

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.

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

**December 31, 2019**

Month / Day / Year

**No LEI**

Reporter's Legal Entity Identifier (LEI) (20-Character LEI Code)

Reporter's Name, Street, and Mailing Address

I, **Victor H. Laws, III**

Name of the Holding Company Director and Official

**Chairman of the Board**

Title of the Holding Company Director and Official

**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)

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.

Person to whom questions about this report should be directed:

**Kimberly T. Thomas VP/Sec/Treasurer**

Name Title

**410-749-1185 1057**

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

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.

*[Signature]*

Signature of Holding Company Director and Official

**3-19-2020**

Date of Signature

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

- 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. \_\_\_\_\_

Is confidential treatment requested for any portion of this report submission? .....	0=No 1=Yes	<input type="checkbox"/> <input checked="" type="checkbox"/>
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 .....		<input type="checkbox"/>
2. a letter justifying this request has been provided separately ...		<input type="checkbox"/>
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.*

<hr/> <p>Legal Title of Subsidiary Holding Company</p> <hr/> <p>(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box</p> <hr/> <p>City State Zip Code</p> <hr/> <p>Physical Location (if different from mailing address)</p> <hr/>	<hr/> <p>Legal Title of Subsidiary Holding Company</p> <hr/> <p>(Mailing Address of the Subsidiary Holding Company) Street / P.O. Box</p> <hr/> <p>City State Zip Code</p> <hr/> <p>Physical Location (if different from mailing address)</p> <hr/>
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**FORM FR Y-6**

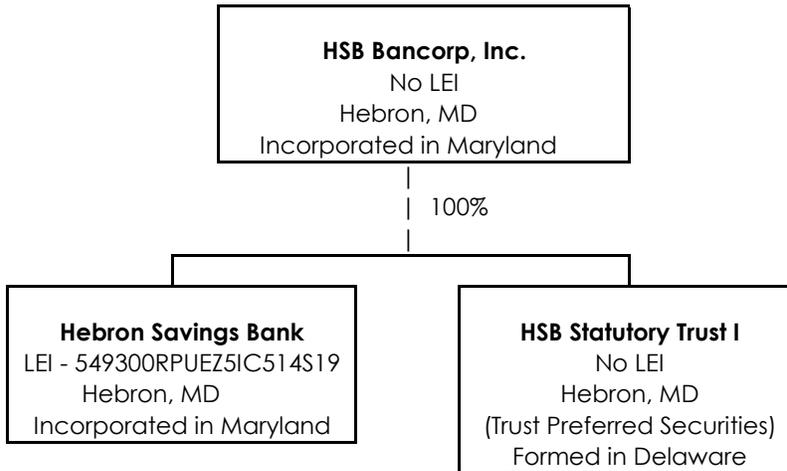
**HSB Bancorp, Inc.**  
**Hebron, Maryland**  
**9Fiscal Year Ending December 31, 2019**

**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, 2019**

**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 **12/31/2019**. Data reflects information that was received and processed through **01/07/2020**.

**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 BOULEVAR	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, 2019**

**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 12-31-19			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 12-31-19		
(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	111,741 - 7.16% Common Stock	None		
Charles R. Smith III Hebron, MD, USA	USA	89,764 - 5.80% Common Stock			

**FORM FR Y-6**  
**HSB Bancorp, Inc.**  
**Fiscal Year Ending December 31, 2019**

**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)
Victor H. Laws III Salisbury, MD, USA	Attorney	Director	Director Hebron Savings Bank	Principal Laws Insley & Benson PA	7.16%	None	Downtown Assoc. LLC (50%) Laws, Insley & Benson, PA (33%) Marvic Associates LLC (25%)
Joseph Gast	Insurance Agent	Director	Director Hebron Savings Bank	President Avery W. Hall Insurance Agency, Inc.	0.09%	None	Farnell & Gast LLC (33%)
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	Retired - 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.	0.79%	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%)
Brent C. Miller	Realtor	Director	Director Hebron Savings Bank	Managing Director SVN-Miller Commercial Real Estate	0.05%	None	B&W Miller LLC (100%) 1001 S Salisbury LLC (100%) 840 S Salisbury LLC (100%) Nsah-Miller LLC (50%) Miller Commercial Real Estate & Property Mgmt Inc, (50%) Synergy Investment Fund LLC (100%) Cross Lake LLC (50%) 927 Eastern Shore Drive LLC (50%) 703 Pike Street LLC (50%) Miller Investment Properties LLC (51%) Single Property Inc. (51%)

