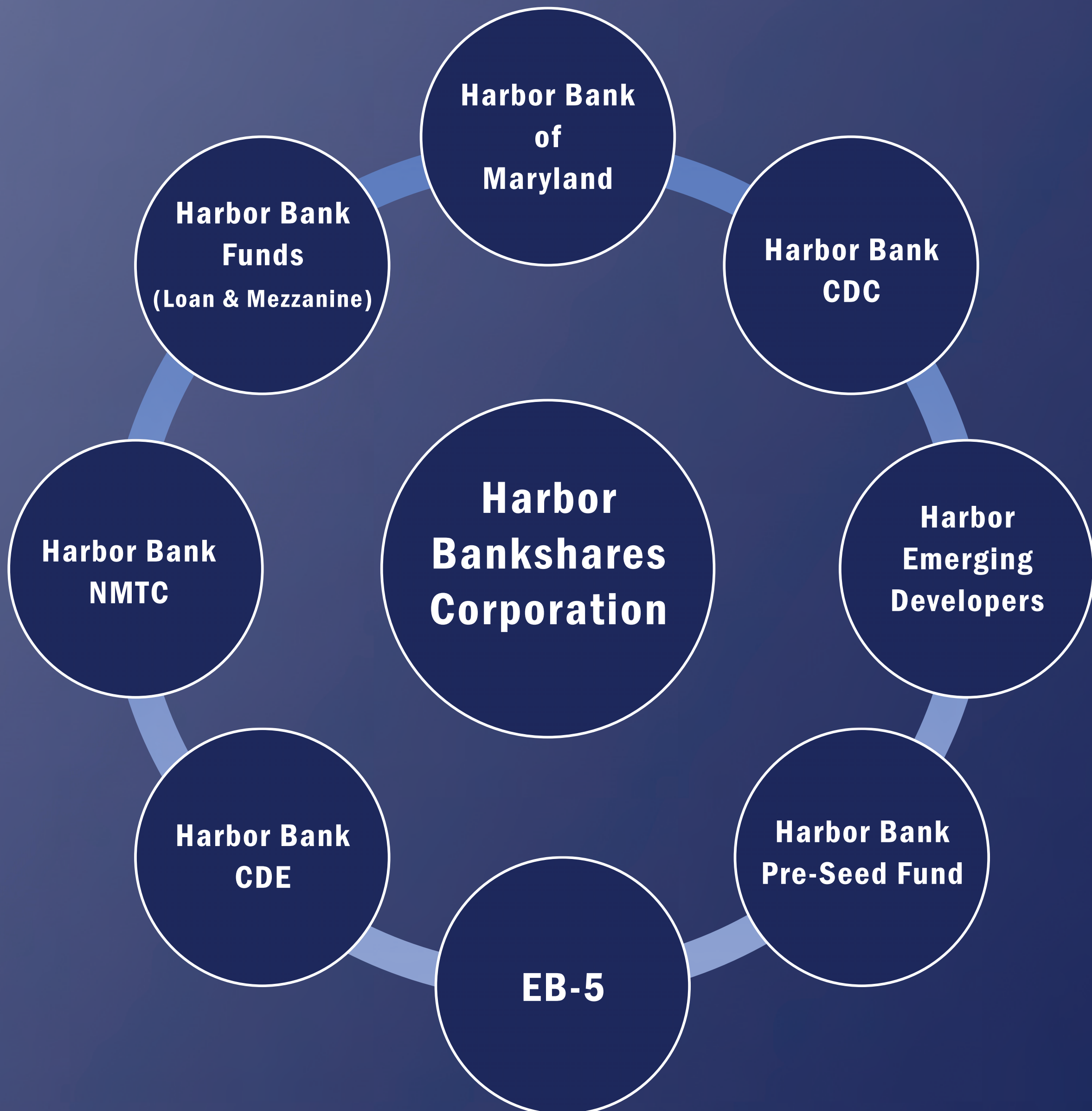
# HARBOR BANKSHARES CORPORATION




## ANNUAL REPORT 2021

HARBOR BANKSHARES
CORPORATION

# BOARD OF DIRECTORS

**James H. DeGraffenreidt, Jr.**
*Retired Chairman & CEO*
*WGL Holdings, Inc.*

**Joseph Haskins, Jr.**
*Chairman & CEO*
*Harbor Bankshares Corporation*

**Kevin M. Johnson**
*President*
*Commercial Group*

**Delores G. Kelley**
*Senator*
*Maryland State Senate*

**Erich W. March**
*Vice President*
*William C. March Funeral Home*

**James Scott, Jr.**
*Principal*
*Penan & Scott, P.C.*

**Stanley W. Tucker**
*President*
*Meridian Management Group, Inc.*

**George F. Vaeth, Jr.**
*Retired Architect*

**Yitzhak Zelmanovitch**
*President*
*Founders' Impact, Inc.*
*(f/k/a East Coast Capital Holdings, Ltd)*

## EXECUTIVE OFFICERS

**Joseph Haskins, Jr.**
*Chairman & CEO*
*Corporation and Bank*

**John Lewis**
*President & Chief Operating Officer*
*Corporation and Bank*

**Kimberly J. Levine**
*Executive Vice President*
*Chief Financial Officer*
*Corporation and Bank*

**James H. DeGraffenreidt, Jr.**
*Chairman*
*Executive Committee*
*Corporation and Bank*

**George F. Vaeth, Jr.**
*Secretary*
*Corporation and Bank*

## EXECUTIVE COMMITTEE

**James H. DeGraffenreidt, Jr., Chairman**
Joseph Haskins, Jr.
Delores G. Kelley
Erich W. March
George F. Vaeth, Jr.

## AUDIT COMMITTEE

**George F. Vaeth, Jr., Chairman**
Erich W. March
James Scott, Jr.
Stanley W. Tucker

## HUMAN RESOURCES COMMITTEE

**Delores G. Kelley, Chairwoman**
James H. DeGraffenreidt, Jr.
Joseph Haskins, Jr.

## INVESTMENT COMMITTEE

**James H. DeGraffenreidt, Jr., Chairman**
Joseph Haskins, Jr.
Kevin M. Johnson
Yitzhak Zelmanovitch

HARBOR BANKSHARES
CORPORATION

March 25, 2022

Dear Shareholder:

This past year was a productive year for Harbor Bankshares Corporation (the Corporation). Adapting to a second year of the COVID-19 pandemic, we reported record earnings of $2.6 million for 2021.

With a focus on strengthening the capital base, in early 2021, the Corporation repurchased 4.3 million shares of stock held by the U.S. Treasury, an ownership interest that originated in 2009 under the Troubled Asset Relief Program (TARP). This repurchase not only increased the book value per share but also favorably positioned the Corporation to raise an additional $6.2 million in fixed rate noncumulative perpetual preferred stock from affiliates of two large financial institutions who made commitments to the Minority Depository Institutions industry. In December 2021, the Corporation received notification that it was eligible to receive a fixed rate noncumulative perpetual preferred equity investment of $71.3 million from the U.S. Treasury Department pursuant to the Emergency Capital Investment Program (ECIP). These planned and completed capital transactions, coupled with strong earnings for the year, are expected to position the Corporation for significant future growth.

The Corporation's earnings in 2021 also included new income streams. A collaboration with JP Morgan Chase Asset Management produced a quarter of a million dollars in earnings from investment distribution fees, while consulting services provided to Google, related to our expertise in financial services and community development, resulted in income of another three quarters of a million dollars. In addition, the Department of Treasury's program to provide necessary capital for community development financial institutions to respond to the economic challenges of the COVID-19 pandemic resulted in a $1.8 million Rapid Response Program Award for The Harbor Bank of Maryland (the Bank) to help meet the needs of underserved communities.

The Corporation expects to forge additional new partnerships in 2022 that will expand its reach into the community. So far this year, the Corporation has entered into an agreement with Cerebro Capital to leverage its customer acquisition technology to increase the Corporation's SBA loan volumes and better serve local businesses. Other technology forward initiatives are focused on delivering enhanced product and service experiences and include the continued successful leveraging of our technology providers. These advancements will help expand the Corporation's beneficial impact in the community. As both a Minority Depository Institution (MDI) and a Community Development Financial Institution (CDFI), the Corporation's mission has always been to improve the communities it serves. Towards that end, in 2022, we plan to open a new branch in Northwood Commons located in Northeast Baltimore City.

The Bank also continued to originate the Small Business Administration's Paycheck Protection Program (PPP) loans with a third round of loans in 2021. At the same time, the

Bank assisted its borrowers with the SBA loan forgiveness process turning these PPP loans into grants, and helping our borrowers overcome economic challenges caused by the COVID-19 pandemic and continue their work in the community.

As a CDFI, the Corporation has access to capital that supports lending to underserved communities to a much greater extent than traditional lending alone. In 2021, the Corporation received another $50 million CDFI New Market Tax Credit (NMTC) award, bringing its total lifetime awards to $434 million; and, as in past years, most of the new award was quickly deployed to create and save jobs and expand access to community services, affordable housing, and charter schools for the most vulnerable populations. As ten-time winners of NMTC awards, we are in the top tier of recipients of these awards.

We continue to forge ahead to make the Corporation and the Bank stronger and to better serve our customers, community, and shareholders.

We thank you for your continued support.

Sincerely,
HARBOR BANKSHARES CORPORATION

Joseph Haskins, Jr.
Chairman & CEO

# Harbor Bankshares Corporation and Subsidiaries

## Consolidated Financial Statements

### Years Ended December 31, 2021 and 2020

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## INDEPENDENT AUDITOR'S REPORT

To the Stockholders and Board of Directors
Harbor Bankshares Corporation

**Opinion**
We have audited the accompanying consolidated financial statements of Harbor Bankshares Corporation and Subsidiaries (the Corporation), which comprise the consolidated balance sheets as of December 31, 2021 and 2020, the related consolidated statements of operations, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Corporation as of December 31, 2021 and 2020, 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.

**Basis for Opinion**
We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Corporation and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

**Responsibilities of Management for the Financial Statements**
Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation's ability to continue as a going concern for one year after the date of the financial statements are issued.

**Auditor's Responsibilities for the Audit of the Financial Statements**
Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material

if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Corporation’s internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Corporation’s ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control–related matters that we identified during the audit.

**Other Information Included in the Annual Report**

Management is responsible for the other information included in the annual report. The other information comprises the Chairman’s Letter but does not include the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information, and we do not express an opinion or any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and consider whether a material inconsistency exists between the other information and the financial statements, or the other information otherwise appears to be materially misstated. If, based on the work performed, we conclude that an uncorrected material misstatement of the other information exists, we are required to describe it in our report.

Yount, Hyde & Barbour, P.C.

Richmond, Virginia
March 15, 2022

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Balance Sheets**
**December 31, 2021 and 2020**

| | **2021** | 2020 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents: | | |
| Cash and due from banks | **$ 3,162,549** | $ 5,562,057 |
| Federal funds sold | **4,889,000** | 9,885,986 |
| Interest-bearing deposits in other banks | **77,501,671** | 43,954,107 |
| Cash and cash equivalents | **85,553,220** | 59,402,150 |
| Investment securities | | |
| Available-for-sale, at fair value | **40,036,107** | 35,574,722 |
| Federal Home Loan Bank of Atlanta stock, at cost | **161,400** | 280,200 |
| Loans | **193,746,000** | 216,309,197 |
| Allowance for loan losses | **(2,440,013)** | (2,428,622) |
| Loans, net | **191,305,987** | 213,880,575 |
| Premises and equipment, net | **2,339,764** | 2,332,057 |
| Other real estate owned | **-** | 214,203 |
| Bank-owned life insurance | **6,306,222** | 6,139,321 |
| Other assets | **5,338,593** | 4,853,827 |
| Total assets | **$ 331,041,293** | $ 322,677,055 |

**See accompanying notes.**

| | **2021** | 2020 |
|---|---|---|
| **LIABILITIES AND STOCKHOLDERS' EQUITY** | | |
| Deposits: | | |
| Noninterest-bearing demand | **$ 86,746,473** | $ 80,306,122 |
| Interest-bearing transaction accounts | **47,124,589** | 34,097,218 |
| Savings and money markets | **74,256,084** | 68,742,689 |
| Time, $250,000 or more | **19,087,483** | 14,667,261 |
| Other time | **54,564,380** | 63,259,304 |
| Total deposits | **281,779,009** | 261,072,594 |
| Federal Reserve Bank borrowings | **11,096,642** | 32,259,756 |
| Junior subordinated debentures | **7,217,000** | 7,217,000 |
| Other borrowings | **-** | 5,000 |
| Accrued interest payable | **726,475** | 804,007 |
| Other liabilities | **13,484,606** | 11,839,608 |
| Total liabilities | **314,303,732** | 313,197,965 |
| Stockholders' equity: | | |
| Preferred stock (par value $0.01) | | |
| Authorized, issued and outstanding 2,700 fixed rate noncumulative perpetual preferred shares, Series B $1,000 liquidation preference; Authorized, issued and outstanding 3,530 fixed rate noncumulative perpetual preferred shares, Series C $1,000 liquidation preference; | **6,230,000** | - |
| Common stock (par value $0.01) | | |
| Authorized 10,000,000 shares; issued 1,149,252; outstanding 1,146,825 at December 31, 2021 (including 23,965 nonvested restricted shares) and issued and outstanding 5,399,328 at December 31, 2020 in addition to 33,795 common nonvoting at December 31, 2021 and 2020 | **11,591** | 54,331 |
| Additional paid-in capital | **14,160,180** | 15,185,083 |
| Accumulated deficit | **(3,138,934)** | (5,773,802) |
| Treasury stock, at cost; 2,427 shares at December 31, 2021 | **(9,708)** | - |
| Accumulated other comprehensive income (loss) | **(515,568)** | 13,478 |
| Total stockholders' equity | **16,737,561** | 9,479,090 |
| Total liabilities and stockholders' equity | **$ 331,041,293** | $ 322,677,055 |

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Statements of Operations**
**December 31, 2021 and 2020**

| | 2021 | 2020 |
|---|---|---|
| Interest income: | | |
| Interest and fees on loans | $ 9,978,496 | $ 10,598,865 |
| Interest on investments | 193,844 | 443,856 |
| Other interest income | 121,425 | 256,448 |
| Total interest income | 10,293,765 | 11,299,169 |
| Interest expense: | | |
| Interest-bearing transaction accounts | 67,769 | 120,352 |
| Savings and money markets | 99,396 | 199,334 |
| Time, $250,000 or more | 316,018 | 429,100 |
| Other time | 1,134,198 | 1,368,669 |
| Federal Home Loan Bank borrowings | - | 1,282 |
| Federal Reserve Bank PPPLF Borrowings | 89,888 | 72,540 |
| Interest on junior subordinated debentures | 224,613 | 275,338 |
| Interest on other borrowings | - | 71,771 |
| Total interest expense | 1,931,882 | 2,538,386 |
| Net interest income | 8,361,883 | 8,760,783 |
| Provision for loan losses | - | 185,000 |
| Net interest income after provision for loan losses | 8,361,883 | 8,575,783 |
| Noninterest income: | | |
| Management fees - New Market Tax Credits | 3,150,462 | 3,043,842 |
| Service charges on deposit accounts | 41,777 | 141,894 |
| Other service charges | 385,289 | 334,143 |
| Investment distribution fees | 265,210 | 12,147 |
| Income from bank-owned life insurance | 166,901 | 166,673 |
| Income from CDFI Rapid Response Program award | 1,826,265 | - |
| Income from CDFI Financial Assistance award | 193,574 | 455,426 |
| Consulting income | 750,000 | - |
| Origination income from Main Street Lending Program | - | 285,440 |
| Gain on sale of securities | - | 27,933 |
| Other income | 500,526 | 418,073 |
| Total noninterest income | 7,280,004 | 4,885,571 |

**See accompanying notes.**

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Statements of Operations**
**December 31, 2021 and 2020**

| | 2021 | 2020 |
|---|---|---|
| Noninterest expenses: | | |
| Salaries and benefits | **6,358,509** | 5,708,473 |
| Occupancy expense of premises | **1,239,188** | 1,393,227 |
| Equipment expense | **240,930** | 196,539 |
| Data processing fees | **1,670,898** | 1,456,805 |
| Professional fees | **1,469,919** | 1,617,727 |
| Advertising | **236,678** | 265,499 |
| FDIC insurance | **205,820** | 245,049 |
| Telephone | **340,824** | 307,753 |
| Loan and collection expense | **131,040** | 135,480 |
| Off balance sheet provision (benefit) | **-** | (150,000) |
| Other expense | **934,650** | 984,941 |
| Total noninterest expense | **12,828,456** | 12,161,493 |
| Income before income taxes | **$ 2,813,431** | $ 1,299,861 |
| Income tax expense | **178,563** | 191,912 |
| Net income | **$ 2,634,868** | $ 1,107,949 |
| Income per common share (basic and diluted) | **$ 1.57** | $ 0.21 |

**See accompanying notes.**

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Statements of Comprehensive Income**
**Years Ended December 31, 2021 and 2020**

| | **2021** | 2020 |
|---|---|---|
| Net income: | **$ 2,634,868** | $ 1,107,949 |
| Changes in unrealized gains (losses) on securities available for sale, net of income taxes of $0 in 2021 and 2020 | **(529,046)** | 84,718 |
| Reclassficiation adjustment, net of income taxes of $0 in 2021 and 2020 | **-** | (27,933) |
| Total comprehensive income | **$ 2,105,822** | $ 1,164,734 |



**See accompanying notes.**

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Statements of Changes in Stockholders' Equity**
**Years Ended December 31, 2021 and 2020**

| | Common Stock | Preferred Stock | Paid-in Capital | Accumulated (Deficit) | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|
| Balance, January 1, 2020 | $ 53,074 | $ - | $ 14,982,240 | $ (6,881,751) | $ - | $ (43,307) | $ 8,110,256 |
| Issuance of common stock (125,760 shares) | 1,257 | | 202,843 | | | | 204,100 |
| Net income | | | | 1,107,949 | | | 1,107,949 |
| Other comprehensive income | | | | | | 56,785 | 56,785 |
| Balance, December 31, 2020 | $ 54,331 | $ - | $ 15,185,083 | $ (5,773,802) | $ - | $ 13,478 | $ 9,479,090 |
| Issuance of common stock (1,000 shares) | 10 | | 2,490 | | | | 2,500 |
| Vesting of Restricted Stock (11,983 shares) | 120 | | (120) | | | | - |
| Stock based compensation expense | | | 83,879 | | | | 83,879 |
| Issuance of preferred stock (6,230 shares) | | 6,230,000 | | | | | 6,230,000 |
| Preferred stock issuance costs | | | (82,266) | | | | (82,266) |
| Repurchase of TARP (4,287,024 shares) | (42,870) | | (1,028,886) | | | | (1,071,756) |
| Purchase of Treasury stock (2,427 shares) | | | | | (9,708) | | (9,708) |
| Net income | | | | 2,634,868 | | | 2,634,868 |
| Other comprehensive income | | | | | | (529,046) | (529,046) |
| Balance, December 31, 2021 | $ 11,591 | $ 6,230,000 | $ 14,160,180 | $ (3,138,934) | $ (9,708) | $ (515,568) | $ 16,737,561 |

**See accompanying notes.**

**Harbor Bankshares Corporation and Subsidiaries**
**Consolidated Statements of Cash Flows**
**Years Ended December 31, 2021 and 2020**

| | 2021 | 2020 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 2,634,868 | $ 1,107,949 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 233,805 | 237,141 |
| Amortization of premiums and discounts on investment securities | 9,569 | 1,184 |
| Provision for loan losses | - | 185,000 |
| Off balance sheet provision (benefit) | - | (150,000) |
| Stock based compensation | 83,879 | - |
| Gain on sale of other real estate owned | (23,787) | - |
| Gain on sale of securities | - | (27,933) |
| Income from bank-owned life insurance | (166,901) | (166,673) |
| Increase in other assets | (484,765) | (2,420,338) |
| Increase in accrued interest payable and other liabilities | 1,567,466 | 1,794,683 |
| Net cash provided by operating activities | 3,854,134 | 561,013 |
| Cash flows from investing activities: | | |
| Change in FHLB stock, net | 118,800 | (26,000) |
| Purchases of securities available-for-sale | (16,000,000) | (72,104,270) |
| Proceeds from calls, maturities and principal payments of investment securities available-for-sale | 11,000,000 | 67,257,933 |
| Proceeds from sale of other real estate owned | 429,781 | - |
| Purchase of loans | (20,599,637) | (11,543,532) |
| Net decrease (increase) in loans | 42,982,433 | (7,635,570) |
| Purchases of premises and equipment | (241,512) | (190,995) |
| Net cash provided by (used in) investing activities | 17,689,865 | (24,242,434) |
| Cash flows from financing activities: | | |
| Net increase (decrease) in deposits | 20,706,415 | (22,231,765) |
| Net increase (decrease) in PPPLF advances from FRB | (21,163,114) | 32,259,756 |
| Decrease in other borrowings | (5,000) | (1,995,000) |
| Issuance of common stock | 2,500 | 204,100 |
| Issuance of preferred stock, net of issuance costs | 6,147,734 | - |
| Purchase of Treasury stock | (9,708) | - |
| Repurchase of common stock | (1,071,756) | - |
| Net cash provided by financing activities | 4,607,071 | 8,237,091 |
| Net increase (decrease) in cash equivalents | 26,151,070 | (15,444,330) |
| Cash and cash equivalents, beginning of period | 59,402,150 | 74,846,480 |
| Cash and cash equivalents, end of period | $ 85,553,220 | $ 59,402,150 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for income taxes | $ 388,213 | $ - |
| Cash paid for interest | $ 2,009,414 | $ 3,423,584 |
| Foreclosure of properties in satisfaction of loans receivable | $ 191,792 | $ 214,203 |
| Unrealized gain (loss) on securities available for sale | $ (515,568) | $ 13,478 |

**See accompanying notes.**

# Notes to Consolidated Financial Statements

## 1. Nature of Operations

Harbor Bankshares Corporation (the "Corporation") is a bank holding company organized under the laws of the State of Maryland in 1992. The Corporation owns all of the outstanding stock of Harbor Bankshares Capital Corporation ("HBCC") and The Harbor Bank of Maryland (the "Bank"). HBCC owns 100% of Harbor Bankshares Asset Management, LLC, a limited liability company and the Bank owns all of the outstanding stock of the Bank's subsidiary, Harbor Financial Services. The Bank was incorporated under the laws of the State of Maryland in 1980 and began operations in 1982. The parent-only consolidated financial statements of the Corporation account for the subsidiaries using the equity method of accounting. Consolidated financial statements include the accounts of Harbor Bankshares Corporation and its subsidiaries. All significant intercompany accounts and transactions have been eliminated.

The Bank is a commercial bank headquartered in Baltimore, Maryland. The deposits of the Bank are insured by the Federal Deposit Insurance Corporation. The Bank conducts general banking business in seven locations and primarily serves the Baltimore, Maryland, metropolitan area. It offers checking, savings and time deposits, commercial real estate, personal, home improvement, automobile, and other installment and term loans. The Bank is also a member of a national ATM network. The retail nature of the Bank allows for diversification of depositors and borrowers, which limits its dependency upon a single or a few customers.

HBCC is an operating entity headquartered in Baltimore, Maryland. Its activities include providing private capital to businesses through loans and principal investments.

## 2. Basis of Presentation and Significant Accounting Policies

The accounting and reporting policies of the Corporation and its subsidiaries conform to U.S. generally accepted accounting principles and those within the banking industry. Certain reclassifications have been made to amounts previously reported to conform to the classifications made in 2021. These reclassifications were immaterial and did not change total stockholders' equity or net income. The following is a summary of the more significant accounting policies:

### *Use of estimates*

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. The Allowance for Loan Losses is the estimate most susceptible to change. Actual results could differ from those estimates.

### *Cash and cash equivalents*

For purposes of the consolidated statements of cash flows, the Corporation considers all highly liquid debt instruments and money market funds to be cash equivalents. Cash and due from banks, federal funds sold, and interest-bearing deposits in other banks have overnight maturities and are generally in excess of amounts that would be recoverable under Federal Deposit Insurance Corporation ("FDIC") insurance. The amount of cash with other banks in excess of FDIC insured limits totals $5,445,583 as of December 31, 2021.

### *Investment securities*

Debt securities which the Corporation has the positive intent and ability to hold to maturity are classified as held-to-maturity and recorded at amortized cost. Debt and equity securities are classified as trading securities if bought and held principally for the purpose of selling them in the near term. Trading securities are reported at estimated fair value, with unrealized gains and losses included in earnings. Debt securities not classified as held to maturity or as trading securities are considered available-for-sale and are reported at estimated fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity, net of tax effects, if any, in accumulated other comprehensive income.

The Corporation designates securities into one of the three categories at the time of purchase. If a decline in value of an individual security classified as held-to-maturity or available-for-sale is judged to be other-than-temporary, the cost basis of that security is reduced to its fair value and the amount of the write-down is reflected in earnings. Estimated fair value is determined based on bid prices published in financial newspapers or bid quotations received from securities dealers. Gains or losses on the sales of investments are calculated using a specific identification basis and are determined on a trade-date basis. Premiums and discounts on investment and mortgage-backed securities are amortized over the lesser of the term or the earliest call date of the security using methods that approximate the interest method. All of the Corporation's securities are designated as available-for-sale.

Management reviews all debt securities that are in an unrealized loss position for other-than-temporary impairment and evaluates outstanding available-for-sale securities for other-than-temporary impairment on at least a quarterly basis. An investment security is deemed impaired if the fair value of the investment is less than its amortized cost. Amortized cost includes adjustments (if any) made to the cost basis of an investment for accretion, amortization, and previous other-than-temporary impairments. After an investment security is determined to be impaired, management evaluates whether the decline in value is other-than-temporary. In estimating other-than-temporary impairment losses for debt securities, management considers whether the Corporation (1) has the intent to sell the security, or (2) will more likely than not be required to sell the security before its anticipated recovery, or (3) will suffer a credit loss as the present value of the cash flows expected to be collected from the security are less than its amortized cost basis. Declines in the fair value of available-for-sale debt securities that are deemed other-than-temporary are recognized in the consolidated statement of operations in net securities gains/(losses) in the period in which the determination is made. Such impairment charges include the impact of declines in both credit quality and liquidity. Declines deemed to be temporary as a result of changes in market conditions are recorded as unrealized gains or losses and recorded in accumulated other comprehensive income (loss).

### *Loans*

Loans are stated at their principal balance outstanding net of any deferred fees and costs. Interest income on loans is accrued at the contractual rate based on the principal outstanding. The Corporation places loans on non-accrual when any portion of the principal or interest is ninety days past due and collateral is insufficient to discharge the debt in full. Interest accrual may also be discontinued earlier if, in management's opinion, collection is unlikely. Loans are considered delinquent when the borrower is in arrears two or more monthly payments and is greater than 30 days past due.

Loans are considered impaired when, based on current information, it is probable that the Corporation will not collect all principal and interest payments according to contractual terms when due. Management also considers the financial condition of the borrower, cash flows of the loan and the net realizable value of the related collateral. Impaired loans do not include large groups of smaller balance homogeneous credits such as residential real estate and consumer installment loans, which are evaluated collectively for impairment. The impairment of a loan is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if repayment is expected to be provided by the collateral. Generally, the Corporation's impairment on such loans is measured by reference to the fair value of the collateral, net of estimated disposal costs.

Discounts and premiums on purchased loans are amortized to interest income using the interest method over the remaining period to contractual maturity, adjusted for anticipated and actual prepayments.

### *Federal Home Loan Bank of Atlanta stock*

The Bank, as a member of the Federal Home Loan Bank system, is required to maintain an investment in capital stock of the Federal Home Loan Bank of Atlanta ("FHLB") in varying amounts based on balances of outstanding home loans and on amounts borrowed from the FHLB. Because no ready market exists for this stock and it has no quoted market value, the Bank's investment in this stock is carried at cost.

### *Allowance for Loan Losses*

The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb probable and estimable losses on existing loans that may become uncollectible. The allowance for loan losses consists of an allocated component and an unallocated component. The components of the allowance for loan losses represent an estimation done as prescribed in accounting guidance issued by the Financial Accounting Standards Board ("FASB"). The adequacy of the allowance for loan losses is determined through careful and continuous review and evaluation of the loan portfolio and involves the balancing of a number of factors as outlined below to establish a prudent level. Loans deemed uncollectible are charged against, while recoveries are credited to, the allowance. Management adjusts the level of the allowance through the provision for loan losses, which is recorded as a current period operating expense on the statement of operations. The Corporation's methodology for assessing the appropriateness of the allowance consists of several key elements, which include the formula allowance, specific allowances, and the unallocated allowance.

The formula allowance is calculated by applying loss factors to corresponding categories of outstanding loans. Loss factors are based on the Corporation's historical loss experience and include management's evaluation of various qualitative/environmental conditions that are not directly measured in the determination of specific allowances. Such conditions include general economic and business conditions affecting key lending areas, credit quality trends (including trends in delinquencies and nonperforming loans expected to result from existing conditions), loan volumes and concentrations, specific industry conditions within portfolio categories, recent loss experience in particular loan categories, duration of the current business cycle, bank regulatory examination results, findings of internal loan review, and management's judgment with respect to various other conditions including loan administration and management and the quality of risk identification systems. Management reviews these conditions quarterly. The use of these loss factors is intended to reduce the difference between estimated losses inherent in the portfolio and observed losses.

Specific allowances are established in cases where management has identified significant conditions or circumstances related to a loan that management believes indicate the probability that a loss may be incurred in an amount different from the amount determined by application of the formula allowance. Management determines the fair value of the loan and recognizes any impairment in accordance with FASB's accounting guidance and recognizes any such impairment as a specific allowance. For other problem graded credits, allowances are established according to the application of credit risk factors. These factors are set by management to reflect its assessment of the relative level of risk inherent in each grade.

The imprecision of the above calculations in estimating probable losses on existing loans that may become uncollectible may result in management's assessment that there is a probability that a loss may be incurred in an amount different from the amount determined by application of the formula allowance, resulting in an unallocated allowance.

Management believes that the allowance for loan losses is adequate. However, the determination of the allowance requires significant judgment, and estimates of probable losses inherent in the loan portfolio can vary significantly from the amounts actually observed. While management uses available information to recognize probable losses, future additions to the allowance may be necessary based on changes in the loans comprising the loan portfolio and changes in the financial condition of borrowers, such as may result from changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's loan portfolio and allowance for loan losses. Such review may result in recognition of additions to the allowance based on their judgments of information available to them at the time of their examination.

### *Premises and equipment*

Premises and equipment are stated at cost less accumulated depreciation and amortization computed using the straight-line method. Premises and equipment are depreciated over the useful lives of the assets, except for leasehold improvements which are amortized over the terms of the respective leases or the estimated useful lives of the improvements, whichever is shorter. Useful lives range from three to fifteen years for furniture, fixtures and equipment and building improvements, and forty years for buildings. The costs of major renewals and betterments are capitalized, while the costs of ordinary maintenance and repairs are expensed as incurred. Land is stated at cost.

### *Other Real Estate Owned*

Real estate acquired through or in lieu of loan foreclosure is initially recorded at the fair value of the property less estimated selling costs at the date of foreclosure, establishing a new cost basis. Any write-downs based on the asset's fair value at the date of acquisition are charged to the allowance for loan losses. After foreclosure, any declines in fair value are recorded as a write down to Other real estate owned and are recorded as a charge to non-interest expense, to reduce the carrying value of the property to the lower of cost or fair value less costs to sell. Costs of significant property improvements are capitalized, and costs related to holding the property are expensed.

### *Bank-owned life insurance*

The Corporation is the beneficiary of insurance policies on the lives of certain officers of the Corporation. The Corporation has recognized the cash surrender value that could be realized under the insurance policies as an asset in the consolidated balance sheets. Appreciation in the value of the insurance policies is classified in non-interest income.

### *Revenue Recognition*

The Corporation's revenue includes net interest income on financial instruments and noninterest income. Specific categories of revenue are presented in the Consolidated Statement of Operations. Most of the Corporation's revenue is not within the scope of Accounting Standard Update *(ASU) No. 2014-09 – Revenue from Contracts with Customers*. For revenue within the scope of ASU 2014-09, the Corporation provides services to customers and has related performance obligations. The revenue from such services is recognized upon satisfaction of all contractual performance obligations. The following discuss the key revenue streams within the scope of the revenue recognition guidance.

*Management fees from NMTC* – The Corporation receives fee income related to the transfer of its New Market Tax Credits ("NMTC"), which varies with each transaction, but which are all similar in nature. There are three types of fees associated with these transactions. The first is a "sub-allocation fee" that is paid to the Corporation when the tax credits are allocated to an entity at the time a qualified equity investment is made. There is also a structuring fee that is paid to the Corporation for providing certain administrative, tax credit advisory and financial structuring services. These two fees are recognized by the Corporation at the time the NMTC transaction is closed. The third type of fee is an asset management fee that is paid to cover the administrative and servicing costs associated with ongoing compliance with the NMTC reporting requirements. This fee is recognized as the services are rendered.

*Service charges on deposit accounts* – Service charges on deposit accounts represent general service fees for monthly account maintenance and activity or transaction-based fees and consist of transaction-based revenue, time-based revenue (i.e., service period), item-based revenue or some other individual attribute-based revenue. Revenue is recognized when the Corporation's performance obligation is completed which is generally monthly for account maintenance services or when the transaction has been completed (such as stop payments). Payment for such performance obligations is generally received at the time the performance obligations are satisfied.

*Other service charges* – Generally the Corporation receives compensation when a customer issues checks drawn on insufficient funds or when a customer or a non-customer utilizes the Corporation's ATM machines. The timing and amount of revenue recognition is not materially impacted by the new standard.

*Investment distribution fees* – Investment distribution fees are received by the Corporation for funds invested by third parties into investment funds maintained by others and not on the Corporation's Consolidated Balance Sheet. Income is recognized monthly as the distribution fees are received and services are delivered and fulfilled.

*Consulting income* – The Corporation may provide consulting services to outside parties related to its expertise in financial services and community development. The Corporation may receive cash compensation, which is recognized as income upon completion of the services.

*Other income* – The Corporation receives income from merchant discount fees and other transaction fees such as wire, check, item handling and other charges related to specific services. Payment for such performance obligations is generally received at the time the transaction has been completed.

*Income from CDFI Financial Assistance and Rapid Response Program award* **–** The Corporation receives income from the CDFI Fund based on a successful application process. As the Corporation achieves certain performance goals with respect to the origination of loans or the delivery of certain services in designated communities, as outlined in the grant agreement, income from the award is recognized in proportion to the achievement of those goals to the total goal. In late 2019, the Bank was designated to receive a Financial Assistance (FA) Award of $649,000 but did not recognize income as none of the goals were achieved. In 2021 and 2020, $193,574 and $455,426, respectively of the FA Award was recognized as income based on a prorata achievement of the designated goals. In 2021, the Corporation received a Rapid Response Program (RRP) Award of $1,826,265 and recognized the entire amount as income based on achievement of designated goals.

### *Stock Based Compensation*

Stock granted under Stock Incentive Plans is valued at the fair market value as of the grant date. Compensation expense is recorded for all stock awards based on the amortization of the fair market value at the date of grant over the period the restrictions lapse.

### *Income taxes*

Income tax expense is based on the results of operations, adjusted for permanent differences between items of income or expense reported in the consolidated financial statements and those reported for tax purposes. Under the liability method, deferred income taxes are determined based on the differences between the financial statement carrying amounts and the income tax basis of assets and liabilities and are measured at the enacted tax rates that will be in effect when these differences reverse. Deferred tax assets are recognized only to the extent that it is more likely than not that such amounts will be realized based upon consideration of available evidence, including tax planning strategies and other factors. The Corporation has recorded a full valuation allowance on its Deferred tax assets.

The Corporation recognizes a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely to be realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The Corporation recognizes interest and penalties related to income tax matters in income tax expense.

The Corporation’s income tax returns are subject to review and examination by federal and state taxing authorities for the years ended December 31, 2018 through and including 2021.

### *Income per common share*

Basic and dilutive net income per common share is computed by dividing net income available to common stockholders by the weighted-average number of shares outstanding during the period. Common stock equivalents, which may include stock options, or restricted or convertible stock, are used in the computation of diluted weighted average common shares for purposes of computing fully diluted earnings per share. The Corporation did not have any potential common stock equivalents at December 31, 2021 and 2020. Restricted stock with terms under which they share in voting and dividend rights during the restricted period are included in the basic weighted average shares calculation.

### *Business segments*

The Corporation has determined that its current business and operations consist of one business segment.

### *Recent Accounting Pronouncements*

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The FASB has issued multiple updates to ASU 2016-13 as codified in Topic 326, including ASU's 2019-04, 2019-05, 2019-10, 2019-11, 2020-02, and 2020-03. These ASU's have provided for various minor technical corrections and improvements to the codification as well as other transition matters. Smaller reporting companies who file with the U.S. Securities and Exchange Commission (SEC) and all other entities who do not file with the SEC are required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The Corporation has created an implementation schedule and has designated its Asset Liability Management Committee to monitor implementation. Alternative methodologies and vendors are being evaluated with plans to begin running parallel scenarios during 2022. The Corporation is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements.

Effective November 25, 2019, the SEC adopted Staff Accounting Bulletin (SAB) 119. SAB 119 updated portions of SEC interpretative guidance to align with FASB ASC 326, "Financial Instruments – Credit Losses." It covers topics including (1) measuring current expected credit losses; (2) development, governance, and documentation of a systematic methodology; (3) documenting the results of a systematic methodology; and (4) validating a systematic methodology.

In December 2019, the FASB issued ASU 2019-12, "Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes." The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers' application of certain income tax-related guidance. This ASU is part of the FASB's simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. ASU 2019-12 was effective for the Corporation on January 1, 2021. There was no material impact on the Corporation's consolidated financial statements.

