2019, respectively. During 2020 repayments totaled $1.7 million. Certain affiliated parties of the Corporation are investors in loan participations of the Corporation. The outstanding balance of loan participations with affiliated parties totaled $1.5 million and $1.7 million as of December 31, 2020 and 2019, respectively. The participations represent investments by the affiliated parties in a portion of the affiliated party loans described aggregate amounts described above.

Residential and commercial real estate loans approximating $2.8 million and $6.7 million as of December 31, 2020 and 2019, respectively, were pledged as collateral on public deposits and for other purposes as required or permitted by law.

NOTE 5 – Loans (cont.)

A TDR includes a loan modification where a borrower is experiencing financial difficulty and the Corporation grants a concession to that borrower that it would not otherwise consider except for the borrower's financial difficulties. Modifications include below market interest rates, interest-only terms, forgiveness of principal, or an exceptionally long amortization period. Most of the Corporation's modifications are below market interest rate concessions. A TDR may be either on accrual or nonaccrual status based upon the performance of the borrower and management's assessment of collectability. If a TDR is placed on nonaccrual status, it remains there until it performs under the restructured terms for a sufficient period of time, generally six consecutive months at which time it is returned to accrual status.

In 2020, the CARES Act, along with regulatory guidance from federal banking agencies, provided that a financial institution may elect to exempt loan modifications related to the COVID-19 pandemic that would otherwise be categorized as a TDR from consideration for TDR treatment. The Corporation elected this treatment for qualifying loan modifications in 2020. The Corporation provided loan modifications to 55 residential real estate loans totaling $6.2 million, 173 commercial real estate loans totaling $125.9 million, 9 multifamily real estate loans totaling $18.9 million, and $2.0 million in commercial loan modifications to 5 customers in 2020 that would have been reviewed for TDR consideration. The residential real estate modifications were primarily three month payment deferrals, with 85% of the customers only requiring one deferral. The commercial, commercial real estate and multifamily real estate modifications were primarily adjustments to defer principal payments, but required interest and escrow payments from the customer, with 95% of the customers only requiring one modification. The commercial real estate loan modifications included 25 non-owner occupied retail properties totaling $25.3 million, 11 non-owner occupied office properties totaling $14.7 million, 21 mixed or special use loans totaling $19.5 million, 17 hotel and motel loans totaling $37.9 million and 36 restaurant and bar loans totaling $12.4 million. As of December 31, 2020, one residential real estate loan and eight commercial real estate loans remained in a modified status, totaling $13.6 million. Two of the commercial real estate loans totaling $1.5 million are classified in a watch rating status while all others are classified in a pass rating status based on recent reviews of the credit and strength of the collateral and borrower guaranty. One of the loans in a pass rating status is a hotel loan for $7.7 million. All loans under a modification period are considered current for payment status. Management continues to carefully monitor those borrowers that remain on payment modifications for additional signs of distress that would result in a downgrade of loan classification.

The following is a summary of loans classified as TDRs as of December 31:

	2020		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 8,808	$ -
Real Estate			
Construction	3	623,955	247,471
Commercial	7	2,276,381	382,428
Residential	109	9,195,687	273,367
Multifamily	-	-	-
Installment & Other	3	18,399	-
Total Loans	123	$ 12,123,230	$ 903,266

	2019		
	Number of Modifications	Total Trouble Debt Restructurings	Allowance For Loan Losses Allocation
Commercial	1	$ 24,278	$ 19,278
Real Estate			
Construction	3	690,814	254,764
Commercial	12	2,799,613	461,136
Residential	124	11,569,806	400,233
Multifamily	-	-	-
Installment & Other	4	63,287	-
Total Loans	144	$ 15,147,798	$ 1,135,411

NOTE 5 - Loans (cont.)

There were no TDR's as of December 31, 2020 and 2019 that defaulted during the period and were modified within the previous 12 months. TDR's in default are past due 90 days or more at the end of the period.