**FORM FR Y-6**  
**HSB Bancorp, Inc.**  
**Fiscal Year Ending December 31, 2019**

**Report Item 4: Insiders**

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(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	0.95%	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%) Scott Tawes & Assoc CPA PA (100%) Tawes Real Estate (50%) Tawes, Nelson & Reynolds (33.33%) Terra Firma Holdings 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
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%)
Donna K. Defino Parsonsburg, MD, USA	N/A	President	Pres./Chief Exe Ofcr Hebron Savings Bank	N/A	0.16%	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. Vandegriff 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.  
& Subsidiary**

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***2019  
Annual Report***

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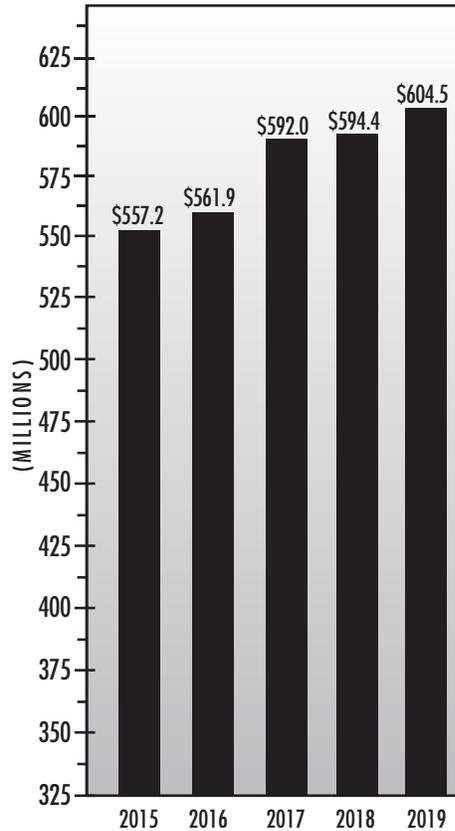
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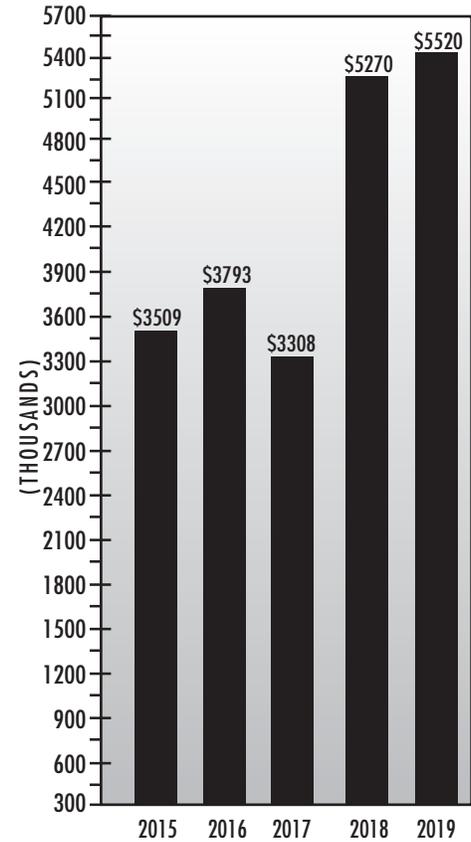