In March 2020, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2020-04 "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting." These amendments provide temporary optional guidance to ease the potential burden in accounting for reference rate reform. The ASU provides optional expedients and exceptions for applying generally accepted accounting principles to contract modifications and hedging relationships, subject to meeting certain criteria, that reference LIBOR or another reference rate expected to be discontinued. It is intended to help stakeholders during the global market-wide reference rate transition period. The guidance is effective for all entities as of March 12, 2020 through December 31, 2022. Subsequently, in January 2021, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2021-01 "Reference Rate Reform (Topic 848): Scope." This ASU clarifies that certain optional expedients and exceptions in Topic 848 for contract modifications and hedge accounting apply to derivatives that are affected by the discounting transition. The ASU also amends the expedients and exceptions in Topic 848 to capture the incremental consequences of the scope clarification and to tailor the existing guidance to derivative instruments affected by the discounting transition. An entity may elect to apply ASU No. 2021-01 on contract modifications that change the interest rate used for margining, discounting, or contract price alignment retrospectively as of any date from the beginning of the interim period that includes March 12, 2020, or prospectively to new modifications from any date within the interim period that includes or is subsequent to January 7, 2021, up to the date that financial statements are available to be issued. An entity may elect to apply ASU No. 2021-01 to eligible hedging relationships existing as of the beginning of the interim period that includes March 12, 2020, and to new eligible hedging relationships entered into after the beginning of the interim period that includes March 12, 2020.The Corporation has a limited number of loans with interest rates based on LIBOR, with most being purchased participations. Loans originated before December 31, 2021, where the interest rate is based on LIBOR may continue to use that index until June 30, 2023, at which point, an alternative index will be used. The Corporation is assessing ASU 2020-04 and its impact on the Corporation's transition away from LIBOR for its loan and other financial instruments.

## 3. Restrictions on Cash and Due from Banks

The Bank may be required by the Federal Reserve or correspondent banks to maintain a reserve balance based principally on deposit liabilities. The balance maintained is included in cash and due from banks. The balances kept at the Federal Reserve Bank as of December 31, 2021 and 2020, were $71,936,478 and $38,031,343, respectively, with no restricted amount for 2021 and $25,000 for 2020. The balances kept at M&T Bank, the Bank's principal correspondent bank, were $2,500,000 for each year.

## 4. Investment Securities

The amortized cost and estimated fair values of investments securities are as follows:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| **Balance at December 31, 2021** | | | | |
| **Available-for-sale:** | | | | |
| **U.S. government agencies** | **$ 40,050,000** | **$ -** | **$ (517,183)** | **$ 39,532,817** |
| **State and municipals** | **501,675** | **1,615** | **-** | **503,290** |
| **Total** | **$ 40,551,675** | **$ 1,615** | **$ (517,183)** | **$ 40,036,107** |
| Balance at December 31, 2020 | | | | |
| Available-for-sale: | | | | |
| U.S. government agencies | $ 34,550,228 | $ 12,299 | $ (15,205) | $ 34,547,322 |
| State and municipals | 1,011,016 | 16,384 | - | 1,027,400 |
| Total | $ 35,561,244 | $ 28,683 | $ (15,205) | $ 35,574,722 |

The Corporation held six securities with unrealized losses of 12 months or longer and eighteen securities with unrealized losses of less than 12 months at December 31, 2021. Securities with unrealized losses segregated by length of impairment at December 31, 2021, and December 31, 2020, were as follows:

| | Less than 12 Months | | More than 12 Months | | Total | |
|---|---|---|---|---|---|---|
| | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses | Estimated Fair Value | Unrealized Losses |
| **December 31, 2021** | | | | | | |
| **Available-for-sale:** | | | | | | |
| **U.S. government agencies** | **$ 30,185,802** | **$ (364,198)** | **$ 9,347,015** | **$ (152,985)** | **$ 39,532,817** | **$ (517,183)** |
| December 31, 2020 | | | | | | |
| Available-for-sale: | | | | | | |
| U.S. government agencies | $ 34,547,322 | $ (15,205) | $ - | $ - | $ 34,547,322 | $ (15,205) |
| State and municipals | $ - | $ - | $ 1,027,400 | $ - | $ 1,027,400 | $ - |

Declines in the fair value of available-for-sale securities below their cost that are deemed to be other-than-temporary are reflected in earnings as realized losses.

Management has the intent to hold the securities classified as available-for-sale for a period of time sufficient for a recovery of cost and it is not likely they will be required to sell the securities before their anticipated recovery. The fair value is expected to recover as the debt securities approach their maturity date or repricing date. Management does not believe any of the securities are impaired due to reasons of credit quality. Accordingly, as of December 31, 2021, management believes the unrealized losses detailed in the table above are temporary and no loss has been realized in the Corporation's consolidated statements of operations.

The amortized cost and estimated fair value of debt securities at December 31, 2021, by contractual maturity, are shown below. Expected maturities may differ from contractual maturities because borrowers have the right to call or repay obligations without call or prepayment penalties.

| | Amortized Cost | Estimated Fair Value |
|---|---|---|
| Available-for-sale: | | |
| Due within three months | $ 501,675 | $ 503,290 |
| Due after three months through one year | - | - |
| Due after one year through three years | 20,500,000 | 20,270,505 |
| Due after three years through five years | 19,550,000 | 19,262,312 |
| Total | $ 40,551,675 | $ 40,036,107 |

Securities with a fair value of $31,144,357 and $32,548,134 at December 31, 2021 and 2020, respectively, have been pledged as collateral for demand, money market and certificate of deposit accounts.

The only investments to a single issuer that exceed 10% of stockholders' equity are to federal government sponsored entities.

## 5. Loans and Allowance for Loan Losses

Loans, net of deferred fees and costs of $482,692 and $696,333, as of December 31, 2021 and 2020, respectively, consist of the following:

| | **2021** | 2020 |
|---|---|---|
| Real estate loans: | | |
| Construction and land development | **$ 4,260,364** | $ 3,013,091 |
| Commercial | **115,780,018** | 109,547,696 |
| Residential | **31,192,692** | 41,579,350 |
| | **151,233,074** | 154,140,137 |
| Commercial and industrial | **40,206,291** | 59,546,652 |
| Consumer | **2,306,635** | 2,622,408 |
| Total loans | **193,746,000** | 216,309,197 |
| Less allowance for loan losses | **(2,440,013)** | (2,428,622) |
| | **$ 191,305,987** | $ 213,880,575 |

The Bank has segregated its loan portfolio into five segments, consisting of construction and land development, commercial real estate, residential real estate, commercial and industrial, and consumer. The Bank primarily serves the Baltimore-Maryland Metropolitan area; therefore, exposure to credit risk is significantly affected by changes in this market area.

Construction lending mainly includes lending for construction and development of residential properties (including multifamily), although the Bank does lend funds for the construction of commercial properties, including faith-based properties. The Bank finances the construction of nonresidential properties on a case-by-case basis. Loan proceeds are disbursed during the construction phase according to a draw schedule based on the stage of completion. Construction loans are underwritten based on the estimated value of the property as completed. Before funds are disbursed, the Corporation's credit monitoring process for construction lending includes property inspections throughout the construction process each time a draw is requested.

The Bank offers fixed rate conventional mortgage loans on one-to-four family residential dwellings. Most loans are originated on properties located in the Bank's primary market area. These loans are typically offered for terms ranging from five to thirty years, typically with a five-year demand clause, and are amortized on a monthly basis with interest and principal due each month.

The Bank originates commercial real estate loans in its market area. These loans are generally larger and involve greater risks than residential real estate loans. Because payments on these loans are often dependent on the successful operation or management of the property, repayment of such loans may be subject to a greater extent to adverse conditions in the real estate market or the economy. The Bank seeks to minimize these risks in a variety of ways, including limiting the size and loan-to-value ratios. The loans are typically originated with a five-year maturity (five-year call or balloon). The Bank's commercial real estate loans are typically secured by retail or wholesale establishments, service industries, faith-based properties and industrial or warehouse facilities.

Commercial and residential real estate loans including construction loans comprised 78.1% and 71.3% of the Corporation's total loan portfolio at December 31, 2021 and 2020, respectively, as follows:

| | **2021** | **% of Loans Outstanding** | 2020 | % of Loans Outstanding |
|---|---|---|---|---|
| Commercial real estate | **$ 120,040,382** | **62.0%** | $112,560,787 | 52.0% |
| Residential real estate | **31,192,692** | **16.1%** | 41,579,350 | 19.3% |
| | **$ 151,233,074** | **78.1%** | $154,140,137 | 71.3% |

Most of the real estate collateralizing these loans is within the greater Baltimore metropolitan area. Consequently, the Corporation and its borrowers are affected by the economic conditions prevailing in the Bank's market area.

The Bank offers secured and unsecured commercial business loans and lines of credit to businesses primarily located in its market area. Most business loans have terms of one to five years, with lines of credit that can be open for longer periods. The security for a business loan depends on the amount borrowed, the business involved, and the strength of the borrower. Commercial business lending entails significant risk, as the payments on such loans may depend upon successful operation or management of the business involved. The Bank attempts to limit its risk of loss on such loans by limiting the amount and the term, and by requiring personal guarantees of the principals of the business.

Commercial loans include Paycheck Protection Program (PPP) loans authorized under the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act"). PPP loans are fully guaranteed by the Small Business Administration (SBA) and totaled $18,192,035 and $31,498,893 at December 31, 2021 and 2020, respectively.

The Bank's consumer loans consist of automobile loans, deposit account loans, and installment loans. The loans are generally offered for terms of up to five years at fixed interest rates. Consumer loans are generally originated at higher interest rates than residential mortgage loans because of their higher risk. Repossessed collateral for a defaulted loan may not provide an adequate source of repayment as a result of damage, loss, or depreciation. In addition, collections are dependent on the borrower's continuing financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness, or personal bankruptcy.

On an ongoing basis, the Bank assigns a grade to each of its loans. The internal grades are Pass, Special mention, Substandard, Doubtful and Loss. Loans graded Pass are high quality loans where the borrower exhibits a strong balance sheet position and good earnings and cash flow history. Loans graded Special mention show potential weaknesses that deserve the Bank's close attention. If these potential weaknesses are not corrected, they may result in deterioration of the repayment prospects for the loan and in the Bank's credit position at some future date. Substandard loans are inadequately protected by the current financial strength and paying capacity of the borrower or of the collateral pledged, if any. Substandard loans have a well-defined weakness that could jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the weaknesses are not corrected. Loans graded Doubtful have all the weaknesses inherent in Substandard loans with the added characteristic that the weaknesses make collection or liquidation in full highly improbable. Assets graded Loss are considered uncollectible and of such little value that their continuance as an asset is not warranted. The Loss classification does not mean the loan has absolutely no recovery value, but that it is not practical to defer charging off the loan even though partial recovery may be received in the future.

The following tables show credit quality indicators, the aging of receivables, and disaggregated balances of loan losses as of December 31, 2021 and 2020.

Information with respect to credit quality indicators is as follows:

| | **Construction and Land Development** | **Commercial Real Estate** | **Residential Real Estate** | **Commercial and Industrial** | **Consumer** | **Total** |
|---|---|---|---|---|---|---|
| **As of December 31, 2021:** | | | | | | |
| **Credit risk profile by internally assigned grade:** | | | | | | |
| **Pass** | **$ 4,260,364** | **$ 112,524,997** | **$ 30,825,812** | **$ 38,227,707** | **$ 2,306,635** | **$ 188,145,515** |
| **Special mention** | **-** | **1,421,678** | **-** | **-** | **-** | **1,421,678** |
| **Substandard** | **-** | **1,833,343** | **366,880** | **1,978,584** | **-** | **4,178,807** |
| **Doubtful** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Loss** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Total** | **$ 4,260,364** | **$ 115,780,018** | **$ 31,192,692** | **$ 40,206,291** | **$ 2,306,635** | **$ 193,746,000** |
| **Credit risk profile based on payment activity:** | | | | | | |
| **Performing** | **$ 4,260,364** | **$ 114,666,885** | **$ 30,530,457** | **$ 37,285,434** | **$ 2,294,996** | **$ 189,038,136** |
| **Nonperforming** | **-** | **1,113,133** | **662,235** | **2,920,857** | **11,639** | **4,707,864** |
| **Total** | **$ 4,260,364** | **$ 115,780,018** | **$ 31,192,692** | **$ 40,206,291** | **$ 2,306,635** | **$ 193,746,000** |
| As of December 31, 2020: | | | | | | |
| Credit risk profile by internally assigned grade: | | | | | | |
| Pass | $ 3,013,091 | $ 105,258,231 | $ 41,247,030 | $ 59,139,816 | $ 2,622,408 | $ 211,280,576 |
| Special mention | - | 3,532,321 | - | - | - | 3,532,321 |
| Substandard | - | 757,144 | 332,320 | 406,836 | - | 1,496,300 |
| Doubtful | - | - | - | - | - | - |
| Loss | - | - | - | - | - | - |
| Total | $ 3,013,091 | $ 109,547,696 | $ 41,579,350 | $ 59,546,652 | $ 2,622,408 | $ 216,309,197 |
| Credit risk profile based on payment activity: | | | | | | |
| Performing | $ 3,013,091 | $ 106,683,831 | $ 40,471,605 | $ 58,577,911 | $ 2,613,641 | $ 211,360,079 |
| Nonperforming | - | 2,863,865 | 1,107,745 | 968,741 | 8,767 | 4,949,118 |
| Total | $ 3,013,091 | $ 109,547,696 | $ 41,579,350 | $ 59,546,652 | $ 2,622,408 | $ 216,309,197 |

Information on aging analysis of past due loans is as follows:

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| **As of December 31, 2021:** | | | | | | |
| **30-59 days past due** | **$ 909,359** | **$ 2,238,162** | **$ -** | **$ 2,869,060** | **$ 10,215** | **$ 6,026,796** |
| **60-89 days past due** | **-** | **204,525** | **-** | **316,722** | **-** | **521,247** |
| **90 days and greater past due** | **-** | **826,833** | **659,211** | **1,205,042** | **11,639** | **2,702,725** |
| **Total past due** | **909,359** | **3,269,520** | **659,211** | **4,390,824** | **21,854** | **9,250,768** |
| **Current** | **3,351,005** | **112,510,498** | **30,533,481** | **35,815,467** | **2,284,781** | **184,495,232** |
| **Total loans receivable** | **$ 4,260,364** | **$115,780,018** | **$ 31,192,692** | **$ 40,206,291** | **$ 2,306,635** | **$193,746,000** |
| **Recorded investment >90 days and accruing** | **$ -** | **$ -** | **$ 292,331** | **$ 911,600** | **$ 10,734** | **$ 1,214,665** |
| As of December 31, 2020: | | | | | | |
| 30-59 days past due | $ - | $ 686,291 | $ 13,869 | $ 5,222,361 | $ 67,149 | $ 5,989,670 |
| 60-89 days past due | - | 6,377,851 | - | 2,401,930 | 254 | 8,780,035 |
| 90 days and greater past due | - | 2,749,146 | 1,107,745 | 467,509 | 8,767 | 4,333,167 |
| Total past due | - | 9,813,288 | 1,121,614 | 8,091,800 | 76,170 | 19,102,872 |
| Current | 3,013,091 | 99,734,408 | 40,457,736 | 51,454,852 | 2,546,238 | 197,206,325 |
| Total loans receivable | $ 3,013,091 | $109,547,696 | $ 41,579,350 | $ 59,546,652 | $ 2,622,408 | $216,309,197 |
| Recorded investment >90 days and accruing | $ - | $ 1,938,291 | $ 765,527 | $ 167,502 | $ 8,767 | $ 2,880,087 |

The following table shows the allowance for loan losses and recorded investment in loans for each of the Bank's segments:

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| **December 31, 2021:** | | | | | | | |
| **Allowance for loan losses:** | | | | | | | |
| **Beginning balance** | **$ 10,479** | **$ 1,580,993** | **$ 219,909** | **$ 349,355** | **$ 16,789** | **$ 251,097** | **$ 2,428,622** |
| **Charge-offs** | **-** | **-** | **-** | **(6,800)** | **(9,837)** | **-** | **(16,637)** |
| **Recoveries** | **-** | **15,818** | **472** | **8,421** | **3,317** | **-** | **28,028** |
| **Provision** | **2,288** | **(212,540)** | **(84,848)** | **319,221** | **285** | **(24,406)** | **-** |
| **Ending balance** | **$ 12,767** | **$ 1,384,271** | **$ 135,533** | **$ 670,197** | **$ 10,554** | **$ 226,691** | **$ 2,440,013** |
| **Allowance for loan losses individually evaluated for impairment** | **$ -** | **$ 62,592** | **$ -** | **$ 484,420** | **$ -** | **$ -** | **$ 547,012** |
| **Allowance for loan losses collectively evaluated for impairment** | **$ 12,767** | **$ 1,321,679** | **$ 135,533** | **$ 185,777** | **$ 10,554** | **$ 226,691** | **$ 1,893,001** |

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Unallocated | Total |
|---|---|---|---|---|---|---|---|
| **Loans receivable:** | | | | | | | |
| **Ending balance** | **$ 4,260,364** | **$ 115,780,018** | **$ 31,192,692** | **$ 40,206,291** | **$ 2,306,635** | **$ -** | **$ 193,746,000** |
| **Ending balance individually evaluated for impairment** | **$ -** | **$ 4,746,435** | **$ 972,100** | **$ 1,978,585** | **$ -** | **$ -** | **$ 7,697,120** |
| **Ending balance collectively evaluated for impairment** | **$ 4,260,364** | **$ 111,033,583** | **$ 30,220,592** | **$ 38,227,706** | **$ 2,306,635** | **$ -** | **$ 186,048,880** |
| December 31, 2020: | | | | | | | |
| Allowance for loan losses: | | | | | | | |
| Beginning balance | $ 46,079 | $ 1,367,779 | $ 292,765 | $ 375,004 | $ 18,466 | $ 138,655 | $ 2,238,748 |
| Charge-offs | - | - | - | (6,666) | (15,461) | - | (22,127) |
| Recoveries | - | 18,175 | - | 6,051 | 2,775 | - | 27,001 |
| Provision | (35,600) | 195,039 | (72,856) | (25,034) | 11,009 | 112,442 | 185,000 |
| Ending balance | $ 10,479 | $ 1,580,993 | $ 219,909 | $ 349,355 | $ 16,789 | $ 251,097 | $ 2,428,622 |
| Allowance for loan losses individually evaluated for impairment | $ - | $ 69,799 | $ - | $ 47,416 | $ - | $ - | $ 117,215 |
| Allowance for loan losses collectively evaluated for impairment | $ 10,479 | $ 1,511,194 | $ 219,909 | $ 301,939 | $ 16,789 | $ 251,097 | $ 2,311,407 |
| Loans receivable: | | | | | | | |
| Ending balance | $ 3,013,091 | $ 109,547,696 | $ 41,579,350 | $ 59,546,652 | $ 2,622,408 | $ - | $ 216,309,197 |
| Ending balance individually evaluated for impairment | $ - | $ 6,487,493 | $ 954,037 | $ 406,836 | $ - | $ - | $ 7,848,366 |
| Ending balance collectively evaluated for impairment | $ 3,013,091 | $ 103,060,203 | $ 40,625,313 | $ 59,139,816 | $ 2,622,408 | $ - | $ 208,460,831 |

Management reviews and identifies loans that require designation as nonperforming assets. Nonperforming assets include loans accounted for on a non-accrual basis, loans past due 90 days or more but still accruing, and other real estate owned. Information with respect to nonperforming assets at December 31, is as follows:

| | **2021** | 2020 |
|---|---|---|
| Non-accrual loans | **$ 3,493,199** | $ 2,069,031 |
| Loans 90 days or more past due and still accruing | **1,214,665** | 2,880,087 |
| Total nonperforming loans | **4,707,864** | 4,949,118 |
| Other real estate owned | **-** | 214,203 |
| Total nonperforming assets | **$ 4,707,864** | $ 5,163,321 |

Loans past due 90 days or more which were still accruing of $1,214,665 included four PPP loans awaiting forgiveness notification by the SBA and one past due mortgage loan.

The balance of non-accrual loans for each of the Bank's loan segments is as follows:

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| **As of December 31, 2021:** | | | | | | |
| **Unpaid principal balance** | **$ -** | **$ 1,113,134** | **$ 369,904** | **$ 2,009,256** | **$ 905** | **$ 3,493,199** |
| As of December 31, 2020: | | | | | | |
| Unpaid principal balance | $ - | $ 925,575 | $ 342,218 | $ 801,238 | $ - | $ 2,069,031 |

Troubled debt restructured ("TDR") loans result from renewals or modifications for which concessions are granted. These concessions include offering an interest rate that is not considered to be a market rate or an extension to the maturity which would not otherwise be considered for other loans with similar credit risk. TDR loans are individually evaluated for impairment and specific reserves are included in the allowance for loan losses as necessary. The following table shows information on TDR loans:

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| **As of December 31, 2021:** | | | | | | |
| **Troubled debt restructuring outstanding principal balance** | **$ -** | **$ 2,413,035** | **$ 915,288** | **$ 1,818,149** | **$ -** | **$ 5,146,472** |
| **Number of loans** | **-** | **6** | **3** | **5** | **-** | **14** |
| **Pre-modification principal balance** | **$ -** | **$ 3,791,771** | **$ 1,113,731** | **$ 2,441,718** | **$ -** | **$ 7,347,220** |
| **Post-modification principal balance** | **$ -** | **$ 3,754,594** | **$ 1,113,731** | **$ 2,010,692** | **$ -** | **$ 6,879,017** |
| **Troubled debt restructuring that subsequently defaulted:** | | | | | | |
| **Number of loans** | **-** | **-** | **-** | **-** | **-** | **-** |
| **Current principal balance** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** |

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| As of December 31, 2020: | | | | | | |
| Troubled debt restructuring outstanding principal balance | $ - | $ 2,512,725 | $ 926,455 | $ 209,290 | $ - | $ 3,648,470 |
| Number of loans | - | 6 | 3 | 2 | - | 11 |
| Pre-modification principal balance | $ - | $ 3,791,772 | $ 1,113,731 | $ 908,997 | $ - | $ 5,814,500 |
| Post-modification principal balance | $ - | $ 3,741,156 | $ 1,113,731 | $ 908,997 | $ - | $ 5,763,884 |
| Troubled debt restructuring that subsequently defaulted: | | | | | | |
| Number of loans | - | - | - | - | - | - |
| Current principal balance | $ - | $ - | $ - | $ - | $ - | $ - |

The CARES Act allows banks to elect to suspend requirements under GAAP for loan modifications related to the COVID-19 pandemic (for loans that were not more than 30 days past due as of December 31, 2019) that would otherwise be categorized as a TDR, including impairment for accounting purposes, until the earlier of 60 days after the termination of the national emergency or January 1, 2022. The Bank provided COVID-19 payment relief on loans totaling $51,809,743 as of December 31, 2020. As of December 31, 2021, payments had resumed on all loans for which the Bank provided COVID-19 payment relief except for $310,518.

Other than COVID-19 payment relief noted above, the Bank modified three loans within one relationship during 2021. Information on the loans modified as a troubled debt restructure for the year ended 2021 is as follows:

| | Number of Contracts | Pre-modification outstanding recorded investment | Post-modification outstanding recorded investment |
|---|---|---|---|
| 2021 Troubled Debt Restructures | | | |
| Loans type | | | |
| Commercial Real Estate | 3 | $ 1,532,720 | $ 1,101,694 |

There are no outstanding commitments to lend additional funds to any loans classified as a TDR as of December 31, 2021, or 2020.

Impaired loans include loans that management has identified where it is probable that all amounts due will not be collected in accordance with the contractual terms of the loan when due. An impaired loan may involve deficiencies in the borrower's overall financial condition, payment history, support available from financial guarantors, changes in expected future cash flows or the fair market value of any collateral. Loans that are returned to accrual status are no longer considered to be impaired.

Information with respect to impaired loans at December 31 for the years then ended is as follows:

| | 2021 | 2020 |
|---|---|---|
| Impaired loans with a valuation allowance | $ 3,535,130 | $ 1,536,687 |
| Impaired loans without a valuation allowance | 4,161,990 | 6,311,679 |
| Total impaired loans | $ 7,697,120 | $ 7,848,366 |
| Allowance for loan losses related to impaired loans | $ 547,012 | $ 117,215 |
| Allowance for loan losses related to other than impaired loans | 1,893,001 | 2,311,407 |
| Total allowance for loan losses | $ 2,440,013 | $ 2,428,622 |
| Average impaired loans for the year | $ 7,726,867 | $ 9,264,992 |
| Interest income recognized on impaired loans | $ 318,818 | $ 532,808 |

Information on impaired loans for each of the Bank's loan segments is as follows:

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| **As of December 31, 2021** | | | | | | |
| **Loans with a valuation allowance:** | | | | | | |
| **Recorded Investment** | $ - | $ 1,722,095 | $ - | $ 1,813,035 | $ - | $ 3,535,130 |
| **Unpaid principal balance** | $ - | $ 1,722,095 | $ - | $ 1,815,663 | $ - | $ 3,537,758 |
| **Related allowance for loan losses** | $ - | $ 62,592 | $ - | $ 484,420 | $ - | $ 547,012 |
| **Average recorded investment** | $ - | $ 1,760,609 | $ - | $ 1,770,150 | $ - | $ 3,530,759 |
| **Interest income recognized** | $ - | $ 133,481 | $ - | $ - | $ - | $ 133,481 |
| **Loans without a valuation allowance:** | | | | | | |
| **Recorded Investment** | $ - | $ 3,024,340 | $ 972,100 | $ 165,550 | $ - | $ 4,161,990 |
| **Unpaid principal balance** | $ - | $ 3,982,984 | $ 1,021,390 | $ 208,645 | $ - | $ 5,213,019 |
| **Average recorded Investment** | $ - | $ 3,038,415 | $ 971,153 | $ 186,540 | $ - | $ 4,196,108 |
| **Interest income recognized** | $ - | $ 153,623 | $ 31,714 | $ - | $ - | $ 185,337 |

| | Construction and Land Development | Commercial Real Estate | Residential Real Estate | Commercial and Industrial | Consumer | Total |
|---|---|---|---|---|---|---|
| **Totals:** | | | | | | |
| **Recorded Investment** | **$ -** | **$ 4,746,435** | **$ 972,100** | **$ 1,978,585** | **$ -** | **$ 7,697,120** |
| **Unpaid principal balance** | **$ -** | **$ 5,705,079** | **$ 1,021,390** | **$ 2,024,308** | **$ -** | **$ 8,750,777** |
| **Related allowance for loan losses** | **$ -** | **$ 62,592** | **$ -** | **$ 484,420** | **$ -** | **$ 547,012** |
| **Average recorded investment** | **$ -** | **$ 4,799,024** | **$ 971,153** | **$ 1,956,690** | **$ -** | **$ 7,726,867** |
| **Interest income recognized** | **$ -** | **$ 287,104** | **$ 31,714** | **$ -** | **$ -** | **$ 318,818** |
| As of December 31, 2020: | | | | | | |
| Loans with a valuation allowance: | | | | | | |
| Recorded Investment | $ - | $ 1,339,142 | $ - | $ 197,545 | $ - | $ 1,536,687 |
| Unpaid principal balance | $ - | $ 1,368,580 | $ - | $ 197,545 | $ - | $ 1,566,125 |
| Related allowance for loan losses | $ - | $ 69,799 | $ - | $ 47,416 | $ - | $ 117,215 |
| Average recorded investment | $ - | $ 1,369,672 | $ - | $ 1,480,439 | $ - | $ 2,850,111 |
| Interest income recognized | $ - | $ 102,817 | $ - | $ - | $ - | $ 102,817 |
| Loans without a valuation allowance: | | | | | | |
| Recorded Investment | $ - | $ 5,148,351 | $ 954,037 | $ 209,291 | $ - | $ 6,311,679 |
| Unpaid principal balance | $ - | $ 6,082,153 | $ 997,769 | $ 233,988 | $ - | $ 7,313,910 |
| Average recorded Investment | $ - | $ 5,232,662 | $ 967,509 | $ 214,710 | $ - | $ 6,414,881 |
| Interest income recognized | $ - | $ 394,835 | $ 33,140 | $ 2,016 | $ - | $ 429,991 |
| Totals: | | | | | | |
| Recorded Investment | $ - | $ 6,487,493 | $ 954,037 | $ 406,836 | $ - | $ 7,848,366 |
| Unpaid principal balance | $ - | $ 7,450,733 | $ 997,769 | $ 431,533 | $ - | $ 8,880,035 |
| Related allowance for loan losses | $ - | $ 69,799 | $ - | $ 47,416 | $ - | $ 117,215 |
| Average recorded investment | $ - | $ 6,602,334 | $ 967,509 | $ 1,695,149 | $ - | $ 9,264,992 |
| Interest income recognized | $ - | $ 497,652 | $ 33,140 | $ 2,016 | $ - | $ 532,808 |

The Bank has granted loans to certain officers and directors of the Corporation and their associates. Related party loans are made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with unrelated persons and do not involve more than the normal risk of collectability. The aggregate dollar amount of these loans was $597,648 and $697,614 at December 31, 2021 and 2020, respectively. During 2021 and 2020, loans totaling $123,749 and $160,170, respectively, were made. During 2021 and 2020, repayments of $223,715 and $1,378,556, respectively, were made.

Loans serviced for others by the Corporation under its New Market Tax Credits Program totaled $243,530,000 and $230,790,000 at December 31, 2021 and 2020, respectively.

Unamortized loan premiums total $1,467,630 at December 31, 2021 and $493,489 at December 31, 2020.

At December 31, 2021, two residential real estate loans were in the process of foreclosure totaling $342,504. At December 31, 2020, three residential real estate loans were in the process of foreclosure totaling $327,726.

## 6. Premises and Equipment

The major classes of premises and equipment at December 31, are summarized as follows:

| | **2021** | 2020 |
|---|---|---|
| Land | **$ 631,900** | $ 631,900 |
| Buildings | **2,265,463** | 2,265,463 |
| Leasehold improvements | **6,267,842** | 6,189,676 |
| Furniture, fixtures, and equipment | **911,174** | 747,828 |
| | **10,076,379** | 9,834,867 |
| Less accumulated depreciation and amortization | **(7,736,615)** | (7,502,810) |
| | **$ 2,339,764** | $ 2,332,057 |

Depreciation and amortization expense was $233,805 and $237,141 for the years ended December 31, 2021, and 2020, respectively.

## 7. Deposits

Maturities of time deposits as of December 31, 2021 are as of follows:

| | |
|---|---|
| 2022 | $ 30,582,745 |
| 2023 | 7,920,611 |
| 2024 | 32,778,325 |
| 2025 | 1,058,986 |
| 2026 | 1,156,982 |
| Thereafter | 154,214 |
| | $ 73,651,863 |

Deposits are the Bank's primary funding source for loans and investment securities. The mix and repricing alternatives can significantly affect the cost of this source of funds and, therefore, impact the net interest margin.

The Corporation has two deposit relationships in excess of 5% of total deposits at December 31, 2021 totaling $35,648,704, and one deposit relationship in excess of 5% of total deposits at December 31, 2020 in the amount of $20,689,897. Total related party deposits are estimated at $4,785,915 and $4,154,970 at December 31, 2021 and 2020, respectively.

Overdrawn demand deposits reclassified as loans receivable in the consolidated balance sheets amounted to $23,533 and $169,262 as of December 31, 2021 and 2020, respectively.

## 8. Federal Home Loan Bank and Federal Reserve Bank Borrowings

The Bank had approved credit facilities of $81,664,750 and $81,862,750 with the Federal Home Loan Bank of Atlanta as of December 31, 2021, and 2020, respectively. There were no borrowings outstanding under these facilities as of December 31, 2021, and 2020, respectively. Loans with a collateral value totaling $54,403,152 and $48,893,074 at December 31, 2021, and 2020, respectively, have been pledged as collateral for these facilities.

During 2020 and 2021, the Bank originated loans under the Small Business Administration's Payroll Protection Program (PPP). Loans originated under this program served as eligible collateral under the Federal Reserve Bank's Payroll Protection Program Loan Facility (PPPLF). As of December 31, 2021 and 2020, the Bank had borrowings of $11,096,642 and $32,259,756, respectively, under the PPPLF program and pledged loans in the same amount. Advances under the PPPLF are summarized by year of maturity and weighted average interest rate as of December 31, 2021:

| | Outstanding | Weighted Average Rate |
|---|---|---|
| 2022 | $ 1,115,266 | 0.35% |
| 2023 | - | - |
| 2024 | - | - |
| 2025 | 37,500 | 0.35% |
| 2026 | 9,943,876 | 0.35% |
| Total | $ 11,096,642 | 0.35% |

## 9. Junior Subordinated Debentures

On October 9, 2003, the Corporation issued floating rate junior subordinated debt securities due 2033 in the amount of $7.2 million. The debt securities were issued by the Corporation pursuant to an indenture, dated as of October 9, 2003, between the Corporation and Wilmington Trust Company. Upon the receipt of the net funds, the Corporation paid off long-term debt in the amount of $1.8 million, and invested $4.9 million as capital in the Bank, increasing the Bank's tier one capital. Payments on the debt securities are used to fund dividends on the Corporation's trust preferred securities. The interest rate on the debentures was approximately 3.13% at December 31, 2021.

The Corporation exercised its right to defer interest payments on the debt securities beginning with the payment due February 8, 2010. This deferment is permitted by the terms of the junior subordinated debentures and does not constitute an event of default so long as there is no other event of default. Interest on the debt securities continues to accrue and is required to be paid in full prior to the expiration of the deferral period. The total deferral period may not exceed 20 consecutive quarters.

While in deferment, the Corporation, after obtaining regulatory approval, paid dividends on its Troubled Asset Relief Program ("TARP") preferred stock. Under the indenture and the trust preferred documents, the payment of dividends on junior securities, such as TARP preferred stock during the interest deferral period and while interest is due on the trust preferred can result in an event of default. An event of default may result in the trust preferred becoming immediately and fully due and an obligation to pay costs and expenses of collection. Attempts were made by the Corporation to cure the potential event of default including a request for permission from its regulators to pay all interest due on its trust preferred at the end of the extension period dated May 8, 2011, which was denied, and a request for the Department of Treasury to refund the TARP dividends previously made during the deferral period, which also was denied. The Corporation received a notice of an event of default from its trust preferred trustee during 2011 requesting the event of default be remedied. Since then, no action or demand for immediate repayment has been brought against the Corporation. The Corporation may not make any distributions of interest or principal on the subordinated debentures without the approval of the Federal Reserve Bank of Richmond (FRB). After receiving regulatory approval from the FRB, a payment of $1,410,506 was made on January 29, 2015 to bring the obligation current. Additional quarterly payments totaling $230,687 and $304,436 were made during 2021 and 2020, respectively. The Corporation guarantees the debt obligation of the trust which remains current as of December 31, 2021.

## 10. Other Borrowings

Other borrowings of $5,000 at December 31, 2020 reflect a payable to a nonconsolidated affiliate. This balance was paid off during 2021.

## 11. Income Tax

The Corporation's provision for income taxes for the years ended December 31, is summarized as follows:

| | **2021** | 2020 |
|---|---|---|
| Current tax expense | **$ 178,563** | $ 191,912 |
| Deferred tax expense (benefit) | **592,999** | (186,959) |
| Change in valuation allowance | **(592,999)** | 186,959 |
| Income tax expense for the year | **$ 178,563** | $ 191,912 |

A reconcilement of the difference between the statutory federal income tax rate and the effective tax rate for the Corporation is as follows:

| | **2021** | 2020 |
|---|---|---|
| Federal income tax statutory rate | **21.0 %** | 21.0 % |
| State income taxes net of federal benefit | **(6.3)%** | (14.8)% |
| Increase in value of bank-owned life insurance | **(3.7)%** | (7.9)% |
| Other permanent differences | **0.6 %** | 3.0 % |
| Change in valuation allowance | **(5.3)%** | 13.5 % |
| Effective tax rate | **6.3 %** | 14.8 % |

Temporary differences between the amounts reported in the consolidated financial statements and tax bases of assets and liabilities result in deferred taxes. The types of temporary differences that give rise to significant portions of the deferred tax assets and liabilities are as follows for the years ended December 31:

| | **2021** | 2020 |
|---|---|---|
| Deferred tax assets: | | |
| Net operating loss | **$ 943,957** | $ 1,626,093 |
| Depreciation | **875,291** | 927,316 |
| Deferred compensation | **647,439** | 629,756 |
| Allowance for loan losses | **474,212** | 485,220 |
| Non-accrual loan interest | **54,151** | 74,015 |
| New market tax credit | **1,933,081** | 1,719,937 |
| Deferred loan fees | **132,837** | 191,630 |
| Other, net | **-** | - |
| Total gross deferred tax assets | **$ 5,060,968** | $ 5,653,967 |

| | 2021 | 2020 |
|---|---|---|
| Net deferred tax assets attributable to operations | **$ 5,060,968** | $ 5,653,967 |
| Deferred tax on unrealized loss on investments charged to other comprehensive income | **141,884** | (3,709) |
| Less valuation allowance | **(5,202,852)** | (5,650,258) |
| Net deferred income tax assets | **$ -** | $ - |

At December 31, 2021, the Corporation has net operating loss carryforwards for federal income tax purposes of approximately $200,000, which are available to offset future taxable income, and which will expire in 2032 through 2037.

Management assesses the available positive and negative evidence to estimate whether sufficient future taxable income will be generated to permit use of the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative losses incurred in prior years including 2019, one of the last three years ended December 31, 2021. Such objective evidence limited the ability to consider other subjective evidence, such as our projections for future growth.

On the basis of this evaluation, as of December 31, 2021, a valuation allowance of $5,202,852 has been recorded to recognize only the portion of the deferred tax asset that is more likely than not to be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are reduced or increased or if objective negative evidence in the form of cumulative losses is no longer present and additional weight is given to subjective evidence such as our projections for growth.

## 12. Preferred Stock

On July 17, 2009 the Corporation entered into and consummated a Letter Agreement (the “Purchase Agreement”) with the United States Department of the Treasury (the “Treasury”), pursuant to which the Corporation issued 6,800 shares of the Corporation’s Fixed Rate Cumulative Perpetual Preferred Stock, Series A (the “Series A Preferred Stock”), having a liquidation amount per share equal to $1,000, for a total purchase price of $6,800,000. The Series A Preferred Stock pays cumulative dividends at a rate of 5% per year for the first five years and thereafter at a rate of 9% per year.

On July 6, 2018, the Corporation and the Treasury agreed to exchange the 6,800 preferred shares outstanding and $4,545,234 of accrued and unpaid dividends payable on the preferred shares beneficially owned and held by the Treasury for 5,491,843 shares of the Corporation’s common stock and a cash payment of $2,272,617, resulting in a deemed preferred stock dividend in the amount of $2,272,617.

In 2019, the Corporation purchased 1,204,819 shares of the Corporation’s common stock held by the Treasury and retired the common stock. On February 16, 2021, the Corporation purchased the remaining 4,287,024 shares of the Corporation’s common stock for a price of $1,071,756.

On April 5, 2021, the Corporation entered into a Preferred Stock Purchase Agreement with J.P. Morgan Chase Community Development Corporation to issue 2,700 shares of the Corporation’s Fixed Rate Noncumulative Perpetual Preferred Stock, Series B (the “Series B Preferred Stock”) for a total purchase price of $2,700,000. Holders of the Series B Preferred Stock are entitled to receive noncumulative dividends at a rate of 1% per year, if and as declared by the Corporation’s board of directors. Dividends must be paid on the Series B Preferred Stock for the most recently completed dividend period prior to paying dividends on the Corporation’s common stock.

On May 21, 2021, the Corporation entered into a Preferred Stock Purchase Agreement with Wells Fargo Central Pacific Holdings, Inc. to issue 3,530 shares of the Corporation’s Fixed Rate Noncumulative Perpetual Preferred Stock, Series C (the “Series C Preferred Stock”) for a total purchase price of $3,530,000.  Holders of the Series C Preferred Stock are entitled to receive noncumulative dividends at a rate of 1% per year, if and as declared by the

Corporation's board of directors. Dividends must be paid on the Series C Preferred Stock for the most recently completed dividend period prior to paying dividends on the Corporation's common stock.

## 13. Employee Benefit Plans

### *Profit sharing retirement savings plan*

The Corporation has established a defined-contribution plan covering employees meeting certain age and service eligibility requirements. The plan provides for cash deferrals qualifying under Section 401(k). Matching contributions made by the Corporation approximated $92,207 and $50,869 for the year ended December 31, 2021 and 2020, respectively.

### *Stock Incentive plan*

On June 16, 2021, the Corporation established a stock incentive plan to promote long-term growth and profitability of the Corporation by providing key people with incentives to improve stockholder value and to contribute to the growth and financial success of the Corporation and enabling the Corporation to attract and retain staff. The Plan, which is administered by the Corporation's Compensation Committee, has up to 50,000 shares available for issuance. In 2021, the Corporation granted 35,948 shares of restricted stock under the plan. Stock granted under this plan is valued at the fair market value as of the date of grant with one third of the shares vesting immediately upon grant and the remainder vesting ratably on the next two anniversary dates, provided the grantee has been continuously employed by the Corporation. Shares shall become fully vested due to death or disability. Compensation expense is recorded ratably as the vesting occurs. As of December 31, 2021, $59,913 of compensation expense remains unamortized with a remaining life of 1.25 years.

| | Shares | Fair Value at Grant Date |
|---|---|---|
| Nonvested, beginning of period | - | $ - |
| Granted – time based | 35,948 | 4.00 |
| Forfeited | - | - |
| Vested | (11,983) | 4.00 |
| Nonvested, end of period | 23,965 | $ 4.00 |

### *Deferred compensation*

The Bank has a deferred compensation agreement with one of its executive officers. Under the agreement, the Bank is obligated to provide for the officer, or his beneficiaries certain lump-sum benefit payments after the employee's death, disability, or retirement. The estimated present value of future benefits to be paid to the executive officer is being accrued over the period from the effective date of the agreement until the full eligibility date of the participant and totaled $2,352,612 and $2,288,357 at December 31, 2021 and 2020, respectively, and is included in other liabilities on the Corporation's consolidated balance sheet. The expense incurred for this plan for the years ended December 31, 2021 and 2020 was $64,255 and $0, respectively. The Bank is the beneficiary of life insurance policies, purchased as a method of partially financing benefits under this plan. The aggregate cash surrender value of the life insurance policies was $6,306,222 and $6,139,321 at December 31, 2021 and 2020, respectively.

## 14. Operating Leases

The Corporation enters into leases in the normal course of business primarily for branch locations and loan production offices. The Corporation's leases have remaining terms ranging from one to five years, some of which include renewal options to extend the lease for up to five years.

The Corporation includes lease extensions if it is deemed reasonably certain the Corporation will exercise the option.

Leases are classified as operating or finance leases at the lease commencement date. Lease expense for operating leases is recognized on a straight-line basis over the lease term. Right-of-use assets represent the Corporation's right to use an underlying asset for the lease term and the lease liabilities represent the Corporation's obligation to make lease payments arising from the lease. Lease liabilities are recognized at the lease commencement date based on the estimated present value of lease payments over the lease term. Lease liabilities represent the Corporation's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Upon adoption, the Corporation elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases and did not reassess any initial direct costs for existing leases.

The Corporation uses the incremental borrowing rate at lease commencement to calculate the present value of lease payments when the rate implicit in the lease is not known. The Corporation's incremental borrowing rate is based on the FHLB amortizing advance rate for the comparable lease period.

Right-of-use assets of $1,833,251 and $1,402,172 at December 31, 2021 and 2020, respectively, are reflected as Other assets while the lease liabilities of $1,889,949 and $1,458,845 at December 31, 2021 and 2020, respectively, are reflected as Other liabilities.

Future minimum payments for each of the five succeeding years under non-cancelable operating leases consisted of the following at December 31, 2021:

| | |
|---|---|
| 2022 | $ 411,524 |
| 2023 | 358,065 |
| 2024 | 321,440 |
| 2025 | 331,083 |
| 2026 | 167,647 |
| Thereafter | 437,080 |
| Total lease payments | 2,026,839 |
| Imputed interest | (136,890) |
| Lease obligation | $ 1,889,949 |

The weighted average discount rate is 2.35% and the weighted average lease term is 5 years. Total lease expense under operating leases amounted to $464,756 and $606,002 for the years ended December 31, 2021 and 2020, respectively.

## 15. Regulatory Matters

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

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain amounts and ratios (set forth in the table below) of Total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital (as defined) to average assets (as defined). As of December 31, 2021, the capital levels of the Corporation and the Bank exceed all minimum capital adequacy requirements to which they are subject. There are no conditions or events since December 31, 2021 that management believes have changed the Bank's capital rating.

The Federal Reserve Bank and the FDIC approved final rules implementing the Basel Committee on Banking Supervision ("BCBS") capital guidelines for U.S. banks. Under the final rules, minimum requirements increased for both the quantity and quality of capital held by the Corporation. The rules include a new common equity Tier 1 capital to risk-weighted assets minimum ratio of 4.5%, raise the minimum ratio of Tier 1 capital to risk-weighted assets to 6.0%, require a minimum ratio of Total Capital to risk-weighted assets of 8.0% and require a minimum Tier 1 leverage ratio of 4.0%. A capital conservation buffer, comprised of common equity Tier 1 capital, is also established above the regulatory minimum capital requirements. This capital conservation buffer was phased in beginning January 1, 2016 at 0.625% of risk-weighted assets and increased each subsequent year by an additional 0.625% until reaching its final level of 2.5% on January 1, 2019. Strict eligibility criteria for regulatory capital instruments were also implemented under the final rules. The final rules also revise the definition and calculation of Tier 1 capital, Total Capital, and risk-weighted assets. At December 31, 2021, the Bank's specific capital conservation buffer was 7.63%.

In August of 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act ("EGRRCPA") directed the Federal Reserve Board to revise the Small Bank Holding Company Policy Statement to raise the total consolidated asset limit in the Policy Statement from $1 billion to $3 billion. The Corporation meets the conditions of the revised policy statement and was, therefore, exempt from the consolidated capital requirements at December 31, 2021 and 2020.

The Bank's actual capital amounts and ratios are also presented in the table (in thousands):

| | Actual | | For Capital Adequacy Purposes | | To Be Well Capitalized Under Prompt Corrective Action Provision | |
|---|---|---|---|---|---|---|
| | Amount | Ratio | Minimum Amount | Required Ratio | Minimum Amount | Required Ratio |
| **As of December 31, 2021:** | | | | | | |
| **Total Capital (to risk-weighted total assets)** | **$ 28,236** | **15.6%** | **$ 14,452** | **8.0%** | **$ 18,065** | **10.0%** |
| **Tier 1 Capital (to risk-weighted assets)** | **$ 25,974** | **14.4%** | **$ 10,839** | **6.0%** | **$ 14,452** | **8.0%** |
| **Common Equity Tier 1 Capital (to risk-weighted assets)** | **$ 25,974** | **14.4%** | **$ 8,129** | **4.5%** | **$ 11,742** | **6.5%** |
| **Tier 1 Capital (to average assets)** | **$ 25,974** | **8.3%** | **$ 12,524** | **4.0%** | **$ 15,655** | **5.0%** |
| As of December 31, 2020: | | | | | | |
| Total Capital (to risk-weighted total assets) | $ 23,197 | 12.1% | $ 15,320 | 8.0% | $ 19,150 | 10.0% |
| Tier 1 Capital (to risk-weighted assets) | $ 20,807 | 10.9% | $ 11,490 | 6.0% | $ 15,320 | 8.0% |
| Common Equity Tier 1 Capital (to risk-weighted assets) | $ 20,807 | 10.9% | $ 8,618 | 4.5% | $ 12,448 | 6.5% |
| Tier 1 Capital (to average assets) | $ 20,807 | 7.2% | $ 11,492 | 4.0% | $ 14,365 | 5.0% |

Bank and holding company regulations, as well as Maryland law, impose certain restrictions on dividend payments by the Bank, as well as restricting extensions of credit and transfers of assets between the Bank and the Corporation. At December 31, 2021, the Bank is restricted from paying dividends to its parent company without regulatory approval.

On April 5, 2010, the Bank entered into a Consent Order (the “Order”) with the Federal Deposit Insurance Corporation (the “FDIC”) and the Maryland Commissioner of Financial Regulation (the “Commissioner”), which directs the Bank to (i) increase its capitalization, (ii) reduce nonperforming loans and concentrations in commercial real estate loans, (iii) strengthen management policies and practices, (iv) establish a comprehensive policy and methodology for determining an appropriate allowance for loan losses, and (v) increase its Board of Directors participation in the affairs of the Bank. On February 13, 2013 the order was terminated and replaced with a Memorandum of Understanding, "MOU", which was superseded by a Memorandum of Understanding as of September 20, 2017 and which is still in effect as of December 31, 2021. The MOU provides for certain restrictions on dividend payments and expresses management's fiduciary responsibility, requests progress reports to be filed by the Corporation within 45 days of each quarter end while under the MOU and compels the Board of Directors to monitor the Corporation's adherence to the memorandum.

Harbor Bankshares Corporation was also a party to a written agreement with the Federal Reserve Bank of Richmond (the "FRB Agreement"), which requires it to serve as a source of strength to the Bank, including taking steps to ensure that the Bank complies with the Consent Order entered into with the FDIC and the Commissioner and any other supervisory action taken by the Bank’s federal or state regulator. As noted above, the Bank had its Consent Order lifted and replaced with an MOU, and accordingly Harbor Bankshares Corporation also had its written agreement lifted and replaced with an MOU. The FRB Agreement also prohibits the Corporation from taking any of the following actions without the FRB's prior written approval: (i) declaring or paying any dividends; (ii) taking dividends from the Bank; (iii) making any distributions of interest, principal or other sums on Harbor Bankshares Corporation’s subordinated debentures or trust preferred securities; (iv) incurring, increasing, or guaranteeing any debt; or (v) repurchasing or redeeming any shares of its stock.

## 16. Earnings Per Common Share

Basic and diluted income per common share calculations for the years ended December 31, 2021 and 2020 are as follows:

| | 2021 | 2020 |
|---|---|---|
| Basic and diluted: | | |
| Income attributable to common stockholders | **$ 2,634,868** | $ 1,107,949 |
| Average common shares outstanding | **1,681,738** | 5,396,104 |
| Income per common share | **$ 1.57** | $ 0.21 |

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding for the period. Restricted stock is included in the average shares outstanding used to compute basic and diluted earnings per share, given its participation in voting and dividend rights during the restriction period.

## 17. Financial Instruments with Off-Balance Sheet Risk

In the normal course of business, the Corporation has various outstanding credit commitments which are properly not reflected in the consolidated financial statements. These commitments are made to satisfy the financing needs of the Corporation’s clients. The associated credit risk is controlled by subjecting such activity to the same credit and quality controls as exist for the Corporation’s lending and investing activities. The commitments are both fixed and variable rate and involve diverse business and consumer customers and are generally well collateralized. Management does not anticipate that losses, if any, which may occur as a result of these commitments would materially affect the stockholders' equity of the Corporation. Since a portion of the commitments have some likelihood of not being exercised, the amounts do not necessarily represent future cash requirements.

Loan and credit line commitments totaled $15,878,679 and $13,168,959 at December 31, 2021 and 2020, respectively. These commitments are contingent upon continuing customer compliance with the terms of the agreement.

Commercial letters of credit, totaling $191,685 and $186,290 at December 31, 2021 and 2020, respectively, are obligations to make payments under certain conditions to meet contingencies related to customers' contractual agreements. They are primarily used to guarantee a customer's contractual and/or financial performance and are seldom exercised.

At both December 31, 2021 and 2020, the Corporation had a reserve established for off balance sheet commitments in the amount of $95,400.

## 18. Fair Value Measurements

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

The Corporation uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. Securities available for sale and equity securities with readily determinable fair values are recorded at fair value on a recurring basis. Additionally, from time to time, the Corporation may be required to record at fair value other assets on a nonrecurring basis, such as impaired loans, loans held for sale and other real estate owned (foreclosed assets). These nonrecurring fair value adjustments typically involve the application of lower of cost or market accounting or write downs of individual assets. In support of this principle, the FASB established a fair value hierarchy that prioritizes the information used to develop those assumptions. The fair value hierarchy is as follows:

1. Level 1 Inputs - Unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access at the measurement date.

2. Level 2 Inputs - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. These might include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability, such as interest rates and yield curves that are observable at commonly quoted intervals.

3. Level 3 Inputs - Unobservable inputs for determining the fair values of assets or liabilities that reflect an entity's own assumptions about the assumptions that market participants would use in pricing the assets or liabilities.

The following table presents the Bank's assets measured at fair value on a recurring basis as of December 31, 2021 and 2020:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Mkts. for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **December 31, 2021** | | | | |
| **Available-for-sale securities -** | | | | |
| **U.S. government agencies** | **$ 39,532,817** | **$ -** | **$ 39,532,817** | **$ -** |
| **State and municipals** | **$ 503,290** | **$ -** | **$ 503,290** | **$ -** |
| December 31, 2020 | | | | |
| Available-for-sale securities - | | | | |
| U.S. government agencies | $ 34,547,322 | $ - | $ 34,547,322 | $ - |
| State and municipals | $ 1,027,400 | $ - | $ 1,027,400 | $ - |

Securities classified as available-for-sale are reported at fair value utilizing Level 2 inputs. For these securities, the Corporation obtains fair value measurements from an independent pricing service. The fair value measurements consider observable data that may include dealer quotes, market spreads, cash flows, the U.S. Treasury yield curve, live trading levels, trade execution data, market consensus prepayment speeds, credit information, and the terms and conditions of the security, among other things.

The following table presents the assets measured at fair value on a nonrecurring basis as of December 31, 2021 and 2020:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | Fair Value | Quoted Prices in Active Mkts. for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **December 31, 2021** | | | | |
| **Impaired loans (net of related allowances):** | | | | |
| **Commercial Real Estate** | **$ 1,659,503** | **$ -** | **$ -** | **$ 1,659,503** |
| **Commercial and Industrial** | **1,328,615** | **-** | **-** | **1,328,615** |
| **Total** | **$ 2,988,118** | **$ -** | **$ -** | **$ 2,988,118** |
| December 31, 2020 | | | | |
| Impaired loans (net of related allowances): | | | | |
| Commercial Real Estate | $ 1,269,343 | $ - | $ - | $ 1,269,343 |
| Commercial and Industrial | 150,129 | - | - | 150,129 |
| Total | $ 1,419,472 | $ - | $ - | $ 1,419,472 |
| Other real estate owned | $ 214,203 | $ - | $ - | $ 214,203 |

Loans for which it is probable that the Corporation will not collect all principal and interest due according to contractual terms are measured for impairment as prescribed by accounting guidance for accounting by creditors for impairment of a loan. Allowable methods for estimating fair value include using the fair value of the collateral for collateral dependent loans or, where a loan is determined not to be collateral dependent, using the discounted cash flow method. In our determination of fair value, we have categorized both methods of valuation as estimates based on Level 3 inputs. Quantitative information considered in developing Level 3 Fair Value measurements at December 31, 2021, and 2020 for impaired loans include appraisal values adjusted for estimated selling costs for collateral dependent Commercial and Residential Real Estate impaired loans and discounted cash flows under modified repayment terms adjusted for third party guarantees, if any, for Commercial and Industrial impaired loans. The weighted average discount rate used to discount cash flow dependent Commercial and Industrial impaired loans was 7.79% with rates ranging from 5% to 8.75% at December 31, 2021 and 7.81%, with rates ranging from 5.00% to 8.75% at December 31, 2020. Quantitative information considered for developing Level 3 Fair Value measurements at December 31, 2020 for other real estate owned, reflects actual sales contracts, less estimated sales costs, if any. No other real estate owned was held at December 31, 2021.

## 19. Fair Value of Financial Instruments

Accounting guidance requires the Corporation to disclose fair value information about financial instruments for which it is practicable to estimate, whether or not such fair values are reflected in the consolidated balance sheets. Estimated fair value amounts have been determined using available market information and other valuation methodologies. However, considerable judgment is required to interpret market data in developing the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amount that could be realized in a current market exchange. The use of different market assumptions and estimation methodologies may have a material effect on the estimated fair value amounts.

The carrying values and estimated fair values of the Corporation's financial assets and liabilities are as follows:

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | Carrying Value | Quoted Prices in Active Mkts. for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **December 31, 2021** | | | | |
| **Financial assets:** | | | | |
| **Cash and due from banks** | **$ 3,162,549** | **$ 3,162,549** | **$ -** | **$ -** |
| **Federal funds sold** | **4,889,000** | **4,889,000** | **-** | **-** |
| **Interest bearing deposits in other banks** | **77,501,671** | **77,501,671** | **-** | **-** |
| **Investment securities** | **40,036,107** | **-** | **40,036,107** | **-** |
| **Loans, net of allowances** | **191,305,987** | **-** | **-** | **192,232,971** |
| **FHLB of Atlanta stock** | **161,400** | **-** | **161,400** | **-** |
| **Accrued interest receivable** | **877,818** | **877,818** | **-** | **-** |
| **BOLI** | **6,306,222** | **-** | **6,306,222** | **-** |
| **Financial liabilities:** | | | | |
| **Deposits** | **$ 281,779,009** | **$ -** | **$208,127,146** | **$ 76,328,696** |
| **Accrued interest payable** | **726,475** | **726,475** | **-** | **-** |
| **Junior subordinated debentures** | **7,217,000** | **-** | | **7,421,359** |
| **Federal Reserve Bank borrowings** | **11,096,642** | **-** | **11,096,642** | **-** |

**Commitments for off balance lending approximate fair value.**

| | | Fair Value Measurements at Reporting Date Using | | |
|---|---|---|---|---|
| | Carrying Value | Quoted Prices in Active Mkts. for Identical Assets (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2020 | | | | |
| Financial assets: | | | | |
| Cash and due from banks | $ 5,562,057 | $ 5,562,057 | $ - | $ - |
| Federal funds sold | 9,885,986 | 9,885,986 | - | - |
| Interest bearing deposits in other banks | 43,954,107 | 43,954,107 | - | - |
| Investment securities | 35,574,722 | - | 35,574,722 | - |
| Loans, net of allowances | 213,880,575 | - | - | 213,407,903 |
| FHLB of Atlanta stock | 280,200 | - | 280,200 | - |
| Accrued interest receivable | 1,571,143 | 1,571,143 | - | - |
| BOLI | 6,139,321 | - | 6,139,321 | - |
| Financial liabilities: | | | | |
| Deposits | $ 261,072,594 | $ - | $183,146,029 | $ 81,963,655 |
| Accrued interest payable | 804,007 | 804,007 | - | - |
| Junior subordinated debentures | 7,217,000 | - | - | 6,094,573 |
| Federal Reserve Bank borrowings | 32,259,756 | - | 32,259,756 | - |
| Other borrowings | 5,000 | - | 5,000 | - |

Commitments for off balance lending approximate fair value.

## 20. Risks and Contingencies

The Corporation is party to certain legal actions in the course of business. There was no material litigation against the Corporation at December 31, 2021. Management is unaware of any additional outstanding risks and contingencies as of the date that the consolidated financial statements were available for issue.

### *New market tax credits indemnifications*

The Corporation has indemnified certain tax credit investors for potential Recapture Events in connection with the Corporation's participation in the Community Development Financial Institutions New Markets Tax Credit Program. Events of Recapture include the Corporation or the applicable community development entity ("CDE") or subsidiary CDE ("sub-CDE") ceasing to be a CDE; redemption of investment in the sub-CDE; failure to meet certain compliance requirements; and indemnitor's gross negligence, fraud, willful misconduct, malfeasance, material violation of law, or bad faith action which results in a Recapture Event. The Corporation's indemnification obligations total $20,104,479 as of December 31, 2021. The Corporation's compliance obligations associated with each indemnification will expire over time as shown in the schedule below. During 2021, compliance obligations associated with indemnifications totaling $2,588,500 expired. In addition, the Corporation and sub-CDE income tax returns are subject to review and examination by Federal and State taxing authorities and are currently open to audit under the applicable statutes of limitations by the Internal Revenue Service ("IRS") for the years ended December 31, 2018, through and including 2021.

Maturities of compliance obligations as of December 31, 2021, are as of follows:

| | |
|---|---|
| 2022 | $ - |
| 2023 | - |
| 2024 | 6,085,400 |
| 2025 | 1,695,400 |
| 2026 | 5,065,600 |
| 2027 | 3,831,079 |
| 2028 | 3,427,000 |
| | $ 20,104,479 |

The Corporation is in compliance with the rules and regulations of the Community Development Financial Institutions New Markets Tax Credit Program and engages experts on an annual basis to monitor such compliance. Management believes that the probability that the Corporation's indemnification obligations will be triggered is low.

## 21. Subsequent Events

The Corporation has evaluated subsequent events for potential recognition and/or disclosure through March 15, 2022, the date the consolidated financial statements were available to be issued.

THE HARBOR BANK OF MARYLAND

# Branch Locations

### Main Office

25 W. Fayette Street
Baltimore, Maryland 21201
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 5:00 p.m.
410-528-1801 or 1-888-833-7920
ATM Available
Safe Deposit Box Available

### Pimlico Office

5000 Park Heights Avenue
Baltimore, Maryland 21215
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 6:00 p.m.
Saturday 9:00 a.m. to 12:00 noon
410-367-3331
ATM Available

### Science & Technology Park East Office

855 N. Wolfe Street, Suite C
Baltimore, Maryland 21205
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 5:00 p.m.
410-675-1167
ATM Available

### Research Park Office

800 West Baltimore Street
Baltimore, Maryland 21201
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 5:00 p.m.
410-545-0633
ATM Available
Safe Deposit Box Available

### Randallstown Office

8530 Liberty Road
Randallstown, Maryland 21133
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 6:00 p.m.
Saturday 9:00 a.m. to 12:00 noon
Drive-in Hours:
Monday-Thursday 9:00 a.m. to 4:00 p.m.
Friday 9:00 a.m. to 6:00 p.m.
Saturday 9:00 a.m. to 12:00 noon
410-922-3003
ATM Available
Safe Deposit Box Available

### Inner Harbor East Office

1000 Lancaster Street, Suite C
Baltimore, Maryland 21202
Monday - Thursday 9:00 a.m. to 3:00 p.m.
Friday 9:00 a.m. to 5:00 p.m.
Saturday 9:00 a.m. to 12:00 noon
410-468-0600
ATM Available

### Northwood Office (opening May 2022)

1509 Havenwood Road
Baltimore, Maryland 21218
Monday - Thursday 9:00 a.m. to 5:00 p.m.
Friday 9:00 a.m. to 6:00 p.m.
Saturday 9:00 a.m. to 12:00 noon
ATM Available

### Montgomery County
(Loan Production Center, not a branch)

1010 Wayne Avenue, Suite 210
Silver Spring, Maryland 20910
By appointment
240-650-6230

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