



Consolidated Financial Statements  
December 31, 2020 and 2019

# Redwood Financial, Inc. and Subsidiaries

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December 31, 2020 and 2019

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CPAs & BUSINESS ADVISORS

## Independent Auditor's Report

The Stockholders and Board of Directors  
Redwood Financial, Inc. and Subsidiaries  
Redwood Falls, Minnesota

### Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Redwood Financial, Inc. and Subsidiaries, 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.

### Auditor's 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, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the 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 Redwood Financial, Inc. and Subsidiaries, as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Eide Bailly LLP".

Mankato, Minnesota  
March 22, 2021

Redwood Financial, Inc. and Subsidiaries

Consolidated Balance Sheets

December 31, 2020 and 2019

	<u>2020</u>	<u>2019</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 9,872,215	\$ 10,511,615
Interest-bearing deposits in banks	6,125,000	6,615,000
Debt securities available-for-sale	177,272,248	70,115,187
Loans, net	243,252,819	231,790,937
Investments in restricted stock	7,850,900	10,191,000
Accrued interest receivable	2,165,790	2,111,041
Premises and equipment, net	15,099,904	15,634,117
Mortgage servicing rights	2,990,304	2,097,312
Goodwill	4,478,398	4,478,398
Other assets	664,839	637,041
	<u>664,839</u>	<u>637,041</u>
Total Assets	<u>\$ 469,772,417</u>	<u>\$ 354,181,648</u>
<b>Liabilities and Stockholders' Equity</b>		
Deposits	\$ 404,422,414	\$ 288,175,116
Borrowings	11,134,368	21,483,461
Subordinated debentures	6,186,000	6,186,000
Accrued interest payable	241,968	238,899
Advance payments by borrowers for taxes and insurance	3,054,963	2,072,201
Accrued expenses and other liabilities	2,585,406	2,023,941
Deferred tax liability	2,210,788	1,668,662
	<u>2,210,788</u>	<u>1,668,662</u>
Total liabilities	<u>429,835,907</u>	<u>321,848,280</u>
Common stock (\$.10 par value), 1,125,000 shares authorized and issued; 405,047 and 399,047 shares outstanding, respectively	112,500	112,500
Additional paid-in capital	10,577,486	10,192,893
Retained earnings	40,442,012	34,387,716
Accumulated other comprehensive income	1,299,723	206,878
Treasury stock, at cost, 719,953 and 725,953 shares, respectively	(12,495,211)	(12,566,619)
	<u>(12,495,211)</u>	<u>(12,566,619)</u>
Total stockholders' equity	<u>39,936,510</u>	<u>32,333,368</u>
Total Liabilities and Stockholders' Equity	<u>\$ 469,772,417</u>	<u>\$ 354,181,648</u>

# Redwood Financial, Inc. and Subsidiaries

Consolidated Statements of Income  
Years Ended December 31, 2020 and 2019

	2020	2019
Interest Income		
Loans, including fees	\$ 18,939,769	\$ 14,252,254
Debt securities available-for-sale	1,589,000	1,118,851
Federal funds sold	21,094	152,255
Interest-bearing deposits in banks	170,064	204,805
Total interest income	20,719,927	15,728,165
Interest Expense		
Demand deposits	528,122	599,781
Savings deposits	248,967	238,663
Certificates of deposits	532,906	468,531
Borrowings	490,420	625,595
Subordinated debentures	153,898	269,220
Total interest expense	1,954,313	2,201,790
Net interest income	18,765,614	13,526,375
Provision for Loan Losses	55,000	142,000
Net interest income after provision for loan losses	18,710,614	13,384,375
Non-Interest Income		
Fees and service charges	1,287,930	1,433,707
Mortgage servicing income	1,708,055	1,111,909
Insurance commissions	594,630	652,612
Other	772,527	604,661
Total non-interest income	4,363,142	3,802,889
Non-Interest Expense		
Compensation and employee benefits	8,969,625	7,179,711
Occupancy expenses	1,353,309	1,467,804
Data processing expenses	1,331,566	1,129,400
Federal deposit insurance premiums	94,451	43,432
Advertising expenses	128,589	188,820
Legal and accounting expenses	395,002	194,506
Other operating expenses	1,242,240	986,812
Total non-interest expense	13,514,782	11,190,485
Income before income taxes	9,558,974	5,996,779
Income Tax Expense	2,694,584	1,617,375
Net income	\$ 6,864,390	\$ 4,379,404
Earnings per Share		
Basic	\$ 16.97	\$ 11.05
Diluted	\$ 16.97	\$ 11.05

Redwood Financial, Inc. and Subsidiaries  
Consolidated Statements of Comprehensive Income  
Years Ended December 31, 2020 and 2019

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	<u>2020</u>	<u>2019</u>
Net Income	<u>\$ 6,864,390</u>	<u>\$ 4,379,404</u>
Other Comprehensive Income, net of tax:		
Unrealized income on securities		
Unrealized holding gains arising during period	1,533,603	981,730
Less: reclassification adjustment for (gains) losses included in net income	(25,734)	15,202
Tax effect	<u>(415,024)</u>	<u>(375,205)</u>
Other comprehensive income, net of tax	<u>1,092,845</u>	<u>621,727</u>
Comprehensive Income	<u><u>\$ 7,957,235</u></u>	<u><u>\$ 5,001,131</u></u>

Redwood Financial, Inc. and Subsidiaries  
Consolidated Statements of Stockholders' Equity  
Years Ended December 31, 2020 and 2019

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance on December 31, 2018	\$ 112,500	\$ 9,869,268	\$ 30,606,883	\$ (414,849)	\$ (12,538,694)	\$ 27,635,108
Net Income	-	-	4,379,404	-	-	4,379,404
Other Comprehensive Income	-	-	-	621,727	-	621,727
Vesting of Restricted Stock Grant	-	323,625	-	-	72,375	396,000
Repurchase of Common Stock	-	-	-	-	(100,300)	(100,300)
Dividends Paid	-	-	(598,571)	-	-	(598,571)
Balance on December 31, 2019	112,500	10,192,893	34,387,716	206,878	(12,566,619)	32,333,368
Net Income	-	-	6,864,390	-	-	6,864,390
Other Comprehensive Income	-	-	-	1,092,845	-	1,092,845
Vesting of Restricted Stock Grant	-	384,593	-	-	71,408	456,001
Dividends Paid	-	-	(810,094)	-	-	(810,094)
Balance on December 31, 2020	<u>\$ 112,500</u>	<u>\$ 10,577,486</u>	<u>\$ 40,442,012</u>	<u>\$ 1,299,723</u>	<u>\$ (12,495,211)</u>	<u>\$ 39,936,510</u>

Redwood Financial, Inc. and Subsidiaries  
Consolidated Statements of Cash Flows  
Years Ended December 31, 2020 and 2019

	2020	2019
Cash Flows from Operating Activities		
Net income	\$ 6,864,390	\$ 4,379,404
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	55,000	142,000
Depreciation	801,136	860,662
Impairment of mortgage servicing rights	600,000	-
Amortization of premiums/discounts on debt securities available-for-sale	652,900	232,072
Mortgage servicing rights capitalized	(2,061,630)	(791,966)
Amortization of mortgage servicing rights	568,638	292,007
(Gain) loss on sale of debt securities available-for-sale	(25,734)	15,202
Loss on disposal of premises and equipment	-	4,224
(Increase) decrease in other assets	(27,798)	105,877
Increase in accrued interest receivable	(54,749)	(6,035)
Increase in accrued interest payable	3,069	98,318
Increase in deferred income taxes	101,368	57,045
Vesting of restricted stock grant	456,001	396,000
Increase in accrued expenses and other liabilities	561,465	117,240
Net Cash Provided by Operating Activities	8,494,056	5,902,050
Cash Flows from Investing Activities		
Proceeds from maturities of interest-bearing deposits in banks	1,960,000	1,715,000
Purchases of interest-bearing deposits in banks	(1,470,000)	(1,960,000)
Proceeds from maturities, calls or paydowns of debt securities available-for-sale	35,583,512	15,240,228
Proceeds from sale of debt securities available-for-sale	954,190	2,194,798
Purchases of debt securities available-for-sale	(142,788,327)	(43,717,041)
(Increase) in loans, net	(11,516,882)	(4,587,466)
Purchase of premises and equipment	(266,923)	(383,052)
Sale (purchase) of restricted stock	2,340,100	(1,297,800)
Net Cash Used in Investing Activities	(115,204,330)	(32,795,333)
Cash Flows from Financing Activities		
Increase in deposits, net	116,247,298	28,723,241
(Decrease) increase in federal funds purchased, net	(1,401,000)	597,000
(Decrease) increase in repurchase agreements, net	(56,581)	26,138
Federal Home Loan Bank advances	6,500,000	8,700,000
Payments on Federal Home Loan Bank advances	(15,000,901)	(8,537,786)
Payments on Bank stock loan	(390,610)	(370,833)
Increase in advance payments by borrowers for taxes and insurance	982,762	377,410
Repurchase of common stock	-	(100,300)
Dividends paid	(810,094)	(598,571)
Net Cash Provided by Financing Activities	106,070,874	28,816,299
(Decrease) Increase in Cash and Cash Equivalents	(639,400)	1,923,016
Cash and Cash Equivalents, Beginning of Year	10,511,615	8,588,599
Cash and Cash Equivalents, End of Year	\$ 9,872,215	\$ 10,511,615
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	\$ 1,951,244	\$ 2,103,472
Income taxes	\$ 2,724,220	\$ 1,567,486

## **Note 1 - Summary of Significant Accounting Policies**

### **Nature of Operations**

Redwood Financial, Inc. (the Company) is the financial holding company of HomeTown Bank (the Bank), a state-chartered bank. The Bank, operating in ten facilities, provides a variety of financial services to the areas of south central and south western Minnesota, as well as the south metropolitan area, including mortgage, commercial, agricultural and consumer lending products and various deposit and savings plans. The Company also conducts business as Community Insurance, Inc. (the Agency). The Agency offers property, casualty, crop insurance, and health/life insurance in nine facilities throughout south central and south western Minnesota, and the south metropolitan area. The Company owns 100% of the common stock of Redwood Financial Statutory Trust I (the Trust). The Trust issued Preferred Trust Securities to independent entities.

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America. The following summarizes the more significant accounting policies the Company follows in preparing and presenting its consolidated financial statements.

### **Principles of Consolidation**

The accompanying consolidated financial statements include the accounts of the Company, the Bank and the Agency. All significant intercompany account balances and transactions have been eliminated in consolidation. In accordance with Financial Accounting Standards Board Codification Topic ASC 810-10, the Company has not consolidated its statutory trust (the Trust), as described in Note 9 – Subordinated Debentures.

### **Use of Estimates**

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and fair value of mortgage servicing rights.

### **Cash, Cash Equivalents and Cash Flows**

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, all of which have original maturities of 90 days or less.

Balances in transaction accounts at other financial institutions may exceed amounts covered by federal deposit insurance. Management regularly evaluates the credit risk associated with other financial institutions and believes that the Company is not exposed to any significant credit risks on cash and cash equivalents.

Cash flows from loans, deposits, federal funds purchased and repurchase agreements are reported net.

### **Interest-Bearing Deposits in Banks**

Interest-bearing deposits in banks have original maturities of ninety days or more and are carried at cost.

**Debt Securities Available-for-Sale**

Debt securities available-for-sale are reported at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income (loss) within stockholders' equity. Debt securities classified as available-for-sale are those debt securities the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a debt security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Purchase premiums and discounts are recognized into income using the interest method over the terms of the debt securities. Gains or losses on the disposition of available-for-sale securities are recognized using the specific identification method. Fair value measurement is based on quoted prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques.

Declines in the fair value of debt securities available-for-sale that are deemed to be other-than-temporary are charged to earnings as a realized loss, and a new cost basis for the securities is established. In evaluating other-than-temporary impairment, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the new term. Declines in the fair value of debt securities below amortized cost are deemed to be other-than-temporary in circumstances where: (1) the Company has the intent to sell a security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the difference between the security's amortized cost basis and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income (loss).

**Loans and Allowance for Loan Losses**

Loans are stated at their principal amount, net of unearned interest and the allowance for loan losses. Interest on loans is calculated using the simple interest method on daily balances of the principal amount outstanding. Loan origination and commitment fees, as well as certain direct origination costs, are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans are generally placed on a nonaccrual status when principal or interest is 90 days past due, or when payment in full is not anticipated. When a loan is placed on nonaccrual status, interest accrued, but not received, is generally reversed against interest income. If collectability is in doubt, cash receipts on nonaccrual loans are used to reduce principal rather than recorded as interest income.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

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

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions; changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Company include commercial, commercial real estate, agricultural, residential real estate and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to-income, collateral type and loan-to-value ratios for consumer loans.

### **Investments in Restricted Stock**

Investments in restricted stock consist of Federal Home Loan Bank (FHLB) stock. The Company, as a member of the FHLB system, is required to maintain a minimum investment in FHLB stock. Membership stock is based on a percentage of total assets and activity stock is based on participation in various mortgage loan programs. No ready market exists for FHLB stock, and has no quoted fair value, thus the FHLB stock is carried at cost and evaluated periodically for impairment.

**Premises and Equipment**

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 40 to 50 years. Building improvements are depreciated using the straight-line method with useful lives ranging from 10 to 35 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 1 to 10 years.

**Mortgage Servicing Rights**

Servicing assets are recognized as separate assets when rights are acquired through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on its fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is recognized through valuation allowance for individual tranches, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported as a separate line item on the consolidated balance sheets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

**Goodwill**

Goodwill is a result of HomeTown Bank entering into branch purchase and assumption agreements. Goodwill is not amortized, rather potential impairment is considered on an annual basis, or more frequently upon the occurrence of an event or when circumstances indicate that the amount of goodwill is greater than its fair value. As of December 31, 2020, the carrying value of the Company's goodwill was not considered impaired.