# HSB BANCORP, INC. & SUBSIDIARY FIVE YEAR FINANCIAL HIGHLIGHTS

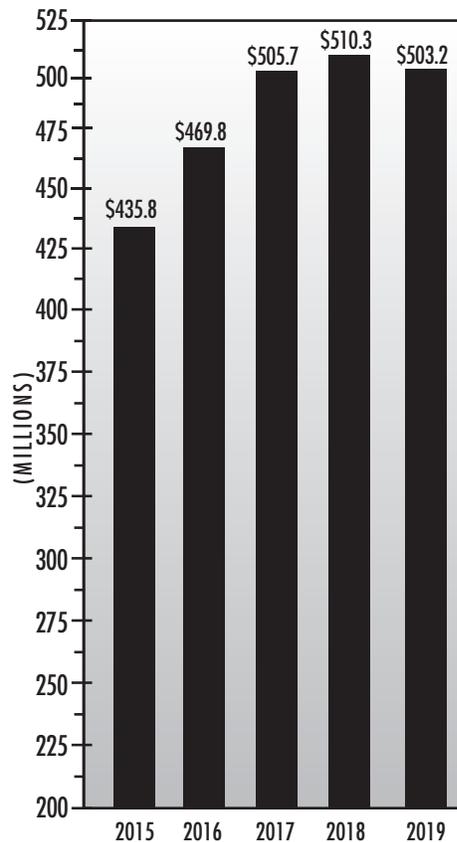
## TOTAL ASSETS



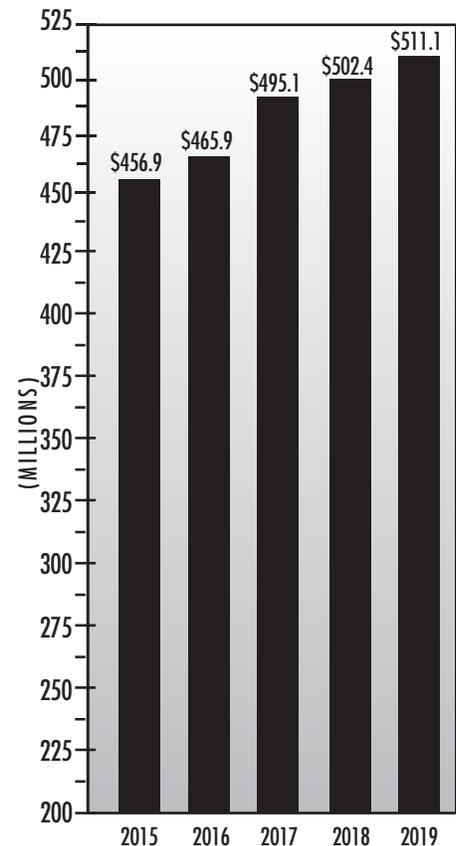
## NET INCOME



## TOTAL LOANS



## TOTAL DEPOSITS





## TO OUR STOCKHOLDERS:

We are pleased to report the results of another remarkable year for HSB Bancorp, Inc. and its wholly-owned subsidiary, Hebron Savings Bank. The Company sustained another year of growth and, for the second year in a row, achieved its highest profit in our 109-year history.

For the past several years, we have been strategically managing our asset growth in order to increase our tier 1 capital ratio, an important indicator of a bank's financial strength. Basically, the ratio is total stockholders' equity divided by average total assets. By simultaneously increasing stockholders' equity through earnings and restraining asset growth, the ratio can be successfully improved. At December 31, 2019, the Bank's tier 1 capital ratio of 9.7% was at its highest level in more than thirty years. Although a bank with a ratio of 5% or greater is considered "well-capitalized" by regulatory standards, it is our intention to continue to increase this percentage to a minimum of 10% by 2021.

At December 31, 2019, consolidated total assets reached a record \$604.5 million, up \$10.1 million, or 1.7%, over last year. We were able to control asset growth and increase profitability by funding loans and investments with existing cash reserves rather than soliciting expensive time deposits. Deposits increased \$8.7 million to \$511.1 million, but the increase occurred in our lower-cost checking and savings accounts. These core deposits increased \$10.2 million, while our higher-cost certificate of deposit (time) accounts decreased \$1.5 million. We continue to hold the highest amount of customer deposits of any bank, large or small, in our three-county branch area of Wicomico, Dorchester, and Somerset Counties.

In 2019, consolidated net income reached \$5.5 million, compared to \$5.3 million in 2018. Several factors contributed to this increase. Net interest income increased \$498 thousand from 2018 to 2019, primarily due to increases in the prime rate in 2018. Although the Fed began reducing interest rates again in 2019, these decreases did not begin until August 2019. In addition, the Bank's provision for credit losses expense declined \$938 thousand due to a stronger economy and fewer troubled loans. Other expenses increased approximately 8.5% due to the expansion of our Hebron headquarters, the implementation of new products and services, and the addition of several new staff positions. Among the new positions added this year was a Chief Technology Officer, a critical position during this time of increased security threats. To enhance our leadership, we also added an additional director position in April, increasing the size of our Board of Directors from eight to nine members.

Coinciding with the higher net income, stockholder dividends increased to \$.85 per share, up \$.05 over last year's per share amount. The total cash payout to our stockholders was \$1.375 million in 2019, 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 most challenging years of the recession. The book value of the stock and earnings per share appreciated to \$35.10 and \$3.41, respectively, at December 31, 2019.

We remain a strong influence on the entire Delmarva Peninsula as, out of the 14 community banks located on the Shore, we remain the third largest in assets, loans, deposits and number of full-service branches. As a local bank with a rich heritage, not only do we provide excellent and innovative banking products and services to individuals, small businesses, nonprofits and local governments, but we also strive to make a positive impact on each of the communities we serve.

As a stockholder of HSB Bancorp, Inc., you can be assured that the shares you hold are a sound investment, backed by a strong book value and dividends yielding a generous return. We appreciate your confidence and support as we make it our priority to balance growth with profitability in order to maximize shareholder value. On behalf of the directors, officers, and employees, we look forward to serving you in the many years to come.

Sincerely,

A handwritten signature in cursive script that reads "Donna K. Defino". The signature is written in dark ink and is positioned above the printed name and title.

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

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



## 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, 2019 and 2018, 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.

## 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, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "YAM Group LLC". The signature is written in a cursive, flowing style.

Salisbury, Maryland

February 3, 2020

**HSB BANCORP, INC. & SUBSIDIARY**  
**CONSOLIDATED BALANCE SHEETS**  
**December 31, 2019 and 2018**

	2019	2018
<b>ASSETS</b>		
Cash and due from banks	\$ 11,741,404	\$ 9,915,616
Interest-bearing deposits in other banks	23,429,370	10,204,095
Securities held-to-maturity, at amortized cost - fair value 2018 \$14,258,590	-	14,453,263
Securities available-for-sale, at fair value	33,054,601	16,582,880
Loans, less allowance for credit losses 2019 \$8,825,000; 2018 \$8,700,000	503,210,126	510,286,871
Accrued interest receivable on investment securities and loans	1,550,657	1,585,735
Bank premises and equipment, at cost, less accumulated depreciation	12,170,661	11,777,336
Federal Home Loan Bank stock, at cost	1,893,700	2,024,800
Common stock in the HSB Statutory Trust I	93,000	93,000
Net deferred income tax benefits	2,669,776	2,787,527
Other real estate owned	922,632	733,705
Cash value of life insurance	12,649,382	12,308,652
Other assets	1,099,835	1,648,104
<b>Total assets</b>	<b>\$ 604,485,144</b>	<b>\$ 594,401,584</b>
<b>LIABILITIES</b>		
Deposits:		
Non-interest bearing demand	\$ 144,274,781	\$ 142,841,012
NOW and Super NOW	27,186,861	20,931,167
Money market	42,538,800	42,330,869
Savings	80,871,157	78,624,645
Time, more than \$250,000	39,639,382	42,994,196
Other time	176,569,514	174,696,731
	<b>511,080,495</b>	<b>502,418,620</b>
Accrued interest payable on deposits and borrowings	610,158	520,604
Short-term borrowings	141,057	896,333
Long-term borrowings	30,952,160	33,703,548
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	3,093,000
Other liabilities	1,857,027	1,695,764
<b>Total liabilities</b>	<b>547,733,897</b>	<b>542,327,869</b>
<b>COMMITMENTS</b>		
<b>STOCKHOLDERS' EQUITY</b>		
Common stock, par value \$.01, authorized 10,000,000 shares, issued and outstanding 2019 1,546,630 and 2018 1,546,630 shares	15,467	15,467
Series A Preferred stock, par value \$.01, authorized 2,000,000 shares, issued and outstanding 2019 70,439 and 2018 70,439 shares	704	704
Surplus	6,201,001	6,201,001
Retained earnings	50,392,266	46,246,851
Accumulated other comprehensive income (loss), net of deferred tax (liability) benefit 2019 (\$53,837); 2018 \$148,177	141,809	(390,308)
<b>Total stockholders' equity</b>	<b>56,751,247</b>	<b>52,073,715</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 604,485,144</b>	<b>\$ 594,401,584</b>

*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, 2019 and 2018**

	2019	2018
<b>INTEREST INCOME ON</b>		
Loans, including fees	\$ 26,332,091	\$ 25,016,315
Investment securities:		
Taxable	745,257	703,268
Exempt from Federal income tax	190,677	227,183
Federal funds sold	4,822	978
Deposits in other banks	339,520	83,158
	<b>27,612,367</b>	<b>26,030,902</b>
<b>INTEREST EXPENSE ON</b>		
Deposits	4,783,145	3,642,074
Borrowings	896,969	963,073
Junior subordinated debentures	134,278	126,107
	<b>5,814,392</b>	<b>4,731,254</b>
<b>NET INTEREST INCOME</b>	<b>21,797,975</b>	<b>21,299,648</b>
Provision for credit losses	1,414,047	2,352,034
<b>NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES</b>	<b>20,383,928</b>	<b>18,947,614</b>
<b>OTHER INCOME</b>		
Service charges on deposit accounts	1,237,540	1,290,747
Earnings of investment in life insurance	340,730	316,021
Other	931,118	846,758
	<b>2,509,388</b>	<b>2,453,526</b>
<b>OTHER EXPENSES</b>		
Salaries and benefits	9,288,931	8,431,719
Occupancy	2,223,976	2,113,276
Losses on other real estate owned	185,406	280,023
Other expenses	3,975,679	3,618,354
	<b>15,673,992</b>	<b>14,443,372</b>
<b>INCOME BEFORE TAXES ON INCOME</b>	<b>7,219,324</b>	<b>6,957,768</b>
Federal and State income taxes	1,699,400	1,687,944
<b>NET INCOME</b>	<b>\$ 5,519,924</b>	<b>\$ 5,269,824</b>

*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, 2019 and 2018**

	2019	2018
<b>NET INCOME</b>	<b>\$ 5,519,924</b>	<b>\$ 5,269,824</b>
<b>Other comprehensive gain (loss), net of tax:</b>		
Unrealized holding gain (loss) on securities available-for-sale arising during the period	<b>734,131</b>	(209,798)
Deferred income tax (liabilities) benefits	<b>(202,014)</b>	57,731
Other comprehensive income (loss), net of tax	<b>532,117</b>	(152,067)
<b>Total other comprehensive income (loss)</b>	<b>532,117</b>	(152,067)
<b>Comprehensive income</b>	<b>\$ 6,052,041</b>	<b>\$ 5,117,757</b>

*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, 2019 and 2018**

	Common Stock	Series A Preferred Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
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
Net income	-	-	-	5,519,924	-	5,519,924
Other comprehensive income, net of tax	-	-	-	-	532,117	532,117
Cash dividends paid, \$.85 per share	-	-	-	(1,374,509)	-	(1,374,509)
<b>Balances, December 31, 2019</b>	<b>\$ 15,467</b>	<b>\$ 704</b>	<b>\$ 6,201,001</b>	<b>\$ 50,392,266</b>	<b>\$ 141,809</b>	<b>\$ 56,751,247</b>

*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, 2019 and 2018**

	2019	2018
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 5,519,924	\$ 5,269,824
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses, net	1,414,047	2,352,034
Depreciation, amortization and accretion	841,048	841,334
Income on investment in life insurance	(340,730)	(316,021)
Losses on other real estate owned	185,406	280,023
Deferred income benefits	(84,263)	(87,887)
Reclassification adjustment for stranded income tax effects in accumulated other comprehensive income	-	39,205
Changes in assets and liabilities:		
Decrease in accrued interest receivable	35,078	25,667
Decrease (increase) in deferred loan origination fees, net	12,544	(41,962)
Decrease (increase) in other assets	548,269	(386,008)
Increase in accrued interest payable	89,554	70,463
Increase in other liabilities	161,263	361,446
Net cash provided by operating activities	8,382,140	8,408,118
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase available-for-sale investment securities	(8,777,387)	(250,000)
Proceeds from maturities and paydowns of held-to-maturity investment securities	1,551,250	1,624,398
Proceeds from maturities and paydowns of available-for-sale investment securities	5,780,744	6,559,466
Proceeds from sale of stock in Federal Home Loan Bank	131,100	340,900
Decrease (increase) in loans, net	4,826,151	(7,614,263)
Proceeds from sale of other real estate owned	449,670	2,065,012
Purchase premises and equipment	(1,073,307)	(1,319,142)
Net cash provided by investing activities	2,888,221	1,406,371
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Increase in demand, NOW, SUPER NOW, money market, and savings deposits, net	10,143,906	6,319,152
(Decrease) increase in time deposits, net	(1,482,031)	950,519
Decrease in borrowings, net	(3,506,664)	(9,163,486)
Cash dividends paid	(1,374,509)	(1,293,655)
Net cash provided (used) by financing activities	3,780,702	(3,187,470)
Net increase in cash and cash equivalents	15,051,063	6,627,019
Cash and cash equivalents, beginning	20,119,711	13,492,692
Cash and cash equivalents, ending	\$ 35,170,774	\$ 20,119,711

*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, 2019 and 2018**

	<b>2019</b>	2018
<b>SUPPLEMENTARY CASH FLOW INFORMATION</b>		
Interest paid	<b>\$ 5,724,838</b>	\$ 4,660,791
Income taxes paid	<b>1,946,476</b>	2,232,842
Unrealized appreciation (depreciation) on securities available-for-sale	<b>734,131</b>	(209,798)
<b>SUPPLEMENTARY NON-CASH INVESTING ACTIVITIES</b>		
Loans converted to other real estate owned	<b>\$ 824,003</b>	\$ 697,347

*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.

#### **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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### 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.

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### Allowance for Credit Losses (Continued)

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 **\$185,406** and \$280,023 for 2019 and 2018, 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 **\$824,003** and \$697,347 at December 31, 2019 and 2018, respectively. The Bank financed sales of OREO totaling **\$121,476** and \$521,452 at December 31, 2019 and 2018, respectively. At December 31, 2019 and 2018, loans secured by residential real estate properties in process of foreclosure totaled approximately **\$538,000** and \$377,000, 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.

#### 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, 2019, certain loans existed in which management considered impaired (See Note 4).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### 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). At December 31, 2019 and 2018, the balances carried in excess of the limit, including unsecured federal funds sold, were **\$6,381,776** and \$801,691, respectively.

#### 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 cash balances on hand or with the Federal Reserve Bank based on average deposit liabilities. At December 31, 2019 and 2018, these reserve balances amounted to **\$4,017,000** and \$2,390,000, respectively.

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 amounted to **\$100,000** during the years ended December 31, 2019 and 2018.

#### Other Comprehensive Income (Loss)

The Bank records unrealized gains and losses on available for sale securities in accumulated other comprehensive income, net of taxes. Unrealized gains and losses on available for sale securities are reclassified into earnings as the gains or losses are realized upon sale of the securities. The credit component of unrealized losses on available for sale securities that are determined to be other-than-temporarily impaired are reclassified into earnings at the time the determination is made.

#### Advertising Costs

The Bank expenses advertising costs for the period in which they are incurred. The Bank incurred advertising costs totaling **\$119,868** and \$90,559, for the years 2019 and 2018, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

#### Financial Statement Presentation

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

### 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
	<b>\$ 14,453,263</b>	<b>\$ 65,196</b>	<b>\$ 259,869</b>	<b>\$ 14,258,590</b>

Securities available-for-sale are as follows:

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Obligations of U.S. Government agencies</b>	<b>\$ 3,296,197</b>	<b>\$ 8,411</b>	<b>\$ 11,387</b>	<b>\$ 3,293,221</b>
Obligations of States and political subdivisions	10,760,086	169,878	4,207	10,925,757
Mortgage-backed securities and CMOs	15,302,671	89,896	73,206	15,319,361
Mutual funds	3,500,000	16,262	-	3,516,262
	<b>\$ 32,858,954</b>	<b>\$ 284,447</b>	<b>\$ 88,800</b>	<b>\$ 33,054,601</b>

	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
	<b>\$ 17,121,364</b>	<b>\$ 4,031</b>	<b>\$ 542,515</b>	<b>\$ 16,582,880</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019:

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	\$ 492,885	\$ 7,115	\$ 785,773	\$ 4,272	\$ 1,278,658	\$ 11,387
Obligations of States and political subdivisions	1,216,923	4,153	249,925	54	1,466,848	4,207
Mortgage-backed securities and CMOs	1,548,579	10,481	6,047,102	62,725	7,595,681	73,206
Mutual Funds	-	-	-	-	-	-
<b>Total securities with unrealized losses</b>	<b>\$ 3,258,387</b>	<b>\$ 21,749</b>	<b>\$ 7,082,800</b>	<b>\$ 67,051</b>	<b>\$ 10,341,187</b>	<b>\$ 88,800</b>

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, 2019, the Bank held 2 obligations of U.S. Government agencies, 30 Mortgage-backed securities and CMOs, and 1 obligation of states and political subdivisions 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, 2019 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.

During 2019 the Bank elected to transfer its held-to-maturity securities to available-for-sale to enhance its liquidity levels. At the date of the transfer the securities had an amortized cost of \$12,847,260 and an unrealized holding gain of \$165,923. The unrealized holding gain was reported in other comprehensive income at the time of the transfer.

In addition to the above analysis, management feels it has the ability and intent to hold 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.

Contractual maturities of investment securities at December 31, 2019 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 2. