Board of Governors of the Federal Reserve System

Annual Report of Holding Companies—FR Y-6

Report at the close of business as of the end of fiscal year

This Report is required by law: Section 5(c)(1)(A) of the Bank Holding Company Act (12 U.S.C. § 1844(c)(1)(A)); sections 8(a) and 13(a) of the International Banking Act (12 U.S.C. §§ 3106(a) and 3108(a)); sections 11(a)(1), 25, and 25A of the Federal Reserve Act (12 U.S.C. §§ 248(a)(1), 602, and 611a); and sections 113, 165, 312, 618, and 809 of the Dodd-Frank Act (12 U.S.C. §§ 5361, 5365, 5412, 1850a(c)(1), and 5468(b)(1)). Return to the appropriate Federal Reserve Bank the original and the number of copies specified.

This report form is to be filed by all top-tier bank holding companies, top-tier savings and loan holding companies, and U.S. intermediate holding companies organized under U.S. law, and by any foreign banking organization that does not meet the requirements of and is not treated as a qualifying foreign banking organization under Section 211.23 of Regulation K (12 C.F.R. § 211.23). (See page one of the general instructions for more detail of who must file.) The Federal Reserve may not conduct or sponsor, and an organization (or a person) is not required to respond to, an information collection unless it displays a currently valid OMB control number.

NOTE: The *Annual Report of Holding Companies* must be signed by one director of the top-tier holding company. This individual should also be a senior official of the top-tier holding company. In the event that the top-tier holding company does not have an individual who is a senior official and is also a director, the chairman of the board must sign the report. If the holding company is an ESOP/ESOT formed as a corporation or is an LLC, see the General Instructions for the authorized individual who must sign the report.

I, Charles R. Smith III
Name of the Holding Company Director and Official

Chairman of the Board
Title of the Holding Company Director and Official

attest that the *Annual Report of Holding Companies* (including the supporting attachments) for this report date has been prepared in conformance with the instructions issued by the Federal Reserve System and are true and correct to the best of my knowledge and belief.

With respect to information regarding individuals contained in this report, the Reporter certifies that it has the authority to provide this information to the Federal Reserve. The Reporter also certifies that it has the authority, on behalf of each individual, to consent or object to public release of information regarding that individual. The Federal Reserve may assume, in the absence of a request for confidential treatment submitted in accordance with the Board's "Rules Regarding Availability of Information," 12 C.F.R. Part 261, that the Reporter and *individual consent to public release of all details in the report concerning that individual.*

✓ Charles R. Smith III
Signature of Holding Company Director and Official

3/13/19
Date of Signature

For holding companies not registered with the SEC–
Indicate status of Annual Report to Shareholders:

- [x] is included with the FR Y-6 report
- [ ] will be sent under separate cover
- [ ] is not prepared

For Federal Reserve Bank Use Only

RSSD ID ______
C.I. ______

Date of Report (top-tier holding company's fiscal year-end):

December 31, 2018
Month / Day / Year

No LEI
Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

HSB Bancorp, Inc.
Legal Title of Holding Company

P.O. Box 59
(Mailing Address of the Holding Company) Street / P.O. Box

Hebron	MD	21830
City	State	Zip Code

101 N. Main Street, Hebron, MD 21830
Physical Location (if different from mailing address)

Person to whom questions about this report should be directed:

Kimberly T. Thomas	VP/Sec/Treasurer
Name	Title

410-749-1185 1035
Area Code / Phone Number / Extension

410-749-1305
Area Code / FAX Number

kthomas@hebronsavingsbank.com
E-mail Address

www.hebronsavingsbank.com
Address (URL) for the Holding Company's web page

Is confidential treatment requested for any portion of this report submission? .... 0=No 1=Yes **0**

In accordance with the General Instructions for this report (check only one),

1. a letter justifying this request is being provided along with the report .... [ ]
2. a letter justifying this request has been provided separately ... [ ]

NOTE: Information for which confidential treatment is being requested must be provided separately and labeled as "confidential."

For Use By Tiered Holding Companies

Top-tiered holding companies must list the names, mailing address, and physical locations of each of their subsidiary holding companies below.

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

Legal Title of Subsidiary Holding Company

(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box

City State Zip Code

Physical Location (if different from mailing address)

FORM FR Y-6

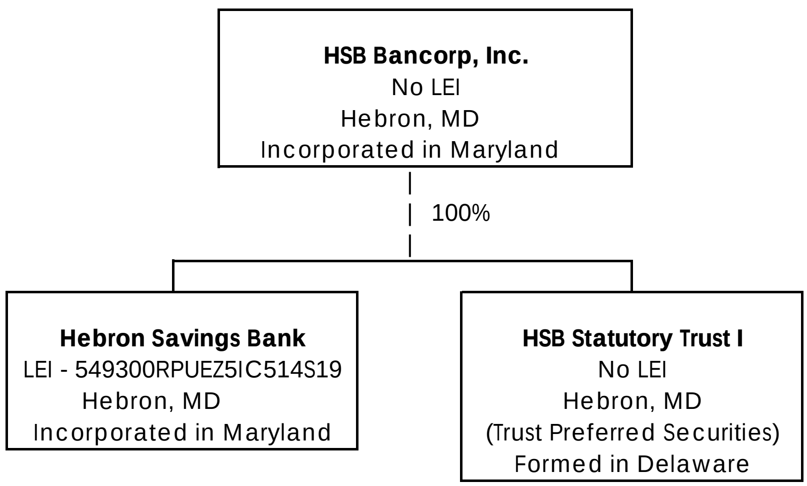
HSB Bancorp, Inc.
Hebron, Maryland
Fiscal Year Ending December 31, 2018

Report Item

1: Annual Report to Shareholders

The bank holding company prepares an annual report for its securities holders. Attached is the annual report.

2a: Organizational Chart



FORM FR Y-6
HSB Bancorp, Inc.
Fiscal Year Ending December 31, 2018

Report Item 2b: Domestic Branch Listing

Results: A list of branches for your depository institution: HEBRON SAVINGS BANK (ID_RSSD: 780722).
This depository institution is held by HSB BANCORP, INC. (2876544) of HEBRON, MD.
The data are as of 12/31/2018. Data reflects information that was received and processed through 01/06/2019.

Reconciliation and Verification Steps
1. In the **Data Action** column of each branch row, enter one or more of the actions specified below
2. If required, enter the date in the **Effective Date** column

Actions
OK: If the branch information is correct, enter 'OK' in the **Data Action** column.
Change: If the branch information is incorrect or incomplete, revise the data, enter 'Change' in the **Data Action** column and the date when this information first became valid in the **Effective Date** column.
Close: If a branch listed was sold or closed, enter 'Close' in the **Data Action** column and the sale or closure date in the **Effective Date** column.
Delete: If a branch listed was never owned by this depository institution, enter 'Delete' in the **Data Action** column.
Add: If a reportable branch is missing, insert a row, add the branch data, and enter 'Add' in the **Data Action** column and the opening or acquisition date in the **Effective Date** column.

If printing this list, you may need to adjust your page setup in MS Excel. Try using landscape orientation, page scaling, and/or legal sized paper.

Submission Procedure
When you are finished, send a saved copy to your FRB contact. See the detailed instructions on this site for more information.
If you are e-mailing this to your FRB contact, put your institution name, city and state in the subject line of the e-mail.

Note:
To satisfy the **FR Y-10 reporting requirements**, you must also submit FR Y-10 Domestic Branch Schedules for each branch with a **Data Action** of Change, Close, Delete, or Add.
The FR Y-10 report may be submitted in a hardcopy format or via the FR Y-10 Online application - https://y10online.federalreserve.gov.

* FDIC UNINUM, Office Number, and ID_RSSD columns are for reference only. Verification of these values is not required.

Data Action	Effective Date	Branch Service Type	Branch ID_RSSD*	Popular Name	Street Address	City	State	Zip Code	County	Country	FDIC UNINUM*	Office Number*	Head Office	Head Office ID_RSSD*	Comments
OK		Full Service (Head Office)	780722	HEBRON SAVINGS BANK	101 N. MAIN STREET	HEBRON	MD	21830	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	2241423	CAMBRIDGE BRANCH	6 CEDAR STREET	CAMBRIDGE	MD	21613	DORCHESTER	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	4794101	CAMBRIDGE RT 50 BRANCH	2801 OCEAN GATEWAY	CAMBRIDGE	MD	21613	DORCHESTER	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	3719714	CRISFIELD BRANCH	57 RICHARDSON AVENUE	CRISFIELD	MD	21817	SOMERSET	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	3443297	FRUITLAND BRANCH	108 EAST CEDAR LANE	FRUITLAND	MD	21826	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	3077991	PRINCESS ANNE BRANCH	30499 MOUNT VERNON ROAD	PRINCESS ANNE	MD	21853	SOMERSET	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	827225	CARROLL STREET BRANCH	415 EAST CARROLL ST	SALISBURY	MD	21804	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	3283868	MT HERMON BRANCH	1310 MT HERMON RD	SALISBURY	MD	21804	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	4974538	NORTH SALISBURY BRANCH	2730 NORTH SALISBURY BOULEV	SALISBURY	MD	21801	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	3078019	QUANTICO SQUARE BRANCH	1008 WEST MAIN STREET	SALISBURY	MD	21801	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	4255161	RIVERSIDE DRIVE BRANCH	543C RIVERSIDE DRIVE	SALISBURY	MD	21801	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	965725	SHARPTOWN BRANCH	303 MAIN ST	SHARPTOWN	MD	21861	WICOMICO	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	
OK		Full Service	642222	VIENNA BRANCH	MARKET & RACE STREETS	VIENNA	MD	21869	DORCHESTER	UNITED STATES	Not Required	Not Required	HEBRON SAVINGS BANK	780722	

FORM FR Y-6
HSB Bancorp, Inc.
Fiscal Year Ending December 31, 2018

Report Item 3: Securities Holders
(1)(a) (1)(b) (1)(c) (2)(a) (2)(b) (2)(c)

Current Shareholders with ownership, control or holdings of 5% or more with power to vote as of 12-31-18			Shareholders not listed in (3)(1)(a) through (3)(1)(c) that had ownership, control or holdings of 5% or more with the power to vote during the fiscal year ending 12-31-18		
(1)(a) Name & Address (City, State, Country)	(1)(b) Country of Citizenship or Incorporation	(1)(c) Number and % of Each Class of Voting Sec's	(2)(a) Name & Address (City, State, Country)	(2)(b) Country of Citizenship or Incorporation	(2)(c) Number and % of Each Class of Voting Sec's
Victor H. Laws, III Salisbury, MD, USA	USA	115,741 - 7.48% Common Stock	None		
Charles R. Smith III Hebron, MD, USA	USA	90,764 - 5.87% Common Stock			

FORM FR Y-6
HSB Bancorp, Inc.
Fiscal Year Ending December 31, 2018

Report Item 4: Insiders
(1)(2)(3)(a)(b)(c) and (4)(a)(b)(c)

(1) Names & Address (City, State, Country)	(2) Principal Occupation if other than with Bank Holding Company	(3)(a) Title & Position with Bank Holding Company	(3)(b) Title & Position with Subsidiaries (include) names of subsidiaries)	(3)(c) Title & Position with Other Businesses (include names of other businesses)	(4)(a) Percentage of Voting Shares in Bank Holding Company	(4)(b) Percentage of Voting Shares in Subsidiaries	(4)(c) List names of other companies (includes partnerships) if 25% or more of voting sec's are held (List names of companies and % of voting sec's held)
Charles R. Smith III Hebron, MD, USA	Entrepreneur	Director & Chairman	Director & Chairman Hebron Savings Bank	Owner - Smith Enterprises	5.87%	None	Smith Enterprises (100%)
Mark S. Holloway Salisbury, MD, USA	Retired Realtor	Director	Director Hebron Savings Bank	N/A	0.26%	None	N/A
Robert E. Holloway Salisbury, MD, USA	Certified Public Accountant	Director	Director Hebron Savings Bank	N/A	0.18%	None	Agrinvestors LLC (50%) Bivalve Properties LLC (50%) Johnson Road CSA LLC (50%) Quantico Creek Leasing LLC (33.33%) Quantico Creek Sod Farms Inc (100%) Wicomico Warrington Farm LLC (50%) Wicomico Levin Dasheill Farm LLC (50%)
Charles W. Kelly Cambridge, MD, USA	Pharmacist	Director	Director Hebron Savings Bank	Pharmacist Craig's Drug Store, Inc.	0.76%	None	Chesapeake Development (66.67%) Craig's Drug Store, Inc. (49.5%) C&K (50%) Nevrdul LLC (50%) Park Place 530 LLC (50%) Mosginley Holdings LLC (50%)
Victor H. Laws III Salisbury, MD, USA	Attorney	Director	Director Hebron Savings Bank	Principal Laws Insley & Benson PA	7.48%	None	Downtown Assoc. LLC (50%) Laws, Insley & Benson, PA (33%) Marvic Associates LLC (25%)
Susan Wilgus-Murphy Salisbury, MD, USA	Entrepreneur	Director	Director Hebron Savings Bank	Owner - Wilgus Insurance Inc	2.06%	None	Wilgus Insurance (100%) WJM Properties LLC (25%) Wilgus-Murphy Properties (100%) HAC (100%) Murphy-Johnson Properties (50%) ERG of Fruitland (33.33%) ERC of Delmar (33.33%)

Report Item 4: Insiders
(1)(2)(3)(a)(b)(c) and (4)(a)(b)(c)

(1) Names & Address (City, State, Country)	(2) Principal Occupation if other than with Bank Holding Company	(3)(a) Title & Position with Bank Holding Company	(3)(b) Title & Position with Subsidiaries (include) names of subsidiaries)	(3)(c) Title & Position with Other Businesses (include names of other businesses)	(4)(a) Percentage of Voting Shares in Bank Holding Company	(4)(b) Percentage of Voting Shares in Subsidiaries	(4)(c) List names of other companies (includes partnerships) if 25% or more of voting sec's are held (List names of companies and % of voting sec's held)
E. Scott Tawes Princess Anne, MD, USA	Certified Public Accountant	Director	Director Hebron Savings Bank	Principal Scott Tawes & Associates	0.91%	None	11545 Somerset Center (100%) A Tyler, J Dodson & S Tawes (33.33%) A&A Realty (50%) Bozman & Tawes (50%) Carson & Tawes Investments (50%) D&T Investments (50%) Evans & Tawes (50%) Hansen & Tawes (50%) Horace & Elwath LLC (50%) Marshall & Tawes (50%) M&S Investments (50%) Nelson & Tawes Farms (50%) Noble & Tawes (50%) Presto Marshall & Tawes (33.33%) Reynolds & Tawes (50%) R's Partners (50%) Scott Tawes & Assoc CPA PA (100%) Tawes Real Estate (50%) Tawes, Nelson & Reynolds (33.33%) Terra Firma LLC (50%) Timmy & Scott Parnership (50%) Tyler & Tawes Investments (50%)
Thomas C. Thompson Salisbury, MD, USA	Retired - Insurance Agent	Director	Director Hebron Savings Bank	N/A	1.07%	None	N/A
Donna K. Defino Parsonsburg, MD, USA	N/A	President	Pres./Chief Exe Ofcr Hebron Savings Bank	N/A	0.13%	None	N/A
W. Trent Pusey Salisbury, MD, USA	N/A	Vice President	EVP/Chief Lending Ofcr Hebron Savings Bank	N/A	0.00%	None	N/A
Cathy D. Brinsfield Salisbury, MD, USA	N/A	Vice President Assistant Secretary	EVP/Compliance/COO Hebron Savings Bank	N/A	0.00%	None	N/A
Kimberly T. Thomas Rhodesdale, MD, USA	N/A	Vice President Secretary/Treasurer	EVP/Chief Fin. Ofcr Hebron Savings Bank	N/A	0.00%	None	N/A
Ellen P. Vandegrift Salisbury, MD, USA	N/A	Vice President	SVP/Retail Lending Hebron Savings Bank	N/A	0.13%	None	N/A

Established 1910

HSB BANCORP, INC.

HSB Bancorp, Inc. & Subsidiary

2018 Annual Report

EQUAL HOUSING LENDER

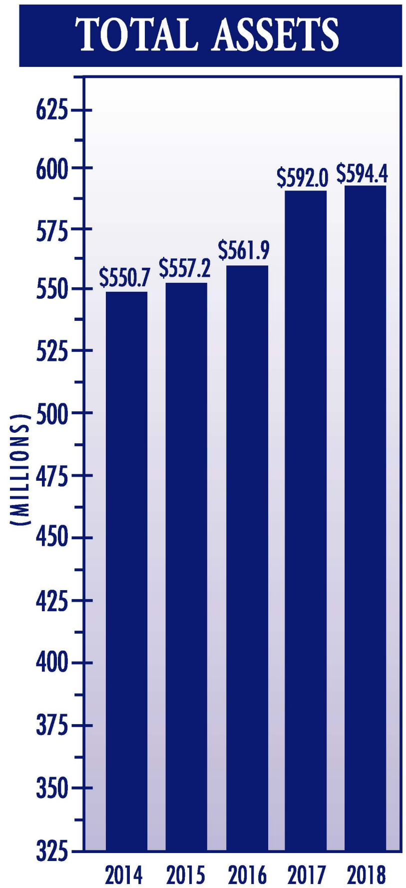
Each depositor insured to at least $250,000

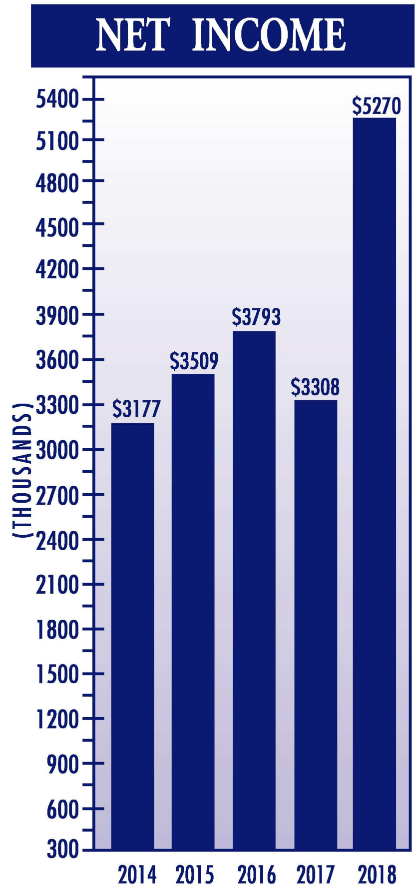
Backed by the full faith and credit of the United States government

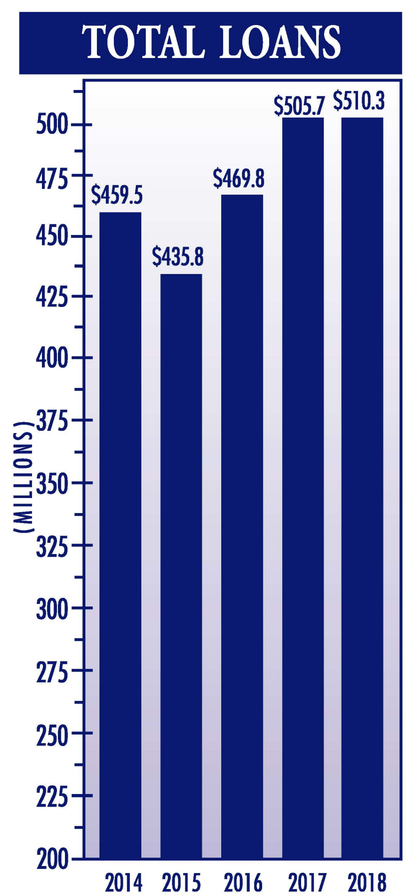
FDIC

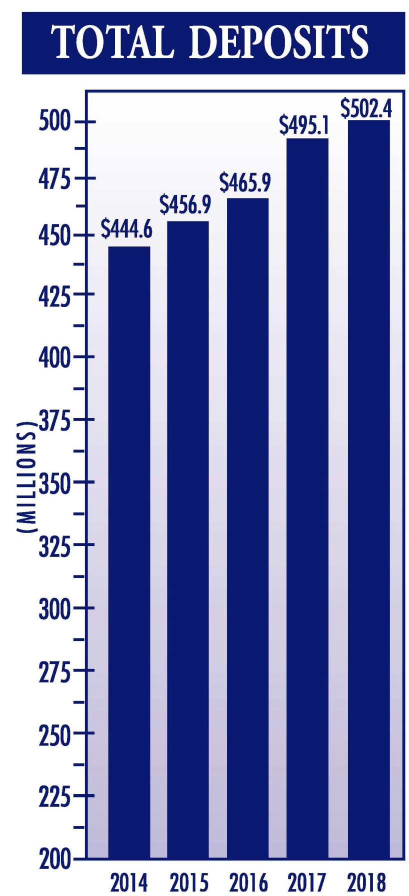
Federal Deposit Insurance Corporation · www.fdic.gov

HSB BANCORP, INC. & SUBSIDIARY
FIVE YEAR FINANCIAL HIGHLIGHTS









TO OUR STOCKHOLDERS:

2018 proved to be a banner year for HSB Bancorp, Inc. and its wholly-owned subsidiary, Hebron Savings Bank, as it marked the most profitable year in our 108-year history! Consolidated net income reached $5.3 million, up $2 million over last year's profit of $3.3 million, a 59% increase. Several factors contributed to the company's record-breaking earnings in 2018. Internally, the combined effect of loan growth and lower-cost deposits was a significant factor. Also, as our balance sheet was appropriately positioned for anticipated rising interest rates, we benefited greatly from the Federal Reserve's interest rate bumps throughout the year, effectively increasing the prime rate from 4.5% to 5.5% by year-end. Likewise, a stronger economy with higher real estate prices and lower unemployment rates helped to foster loan and deposit growth as well as lessen troubled loans. Lastly, our income taxes were substantially reduced this past year due to the 2017 Tax Cuts and Jobs Act, which universally lowered the federal corporate tax rate from 35% to 21%.