A summary of the type of modifications made on TDR's that occurred during 2020 and 2019 are noted in the table below.

	For the Year Ended December 31, 2020					
	Modification of Terms Balance	Reduction of Interest Rate Balance	Modification to Interest-only Payments Balance	Forgiveness of Debt Balance	Bankruptcy Balance	Total Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Residential	-	-	-	-	199,986	199,986
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	4,390	4,390
Total Loans	$ -	$ -	$ -	$ -	$ 204,376	$ 204,376
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	-	-	-	-	-	-
Residential	-	-	-	-	1	1
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	1	1
Total Loans	-	-	-	-	2	2

	For the Year Ended December 31, 2019					
	Modification of Terms Balance	Reduction of Interest Rate Balance	Modification to Interest-only Payments Balance	Forgiveness of Debt Balance	Bankruptcy Balance	Total Balance
Commercial	$ -	$ -	$ -	$ -	$ -	$ -
Real Estate						
Construction	-	-	-	-	-	-
Commercial	520,309	-	166,353	90,049	-	776,711
Residential	186,478	149,718	306,724	-	218,506	861,426
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	$ 706,787	$ 149,718	$ 473,077	$ 90,049	$ 218,506	$ 1,638,137
	Count	Count	Count	Count	Count	Count
Commercial	-	-	-	-	-	-
Real Estate						
Construction	-	-	-	-	-	-
Commercial	1	-	1	1	-	3
Residential	3	4	1	-	2	10
Multifamily	-	-	-	-	-	-
Installment & Other	-	-	-	-	-	-
Total Loans	4	4	2	1	2	13

NOTE 6 - Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation as of December 31 and are summarized as follows:

		2020		2019
Land	$	6,718,092	$	6,674,467
Buildings and leasehold improvements		32,359,743		32,163,529
Furniture and equipment		17,758,521		16,647,199
Total		56,836,356		55,485,195
Less: Accumulated depreciation		(40,810,275)		(38,930,101)
Net Premises and Equipment	$	16,026,081	$	16,555,094

NOTE 7 – New Markets Tax Credits - Variable Interest Entities

The Corporation invests in CDEs that are designed to generate a return primarily through the realization of New Markets Tax Credits. The CDEs are formed as limited partnerships and limited liability companies in which the Corporation invests as a limited partner/investor member through equity contributions. The economic performance of the CDEs, which are variable interest entities ("VIEs"), is subject to the performance of their underlying loans. The Corporation has determined that it is not the primary beneficiary of any CDE as it lacks the power to direct the activities that most significantly impact the economic performance of the underlying loans or to affect their ability to operate in compliance with the rules and regulations necessary for the qualification of tax credits generated by equity investments. This power is held by the general partners and managing members who exercise full and exclusive control of the operations of the VIEs.

As of December 31, 2020 and 2019, the carrying amounts of these investments in CDEs that generate the tax credits, included in accrued interest receivable and other assets in the consolidated balance sheets, totaled $7.2 million and $8.8 million, respectively. The risk of loss in these investments is tied to the ability of the CDE to operate in compliance with the rules and regulations necessary for the qualification of the tax credits generated by equity investments. As of December 31, 2020 and 2019 there are no compliance issues associated with these entities.

NOTE 8 – Accrued Interest Receivable and Other Assets

A summary of accrued interest receivable and other assets as of December 31 is as follows:

		2020		2019
Accrued interest receivable	$	4,735,605	$	3,643,328
Federal Reserve Bank stock		322,100		322,100
Mortgage servicing rights		1,672,249		1,491,001
Interest rate swaps		2,783,449		1,408,366
Investment in New Markets Tax Credit CDEs		7,214,654		8,834,450
Investment in FHLB Chicago stock		1,503,200		-
Receivable for proceeds from bank owned life insurance death benefit		1,120,000		-
Security investment maturity receivable		345,201		2,098,704
Current income taxes		189,795		360,545
Deferred income taxes		-		1,487,442
Prepaid expenses and other assets		2,513,965		715,307
Total	$	22,400,218	$	20,361,243

NOTE 9 - Deposits

The distribution of deposits as of December 31 is as follows:

	2020	2019
Noninterest bearing demand accounts	$ 420,974,242	$ 298,876,234
Interest bearing demand accounts	553,052,844	463,117,927
Money Market accounts	262,300,620	216,301,871
Savings accounts	280,877,083	233,831,950
Certificates of Deposit	57,382,365	59,621,618
Total	$ 1,574,587,154	$ 1,271,749,600

The aggregate amount of time deposits, each with a minimum denomination of $250,000, was $6,534,856 and $6,974,902 as of December 31, 2020 and 2019, respectively.

Scheduled maturities of time deposits as of December 31 are:

	2020	2019
Due within one year	$ 35,890,695	$ 34,763,063
After one year but within two years	12,988,056	13,426,282
After two years but within three years	4,894,512	5,464,231
After three years but within four years	1,746,291	4,090,556
After four years but within five years	1,862,811	1,877,486
Total	$ 57,382,365	$ 59,621,618

Deposits from the Corporation's directors and related parties as of December 31, 2020 and December 31, 2019 amounted to $12.5 million and $8.6 million, respectively.

NOTE 10 – Accrued Interest Payable and Other Liabilities

A summary of accrued interest payable and other liabilities as of December 31 is as follows:

	2020	2019
Accrued interest payable	$ 58,125	$ 74,001
FICA taxes payable	911,411	-
Real estate and personal property taxes payable	796,738	758,476
Medical and dental self insurance reserves	960,592	755,143
Interest rate swaps	2,783,449	1,408,366
Security investment purchases payable	7,598,934	-
Deferred income taxes	691,024	-
Other liabilities	1,263,081	1,445,001
Total	$ 15,063,354	$ 4,440,987

NOTE 11 - Other Borrowings

The Corporation has the ability to borrow (purchase) federal funds of up to $70,000,000 under revolving lines-of-credit. Such borrowings bear interest at the lender bank's announced daily federal funds rate and mature daily. There were no federal funds purchased outstanding as of December 31, 2020 or 2019.

The Corporation may also borrow through the Federal Reserve Bank Discount Window short term funds up to the amount of $1,942,150 and $3,971,438 as of December 31, 2020 and 2019, respectively. These funds are secured by U.S. government sponsored entity securities or qualified municipal securities totaling $2,157,944 and $4,412,709 as of December 31, 2020 and 2019, respectively.

The Bank became a member of the FHLB Chicago in April, 2020. As a member, the Bank has the ability to borrow funds from FHLB Chicago pursuant to a variety of advance programs and the terms of an Advances, Collateral Pledge and Security Agreement between the parties. Any advance would be collateralized by first mortgage loans pledged by the Bank, FHLB Chicago capital stock held by the Bank, and all deposit accounts held by the Bank at the FHLB Chicago. As of December 31, 2020, the Bank has not pledged any collateral to establish an active borrowing capability with the FHLB Chicago.

NOTE 12 - Income Taxes

Income tax expense (benefit) consists of the following components for the year ending December 31:

	2020	2019
Current income taxes		
Federal	$ 1,512,325	$ 1,740,237
State	1,468,034	1,554,230
Total current income taxes	2,980,359	3,294,467
Deferred income taxes		
Federal	(275,075)	438,902
State	(186,489)	(3,869)
Total deferred income taxes	(461,564)	435,033
Total income taxes	$ 2,518,795	$ 3,729,500

NOTE 12 - Income Taxes (cont.)

The net deferred income tax assets in the accompanying consolidated balance sheets include the following amounts of deferred income tax assets and liabilities as of December 31:

	2020	2019
Deferred income tax assets:		
Allowance for loan losses	$ 3,669,469	$ 3,107,008
Reserve for health plan	204,074	184,948
Non-accrual interest	7,255	43,310
Lease liability	4,265,831	4,397,408
Loss carryforwards	28,941	31,572
Accrued FICA payroll tax	131,132	-
Other	6,810	6,810
Total deferred income tax assets	8,313,512	7,771,056
Deferred income tax liabilities:		
Loan acquisition fair market valuation	(330,507)	(404,104)
Depreciation	(442,933)	(203,441)
Right of use lease asset	(4,265,831)	(4,397,408)
Mortgage servicing rights	(455,538)	(406,164)
New Markets Tax Credit Investments	(383,289)	(407,760)
Unrealized gains on securities available for sale	(3,026,281)	(386,251)
Other	(100,157)	(78,486)
Total deferred income tax liabilities	(9,004,536)	(6,283,614)
Net deferred income tax (liability) asset	$ (691,024)	$ 1,487,442

The Corporation has state net operating loss carryforwards of approximately $464,000 and $506,000 as of December 31, 2020 and 2019, respectively. The net operating loss carryforwards expire in 2032.

Realization of the deferred income tax asset over time is dependent upon the Corporation generating sufficient taxable income in future periods. In determining that realization of the deferred income tax asset recorded was more likely than not, the Corporation gave consideration to a number of factors including its recent earnings history, its expectations for earnings in the future, and where applicable, the expiration dates associated with tax carryforwards.

A reconciliation of statutory federal income taxes based upon income before taxes to the provision for federal and state income taxes is as follows:

	2020		2019	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal incomet taxes at statutory rate	$ 3,514,381	21.00%	$ 4,715,035	21.00%
Adjustments for:				
Tax exempt interest on municipal obligations	(294,317)	-1.76%	(188,408)	-0.84%
Increase in taxes resulting from state income taxes, net of federal tax benefit	969,276	5.79%	1,223,826	5.45%
Increase in cash surrender value of life insurance	(220,638)	-1.32%	(188,948)	-0.84%
Gain from life insurance death benefits	(94,500)	-0.56%	(490,090)	-2.18%
New markets tax credits	(1,415,219)	-8.46%	(1,335,087)	-5.95%
Other - net	59,812	0.36%	(6,828)	-0.03%
Income tax expense	$ 2,518,795	15.05%	$ 3,729,500	16.61%

As of December 31, 2020 and 2019, the Corporation had no uncertain tax positions. The Corporation's policy is to record interest and penalties related to income tax liabilities in income tax expense. The Corporation, along with its subsidiaries, files U.S. federal and Wisconsin income tax returns. The Corporation's federal tax returns for 2016 and prior and its 2015 and prior year Wisconsin tax returns are no longer subject to examination by tax authorities.

NOTE 13 - Employee Benefit Plan

The Corporation has a contributory defined-contribution 401(k) retirement plan. This plan covers substantially all employees who have attained the age of 21. Participants may contribute a portion of their compensation (up to IRS limits) to the plan. The Corporation may make regular and matching contributions to the plan each year. In 2020 and 2019, the Corporation provided a dollar-for-dollar match of employee contributions up to 5% of their compensation. The Corporation recorded contribution expense of $854,877 and $804,358 in 2020 and 2019, respectively.

NOTE 14 - Leases

The Corporation leases various banking facilities under operating lease agreements from various companies. The majority of the agreements include renewal options. The Corporation includes lease renewal options in the lease term and determination of right of use lease assets and lease liabilities, given it is reasonably certain the Corporation will exercise the options. The discount rate used to capitalize the operating leases is the FHLB Chicago advance fixed rate as of January 1, 2019, or the date of any subsequent lease extension or commencement, considering the remaining lease term including all renewal options. The right of use lease asset and lease liability amount as of December 31, 2020 and 2019 is $15,659,597 and $16,143,202, respectively. The initial lease liability at the adoption of the right of use lease accounting was $15,573,043 on January 1, 2019. The Corporation had three lease extensions and remeasurements in 2020, and one lease extension and remeasurement in 2019 adding $220,925 and $1,317,434, respectively to the right of use lease asset and lease liability. Lease liability amortization in 2020 and 2019 was $704,530 and $747, 275, respectively. As of December 31, 2020, the weighted-average remaining lease term is 21.4 years and the weighted average discount rate used in the determination of lease liabilities is 3.69%.

Rental amounts under the operating lease agreements are subject to annual escalation based upon increases in the Consumer Price Index. Aggregate rental expense under all leases amounted to $1,302,972 and $1,323,347 in 2020 and 2019 respectively, with no significant amounts associated with variable escalation adjustments. The rental expense amounts include $824,992 and $813,914 respectively, for four of the facilities leased from a company held by a major shareholder of the Corporation.

Contractual lease payment obligations, including all unexecuted options, for each of the next five years and thereafter, in addition to a reconciliation to the Corporation's lease liability are as follows as of December 31, 2020:

2021	$ 1,294,521
2022	1,255,829
2023	1,230,829
2024	1,230,829
2025	1,154,463
Thereafter	16,946,873
Total lease payments	$ 23,113,344
Less interest	(7,453,747)
Present value of lease payments	$ 15,659,597

Contractual lease payments do not reflect annual escalation increases based on the Consumer Price Index.

Office space at certain facilities is leased to unrelated third parties under operating lease agreements. The terms of the agreements vary, with some being month to month arrangements, some including lessee renewal options, and some having fixed or variable Consumer Price Index escalation provisions. Rental income included in net occupancy costs was $900,890 and $1,003,994 for the years ended December 31, 2020 and 2019, respectively.

NOTE 14 – Leases (cont.)

Contractual third party lessee payment obligations to the Corporation, excluding all unexecuted options, for each of the next five years and thereafter are as follows as of December 31, 2020:

2021	$ 597,106
2022	513,819
2023	385,052
2024	219,367
2025	187,833
Thereafter	318,683
Total lessee payments	$ 2,221,860

NOTE 15 - Commitments and Contingencies

The Corporation 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 include commitments to extend credit, financial guarantees and standby letters of credit. They involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized on the consolidated balance sheets.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and issuing letters of credit as they do for on-balance-sheet instruments.

A summary of the contract or notional amount of the Corporation's exposure to off-balance sheet risk as of December 31, are as follows:

	2020	2019
Financial instruments whose contract amounts represent credit risk:		
Commitments to extend credit	$ 141,434,849	$ 150,692,959
Standby letters of credit	6,956,442	9,210,008
	$ 148,391,291	$ 159,902,967

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Standby letters of credit are conditional commitments issued to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Corporation upon extension of credit, is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property and equipment, and income-producing commercial properties.

NOTE 16 - Stockholders' Equity

Dividends declared by the Bank that exceed the retained net income for the most current year plus retained net income for the preceding two years must be approved by federal regulatory agencies.

Under Federal Reserve regulations, the Bank is limited as to the amount it may lend to its affiliates, including the Corporation. Such loans are required to be collateralized by investments defined in the regulations. In addition, the maximum amount available for transfer from the Bank to the Corporation in the form of loans is limited to 10% of the Bank's stockholders' equity in the case of any one affiliate or 20% in the case of all affiliates.

NOTE 17 - Regulatory Capital Requirements

Banks and bank holding companies are subject to regulatory requirements administered by federal banking agencies. The Corporation is a small bank holding company pursuant to Federal Reserve Bank regulations. Management believes the Corporation has complied with all other reporting requirements.

The Bank is subject to various regulatory capital requirements administered by federal banking agencies. Capital adequacy guidelines and prompt correction action regulations involve quantitative measures of assets, liabilities and certain off balance sheet items calculated under regulatory accounting practices. Capital amounts and classifications are also subject to qualitative judgments by regulators. Failure to meet minimum capital requirements can initiate certain mandatory and additional discretionary regulatory action, that if undertaken, could have a direct material effect on the Corporation's financial statements. Management believes as of December 31, 2020 the Bank meets all capital adequacy requirements to which it is subject.

Prompt corrective action regulations provide five classifications: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. As of December 31, 2020 and 2019, the most recent regulatory notifications categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since that notification that Management believes have changed the Bank's classification.

In 2019, the federal banking agencies jointly issued a final rule that provides for an optional, simplified measure of capital adequacy, the community bank leverage ratio framework (the "CBLR framework"), for qualifying community banking organizations, consistent with Section 201 of the Economic Growth, Regulatory Relief, and Consumer Protection Act. The final rule became effective on January 1, 2020 and was elected by the Bank as of June 30, 2020. In April 2020, the federal banking agencies issued an interim final rule that makes temporary changes to the CBLR framework, pursuant to Section 4012 of the CARES Act, and a second interim final rule that provides a graduated increase in the community bank leverage ratio requirement after the expiration of the temporary changes implemented pursuant to Section 4012 of the CARES Act.

The community bank leverage ratio removes the requirement for qualifying banking organizations to calculate and report risk-based capital, but rather, only requires a Tier 1 capital to quarterly average assets ("leverage") ratio. The net unrealized gain or loss on securities available for sale is not included in computing the leverage ratio. Qualifying banking organizations that elect to use the CBLR framework and that maintain a leverage ratio of greater than the required minimums will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules and will be considered to have met the well capitalized ratio requirements for purposes of Section 38 of the Federal Deposit Insurance Act. Under the interim final rules the community bank leverage ratio minimum requirement is 8% as of December 31, 2020, 8.5% for calendar year 2021, and 9% for calendar year 2022 and beyond. The interim rule allows for a two-quarter grace period to correct a ratio that falls below the required amount, provided that the Bank maintains a leverage ratio of 7% as of December 31, 2020, 7.5% for calendar year 2021 and 8% for calendar year 2022 and beyond.

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

NOTE 17 - Regulatory Capital Requirements (cont.)

Actual and required capital amounts and ratios as of December 31, 2020 under the CBLR framework and as of December 31, 2019 under the risk-weighting framework are presented below.

	Actual		To Be Well Capitalized Under CBLR Framework Prompt Corrective Action Regulations	
	Amount	Ratio	Amount	Ratio
As of December 31, 2020				
Tier 1 capital (to quarterly average assets)	$ 180,887,751	10.2%	$ 142,112,080	8.0%

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provision	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019						
Total capital (to risk-weighted assets)	$ 182,414,000	18.0%	$ 81,188,560	8.0%	$ 101,485,700	10.0%
Tier 1 capital (to risk-weighted assets)	$ 171,341,000	16.9%	$ 60,891,420	6.0%	$ 81,188,560	8.0%
Common Equity Tier 1 (to risk-weighted assets)	$ 171,341,000	16.9%	$ 45,668,565	4.5%	$ 65,965,705	6.5%
Tier 1 capital (to quarterly average assets)	$ 171,341,000	11.6%	$ 59,070,560	4.0%	$ 73,838,200	5.0%

NOTE 18 - Concentration of Credit Risk

Practically all of the Corporation's loans, commitments, and commercial and standby letters of credit have been granted to customers in the Bank's market area of Southeastern Wisconsin. Although the Corporation has a diversified loan portfolio, the ability of its debtors to honor its contracts is dependent on the economic conditions of this market area. The concentration of credit by type of loan is set forth in Note 5.

THANK YOU!

To our truly remarkable bankers, we thank you for all you have done for our customers and community. You were there to meet every challenge of the past year, and have proven to be the best of the best.

TriCity National Bank

BPtW
2020 BEST PLACES TO WORK
MILWAUKEE BUSINESS JOURNAL

TOP WORK PLACES 2021
journal sentinel