**Other Real Estate Owned**

Other real estate owned (ORE) represents properties acquired through foreclosure or other proceedings. ORE is recorded at the lower of the carrying amounts of the related loans or fair value of the properties at the date of foreclosure, less estimated costs of disposal. Any write-down to fair value less estimated costs of disposal at the time of transfer to ORE is charged to the allowance for loan losses. Property is evaluated periodically to ensure that the recorded amount is supported by its current fair value less estimated costs of disposal. Subsequent write-downs are charged to other expense. Gains or losses on the sale of ORE are charged to operations.

### **Income Taxes**

The Company files its tax return as a C corporation and consolidates the results of operations of its subsidiaries for tax reporting purposes.

The Company evaluates its tax positions that have been taken or are expected to be taken on income tax returns to determine if an accrual is necessary for uncertain tax positions. As of December 31, 2020 and 2019, the unrecognized tax benefit accrual was zero. The Company will recognize future accrued interest and penalties related to unrecognized tax benefits in income tax expense if incurred. The Company is no longer subject to Federal tax examinations by tax authorities for years before 2017.

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

### **Transfers of Financial Assets**

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

### **Comprehensive Income**

Comprehensive income is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income is the total of net income and other comprehensive income (loss) which, for the Company, is comprised entirely of unrealized gains and losses on securities available-for-sale, net of the related deferred tax effect.

### **Reclassifications**

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements to maintain consistency between periods presented. The reclassifications had no impact on the net income or stockholders' equity.

### **Advertising Costs**

The Company expenses advertising costs as incurred.

**Earnings per Common Share**

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock plans. A reconciliation of earning per share for the years ended December 31, 2020 and 2019 is below:

	<u>2020</u>	<u>2019</u>
Net income	\$ 6,864,390	\$ 4,379,404
Basic EPS:		
Weighted average number of shares	404,537	396,334
Earnings per share	\$ 16.97	\$ 11.05
Diluted EPS:		
Weighted average number of shares	404,537	396,334
Earnings per share	\$ 16.97	\$ 11.05

**Revenue Recognition**

The provisions of FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with Customers* (Topic 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as foreclosed assets. The majority of the Company's revenues come from interest income and other sources, including loans and securities that are outside the scope of Topic 606. The Company's services that fall within the scope of Topic 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of Topic 606 include service charges and fees, insurance commissions and the sale of foreclosed assets.

A description of the Company's revenue streams accounted for under Topic 606 follows:

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

**Insurance Commissions:** The Company receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The fees are recognized monthly and a receivable is recorded until commissions are paid. Because the Company (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers, insurance commissions are presented net of related costs.

Gains (Losses) on Sales of Foreclosed Assets: The Company records a gain or loss from the sale of foreclosed assets when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of foreclosed asset to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed 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 Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

### **Subsequent Events**

Subsequent to year-end, the Company signed a purchase agreement for approximately \$5 million to purchase substantially all the assets of a crop insurance related business.

The Company has evaluated subsequent events through March 22, 2021, the date which the consolidated financial statements were available to be issued.

### **Note 2 - Restrictions on Cash and Cash Equivalents**

Based on the type and amount of deposits received, the Bank must maintain an appropriate cash reserve in accordance with Federal Reserve Bank reserve requirements. The total of the reserve requirements was approximately \$2,705,000 as of December 31, 2019.

Effective March 26, 2020, the Federal Reserve announced the reduction of the reserve requirement ratio to zero percent across all deposit tiers. Depository institutions that were required to maintain deposits in a Federal Reserve Bank account to satisfy reserve requirements will no longer be required to do so and can use the additional liquidity to lend to individuals and businesses. It is our understanding that the Federal Reserve currently has no current plans to reinstate the reserve requirement. However, the Federal Reserve may adjust reserve requirement ratios in the future if conditions warrant.

**Note 3 - Debt Securities Available-for-Sale**

Debt securities available-for-sale at December 31, 2020 and 2019, are summarized as follows:

	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ 61,558,007	\$ 170,271	\$ (182,784)	\$ 61,545,494
State and municipal securities	21,536,269	307,653	-	21,843,922
Mortgage-backed securities	79,346,201	1,285,329	(65,800)	80,565,730
Collateralized mortgage obligations	13,007,853	323,853	(14,604)	13,317,102
<b>Total securities available-for-sale</b>	<b>\$ 175,448,330</b>	<b>\$ 2,087,106</b>	<b>\$ (263,188)</b>	<b>\$ 177,272,248</b>

  

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ 14,355,725	\$ 40,476	\$ (29,913)	\$ 14,366,288
State and municipal securities	10,967,295	65,191	(4,292)	11,028,194
Mortgage-backed securities	31,631,336	348,382	(92,148)	31,887,570
Collateralized mortgage obligations	12,870,517	40,433	(77,815)	12,833,135
<b>Total securities available-for-sale</b>	<b>\$ 69,824,873</b>	<b>\$ 494,482</b>	<b>\$ (204,168)</b>	<b>\$ 70,115,187</b>

The amortized cost and estimated fair value of investment securities available-for-sale at December 31, 2020, by contractual maturity, are shown below:

	Amortized Cost	Fair Value
Due within one year	\$ 2,343,611	\$ 2,347,263
Due after one year through five years	17,985,908	18,189,462
Due after five years through ten years	62,764,757	62,852,691
	83,094,276	83,389,416
Mortgage-backed securities	79,346,201	80,565,730
Collateralized mortgage obligations	13,007,853	13,317,102
<b>Total</b>	<b>\$ 175,448,330</b>	<b>\$ 177,272,248</b>

Anticipated maturities on mortgage-backed securities and collateralized mortgage obligations are not readily determinable since they may be prepaid without penalty.

## Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

At December 31, 2020 and 2019, debt securities and interest-bearing deposits in banks with an amortized cost of approximately \$18,011,000 and \$15,259,000, respectively, were pledged to secure public and private deposits. The fair value of pledged securities was approximately \$18,352,000 and \$15,368,000 as of December 31, 2020 and 2019, respectively.

Proceeds from the sale of available-for-sale securities during the year ended December 31, 2020 was \$954,190, resulting in gross realized gains of \$28,136 and losses of \$2,402. Proceeds for the sale of available-for-sale securities during the year ended December 31, 2019 was \$2,194,798, resulting in gross unrealized losses of \$15,202.

The following table shows the gross unrealized losses and fair value of the Company's debt securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual debt securities have been in a continuous unrealized loss position at December 31, 2020 and 2019.

	December 31, 2020			
	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ (182,784)	\$ 35,526,449	\$ -	\$ -
Mortgage-backed securities	(65,800)	20,601,310	-	-
Collateralized mortgage obligations	(14,604)	5,095,399	-	-
Total	\$ (263,188)	\$ 61,223,158	\$ -	\$ -
	December 31, 2019			
	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government agency securities	\$ (28,981)	\$ 7,901,019	\$ (932)	\$ 684,440
State and municipal securities	(3,830)	922,827	(462)	184,538
Mortgage-backed securities	(72,369)	11,178,050	(19,779)	2,123,099
Collateralized mortgage obligations	(73,971)	7,130,462	(3,844)	588,756
Total	\$ (179,151)	\$ 27,132,358	\$ (25,017)	\$ 3,580,833

At December 31, 2020, a total of 30 debt securities had unrealized losses, none of which management considers to be other-than-temporarily impaired. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the insurer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. During the years ending December 31, 2020 and 2019, the Company recognized no other-than-temporary impairments on investments.

**Note 4 - Loans and Allowance for Loan Losses and Impaired Loans**

Loans at December 31 are summarized as follows:

	2020	2019
Commercial	\$ 48,945,572	\$ 23,146,818
Commercial real estate	90,712,462	90,951,852
Agricultural	18,604,368	25,436,418
Residential real estate	66,403,429	70,506,178
Consumer	22,713,297	25,775,432
	<u>247,379,128</u>	<u>235,816,698</u>
Less: allowance for loan losses	<u>(4,126,309)</u>	<u>(4,025,761)</u>
Loans, net	<u>\$ 243,252,819</u>	<u>\$ 231,790,937</u>

**Credit Quality Indicators**

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, collateral adequacy, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on an ongoing basis as new information is obtained. The Company uses the following definitions for risk ratings:

**Pass** – Loans classified as Pass represent loans that are evaluated and are performing under the stated terms. Pass rated assets are analyzed by the paying capacity, the current net worth, and the value of the loan collateral of the obligor.

**Watch** – Loans classified as Watch possess potential weaknesses that require management attention, but do not yet warrant adverse classification. While the status of a loan put on this list may not technically trigger their classification as Substandard or Doubtful, it is considered a proactive way to identify potential issues and address them before the situation deteriorates further and does result in a loss for the Company.

**Substandard** – Loans classified as Substandard are inadequately protected by the current net worth, paying capacity of the obligor, or by the collateral pledged. Substandard loans must have a well-defined weakness or weaknesses that jeopardize the repayment of the debt as originally contracted. They are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected.

**Doubtful** – Loans classified as Doubtful have the weaknesses of those classified as Substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. Loans in this category are allocated a specific reserve based on the estimated discounted cash flows from the loan (or collateral value less cost to sell for collateral dependent loans) or are charged off if deemed uncollectible.

Redwood Financial, Inc. and Subsidiaries  
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December 31, 2020 and 2019

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows as of December 31, 2020 and 2019:

December 31, 2020	Pass	Watch	Substandard	Doubtful	Total
Commercial	\$ 48,860,178	\$ -	\$ 85,394	\$ -	\$ 48,945,572
Commercial real estate	84,282,325	4,904,410	1,525,727	-	90,712,462
Agricultural	12,079,133	2,514,735	4,010,500	-	18,604,368
Residential real estate	64,689,541	652,599	1,061,289	-	66,403,429
Consumer	22,620,906	85,986	6,405	-	22,713,297
	<u>\$ 232,532,083</u>	<u>\$ 8,157,730</u>	<u>\$ 6,689,315</u>	<u>\$ -</u>	<u>\$ 247,379,128</u>
December 31, 2019	Pass	Watch	Substandard	Doubtful	Total
Commercial	\$ 22,470,280	\$ 532,890	\$ 143,648	\$ -	\$ 23,146,818
Commercial real estate	88,411,308	975,419	1,565,125	-	90,951,852
Agricultural	19,637,437	463,429	5,335,552	-	25,436,418
Residential real estate	68,921,606	130,809	1,453,763	-	70,506,178
Consumer	25,720,708	-	54,724	-	25,775,432
	<u>\$ 225,161,339</u>	<u>\$ 2,102,547</u>	<u>\$ 8,552,812</u>	<u>\$ -</u>	<u>\$ 235,816,698</u>

Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

The following table summarizes the aging of the past due loans by portfolio segments at December 31, 2020 and 2019:

December 31, 2020	Still Accruing		Nonaccrual Balance
	30-89 Days Past Due	Over 90 Days Past Due	
Commercial	\$ 309,182	\$ -	\$ -
Commercial real estate	-	-	20,710
Agricultural	-	-	-
Residential real estate	552,191	-	650,534
Consumer	32,208	-	-
Total	<u>\$ 893,581</u>	<u>\$ -</u>	<u>\$ 671,244</u>
December 31, 2019	Still Accruing		Nonaccrual Balance
	30-89 Days Past Due	Over 90 Days Past Due	
Commercial	\$ 22,227	\$ -	\$ -
Commercial real estate	163,441	-	251,824
Agricultural	-	-	-
Residential real estate	418,978	-	1,080,737
Consumer	9,918	-	30,140
Total	<u>\$ 614,564</u>	<u>\$ -</u>	<u>\$ 1,362,701</u>

## Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

The following table summarizes individually impaired loans by class of loans as of December 31, 2020 and 2019:

December 31, 2020	<u>Recorded Investment</u>	<u>Unpaid Principal Balance (1)</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	
With no related allowance recorded					
Commercial	\$ -	\$ -	\$ -	\$ -	
Commercial real estate	170,119	286,037	291,531	12,029	
Agricultural	-	-	-	-	
Residential real estate	321,350	349,990	355,295	26,454	
Consumer	-	-	-	-	
	<u>\$ 491,469</u>	<u>\$ 636,027</u>	<u>\$ 646,826</u>	<u>\$ 38,483</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance (1)</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With an allowance recorded					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	1,131,150	1,143,315	242,779	1,204,732	38,882
Agricultural	-	-	-	-	-
Residential real estate	329,184	378,963	3,317	380,649	23,165
Consumer	-	-	-	-	-
	<u>\$ 1,460,334</u>	<u>\$ 1,522,278</u>	<u>\$ 246,096</u>	<u>\$ 1,585,381</u>	<u>\$ 62,047</u>

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

December 31, 2019	<u>Recorded Investment</u>	<u>Unpaid Principal Balance (1)</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>	
With no related allowance recorded					
Commercial	\$ -	\$ -	\$ -	\$ -	
Commercial real estate	156,974	272,893	301,782	-	
Agricultural	-	-	-	-	
Residential real estate	725,029	725,029	809,515	6,865	
Consumer	<u>8,679</u>	<u>8,679</u>	<u>9,487</u>	<u>77</u>	
	<u>\$ 890,682</u>	<u>\$ 1,006,601</u>	<u>\$ 1,120,784</u>	<u>\$ 6,942</u>	
	<u>Recorded Investment</u>	<u>Unpaid Principal Balance (1)</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
With an allowance recorded					
Commercial	\$ -	\$ -	\$ -	\$ -	\$ -
Commercial real estate	94,850	94,850	32,379	102,056	-
Agricultural	-	-	-	-	-
Residential real estate	355,708	355,708	3,317	382,700	2,294
Consumer	<u>21,460</u>	<u>21,460</u>	<u>2,992</u>	<u>24,013</u>	<u>234</u>
	<u>\$ 472,018</u>	<u>\$ 472,018</u>	<u>\$ 38,688</u>	<u>\$ 508,769</u>	<u>\$ 2,528</u>

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

Redwood Financial, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2020 and 2019

The following table presents the activity in the allowance for loan losses for the year 2020 and the recorded investment in loans and impairment method as of December 31, 2020, by portfolio segment:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Total
Allowance for Loan Losses						
Balance at beginning of period	\$ 286,939	\$ 1,466,002	\$ 965,394	\$ 911,608	\$ 395,818	\$ 4,025,761
Charge-offs	-	-	-	-	(80,406)	(80,406)
Recoveries	38,837	-	-	31,813	55,304	125,954
Provisions	(15,330)	327,725	(231,140)	(6,556)	(19,699)	55,000
Balance at end of period	<u>\$ 310,446</u>	<u>\$ 1,793,727</u>	<u>\$ 734,254</u>	<u>\$ 936,865</u>	<u>\$ 351,017</u>	<u>\$ 4,126,309</u>
Individually evaluated for impairment	\$ -	\$ 242,779	\$ -	\$ 3,317	\$ -	\$ 246,096
Collectively evaluated for impairment	<u>310,446</u>	<u>1,550,948</u>	<u>734,254</u>	<u>933,548</u>	<u>351,017</u>	<u>3,880,213</u>
Balance at end of period	<u>\$ 310,446</u>	<u>\$ 1,793,727</u>	<u>\$ 734,254</u>	<u>\$ 936,865</u>	<u>\$ 351,017</u>	<u>\$ 4,126,309</u>
Loans						
Individually evaluated for impairment	\$ -	\$ 1,301,269	\$ -	\$ 650,534	\$ -	\$ 1,951,803
Collectively evaluated for impairment	<u>48,945,572</u>	<u>89,411,193</u>	<u>18,604,368</u>	<u>65,752,895</u>	<u>22,713,297</u>	<u>245,427,325</u>
Balance at end of period	<u>\$ 48,945,572</u>	<u>\$ 90,712,462</u>	<u>\$ 18,604,368</u>	<u>\$ 66,403,429</u>	<u>\$ 22,713,297</u>	<u>\$ 247,379,128</u>

Redwood Financial, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2020 and 2019

The following table presents the activity in the allowance for loan losses for the year 2019 and the recorded investment in loans and impairment method as of December 31, 2019, by portfolio segment:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Total
Allowance for Loan Losses						
Balance at beginning of period	\$ 287,020	\$ 1,619,751	\$ 628,483	\$ 928,868	\$ 400,609	\$ 3,864,731
Charge-offs	-	-	-	-	(13,312)	(13,312)
Recoveries	6,874	-	-	13,698	11,770	32,342
Provisions	(6,955)	(153,749)	336,911	(30,958)	(3,249)	142,000
Balance at end of period	<u>\$ 286,939</u>	<u>\$ 1,466,002</u>	<u>\$ 965,394</u>	<u>\$ 911,608</u>	<u>\$ 395,818</u>	<u>\$ 4,025,761</u>
Individually evaluated for impairment	\$ -	\$ 32,379	\$ -	\$ 3,317	\$ 2,992	\$ 38,688
Collectively evaluated for impairment	<u>286,939</u>	<u>1,433,623</u>	<u>965,394</u>	<u>908,291</u>	<u>392,826</u>	<u>3,987,073</u>
Balance at end of period	<u>\$ 286,939</u>	<u>\$ 1,466,002</u>	<u>\$ 965,394</u>	<u>\$ 911,608</u>	<u>\$ 395,818</u>	<u>\$ 4,025,761</u>
Loans						
Individually evaluated for impairment	\$ -	\$ 251,824	\$ -	\$ 1,080,737	\$ 30,139	\$ 1,362,700
Collectively evaluated for impairment	<u>23,146,818</u>	<u>90,700,028</u>	<u>25,436,418</u>	<u>69,425,441</u>	<u>25,745,293</u>	<u>234,453,998</u>
Balance at end of period	<u>\$ 23,146,818</u>	<u>\$ 90,951,852</u>	<u>\$ 25,436,418</u>	<u>\$ 70,506,178</u>	<u>\$ 25,775,432</u>	<u>\$ 235,816,698</u>

Impaired loans also include loans modified in a troubled debt restructuring (TDR) where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collections.

There were no troubled debt restructurings that occurred during the years ended December 31, 2020 and 2019.

There were no troubled debt restructurings that defaulted for the years ended December 31, 2020 and 2019.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2020 and 2019.

#### Note 5 - Premises and Equipment

A summary of premises and equipment at December 31 are as follows:

	<u>2020</u>	<u>2019</u>
Land and office buildings	\$ 17,431,165	\$ 17,415,250
Furniture and equipment	<u>3,435,156</u>	<u>3,670,378</u>
	20,866,321	21,085,628
Less: accumulated depreciation	<u>(5,766,417)</u>	<u>(5,451,511)</u>
Total premises and equipment, net	<u><u>\$ 15,099,904</u></u>	<u><u>\$ 15,634,117</u></u>

Depreciation expense totaled \$801,136 and \$860,662 for the years ended December 31, 2020 and 2019, respectively.

The Company leased one of their facilities through June 30, 2020. Total rent and lease expense for the years ended December 31, 2020 and 2019 amounted to \$21,582 and \$43,163, respectively.

**Note 6 - Mortgage Servicing Rights**

Loans serviced for others are not included in the accompanying consolidated balance sheet. The risks inherent in mortgage servicing rights relate primarily to changes in prepayments that result from shifts in mortgage interest rates. The unpaid principal balances of loans serviced for others was approximately \$403,261,000 and \$268,197,000 as of December 31, 2020 and 2019, respectively. The carrying amount of the mortgage servicing rights were \$2,990,304 and \$2,097,312 as of December 31, 2020 and 2019, respectively.

Mortgage servicing rights for the years ended December 31, 2020 and 2019 were:

	2020	2019
Mortgage servicing rights at beginning of year	\$ 2,097,312	\$ 1,597,353
Additions	2,061,630	791,966
Disposals	-	-
Amortization	(568,638)	(292,007)
Mortgage servicing rights at end of year	3,590,304	2,097,312
Valuation allowance at beginning of year	-	-
Additions	600,000	-
Reductions	-	-
Write-downs	-	-
Valuation allowance at end of year	600,000	-
Mortgage servicing rights, net	\$ 2,990,304	\$ 2,097,312
Estimated fair value of servicing rights, beginning of period	\$ 2,292,559	\$ 2,304,173
Estimated fair value of servicing rights, end of period	2,592,198	2,292,559

The fair value of servicing rights was determined using discount rates ranging from 9.0% to 12.0%, prepayment speeds ranging from 267 PSA to 411 PSA, depending on the stratification of the specific right.

Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

Future amortization of mortgage servicing rights for the years ending December 31 follows:

2021		\$ 1,223,934
2022		933,529
2023		499,312
2024		466,765
2025		466,764
Thereafter		-
		\$ 3,590,304

Projections of amortization are based on existing asset balances and the existing interest rate environment as of December 31, 2020 and 2019. The Company's actual experiences may be significantly different depending upon changes in mortgage rates and other market conditions.

Contractually specified servicing and ancillary fees are included in mortgage servicing income, and late fees are included in fees and service charges.

	2020	2019
Contractually specified servicing fees	\$ 815,063	\$ 611,950
Late fees	14,432	14,035
	\$ 829,495	\$ 625,985

**Note 7 - Deposits**

A summary of deposits at December 31 follows:

	2020	2019
Non-interest bearing demand deposit accounts	\$ 113,027,116	\$ 72,978,690
Interest-bearing demand deposit accounts	129,668,631	80,174,668
Savings and money market accounts	128,125,297	99,986,898
Time deposits, meet or exceed the FDIC insurance limit	4,651,549	4,795,871
Other time deposits	28,949,821	30,238,989
Total deposits	\$ 404,422,414	\$ 288,175,116

## Redwood Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2020 and 2019

At December 31, 2020, the scheduled maturities of time deposits are as follows:

2021		\$ 21,277,682
2022		9,889,634
2023		1,087,690
2024		629,292
2025 and thereafter		<u>717,072</u>
Total time deposits		<u><u>\$ 33,601,370</u></u>

### Note 8 - Borrowings

Borrowings at December 31 are summarized as follows:

	2020	2019
Federal Home Loan Bank advances	\$ 7,382,782	\$ 15,883,684
Federal funds purchased	-	1,401,000
Repurchase agreements	444,557	501,138
Bank stock loan	<u>3,307,029</u>	<u>3,697,639</u>
Total borrowings	<u><u>\$ 11,134,368</u></u>	<u><u>\$ 21,483,461</u></u>

### Federal Home Loan Bank Advances

At December 31, 2020 and 2019, the interest rates on the Company's Federal Home Loan Bank (FHLB) advances ranged from 2.15% to 3.41%. At December 31, 2020, the scheduled maturities of the FHLB advances are as follows:

Due in 2021		\$ -
Due in 2022		750,000
Due in 2023		2,500,000
Due in 2024		2,029,061
Due in 2025 and thereafter		<u>2,103,721</u>
Total FHLB advances		<u><u>\$ 7,382,782</u></u>

The Company's level of FHLB stock at December 31, 2020 and 2019, is required by FHLB to maintain the current level of FHLB advances.

The Company maintains a collateral pledge agreement with the Federal Home Loan Bank of Des Moines covering secured advances whereby the Company has agreed to retain, free of all other pledges, liens and encumbrances, residential, and commercial and agricultural real estate loans. The pledged loans are discounted at 125% to 156% as of December 31, 2020, when aggregating the amount of loans required by the pledge agreement. The amount of eligible loans was approximately \$60,153,000 and \$65,307,000 as of December 31, 2020 and 2019, respectively.

With sufficient collateral, the total borrowing limit from the FHLB was approximately \$36,144,000 at December 31, 2020. With the total FHLB advances of \$7,382,783 and the net credit enhancement commitments on the loans sold to FHLB of \$1,463,692 as of December 31, 2020, the Company can borrow approximately an additional \$27,298,000 from FHLB.

### Repurchase Agreements

Repurchase agreements, which are classified as secured borrowings, generally mature within one year from the transaction date. Repurchase agreements are reflected at the amount of cash received in connection with a transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities.

### Bank Stock Loan

The Company borrowed \$5,000,000 on February 3, 2016, collateralized by HomeTown Bank stock.

Amount	\$	3,307,029
Issuance date		February 3, 2016
Maturity date		May 31, 2025
Fixed interest rate		3.40%

The scheduled maturities of the Bank stock loan are as follows:

Due in 2021	\$	454,910
Due in 2022		436,317
Due in 2023		451,553
Due in 2024		467,144
Due in 2025		1,497,105
		<u>1,497,105</u>
	\$	<u>3,307,029</u>

The Company has a \$3,000,000 line of credit with Bell Bank. At December 31, 2020, this line is subject to a variable interest rate of .50 % under the current "Prime Rate". The rate at December 31, 2020 was 3.25%. This line matures on March 1, 2021. As of December 31, 2020, there were no advances on the line of credit.

**Note 9 - Subordinated Debentures**

The Company has a statutory business trust for the purpose of issuing trust preferred securities. The proceeds from such issuances, together with the proceeds of the related issuances of common securities of the trust, were invested in junior subordinated debentures (debentures). Concurrent with the issuance of the preferred securities by the trust, the trust issued guarantees for the benefit of the security holders.

The sole assets of the trust are the debentures. The common securities of the trust are owned by the Company and are reported as an investment in unconsolidated subsidiaries within other assets of the consolidated balance sheet. The preferred securities issued by the trust rank senior to the common securities. The obligations of Redwood Financial Statutory Trust I under the debentures, the indentures, the relevant trust agreements and the guarantees, in the aggregate, constitute a full and unconditional guarantee by the trust of the obligations of the trust under the trust preferred securities and rank subordinate and junior in right of payment to all their other liabilities. The Company guarantees the obligations of Redwood Financial Statutory Trust I.

Amount	\$	6,186,000
Issuance date		September 21, 2006
Maturity date		December 15, 2036
Interest rate		LIBOR + 1.75%
Interest rate on December 31, 2020		1.97%

The trust preferred securities are subject to mandatory redemption at the stated maturity date of the debentures, upon repayment of the debentures, or earlier, pursuant to the terms of the Trust Agreement. On any interest payment date, the trust preferred securities may be redeemed, and the corresponding debentures may be prepaid at the option of the Company subject to Federal Reserve Bank approval, at declining redemption prices. Prior to the maturity date indicated above, the trust preferred securities may be redeemed at the option of the Company, on the occurrence of certain events that result in a negative tax impact, negative regulatory impact on the trust preferred securities or negative legal or regulatory impact on the appropriate special purpose trust which would define it as an investment company. In addition, the Company has the right to defer payment of interest on the debentures and, therefore, distributions on the trust preferred securities for up to five years.

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**Note 10 - Income Taxes**

Deferred tax assets and liabilities consists of the following components as of December 31, 2020 and 2019:

	2020	2019
Deferred tax assets:		
Allowance for losses on loans receivable	\$ 1,185,901	\$ 1,157,004
Other	900,176	719,887
Total deferred tax assets	2,086,077	1,876,891
Deferred tax liabilities:		
Goodwill	(1,098,335)	(1,098,197)
Mortgage servicing asset	(859,413)	(602,767)
Premises and equipment	(1,252,266)	(1,166,933)
Unrealized gain on securities available-for-sale	(524,194)	(83,436)
Other	(562,657)	(594,220)
Total deferred tax liabilities	(4,296,865)	(3,545,553)
Net deferred tax liability	\$ (2,210,788)	\$ (1,668,662)

The provision for income taxes charged to operations consists of the following:

	2020	2019
Current tax expense	\$ 2,593,216	\$ 1,560,330
Deferred tax	101,368	57,045
	\$ 2,694,584	\$ 1,617,375

The income tax provision differs from the amount of income tax determined by applying the U.S. Federal income tax rate to pretax income as follows:

	2020	2019
Computed "expected" federal income tax expense	\$ 1,441,522	\$ 1,259,324
Increase (decrease) resulting from:		
State income taxes, net of federal tax benefit	531,441	464,271
Tax-exempt interest income (net of disallowed expenses)	(89,216)	(89,242)
Other	810,837	(16,978)
Income tax expense	\$ 2,694,584	\$ 1,617,375

### **Note 11 - Related Party Transactions**

There were no loans to directors and executive officers of the Company as of December 31, 2020 and 2019.

Liabilities at December 31, 2020 and 2019, included amounts on deposit from Company directors and executive officers of \$813,268 and \$571,455, respectively. Such deposits were accepted in the ordinary course of business with normal interest rates, interest payment terms, and maturities.

### **Note 12 - Employee Benefits**

#### **401(k) Plan**

All employees are eligible to participate in the Company's 401(k) plan on the first day of the following quarter from the date of hire, after they attain age 21, and are employed at least 1,000 hours during the plan year. Participating employees may contribute the maximum amount allowed by law and the Company will match up to five percent. The match vests at 20% after the second year of service, until fully vested after six years of service. Contributions to the plan for the years ended December 31, 2020 and 2019 were \$285,255 and \$233,408, respectively.

#### **Phantom Stock Plan**

The Company has a phantom stock plan. The phantom stock plan grants phantom shares up to a total of 35,000 shares to certain key management employees, which vest over a five-year period at 20% per year. At December 31, 2020 and 2019, there were 30,435 and 28,580 shares of phantom stock granted to 12 employees, respectively. 26,603 and 24,526 shares were vested at December 31, 2020 and 2019, respectively. Expense related to the vesting of the shares at December 31, 2020 and 2019 totaled \$174,468 and \$185,856, respectively.

#### **Restricted Stock Grant Plan**

The Company had a restricted stock grant agreement. Under the agreement, future grants of certain shares of Company stock were granted to six directors of the Company. A total grant of 30,000 shares of common stock of the Company will be awarded equally over the agreement's first five one-year anniversary dates. No vesting restrictions apply. Shares are fully vested upon the grant date. Expenses related to the vesting of shares for 2020 and 2019 were \$456,000 and \$396,000, respectively. Subsequent to year end, this plan has been terminated.

**Note 13 - Minimum Regulatory Capital Requirements**

The federal banking agencies published final rules (the “Basel III Capital Rules”) that revised their risk-based and leverage capital requirements and their method for calculating risk-weighted assets to implement, in part, agreements reached by the Basel Committee and certain provisions of the Dodd-Frank Act. The Basel III Capital Rules apply to banking organizations, including the Bank.

In connection with the effective date of Basel III, most banks were required to decide whether to elect to opt-out of the inclusion of Accumulated Other Comprehensive Income (“AOCI”) in their Common Equity Tier 1 Capital. This was a one-time election and generally irrevocable. If electing to opt-out, most AOCI items will be treated, for regulatory capital purposes, in the same manner in which they were prior to Basel III. The Bank has elected to opt-out of the inclusion.

Among other things, the Basel III Capital Rules: (i) introduce a new capital measure entitled “Common Equity Tier 1” (“CET1”); (ii) specify that tier 1 capital consist of CET1 and additional financial instruments satisfying specified requirements that permit inclusion in tier 1 capital; (iii) define CET1 narrowly by requiring that most deductions or adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions or adjustments from capital as compared to the existing regulations.

A minimum leverage ratio (tier 1 capital as a percentage of total assets) of 4.0% is also required under the Basel III Capital Rules (even for highly rated institutions). The Basel III Capital Rules additionally require institutions to retain a capital conservation buffer of 2.5% above these required minimum capital ratio levels. Banking organizations that fail to maintain the minimum 2.5% capital conservation buffer could face restrictions on capital distributions or discretionary bonus payment to executive officers.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Common Equity Tier 1 Capital (“CET1”), Tier 1 Capital, Total Capital and leverage ratio of Tier 1 Capital. As of January 1, 2015, the requirements are:

- 4.5% based upon CET1
- 6.0% based upon tier 1 capital
- 8.0% based on total regulatory capital
- Leverage ratio of Tier 1 Capital assets equal to 4%

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As of December 31, 2020 and 2019, management believes the Bank met all capital adequacy requirements to which they are subject. As of December 31, 2020, the most recent notification from the Federal Deposit Insurance Company (FDIC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Banks' actual capital amounts and ratios are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2020:						
Common equity Tier 1 capital (to risk weighted assets)	\$ 40,492,000	15.4%	≥ \$11,813,000	≥4.5%	≥ \$17,063,000	≥6.5%
Tier I capital (to risk weighted assets)	\$ 40,492,000	15.4%	≥ \$15,751,000	≥6.0%	≥ \$21,001,000	≥8.0%
Total capital (to risk weighted assets)	\$ 43,785,000	16.7%	≥ \$21,001,000	≥8.0%	≥ \$26,251,000	≥10.0%
Tier I capital (to average assets)	\$ 40,492,000	8.8%	≥ \$18,336,000	≥4.0%	≥ \$22,920,000	≥5.0%
As of December 31, 2019:						
Common equity Tier 1 capital (to risk weighted assets)	\$ 35,475,000	14.1%	≥ \$11,283,000	≥4.5%	≥ \$16,298,000	≥6.5%
Tier I capital (to risk weighted assets)	\$ 35,475,000	14.1%	≥ \$15,044,000	≥6.0%	≥ \$20,059,000	≥8.0%
Total capital (to risk weighted assets)	\$ 38,620,000	15.4%	≥ \$20,059,000	≥8.0%	≥ \$25,074,000	≥10.0%
Tier I capital (to average assets)	\$ 35,475,000	10.2%	≥ \$13,858,000	≥4.0%	≥ \$17,323,000	≥5.0%

**Note 14 - Restrictions**

The Company's ability to pay dividends to stockholders is subject to the requirements of their state charter. No dividend may be paid by the Company unless the Board of Directors determines that the Company will be able to pay its debts in the ordinary course of business after payment of the dividend. In addition, the Company's ability to pay dividends is dependent, in part, upon the dividends from the subsidiary bank.

**Note 15 - Stock Repurchases**

During the year ended December 31, 2020, the Company did not repurchase any shares of outstanding common stock. During the year ended December 31, 2019 the Company repurchased 1,003 of its shares of outstanding common stock at an average price per share of \$100. During 2020 and 2019, the Company released 6,000 shares of treasury shares into shares of outstanding common stock at an average price per share of \$11.91 and \$12.06 as part of the Restricted Stock Grant Plan during each year. Repurchased shares are considered treasury shares and will be utilized for general corporate and other purposes.

**Note 16 - Commitments and Contingencies**

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying balance sheets. The contract amounts of these instruments reflect the extent of involvement by the Company.

The Company'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 contract amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

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

	<u>2020</u>	<u>2019</u>
Financial instruments whose contract amount represents risk:		
Commitments to extend credit	\$ 53,116,219	\$ 46,727,875
Standby letters of credit	351,752	531,906
MPF credit enhancement	<u>1,463,692</u>	<u>1,194,131</u>
 Total	 <u>\$ 54,931,663</u>	 <u>\$ 48,453,912</u>

Commitments to extend credit are agreements to lend to a customer provided 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 a portion of the commitments may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on the loan type and on management's evaluation of the borrower. Collateral held varies, but may include real estate, accounts receivable, crops, livestock, inventory, property and equipment, and income-producing commercial properties. The Company would incur no losses if any or all of these commitments expire unused.

Standby letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

The Banks' 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 Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Mortgage Partnership Finance (MPF) credit enhancements allow the Corporation to share the credit risk associated with home mortgage finance with the Federal Home Loan Bank (FHLB). MPF provides the Corporation the ability to originate, sell, and service fixed rate residential mortgage loans, and receive a credit enhancement fee based on the performance of the loans. FHLB manages the liquidity, interest rate, and prepayment risks of the loans only after a foreclosure loss exceeds the borrower's equity, private mortgage insurance, and the funded first loss account. Based on the delinquency results for states where properties are located and the Corporation's historical loss experience, the estimated foreclosure losses are immaterial.

#### **Financial Instruments with Concentrations of Credit Risk**

Concentration by Loan Type: A large portion of the Company's loan portfolio finances properties secured by real estate, including retail buildings, multi-family homes, farmland, land development, and other non-residential real estate.

#### **Litigation**

In the ordinary course of business, the Company and the Bank may be subject to litigation. Based upon the available information and advice from the Company's legal counsel, management does not believe that any potential, threatened, or pending litigation to which it is a party will have a material adverse effect on the Company's liquidity, financial condition, or results of operations.

## **Note 17 - Fair Values of Assets and Liabilities**

### **Determination of Fair Value**

Accounting guidance on fair value measurements and disclosures defines fair value, and establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system and expands disclosures about fair value measurement. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business.

The three-level valuation hierarchy for disclosure of fair value is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

### **Debt Securities Available-for-Sale**

Fair values for debt securities available-for-sale are based on quoted market prices, if available, and are classified within Level 1 of the valuation hierarchy. For those debt securities available-for-sale where quoted prices are unavailable, fair values are calculated based on market prices of similar securities and, therefore, are classified as Level 2 within the valuation hierarchy.

### **Impaired Loans**

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific reserve is established. The specific reserves for collateral dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of the collateral was determined based on appraisals. When significant adjustments were based on unobservable inputs, the resulting fair value measurement has been categorized as a Level 3 measurement.

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Fair values of assets measured on a recurring basis at December 31, 2020 and 2019, are as follows:

	Fair Value	Fair Value Measurements at Reporting Date Using:		
		Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<u>December 31, 2020</u>				
Debt securities available-for-sale				
U.S. government agency securities	\$ 61,545,494	\$ -	\$ 61,545,494	\$ -
State and municipal securities	21,843,922	-	21,843,922	-
Mortgage-backed securities	80,565,730	-	80,565,730	-
Collateralized mortgage obligations	13,317,102	-	13,317,102	-
<u>December 31, 2019</u>				
Debt securities available-for-sale				
U.S. government agency securities	\$ 14,366,288	\$ -	\$ 14,366,288	\$ -
State and municipal securities	11,028,194	-	11,028,194	-
Mortgage-backed securities	31,887,570	-	31,887,570	-
Collateralized mortgage obligations	12,833,135	-	12,833,135	-

Fair values of assets measured on a non-recurring basis at December 31, 2020 and 2019, are as follows:

	Fair Value	Fair Value Measurements at Reporting Date Using:			Valuation Technique	Unobservable input	Range (Weighted Avg.)
		Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)			
<u>December 31, 2020</u>							
Impaired loans	\$ 1,705,707	\$ -	\$ -	\$ 1,705,707	Collateral valuation	Discount from market value	0%-30%
<u>December 31, 2019</u>							
Impaired loans	\$ 1,324,012	\$ -	\$ -	\$ 1,324,012	Collateral valuation	Discount from market value	5%-10%

Level 3 assets consist entirely of mortgage servicing rights. The Company determines the fair value of mortgage servicing rights using a valuation model that calculates the present value of estimated future net servicing income. The Company utilizes assumptions in the valuation model that market participants use in estimating future net servicing income, including estimates of prepayment speeds, discount rate, costs to service, escrow account earnings and contractual servicing income. These assumptions change from quarter to quarter as market conditions and projected interest rates change.

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The following table presents quantitative information about recurring Level 3 fair value measurements at December 31, 2020 and 2019:

	2020	2019	Valuation Technique	Unobservable input	Range (Weighted Avg.)
Mortgage servicing rights	\$ 2,990,304	\$ 2,097,312	Discounted Cash Flows	Prepayment speeds Discount Rates	9.0% - 12.0%

The following is a reconciliation for Level 3 assets and liabilities measured on a recurring basis:

	Mortgage Servicing Rights	
	2020	2019
Beginning balance	\$ 2,097,312	\$ 1,597,353
Additions	2,061,630	791,966
Impairment	(600,000)	-
Amortization	(568,638)	(292,007)
Ending balance	<u>\$ 2,990,304</u>	<u>\$ 2,097,312</u>

The estimated fair values, and related carrying amounts, of the Company's financial instruments as of December 31, 2020 are as follows:

	Carrying Amount	December 31, 2020			
		Total	(Level 1)	(Level 2)	(Level 3)
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 9,872,215	\$ 9,872,215	\$ 9,872,215	\$ -	\$ -
Interest-bearing deposits in banks	6,125,000	6,125,000	6,125,000	-	-
Debt securities available-for-sale	177,272,248	177,272,248	-	177,272,248	-
Loans, net	243,252,819	243,217,155	-	-	243,217,155
Investments in restricted stock	7,850,900	7,850,900	7,850,900	-	-
Interest receivable	2,165,790	2,165,790	2,165,790	-	-
Mortgage servicing rights	2,990,304	2,990,304	-	2,990,304	-
<b>Financial liabilities:</b>					
Deposits	\$ 404,422,414	\$ 405,202,657	\$ -	\$ -	\$ 405,202,657
Borrowings	11,134,368	11,656,548	-	11,656,548	-
Subordinated debentures	6,186,000	6,186,000	6,186,000	-	-
Interest payable	241,968	241,968	241,968	-	-
<b>Off-balance sheet commitments:</b>					
Commitments to extend credit	53,467,971	53,467,971	53,467,971	-	-

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The estimated fair values, and related carrying amounts, of the Company's financial instruments as of December 31, 2019 are as follows:

	Carrying Amount	December 31, 2019			
		Total	(Level 1)	(Level 2)	(Level 3)
<b>Financial assets:</b>					
Cash and cash equivalents	\$ 10,511,615	\$ 10,511,615	\$ 10,511,615	\$ -	\$ -
Interest-bearing deposits in banks	6,615,000	6,615,000	6,615,000	-	-
Debt securities available-for-sale	70,115,187	70,115,187	-	70,115,187	-
Loans, net	231,790,937	230,821,120	-	-	230,821,120
Investments in restricted stock	10,191,000	10,191,000	10,191,000	-	-
Interest receivable	2,111,041	2,111,041	2,111,041	-	-
Mortgage servicing rights	2,097,312	2,097,312	-	2,097,312	-
<b>Financial liabilities:</b>					
Deposits	\$ 288,175,116	\$ 288,558,894	\$ -	\$ -	\$ 288,558,894
Borrowings	21,483,461	21,367,424	-	21,367,424	-
Subordinated debentures	6,186,000	6,186,000	6,186,000	-	-
Interest payable	238,899	238,899	238,899	-	-
<b>Off-balance sheet commitments:</b>					
Commitments to extend credit	47,259,781	47,259,781	47,259,781	-	-