As you may recall, for the past few years, we have been intentionally limiting our asset growth in an effort to improve our tier 1 capital ratio, the primary indicator of a safe and sound financial institution. The two main components of this ratio are stockholders' equity (the numerator) and total assets (the denominator). Simply put, by growing stockholders' equity more than total assets, the capital ratio increases. In 2018, our assets increased $2.4 million, .4%, to $594.4 million. Stockholders' equity, due to the strong earnings, increased by $3.8 million, or 7.9%. The result was an improvement in the bank's tier 1 capital ratio, from 8.7% at December 31, 2017, to 9.4% at December 31, 2018, its highest level in more than thirty years. Although a bank with a ratio of 5% or greater is considered to be "well-capitalized", it is our strategic goal to increase this percentage to at least 10% by 2021 to further enhance the company's financial strength.

This past year, we were once again able to control asset growth by deploying existing cash reserves and investments, rather than soliciting expensive new deposits, to fund our loan growth of $5.6 million. Deposits also increased $7.3 million to $502 million at year-end. It is important to recognize that the majority of this increase was in our lower-cost checking and savings accounts. These core deposits increased $6.3 million, while our higher-cost certificate of deposit accounts increased only $1 million. We continue to be a major competitor in Wicomico, Dorchester, and Somerset Counties. As of the latest annual deposit market share report, dated June 30, 2018, we held the highest amount of customer deposits of any bank, large or small, in the three-county area. Out of the 14 community banks on the Eastern Shore, Hebron Savings Bank is the third largest in asset size, loans, deposits, and number of full-service branches.

We also made great strides in reducing our troubled loans in 2018. Nonaccrual loans, those impaired loans for which interest income is no longer being accrued, decreased from 2.7% of total loans at December 31, 2017, to 1.9% at December 31, 2018. Net loan charge-offs also declined from $1.7 million in 2017 to $1.4 million in 2018. Substandard loans, as a percentage of total loans, also improved from 4.3% to 3.8%, year over year.

Coinciding with the higher net income, stockholder dividends increased to $.80 per share, up $.15 over last year's $.65 per share, for a total payout of $1.3 million, another record in our company's history. Since 2002, we have consistently distributed at least 25% of our annual earnings to our stockholders, even during the turbulent years of the recession. The book value of the company's stock appreciated to $32.20 and earnings per share to $3.26 at December 31, 2018.

You can be proud to be a shareholder of HSB Bancorp, Inc. Financially, your stock holdings are a sound investment, with a strong book value and dividends yielding a generous return, but Hebron Savings Bank is so much more than that. As a local bank with a rich heritage, not only do we continue to provide excellent banking products and services to individuals, small businesses, nonprofits, and local governments, but we are also sincerely devoted to our communities, determined to make a difference in each of our branch areas. On behalf of the directors, officers, and employees, we appreciate your support and look forward to serving you in the many years to come.

Sincerely,

Donna K. Defino

Donna K. Defino, CPA, MBA
President & Chief Executive Officer

CONTENTS

Herbert J. Geary III
Corey N. Duncan
Roy J. Geiser
Chris A. Hall
Ronald W. Hickman
Charles M. Meenehan
Craig A. Walter
Mark A. Welsh

TGMGROUP LLC
CERTIFIED PUBLIC ACCOUNTANTS
www.tgmgroupllc.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
HSB Bancorp, Inc. & Subsidiary
Hebron, Maryland

We have audited the accompanying consolidated financial statements of HSB Bancorp, Inc. and subsidiary, which comprise the consolidated balance sheets as of December 31, 2018 and 2017, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

955 Mt. Hermon Road | Salisbury, MD 21804 | 410-742-1328 | 1-888-546-1574
114 Bay Street, Building A | PO Box 627 | Easton, MD 21601 | 410-822-4008

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HSB Bancorp, Inc. and subsidiary as of December 31, 2018 and 2017, 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.

TGM Group LLC

Salisbury, Maryland
January 31, 2019

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
December 31, 2018 and 2017

	2018	2017
ASSETS		
Cash and due from banks	**$ 9,915,616**	$ 9,320,615
Interest-bearing deposits in other banks	**10,204,095**	4,172,077
Securities held-to-maturity, at amortized cost -		
fair value 2018 $14,258,590; 2017 $16,206,461	**14,453,263**	16,182,751
Securities available-for-sale, at fair value	**16,582,880**	23,189,657
Loans, less allowance for credit losses		
2018 $8,700,000; 2017 $7,700,000	**510,286,871**	505,680,027
Accrued interest receivable on investment securities and loans	**1,585,735**	1,611,402
Bank premises and equipment, at cost,		
less accumulated depreciation	**11,777,336**	11,106,925
Federal Home Loan Bank stock, at cost	**2,024,800**	2,365,700
Common stock in the HSB Statutory Trust I	**93,000**	93,000
Net deferred income tax benefits	**2,787,527**	2,681,114
Other real estate owned	**733,705**	2,381,393
Cash value of life insurance	**12,308,652**	11,992,631
Other assets	**1,648,104**	1,262,096
Total assets	**$ 594,401,584**	$ 592,039,388
LIABILITIES		
Deposits:		
Non-interest bearing demand	**$ 142,841,012**	$ 133,546,874
NOW and Super NOW	**20,931,167**	21,576,577
Money market	**42,330,869**	43,870,001
Savings	**78,624,645**	79,415,089
Time, more than $250,000	**42,994,196**	38,343,777
Other time	**174,696,731**	178,396,631
	502,418,620	495,148,949
Accrued interest payable on deposits and borrowings	**520,604**	450,141
Short-term borrowings	**896,333**	3,496,033
Long-term borrowings	**33,703,548**	40,267,334
Junior subordinated debentures owed to unconsolidated		
subsidiary trust	**3,093,000**	3,093,000
Other liabilities	**1,695,764**	1,334,318
Total liabilities	**542,327,869**	543,789,775
COMMITMENTS		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01, authorized 10,000,000 shares,		
issued and outstanding 2018 1,546,630 and 2017 1,546,630 shares	**15,467**	15,467
Series A Preferred stock, par value $.01, authorized 2,000,000 shares,		
issued and outstanding 2018 70,439 and 2017 70,439 shares	**704**	704
Surplus	**6,201,001**	6,201,001
Retained earnings	**46,246,851**	42,231,477
Accumulated other comprehensive loss, net of deferred		
tax benefit 2018 $148,177; 2017 $129,651	**(390,308)**	(199,036)
Total stockholders' equity	**52,073,715**	48,249,613
Total liabilities and stockholders' equity	**$ 594,401,584**	$ 592,039,388

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2018 and 2017

		2018		2017
INTEREST INCOME ON				
Loans, including fees	**$**	**25,016,315**	$	23,361,751
Investment securities:				
Taxable		**703,268**		762,355
Exempt from Federal income tax		**227,183**		243,425
Federal funds sold		**978**		6,549
Deposits in other banks		**83,158**		64,978
		26,030,902		24,439,058
INTEREST EXPENSE ON				
Deposits		**3,642,074**		3,133,831
Borrowings		**963,073**		1,031,324
Junior subordinated debentures		**126,107**		95,377
		4,731,254		4,260,532
NET INTEREST INCOME		**21,299,648**		20,178,526
Provision for credit losses		**2,352,034**		2,159,639
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES		**18,947,614**		18,018,887
OTHER INCOME				
Service charges on deposit accounts		**1,290,747**		1,260,817
Earnings of investment in life insurance		**316,021**		294,803
Other		**846,758**		692,394
		2,453,526		2,248,014
OTHER EXPENSES				
Salaries and benefits		**8,431,719**		7,888,677
Occupancy		**2,113,276**		2,057,681
Losses on other real estate owned		**280,023**		100,773
Other expenses		**3,618,354**		3,534,484
		14,443,372		13,581,615
INCOME BEFORE TAXES ON INCOME		**6,957,768**		6,685,286
Federal and State income taxes		**1,687,944**		3,377,466
NET INCOME	**$**	**5,269,824**	$	3,307,820

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2018 and 2017

		2018		2017
NET INCOME	**$**	**5,269,824**	$	3,307,820
Other comprehensive (loss) gain, net of tax:				
Unrealized holding (loss) gain on securities available-for-sale arising during the period		**(209,798)**		1,513
Deferred income tax benefits (liabilities)		**57,731**		(597)
Other comprehensive (loss) income, net of tax		**(152,067)**		916
Total other comprehensive (loss) income		**(152,067)**		916
Comprehensive income	**$**	**5,117,757**	$	3,308,736

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2018 and 2017

	Common Stock	Series A Preferred Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, December 31, 2016	$ 15,467	$ 704	$ 6,201,001	$ 39,974,752	$ (199,952)	$ 45,991,972
Net income	-	-	-	3,307,820	-	3,307,820
Other comprehensive income, net of tax	-	-	-	-	916	916
Cash dividends paid, $.65 per share	-	-	-	(1,051,095)	-	(1,051,095)
Balances, December 31, 2017	15,467	704	6,201,001	42,231,477	(199,036)	48,249,613
Net income	**-**	**-**	**-**	**5,269,824**	**-**	**5,269,824**
Other comprehensive loss, net of tax	**-**	**-**	**-**	**-**	**(152,067)**	**(152,067)**
Cash dividends paid, $.80 per share	**-**	**-**	**-**	**(1,293,655)**	**-**	**(1,293,655)**
Reclassification adjustment for stranded income tax effects in accumulated other comprehensive income	**-**	**-**	**-**	**39,205**	**(39,205)**	**-**
Balances, December 31, 2018	**$ 15,467**	**$ 704**	**$ 6,201,001**	**$ 46,246,851**	**$ (390,308)**	**$ 52,073,715**

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 5,269,824**	$ 3,307,820
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses, net	**2,352,034**	2,159,639
Depreciation, amortization and accretion	**841,334**	921,313
Income on investment in life insurance	**(316,021)**	(294,803)
Losses on other real estate owned	**280,023**	100,773
Deferred income (benefits) taxes	**(87,887)**	847,518
Reclassification adjustment for stranded income tax effects in accumulated other comprehensive income	**39,205**	-
Changes in assets and liabilities:		
Decrease (increase) in accrued interest receivable	**25,667**	(115,472)
Decrease in deferred loan origination fees, net	**(41,962)**	(11,142)
Increase in other assets	**(386,008)**	(23,051)
Increase in accrued interest payable	**70,463**	16,505
Increase in other liabilities	**361,446**	64,787
Net cash provided by operating activities	**8,408,118**	6,973,887
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase available-for-sale investment securities	**(250,000)**	-
Proceeds from maturities and paydowns of held-to-maturity investment securities	**1,624,398**	473,123
Proceeds from maturities and paydowns of available-for-sale investment securities	**6,559,466**	4,194,388
Purchase of life insurance	**-**	(1,000,000)
Proceeds from sale of stock in Federal Home Loan Bank	**340,900**	141,300
Increase in loans, net	**(7,614,263)**	(39,721,503)
Proceeds from sale of other real estate owned	**2,065,012**	1,079,337
Purchase premises and equipment	**(1,319,142)**	(431,147)
Net cash provided (used) by investing activities	**1,406,371**	(35,264,502)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in demand, NOW, SUPER NOW, money market, and savings deposits, net	**6,319,152**	17,378,702
Increase in time deposits, net	**950,519**	11,843,490
Decrease in borrowings, net	**(9,163,486)**	(1,403,508)
Cash dividends paid	**(1,293,655)**	(1,051,095)
Net cash (used) provided by financing activities	**(3,187,470)**	26,767,589
Net increase (decrease) in cash and cash equivalents	**6,627,019**	(1,523,026)
Cash and cash equivalents, beginning	**13,492,692**	15,015,718
Cash and cash equivalents, ending	**$ 20,119,711**	$ 13,492,692

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

		2018		2017
SUPPLEMENTARY CASH FLOW INFORMATION				
Interest paid	**$**	**4,660,791**	$	4,244,027
Income taxes paid		**2,232,842**		2,807,275
Unrealized (depreciation) appreciation on securities available-for-sale		**(209,798)**		1,513
SUPPLEMENTARY NON-CASH INVESTING ACTIVITIES				
Loans converted to other real estate owned	**$**	**697,347**	$	1,703,703

The Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Its Significant Accounting Policies

Hebron Savings Bank provides financial services to individuals and corporate customers, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain Federal and State agencies and undergoes periodic examinations by those regulatory authorities. The accounting policies of the Bank conform, in all material respects, to U.S. generally accepted accounting principles and general practices within the banking industry.

Significant accounting policies not disclosed elsewhere in the consolidated financial statements are as follows:

Principles of Consolidation

The consolidated financial statements include the accounts of HSB Bancorp, Inc., (the "Company") and its wholly owned subsidiary, Hebron Savings Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated. The Parent Only financial information of the Company (see Note 18) accounts for the Bank using the equity method of accounting.

The Bank determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under accounting principles generally accepted in the United States. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIEs) are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interest, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company's wholly owned subsidiary, HSB Statutory Trust I is a VIE for which the Company is not the primary beneficiary. Accordingly, the accounts of this entity are not included in the Company's consolidated financial statements.

Use of Estimates

The preparation of the 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 the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Its Significant Accounting Policies (Continued)

Securities Held-to-Maturity

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using methods approximating the interest method over the periods to maturity. Securities transferred into held-to-maturity from the available-for-sale portfolio are recorded at fair value at time of transfer with unrealized gains or losses reflected in equity and amortized over the remaining life of the security.

Securities Available-for-Sale

Securities designated as available-for-sale are stated at estimated fair value as determined by quoted market prices. They represent those securities, which management may decide to sell as part of the Bank's asset/liability strategy, or that may be sold in response to changing interest rates or liquidity needs. Changes in unrealized appreciation (depreciation) on securities available-for-sale are reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. The gains and losses on securities sold are determined by the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Additionally, declines in the fair value of the individual investment securities below their cost that are other than temporary are reflected as realized losses in the consolidated statements of income.

Other Securities

Federal Home Loan Bank ("FHLB") stock is an equity interest in the FHLB, which does not have a readily determinable fair value for purposes of ASC Topic 320 Investments-Debts and Equity Securities because its ownership is restricted and it lacks a market. FHLB stock can be sold back only at its par value of $100 per share and only to the FHLB or another member institution.

Allowance for Credit Losses

Loans are generally carried at the amount of unpaid principal, adjusted for unearned loan fees, which are amortized over the term of the loan using the effective interest rate method. Interest on loans is accrued based on the principal amounts outstanding. It is the Bank's policy to discontinue the accrual of interest when a loan is specifically determined to be impaired or when principal or interest is delinquent for ninety days or more. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Cash collections on such loans are applied as reductions of the loan principal balance and no interest income is recognized on those loans until the principal balance has been collected. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. The carrying value of impaired loans is based on the present value of the loan's expected future cash flows or, alternatively, the observable market price of the loan or the fair value of the collateral.

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, the value of the underlying collateral, and current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions.

Note 1. The Company and Its Significant Accounting Policies (Continued)

Allowance for Credit Losses (Continued)

Determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least monthly and more often if deemed necessary.

The allowance for credit losses typically consists of an allocated component and an unallocated component. The allocated component of the allowance for credit losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on regular analyses of all loans over a fixed-dollar amount where the internal credit rating is at or below a predetermined classification. The historical loan loss element is determined statistically using an informal loss migration analysis that examines loss experience and the related internal grading of loans charged off over a current three year period. The loss migration analysis is performed quarterly and loss factors are updated regularly based on actual experience. The allocated component of the allowance for credit losses also includes consideration of concentrations and changes in portfolio mix and volume.

Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. In addition, the unallocated allowance includes a component that explicitly accounts for the inherent imprecision in loan loss migration models. The historical losses used in the migration analysis may not be representative of actual unrealized losses inherent in the portfolio. It is management's intent to continually refine the methodology for the allowance for credit losses in an attempt to directly allocate potential losses in the loan portfolio under ASC Topic 310 and minimize the unallocated portion of the allowance for credit losses.

Other Real Estate Owned (OREO)

OREO comprises properties acquired in partial or total satisfaction of problem loans. The properties are recorded at the lower of cost or fair value (appraised value) at the date acquired. Losses arising at the time of acquisition of such properties are charged against the allowance for credit losses. Subsequent write-downs and losses realized from the sale of OREO totaled **$280,023** and $100,773 for 2018 and 2017, respectively, and are included in other expenses. Expenses of operation are also included in other expenses as detailed in Note 11. Property acquired through foreclosure proceedings totaled **$733,705** and $2,381,393 at December 31, 2018 and 2017, respectively. The Bank financed sales of OREO totaling **$521,452** and $754,041 at December 31, 2018 and 2017, respectively. At December 31, 2018 and 2017, loans secured by residential real estate properties in process of foreclosure totaled approximately **$377,000** and $855,000, respectively.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is established through a provision for unfunded commitments charged to other expenses. The reserve is calculated by utilizing the same methodology and factors as the allowance for credit losses. The reserve, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

Note 1. The Company and Its Significant Accounting Policies (Continued)

Long-Lived Assets

The carrying value of long-lived assets and certain identifiable intangibles, including goodwill, is reviewed by the Bank for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as prescribed in ASC Topic 360 Property, Plant and Equipment. As of December 31, 2018, certain loans existed in which management considered impaired (See Note 4).

Premises, Equipment, and Depreciation

Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line and accelerated methods over the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Income Taxes

The provision for federal and state income taxes is based upon the results of operations, adjusted for tax exempt income. Deferred income taxes are provided under ASC Topic 740 Income Taxes by applying the enacted statutory tax rates to temporary differences between financial and taxable bases.

Temporary differences, which give rise to deferred tax benefits, relate principally to the allowance for credit losses, deferred subcontractor costs, OREO property, accrued vacation and net unrealized depreciation on securities available-for-sale.

Temporary differences, which give rise to deferred tax liabilities, relate principally to accumulated depreciation, unearned income on loans and net unrealized appreciation on securities available-for-sale.

Credit Risk

The Bank has deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC).

Cash and Cash Equivalents

The Bank has included cash and due from banks, Federal funds sold, and interest-bearing deposits in other banks with maturities less than three months as cash and cash equivalents for the purposes of reporting cash flows.

The Bank is required to maintain a non-interest bearing cash reserve at one of its correspondent banks against its corporate credit card account. Such reserve averaged approximately **$100,000** during the years ended December 31, 2018 and 2017.

Advertising Costs

The Bank expenses advertising costs for the period in which they are incurred. The Bank incurred advertising costs totaling **$90,559** and $68,357, for the years 2018 and 2017, respectively.

Financial Statement Presentation

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2. Debt and Equity Securities

Securities held-to-maturity are as follows:

	December 31, 2018			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Obligations of States and political subdivisions	**$ 14,452,012**	**$ 65,180**	**$ 259,869**	**$ 14,257,323**
Mortgage-backed securities and CMOs	**1,251**	**16**	**-**	**1,267**
	$ 14,453,263	**$ 65,196**	**$ 259,869**	**$ 14,258,590**

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of States and political subdivisions	$ 16,171,807	$ 184,487	$ 161,108	$ 16,195,186
Mortgage-backed securities and CMOs	10,944	331	-	11,275
	$ 16,182,751	$ 184,818	$ 161,108	$ 16,206,461

Securities available-for-sale are as follows:

	December 31, 2018			
	Amortized Cost	**Gross Unrealized Gains**	**Gross Unrealized Losses**	**Fair Value**
Obligations of U.S. Government agencies	**$ 900,965**	**$ -**	**$ 15,757**	**$ 885,208**
Mortgage-backed securities and CMOs	**12,970,399**	**4,031**	**449,941**	**12,524,489**
Mutual funds	**3,250,000**	**-**	**76,817**	**3,173,183**
	$ 17,121,364	**$ 4,031**	**$ 542,515**	**$ 16,582,880**

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. Government agencies	$ 4,632,510	$ 2,921	$ 18,182	$ 4,617,249
Mortgage-backed securities and CMOs	15,885,834	14,305	314,379	15,585,760
Mutual funds	3,000,000	-	13,352	2,986,648
	$ 23,518,344	$ 17,226	$ 345,913	$ 23,189,657

Note 2. Debt and Equity Securities (Continued)

The following is a summary of gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at December 31, 2018:

Securities held-to-maturity:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of States and political subdivisions	$ 1,342,436	$ 6,127	$ 7,172,591	$ 253,742	$ 8,515,027	$ 259,869
Mortgage-backed securities and CMOs	-	-	-	-	-	-
Total securities with unrealized losses	$ 1,342,436	$ 6,127	$ 7,172,591	$ 253,742	$ 8,515,027	$ 259,869

Securities available-for-sale:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Obligations of U.S. Government agencies	$ 391,675	$ 2,117	$ 486,175	$ 13,640	$ 877,850	$ 15,757
Mortgage-backed securities and CMOs	730,152	7,625	11,530,015	442,316	12,260,167	449,941
Mutual Funds	-	-	3,173,183	76,817	3,173,183	76,817
Total securities with unrealized losses	$ 1,121,827	$ 9,742	$ 15,189,373	$ 532,773	$ 16,311,200	$ 542,515

For individual securities classified as either available-for-sale or held-to-maturity, the Bank must determine whether a decline in fair value below the amortized cost basis is other than temporary. If the decline in fair value is considered to be other than temporary, the cost basis of the individual security shall be written down to the fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). At December 31, 2018, the Bank held 1 obligation of U.S. Government agencies, 50 Mortgage-backed securities and CMOs, 23 obligations of states and political subdivisions, and 1 Mutual fund having continuous unrealized loss positions for more than 12 months. Management has reviewed each investment and determined through various valuation methods that all unrealized loss positions as of December 31, 2018 are temporary unrealized losses relating primarily to changes in market interest rates over the yields available at the time the underlying securities were purchased and that none of the losses are due to reasons of credit quality.

In addition to the above analysis, management also believes it has the ability and intent to hold the securities classified as held-to-maturity until they mature, at which time management believes the Bank will receive full value for the securities. Management also feels it has the ability and intent to hold the securities classified as available-for-sale for a period of time sufficient for a recovery of cost and has no plans to sell securities that are currently in a loss position.

Note 2. Debt and Equity Securities (Continued)

Contractual maturities of investment securities at December 31, 2018 are shown below. Actual maturities may differ from contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have no stated maturity and primarily reflect investments in various Pass-through and Participation Certificates issued by the Federal National Mortgage Association and the Government National Mortgage Association. Repayment of mortgage-backed securities is affected by the contractual repayment terms of the underlying mortgages collateralizing these obligations and the current level of interest rates.

The following is a summary of maturities of securities held-to-maturity and available-for-sale:

	December 31, 2018			
	Securities Held-to-Maturity		Securities Available-for-Sale	
Amounts maturing:	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	$ 4,631,462	$ 4,645,837	$ 544,439	$ 530,740
After one year through five years	5,284,662	5,222,519	11,912,671	11,519,341
After five years through ten years	4,537,139	4,390,234	1,414,254	1,359,616
After ten years	-	-	-	-
Mutual funds	-	-	3,250,000	3,173,183
	$ 14,453,263	$ 14,258,590	$ 17,121,364	$ 16,582,880

The Bank has pledged certain debt securities as collateral for deposits of certain government agencies and municipalities. The carrying value of these securities totaled **$24,217,099** and $29,001,998 at December 31, 2018 and 2017, respectively.

Note 3. Bank Owned Life Insurance

The Bank has purchased life insurance contracts on certain senior officers and is the sole owner and primary beneficiary of the policies. Income from these contracts will be used to offset or recover increasing costs associated with employee benefits. Cash value totaled **$12,308,652** and $11,992,631 at December 31, 2018 and 2017, respectively.

Note 4. Loans and Allowances for Credit Losses

The Bank makes loans to customers primarily throughout the Lower Eastern Shore of the State of Maryland. The principal categories of the loan portfolio are as follows:

	2018	2017
Real estate loans:		
Construction	**$ 77,670,020**	$ 83,583,527
Residential Mortgages	**212,464,232**	214,149,279
Commercial Mortgages	**157,522,711**	149,136,208
	447,656,963	446,869,014
Commercial & industrial loans	**68,439,962**	64,098,635
Consumer loans	**2,889,946**	2,441,242
	518,986,871	513,408,891
Less: unearned income on loans	**-**	28,864
	518,986,871	513,380,027
Less: allowance for credit losses	**8,700,000**	7,700,000
	$ 510,286,871	$ 505,680,027

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: real estate loans, commercial and industrial loans, and consumer loans. Real estate loans are further divided into the following three classes: construction, land development, and other land loans ("construction"), residential mortgages, and commercial mortgages. Each of these segments are reviewed and analyzed quarterly using the average historical charge-offs over a current three year period for their respective segments as well as the following qualitative factors:

1. Changes in the levels and trends in delinquencies, nonaccruals, classified assets and troubled debt restructurings.
2. Changes in the nature and volume of the portfolio.
3. Effects of any changes in lending policies, procedures, including underwriting standards and collections, charge off and recovery practices.
4. Changes in the experience, depth and ability of management.
5. Changes in the national and local economic conditions and developments, including the condition of various market segments.
6. Changes in the concentration of credits within each pool.
7. Changes in the quality of the Bank's loan review system and the degree of oversight by the Board.
8. Changes in external factors such as competition and the legal environment.

The above factors result in a codified FASB ASC 450-10- 20 calculated reserve for environmental factors.

All credit exposures risk rated at "substandard" or "doubtful" with outstanding balances or "special mention" with outstanding balances greater than or equal to $250,000 are to be reviewed no less than quarterly for the purpose of determining if a specific allocation is needed for that credit. The establishment of a specific reserve does not necessarily mean that the credit with the specific reserve will definitely incur loss at the reserve level. It is only an estimation of potential loss based upon anticipated events. A specific reserve will not be established unless loss elements can be determined and quantified based on known facts. The total allowance reflects management's estimate of loan losses inherent in the loan portfolio as of December 31, 2018.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4. Loans and Allowances for Credit Losses (Continued)

The activity in the allowance for loan losses for 2018 and 2017 is as follows:

	December 31, 2018						
	Real Estate Loans			Commercial and Industrial	Consumer	Unallocated	Total
	Construction	Residential Mortgages	Commercial Mortgages				
Beginning Balance	$ 1,511,817	$ 3,713,048	$ 1,500,276	$ 778,030	$ 110,699	$ 86,130	$ 7,700,000
Charge-offs	(438,675)	(632,045)	(221,722)	(223,178)	(104,442)	-	(1,620,062)
Recoveries	69,442	21,189	153,471	6,227	17,699	-	268,028
Provision	264,213	867,844	333,107	716,626	163,711	6,533	2,352,034
Ending Balance	1,406,797	3,970,036	1,765,132	1,277,705	187,667	92,663	8,700,000
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	11,377,519	22,264,893	14,133,820	2,024,981	134,512	-	49,935,725
Balance in allowance	746,657	2,227,753	502,028	645,481	52,697	-	4,174,616
Collectively evaluated for impairment:							
Related loan balance	66,292,501	190,199,339	143,388,891	66,414,981	2,755,434	-	469,051,146
Balance in allowance	660,140	1,742,283	1,263,104	632,224	134,970	92,663	4,525,384
Total							
Related loan balance	77,670,020	212,464,232	157,522,711	68,439,962	2,889,946	-	518,986,871
Balance in allowance	1,406,797	3,970,036	1,765,132	1,277,705	187,667	92,663	8,700,000

	December 31, 2017						
	Real Estate Loans			Commercial and Industrial	Consumer	Unallocated	Total
	Construction	Residential Mortgages	Commercial Mortgages				
Beginning Balance	$ 1,155,469	$ 3,852,519	$ 1,273,347	$ 743,557	$ 185,079	$ 52,408	$ 7,262,379
Charge-offs	(299,900)	(614,130)	(635,805)	(85,131)	(169,608)	-	(1,804,574)
Recoveries	3,758	12,877	57,151	6,021	2,749	-	82,556
Provision	652,490	461,782	805,583	113,583	92,479	33,722	2,159,639
Ending Balance	1,511,817	3,713,048	1,500,276	778,030	110,699	86,130	7,700,000
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	10,678,661	23,073,272	17,072,934	1,886,317	49,773	-	52,760,957
Balance in allowance	712,947	2,113,087	414,791	240,007	15,753	-	3,496,585
Collectively evaluated for impairment:							
Related loan balance	72,904,866	191,076,007	132,063,274	62,212,318	2,391,469	-	460,647,934
Balance in allowance	798,870	1,599,961	1,085,485	538,023	94,946	86,130	4,203,415
Total							
Related loan balance	83,583,527	214,149,279	149,136,208	64,098,635	2,441,242	-	513,408,891
Balance in allowance	1,511,817	3,713,048	1,500,276	778,030	110,699	86,130	7,700,000

As of December 31, 2018 and 2017, the allowance for loan losses included an unallocated excess of **$92,663** and $86,130, respectively. Management is comfortable with these amounts as they feel the amounts are adequate to absorb additional inherent potential losses in the loan portfolio as further described in Note 1.

Note 4. Loans and Allowances for Credit Losses (Continued)

Following is an aging analysis by loan class and amount as of December 31, 2018 and 2017:

	December 31, 2018					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	**$ 406,479**	**$ 3,110,570**	**$ 1,846,269**	**$ 1,084,093**	**$ 33,830**	**$ 6,481,241**
Greater than 90 Days Past Due	**-**	**-**	**-**	**-**	**-**	**-**
Nonaccrual loans - non current	**2,406,181**	**4,905,092**	**1,414,268**	**492,918**	**-**	**9,218,459**
Total Past Due	**2,812,660**	**8,015,662**	**3,260,537**	**1,577,011**	**33,830**	**15,699,700**
Current nonaccrual loans	**-**	**474,538**	**-**	**-**	**-**	**474,538**
Current accrual loans	**74,857,360**	**203,974,032**	**154,262,174**	**66,862,951**	**2,856,116**	**502,812,633**
Total Loans	**$ 77,670,020**	**$ 212,464,232**	**$ 157,522,711**	**$ 68,439,962**	**$ 2,889,946**	**$ 518,986,871**

	December 31, 2017					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	$ 438,009	$ 3,342,682	$ 373,900	$ 58,663	$ 17,203	$ 4,230,457
Greater than 90 Days Past Due	-	-	-	-	-	-
Nonaccrual loans - non current	3,266,802	6,237,128	1,552,341	508,083	-	11,564,354
Total Past Due	3,704,811	9,579,810	1,926,241	566,746	17,203	15,794,811
Current nonaccrual loans	33,340	1,242,927	829,079	-	587	2,105,933
Current accrual loans	79,845,376	203,326,542	146,380,888	63,531,889	2,423,452	495,508,147
Total Loans	$ 83,583,527	$ 214,149,279	$ 149,136,208	$ 64,098,635	$ 2,441,242	$ 513,408,891

Note 4. Loans and Allowances for Credit Losses (Continued)

The Bank's policies, consistent with regulatory guidelines, provide for the classification of loans that are considered to be of lesser quality as special mention, substandard, or doubtful assets. Special mention is a warning or watch classification, which portrays one or more deficiencies in the credit quality of the borrower or the pledged collateral. Substandard loans include loans with a high loan-to-value ratio or credits that are unable to adjust due to unfavorable industry or economic conditions. Loans classified as doubtful are critical credits with an element of probable loss and insufficient collateral. The risk ratings are adjusted, as necessary, if loans become delinquent, if significant adverse information is discovered regarding the underlying credit, and if the normal periodic reviews of the underlying credits indicate that a change in risk rating is appropriate. A summary of the risk rating of loans receivable as of December 31, 2018 and 2017 is as follows:

	December 31, 2018					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Pass	**$ 65,905,178**	**$ 187,177,947**	**$ 142,247,150**	**$ 65,811,605**	**$ 2,768,716**	**$ 463,910,596**
Special Mention	**7,185,334**	**15,854,599**	**11,238,256**	**973,646**	**26,447**	**35,278,282**
Substandard	**4,579,508**	**9,431,686**	**4,037,305**	**1,654,711**	**94,783**	**19,797,993**
Doubtful	**-**	**-**	**-**	**-**	**-**	**-**
	$ 77,670,020	**$ 212,464,232**	**$ 157,522,711**	**$ 68,439,962**	**$ 2,889,946**	**$ 518,986,871**

	December 31, 2017					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Pass	$ 72,858,699	$ 187,300,326	$ 131,485,887	$ 61,409,136	$ 2,400,273	$ 455,454,321
Special Mention	5,566,029	15,841,433	13,453,850	861,017	38,239	35,760,568
Substandard	5,158,799	11,007,520	4,196,471	1,828,482	2,730	22,194,002
Doubtful	-	-	-	-	-	-
	$ 83,583,527	$ 214,149,279	$ 149,136,208	$ 64,098,635	$ 2,441,242	$ 513,408,891

Note 4. Loans and Allowances for Credit Losses (Continued)

Management considers a loan to be impaired when, based on current information and events, it is determined that the Bank will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the fair value of the collateral, less selling costs, or the present value of expected future cash flows, discounted at the loan's effective interest rate. If management determines that the value of the impaired loan is less than the carrying value of the loan, impairment is recognized through a reserve amount or charge-off to the allowance. The total allowance reflects management's estimate of loan losses inherent in the loan portfolio as of December 31, 2018.

Impaired loans, which include loans on non-accrual status, TDRs and other specifically identified loans, as of December 31, 2018 and 2017, are as follows:

	December 31, 2018					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Recorded Investment with a related allowance	**$ 8,164,074**	**$ 14,258,276**	**$ 5,824,578**	**$ 2,024,981**	**$ 134,512**	**$ 30,406,421**
Recorded Investment with no related allowance	**3,213,445**	**8,006,617**	**8,309,242**	**-**	**-**	**19,529,304**
Total Recorded Investment	**$ 11,377,519**	**$ 22,264,893**	**$ 14,133,820**	**$ 2,024,981**	**$ 134,512**	**$ 49,935,725**
Unpaid Principal Balance	**$ 12,577,059**	**$ 24,914,213**	**$ 14,420,292**	**$ 2,041,132**	**$ 134,512**	**$ 54,087,208**
Related Allowance	**746,657**	**2,227,753**	**502,028**	**645,481**	**52,697**	**4,174,616**
Average Recorded Investment	**11,151,065**	**22,440,476**	**14,250,442**	**1,867,037**	**90,778**	**49,799,798**
Interest Income Recognized	**420,409**	**908,144**	**589,286**	**70,225**	**2,820**	**1,990,884**

	December 31, 2017					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Recorded Investment with a related allowance	$ 8,008,815	$ 14,478,560	$ 7,845,368	$ 1,686,317	$ 49,773	$ 32,068,833
Recorded Investment with no related allowance	2,669,846	8,594,712	9,227,566	200,000	-	20,692,124
Total Recorded Investment	$ 10,678,661	$ 23,073,272	$ 17,072,934	$ 1,886,317	$ 49,773	$ 52,760,957
Unpaid Principal Balance	$ 12,546,810	$ 25,479,533	$ 17,440,692	$ 1,908,588	$ 49,773	$ 57,425,396
Related Allowance	712,947	2,113,087	414,791	240,007	15,753	3,496,585
Average Recorded Investment	10,257,028	23,306,512	14,617,916	1,615,857	46,600	49,843,913
Interest Income Recognized	360,749	951,034	667,381	79,851	1,920	2,060,935

Note 4. Loans and Allowances for Credit Losses (Continued)

The Bank generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loan reaches 90 days past due. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income, and future payments are applied to principal. Loans are returned to accrual status when the borrower makes at least six regularly scheduled payments and the collectability is no longer doubtful. The Bank classifies loans on nonaccrual status as impaired. Information regarding these loans as of December 31, 2018 and 2017 is summarized as follows:

	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
December 31, 2018	**$ 2,406,181**	**$ 5,379,630**	**$ 1,414,268**	**$ 492,918**	**$ -**	**$ 9,692,997**
December 31, 2017	$ 3,300,142	$ 7,480,055	$ 2,381,420	$ 508,083	$ 587	$ 13,670,287

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a Troubled Debt Restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal or interest forgiveness, or other actions intended to minimize the loss and to avoid foreclosure or repossession of the collateral. For TDRs with interest rates modified below market, the “specific” valuation allowance amounts were determined by comparing the discounted future expected present value of cash flows under the modified agreements against the carrying value of the original loan and a separate reserve in the allowance for loan losses has been established and identified as for TDRs. TDRs with principal reductions are individually evaluated for impairment and have been charged off to their net realizable value through the allowance for loan losses.

The following table includes the recorded investment and number of modifications for TDRs. The Bank reports the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured.

	December 31, 2018					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Number of modifications	**6**	**69**	**7**	**3**	**7**	**92**
Recorded investment prior to modification	**$ 4,340,635**	**$ 15,864,981**	**$ 3,841,882**	**$ 170,016**	**$ 153,429**	**$ 24,370,943**
Recorded investment after modification	**$ 2,225,949**	**$ 12,246,608**	**$ 3,365,223**	**$ 148,018**	**$ 134,512**	**$ 18,120,310**

	December 31, 2017					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Number of modifications	13	76	12	3	3	107
Recorded investment prior to modification	$ 8,616,696	$ 16,850,311	$ 6,357,945	$ 105,256	$ 55,762	$ 31,985,970
Recorded investment after modification	$ 5,329,535	$ 13,871,230	$ 5,754,965	$ 96,821	$ 47,043	$ 25,099,594

Note 4. Loans and Allowances for Credit Losses (Continued)

TDRs, included in impaired loans, which are not performing as agreed in the current reporting period, are as follows:

	December 31, 2018					
	Real Estate Loans			Commercial		
		Residential	Commercial	and		
	Construction	Mortgages	Mortgages	Industrial	Consumer	Total
Number of modifications	**3**	**23**	**3**	**1**	**-**	**30**
Recorded investment	**$ 1,848,137**	**$ 3,001,551**	**$ 1,063,255**	**$ 37,749**	**$ -**	**$ 5,950,692**

	December 31, 2017					
	Real Estate Loans			Commercial		
		Residential	Commercial	and		
	Construction	Mortgages	Mortgages	Industrial	Consumer	Total
Number of modifications	3	39	4	-	-	46
Recorded investment	$ 2,461,923	$ 4,293,928	$ 1,205,550	$ -	$ -	$ 7,961,401

Troubled debt restructurings (TDRs) with a commitment to lend additional funds were **$0** at December 31, 2018 and 2017.

In the normal course of banking business, loans are made to senior officers and directors and their affiliated interests. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than the normal risk of collectability.

Loans to senior officers, directors, and their affiliates at December 31, 2018 and 2017 are summarized as follows:

	2018	2017
Loans, beginning	**$ 13,942,000**	$ 12,088,000
Additions	**6,408,000**	8,059,000
Repayments/eliminations	**(4,721,000)**	(6,205,000)
Loans, ending	**$ 15,629,000**	$ 13,942,000

Outstanding loan commitments and unused lines and letters of credit were approximately as follows:

	2018	2017
Loan commitments, including approved loans and unused lines of credit	**$ 109,783,000**	$ 90,817,000
Letters of credit	**6,173,000**	5,540,000

Note 4. Loans and Allowances for Credit Losses (Continued)

Loan commitments and lines of credit are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Many of the loan commitments and lines of credit are expected to expire without being drawn upon; accordingly, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral or other security obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, accounts receivable, inventory, property and equipment, personal residences, income-producing commercial properties, and land under development. Personal guarantees are also obtained to provide added security for certain commitments.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank has accrued credit losses of **$300,000** and $250,000, related to these financial instruments with off-balance sheet risk in other liabilities at December 31, 2018 and 2017, respectively.

Note 5. Premises, Equipment, and Depreciation

Bank premises and equipment are as follows:

	December 31, 2018		
	Cost	**Accumulated Depreciation**	**Net**
Land	**$ 4,551,538**	**$ -**	**$ 4,551,538**
Buildings and land improvements	**9,121,138**	**3,088,036**	**6,033,102**
Furniture and equipment	**8,088,015**	**6,895,319**	**1,192,696**
	$ 21,760,691	**$ 9,983,355**	**$ 11,777,336**

	December 31, 2017		
	Cost	Accumulated Depreciation	Net
Land	$ 4,549,738	$ -	$ 4,549,738
Buildings and land improvements	8,128,307	2,927,549	5,200,758
Furniture and equipment	7,894,358	6,537,929	1,356,429
	$ 20,572,403	$ 9,465,478	$ 11,106,925

The Bank has entered into a construction contract with an unrelated party for the expansion of its main headquarters located in Hebron, Maryland. The total contract value as of December 31, 2018 was **$1,281,273** (including change orders) of which **$1,051,802** was paid and included in buildings and land improvements at December 31, 2018.

Depreciation expense totaled **$648,731** and $677,636 for the years ended December 31, 2018 and 2017, respectively.

Note 6. Income Taxes

Components of income tax expense for the years ended December 31, 2018 and 2017 are as follows:

		2018		2017
Currently payable				
Federal	$	**1,213,410**	$	1,993,092
State		**523,215**		536,856
Total current		**1,736,625**		2,529,948
Deferred income (benefits) taxes				
Federal		**(22,331)**		901,566
State		**(26,350)**		(54,048)
Total deferred		**(48,681)**		847,518
	$	**1,687,944**	$	3,377,466

A reconciliation of tax computed at the respective federal statutory tax rate of 21% for the year ended December 31, 2018 and 34% for the year ended December 31, 2017 to the actual tax expense is as follows:

		2018		2017
Tax at federal statutory rate	$	**1,461,131**	$	2,272,998
Tax effect of:				
Tax exempt income		**(211,607)**		(331,238)
One-time adjustment to deferred tax asset due to the Tax Cuts and Jobs Act		**-**		1,105,935
Reclassification adjustment for stranded income tax effects in accumulated other comprehensive income		**39,205**		-
Other		**6,725**		16,534
State income taxes, net of federal benefit		**392,490**		313,237
	$	**1,687,944**	$	3,377,466

Income taxes included in other assets on the balance sheets are as follows:

		2018		2017
Federal income tax refund claims	$	**437,057**	$	200,467
State income tax refund claims		**59,354**		82,569
Deferred tax benefits:				
Allowance for credit losses	$	**2,394,022**	$	2,118,847
Deferred subcontractor costs		**36,707**		74,208
OREO property		**211,772**		361,962
Accrued vacation		**118,374**		103,017
Net unrealized depreciation on securities available-for-sale		**148,177**		129,651
		2,909,052		2,787,685
Deferred tax liabilities:				
Accumulated depreciation		**106,523**		101,043
Unearned income on loans		**15,002**		5,528
		121,525		106,571
Net deferred income tax benefits	$	**2,787,527**	$	2,681,114

Note 6. Income Taxes (Continued)

On December 22, 2017 the Tax Cuts and Jobs Act was signed into law which, among other items, reduced the corporate tax rate from a graduated set of rates with a maximum of 35% to a flat 21% beginning with taxable years starting after December 31, 2017. As required under ASC Topic 740, the Bank re-measured its deferred income tax assets and liabilities for temporary differences from the then current corporate tax rate to the new corporate tax rate of 21% as of December 31, 2017. The cumulative adjustment, which totaled $1,105,935, was recognized in income tax expense from continuing operations as a discrete item in the period that included the enactment date, December 31, 2017. Beginning in 2018 the Company's new federal statutory tax rate was 21%.

In February 2018, FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The amendments in this ASU allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The ASU did not have any impact on the underlying ASC Topic 740 guidance that requires the effect of a change in tax law be included in income from continuing operations. The amendments in this ASU were effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption was permitted and would be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act was recognized. The Company adopted the guidance in the ASU in its December 31, 2018 consolidated financial statements resulting in a reclassification of $39,205 of stranded tax effects related to net unrealized losses on investment securities. The amount of the reclassification was the difference between the 34% historical corporate tax rate and the new 21% corporate tax rate.

Management has determined that no valuation allowance is required as it believes it is more likely than not that all of the deferred tax assets will be fully realizable in the future. At December 31, 2018 and 2017, management believes there are no uncertain tax positions under ASC Topic 740 Income Taxes. The Bank's federal and state income tax returns for 2015, 2016, and 2017 are subject to examination by the IRS and/or state tax authorities, generally for three years after they were filed. The 2018 income returns will be filed in 2019.

Note 7. Junior Subordinated Debentures owed to Unconsolidated Subsidiary Trust

The Company sponsored a trust, HSB Statutory Trust I, of which 100% of the common equity is owned by the Company. Trust I was formed for the purpose of issuing Company-obligated mandatorily redeemable capital securities (the capital securities) to third-party investors and investing the proceeds from the sale of such capital securities solely in junior subordinated debt securities of the Company (the debentures). The debentures held by the trust are the sole assets of that trust. Trust I is a variable interest entity (VIE), however, since the Company is not the primary beneficiary of this arrangement, the accounts of this entity are not included in the consolidated financial statements. Distributions on the capital securities issued by the trust are payable quarterly at a 5.95% rate per annum for 5 years until June 2010, then floating at the 3-month LIBOR plus 1.85% thereafter. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of each of the guarantees. Both the capital securities of the statutory trust and the junior subordinated debentures are scheduled to mature on June 2035, unless called by the Company.

Despite the fact that HSB Statutory Trust I is not included in the Company's consolidated financial statements, the trust preferred securities issued by these subsidiary trusts are included in the Tier 1 capital of the Company for regulatory capital purposes. Federal Reserve Board rules limit the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier 1 capital of most bank holding companies to 25% of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The current quantitative limits do not preclude the Company from including the $3.0 million in trust preferred securities outstanding in Tier 1 capital.

Note 8. Deposits

Time deposits and their remaining maturities at December 31, 2018 are approximately as follows:

2019	$	83,003,000
2020		41,493,000
2021		31,545,000
2022		34,218,000
2023 and thereafter		27,432,000
	$	217,691,000

Interest expense on deposits for the years ended December 31, 2018 and 2017 is as follows:

		2018		2017
NOW, Super NOW and money market	**$**	**138,265**	$	111,891
Savings		**104,658**		100,182
Time, more than $250,000		**670,972**		493,423
Other time		**2,728,179**		2,428,335
	$	**3,642,074**	$	3,133,831

Deposit balances of senior officers and directors and their affiliated interests totaled **$14,575,383** and $17,179,186 at December 31, 2018 and 2017, respectively.

Overdraft deposit balances, included in loans, totaled **$104,539** and $139,570 at December 31, 2018 and 2017, respectively.

Note 9. Benefit Plans

The Bank has a 401(k) profit sharing plan covering substantially all full-time employees. The plan requires the Bank to match employee contributions up to 5% of compensation, as defined under the plan, and permits additional contributions at the discretion of management.

Expense under this plan totaled **$214,426** and $210,945 for the years ended December 31, 2018 and 2017, respectively.

Note 10. Lease Commitments

The Bank leases one of its branch facilities under an operating lease which expires in 2021, with two 5-year renewal options. The Bank also leases the land on which one of the Bank's branch facilities resides under an operating lease through 2022, with eight 5-year renewal options. The Bank also leases a portion of a parking lot at one of its branch facilities under an operating lease through 2019, with one 3-year renewal option. The Bank also leases a portion of a parking lot adjacent to one of its branch facilities under an operating lease through 2019.

Minimum lease commitments for the next five years are approximately as follows:

2019	$	82,000
2020		74,000
2021		43,000
2022		32,000
2023		-

Rent expense under these arrangements totaled **$87,714** and $85,770 for the years ended December 31, 2018 and 2017, respectively.

Note 11. Other Operating Expenses

Other operating expenses include the following:

	2018	2017
Advertising and marketing	$ **121,674**	$ 110,811
ATM and debit card processing	**508,358**	403,914
Bank service charges	**89,487**	88,450
Courier and travel	**173,306**	164,838
Data processing outsourced	**261,601**	229,405
Directors' fees	**286,067**	246,037
Donations	**78,661**	77,554
Dues and subscriptions	**84,990**	76,845
FDIC and Maryland assessments	**530,275**	551,561
Insurance	**110,222**	112,326
Loan collection and OREO operating	**198,511**	409,676
Long and short	**32,805**	22,763
Postage	**167,148**	153,725
Professional services	**314,044**	308,147
Seminars	**34,510**	29,546
Stationery, printing, and supplies	**324,344**	272,707
Telephone	**252,351**	238,595
Provision for unfunded commitments	**50,000**	37,584
	$ **3,618,354**	$ 3,534,484

Note 12. Borrowings and Credit Facilities

The Bank has borrowings from the FHLB totaling **$34,599,881** and $43,763,367 at December 31, 2018 and 2017, respectively, with fixed and variable interest rates ranging from 1.29% to 5.94%, maturing at various dates through August 2038. Based on lendable collateral value, the Bank has available for future borrowings approximately **$57,000,000** and $46,000,000 at December 31, 2018 and 2017, respectively. The Bank has pledged approximately **$122,000,000** and $118,000,000 at December 31, 2018 and 2017, respectively, of its wholly owned residential (1-4 units) first mortgage loan portfolio, as collateral for this credit facility. The Bank has purchased stock of the FHLB as a condition for obtaining a credit facility from the FHLB.

At December 31, 2018, the scheduled maturities of borrowings are approximately as follows:

2019	$ 896,000
2020	307,000
2021	3,064,000
2022	11,250,000
2023	3,801,000
2024 and thereafter	15,282,000
	$ 34,600,000

Additionally, the Bank has unsecured credit availability of $10,000,000 with one correspondent bank and secured credit availability of $8,000,000 with another correspondent bank for short-term liquidity needs, if necessary. The secured credit facility must be collateralized with securities at the time of usage. At December 31, 2018 and 2017, there were no borrowings outstanding under any of the credit facilities. At December 31, 2018, securities pledged under the secured credit facility had an amortized cost and fair value of **$245,712** and **$235,190**, respectively. At December 31, 2017, securities pledged under the secured credit facilities had an amortized cost and fair value of $1,299,820 and $1,291,011, respectively.

Note 13. Regulatory Capital Requirements

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

The Common Equity Tier 1, Tier 1 and Total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, with certain exclusions, allocated by risk weight category, and certain off-balance-sheet items, among other things. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets, among other things.

When fully phased in on January 1, 2019, the Basel III Capital Rules will require the Company and Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% Common Equity Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0% upon full implementation), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio as that buffer is phased in, effectively resulting in a minimum Tier 1 capital ratio of 8.5% upon full implementation), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% Total capital ratio as that buffer is phased in, effectively resulting in a minimum Total capital ratio of 10.5% upon full implementation) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and will be phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reaches 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company or Bank. The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

Management believes, as of December 31, 2018 and 2017, that the Company and Bank meet all capital adequacy requirements to which it is subject. The most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum Common Equity Tier 1, Tier 1 and Total capital to risk-weighted assets and Tier I leverage ratios. There have been no conditions or events since that notification that management believes have changed the Bank's category.

As discussed in Note 7, the capital securities held by the HSB Statutory Trust I qualifies as Tier 1 capital for the Company under Federal Reserve Board guidelines.

Note 13. Regulatory Capital Requirements (Continued)

A comparison of capital as of December 31, 2018 and 2017 for the Company and Bank is presented below. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2018 and December 31, 2017, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

As of December 31, 2018	**Actual**		**For Minimum Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)						
Company	**$ 62,063,000**	**11.7%**	**$ 52,338,000**	**9.9%**	**$ -**	**N/A**
Bank	**61,987,000**	**11.7%**	**52,318,000**	**9.9%**	**52,980,000**	**10.0%**
Tier I Capital (to Risk-Weighted Assets)						
Company	**55,408,000**	**10.5%**	**41,755,000**	**7.9%**	**-**	**N/A**
Bank	**55,333,000**	**10.4%**	**41,738,000**	**7.9%**	**42,401,000**	**8.0%**
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	**52,408,000**	**9.9%**	**33,782,000**	**6.4%**	**-**	**N/A**
Bank	**55,333,000**	**10.4%**	**33,788,000**	**6.4%**	**34,451,000**	**6.5%**
Tier I Capital (to Average Assets)						
Company	**55,408,000**	**9.4%**	**23,653,000**	**4.0%**	**-**	**N/A**
Bank	**55,333,000**	**9.4%**	**23,647,000**	**4.0%**	**29,558,000**	**5.0%**

As of December 31, 2017						
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)						
Company	$ 58,029,000	11.0%	$ 48,664,000	9.3%	$ -	N/A
Bank	57,963,000	11.0%	48,653,000	9.3%	52,598,000	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Company	51,435,000	9.8%	38,129,000	7.3%	-	N/A
Bank	51,370,000	9.8%	38,159,000	7.3%	42,107,000	8.0%
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	48,435,000	9.2%	30,272,000	5.8%	-	N/A
Bank	51,370,000	9.8%	30,264,000	5.8%	34,212,000	6.5%
Tier I Capital (to Average Assets)						
Company	51,435,000	8.7%	23,594,000	4.0%	-	N/A
Bank	51,370,000	8.7%	23,591,000	4.0%	29,489,000	5.0%

According to FDIC capital guidelines, the Bank is considered to be “Well Capitalized.”

Note 13. Regulatory Capital Requirements (Continued)

Under Maryland banking law, the Board of Directors may declare cash dividends from undivided profits after providing for expenses, losses, interest and taxes accrued or due.

Note 14. Issuance of Preferred Stock

On October 15, 2008, the Company issued Series A Preferred Stock to all Common stockholders with less than 1,000 shares on a one-for-one basis. No dividends or distributions will be given to Common stockholders unless the Series A Preferred stockholders receive at least an equal amount. Dividends on the Series A Preferred Stock are not cumulative and no rights accrue. Series A Preferred Stock are not entitled to vote, they are not convertible into or exchangeable for any other class of stock and are entitled to receive any liquidation amount, prior to payment to Common stockholders. Except as noted above, all pertinent rights and privileges of the Series A Preferred Stock are the same as the Common Stock.

Note 15. Fair Values of Financial Instruments

Disclosure about Fair Value of Financial Instruments (“ASC Topic 825") requires the disclosure of the estimated fair values of financial instruments. Quoted market prices, where available, are shown as estimates of fair values. Because no quoted market prices are available for a significant part of the Company’s financial instruments, the fair values of such instruments have been derived based on the amount and timing of future cash flows and estimated discount rates.

Present value techniques used in estimating the fair value of many of the Company’s financial instruments are significantly affected by the assumptions used. Fair values derived from using present value techniques are not substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

ASC Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Note 15. Fair Values of Financial Instruments (Continued)

The following table shows the estimated fair values and the related carrying values of the Bank's financial instruments at December 31, 2018 and 2017. Items that are not financial instruments are not included.

	2018		2017	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	**$ 9,915,616**	**$ 9,915,616**	$ 9,320,615	$ 9,320,615
Interest-bearing deposits in other banks	**10,204,095**	**10,204,095**	4,172,077	4,172,077
Securities held-to-maturity	**14,453,263**	**14,258,590**	16,182,751	16,206,461
Securities available-for-sale	**16,582,880**	**16,582,880**	23,189,657	23,189,657
Loans, net of allowance for credit losses	**510,286,871**	**516,690,869**	505,680,027	514,412,027
Accrued interest receivable	**1,585,735**	**1,585,735**	1,611,402	1,611,402
Federal Home Loan Bank stock	**2,024,800**	**2,024,800**	2,365,700	2,365,700
Common stock-Statutory Trust I	**93,000**	**93,000**	93,000	93,000
Cash value of life insurance	**12,308,652**	**12,308,652**	11,992,631	11,992,631
Financial liabilities:				
Deposits	**$ 502,418,620**	**$ 486,883,632**	$ 495,148,949	$ 492,860,949
Accrued interest payable	**520,604**	**520,604**	450,141	450,141
Short-term borrowings	**896,333**	**896,333**	3,496,033	3,496,033
Long-term borrowings	**33,703,548**	**33,620,549**	40,267,334	39,306,326
Junior subordinated debentures owed to unconsolidated subsidiary trust	**3,093,000**	**1,868,252**	3,093,000	1,478,713
Unrecognized financial instruments:				
Commitments to extend credit	**109,783,000**	**109,783,000**	90,817,000	90,817,000
Standby letters of credit	**6,173,000**	**6,173,000**	5,540,000	5,540,000

For purposes of the above disclosures of estimated fair value, the following assumptions were used:

Cash and cash equivalents

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds sold is considered to approximate cost because of their short-term nature.

Investment Securities

Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. See Note 16 for further discussion.

Note 15. Fair Values of Financial Instruments (Continued)

Loans

The estimated fair value for certain homogeneous categories of loans, such as residential mortgages, is based on the quoted market price for securities backed by similar loans, adjusted for differences in loan characteristics. The estimated fair value of other loans is determined by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits

The estimated fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, NOW and super NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the rates currently offered for deposits of similar maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Borrowings

The estimated fair value approximates carrying value for short-term borrowings. The fair value of long-term fixed rate borrowings is estimated by discounting future cash flows using current interest rates currently offered for similar financial instruments.

Junior Subordinated Debentures

Fair value is usually estimated based on quoted market prices of similar instruments. If quoted market prices are not available the fair value is determined by using the discounted value of expected cash flows using market rates.

Other Assets and Liabilities

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds sold is considered to approximate cost because of their short-term nature.

Other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. Also, non-financial instruments typically not recognized in the financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

The following table presents the carrying amount, fair value, and placement in the fair value hierarchy of the Bank's financial instruments not disclosed elsewhere as of December 31, 2018. This table excludes financial instruments for which the carrying amount approximates fair value.

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Loans, net	$ 510,286,871	$ 516,690,869	$ -	$ 516,690,869	$ -
Financial Liabilities:					
Deposits	502,418,620	486,883,632	271,174,709	215,708,923	-
Long-term borrowings	33,703,548	33,620,549	-	33,620,549	-
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	1,868,252	-	1,868,252	-

Note 16. Fair Value Measurements

ASC Topic 820 Fair Value Measurements and Disclosures provides a framework for measuring and disclosing fair value under generally accepted accounting principles. ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans and OREO).

ASC Topic 820 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. ASC Topic 820 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 standard describes three levels of inputs that may be used to measure fair value.

Fair Value Hierarchy

Level 1 – Quoted prices in active markets for identical assets or liabilities
Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities)
Level 3 – Significant unobservable inputs (including the Bank's own assumptions in determining the fair value of assets or liabilities)

In determining the appropriate levels, the Bank performs a detailed analysis of assets and liabilities that are subject to ASC Topic 820.

The following table presents fair value measurements on a recurring basis as of December 31, 2018:

	Level 1	Level 2	Level 3	Fair Value
Securities available-for-sale:				
Obligations of U.S. Government agencies	$ -	$ 885,208	$ -	$ 885,208
Mortgage-backed securities and CMOs	-	12,524,489	-	12,524,489
Mutual funds	-	3,173,183	-	3,173,183
Total	$ -	$ 16,582,880	$ -	$ 16,582,880

Level 1 securities are based on quoted market prices. When quoted market prices are not available, Level 2 securities are based on the data provider's logic matrix table for quoted market prices of comparable instruments. Level 3 securities are valued by default matrix pricing. The Company obtains fair value measurements from an independent pricing service.

The Bank had no significant transfers of available-for-sale securities in which the fair value measurements are valued on a recurring basis between Level 1 and Level 2 during the period ending December 31, 2018.

The Bank may also be required, from time to time, to measure certain other financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP. The following table presents fair value measurements on a non-recurring basis as of December 31, 2018:

	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ -	$ -	$ 45,758,109	$ 45,758,109
OREO	-	733,705	-	733,705
Total	$ -	$ 733,705	$ 45,758,109	$ 46,491,814

Note 16. Fair Value Measurements (Continued)

The Bank is predominantly a cash flow lender with real estate serving as collateral on a majority of loans. In accordance with ASC Topic 310 Receivables, loans which the Bank has deemed to be impaired financial assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Bank determines such fair values from independent appraisals. When appropriate, management may also reduce the independent appraised value based on the current listing price of real estate for sale, prior experience in selling similar real estate or other factors not considered in the independent appraisal. In addition, on non-collateral dependent TDRs the impairment is measured as the present value of expected future cash flows discounted at the loan's original effective interest rate. All impaired loans are classified as Level 3 inputs.

Non-Financial Assets and Non-Financial Liabilities:

Application of ASC Topic 820 to non-financial assets and non-financial liabilities became effective January 1, 2009. The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets and non-financial liabilities typically measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment.

In accordance with ASC Topic 360 Property, Plant and Equipment, foreclosed real estate (OREO) was adjusted to their fair values, resulting in an impairment charge, which was included in earnings for the year. Foreclosed real estate, which are considered to be non-financial assets, have been valued using a market approach. The values were determined using current market prices of similar real estate assets, less costs to sell, which the Bank considers to be Level 2 inputs.

Note 17. Date of Management's Review

In preparing the financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through January 31, 2019, the date that the financial statements were available to be issued.

Note 18. Parent Company Financial Information

Comparative Balance Sheets, Statements of Income, and Statements of Cash Flows for HSB Bancorp, Inc. (Parent Only) are presented below:

BALANCE SHEETS
December 31, 2018 and 2017

		2018		2017
ASSETS				
Cash and due from banks	**$**	**52,085**	$	31,380
Investment in Bank		**54,997,947**		51,183,757
Investment in the HSB Statutory Trust I		**93,000**		93,000
Other assets		**29,660**		38,907
Total assets	**$**	**55,172,692**	$	51,347,044
LIABILITIES				
Borrowed funds from subsidiary	**$**	**3,093,000**	$	3,093,000
Accrued interest payable on borrowed funds		**5,977**		4,431
Total liabilities		**3,098,977**		3,097,431
STOCKHOLDERS' EQUITY				
Common stock		**15,467**		15,467
Series A Preferred stock		**704**		704
Surplus		**6,201,001**		6,201,001
Retained earnings		**46,246,851**		42,231,477
Accumulated other comprehensive loss		**(390,308)**		(199,036)
Total stockholders' equity		**52,073,715**		48,249,613
Total liabilities and stockholders' equity	**$**	**55,172,692**	$	51,347,044

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18. Parent Company Financial Information (Continued)

The borrowed funds from subsidiary balance represent the junior subordinated debt securities payable to the wholly owned subsidiary trust that was deconsolidated as a result of applying the provisions of FIN 46. The Company continues to guarantee the capital securities issued by the trust, which totaled **$3,000,000** at December 31, 2018 (see Note 7 for further discussions on FIN 46R).

STATEMENTS OF INCOME
Years Ended December 31, 2018 and 2017

		2018		2017
Dividend income from bank	**$**	**1,414,472**	$	1,142,824
Undistributed net income of bank		**3,966,256**		2,240,264
Other operating income		**3,793**		2,868
Other operating expenses		**(144,177)**		(116,910)
Income before taxes		**5,240,344**		3,269,046
Income tax benefits (*)		**(29,480)**		(38,774)
NET INCOME	**$**	**5,269,824**	$	3,307,820

(*) Benefits from filing a consolidated federal income tax return.

STATEMENTS OF CASH FLOWS
Years Ended December 31, 2018 and 2017

		2018		2017
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	**$**	**5,269,824**	$	3,307,820
Adjustments to reconcile net income to net cash provided by operating activities:				
Equity in undistributed net income of subsidiary		**(3,966,256)**		(2,240,264)
Changes in assets or liabilities:				
Decrease (increase) in other assets		**9,247**		(6,888)
Increase in liabilities		**1,545**		804
Net cash provided by operating activities		**1,314,360**		1,061,472
CASH FLOWS FROM FINANCING ACTIVITIES				
Dividends paid		**(1,293,655)**		(1,051,095)
Net cash used in financing activities		**(1,293,655)**		(1,051,095)
Net increase in cash		**20,705**		10,377
Cash, beginning of year		**31,380**		21,003
Cash, end of year	**$**	**52,085**	$	31,380

OFFICERS & DIRECTORS

OFFICERS – HSB BANCORP, INC.

DONNA K. DEFINO, CPA, MBA, President
KIMBERLY T. THOMAS, CPA, Vice-President & Secretary/Treasurer
CATHY D. BRINSFIELD, Vice-President & Assistant Secretary
W. TRENT PUSEY, Vice-President
ELLEN P. VANDERGRIFT, Vice-President

SENIOR OFFICERS – HEBRON SAVINGS BANK

DONNA K. DEFINO, CPA, MBA, President & Chief Executive Officer
CATHY D. BRINSFIELD, Executive Vice-President & Chief Operating Officer
W. TRENT PUSEY, Executive Vice-President & Chief Lending Officer
KIMBERLY T. THOMAS, CPA, Executive Vice President & Chief Financial Officer
RONALD T. EVANS, Senior Vice-President & Chief Credit Officer
ELLEN P. VANDEGRIFT, Senior Vice-President & Chief Retail Lending Officer

DIRECTORS – HSB BANCORP, INC. & HEBRON SAVINGS BANK

CHARLES R. SMITH, III, Chairman of the Board
MARK S. HOLLOWAY
ROBERT E. HOLLOWAY
CHARLES W. KELLY
VICTOR H. LAWS, III
E. SCOTT TAWES
THOMAS C. THOMPSON
SUSAN WILGUS-MURPHY

HONORARY DIRECTORS – HSB BANCORP, INC. & HEBRON SAVINGS BANK

EDWARD Q. WILGUS
EDWARD C. WRIGHT

More Than 100 Years of Personal Banking Services

Branch Locations

HEBRON

101 N. Main Street • P.O. Box 59 • Hebron, MD 21830
410.749.1185 • Fax 410.543.0703

SALISBURY

415 E. Carroll Street • Salisbury, MD 21804
410.742.8526 • Fax 410.742.8630

Quantico Square • 1008 W. Main Street • Salisbury, MD 21801
410.543.9183 • Fax 410.543.9401

1310 Mt. Hermon Road • Salisbury, MD 21804
410.546.8118 • Fax 410.546.8050

543C Riverside Drive • Salisbury, MD 21801
410.341.6670 • Fax 410.341.6678

2730 North Salisbury Boulevard • Salisbury, MD 21801
410.548.2233 • Fax 410.548.9706

FRUITLAND

108 E. Cedar Lane • Fruitland, MD 21826
410.860.4884 • Fax 410.860.2662

SHARPTOWN

303 Main Street • P.O. Box 236 • Sharptown, MD 21861
410.883.3121 • Fax 410.883.2322

VIENNA

100 Market & Race Streets • P.O. Box 158 • Vienna, MD 21869
410.376.3186 • Fax 410.376.0343

CAMBRIDGE

6 Cedar Street • Cambridge, MD 21613
410.228.9202 • Fax 410.228.5787

2801 Ocean Gateway • Cambridge, MD 21613
410.228.2440 • Fax 410.228.2446

PRINCESS ANNE

30499 Mount Vernon Road • Princess Anne, MD 21853
410.651.1722 • Fax 410.749.5528

CRISFIELD

57 Richardson Avenue • Crisfield, MD 21817
410.968.0500 • Fax 410.968.0550

Visit us at our website: www.HebronSavingsBank.com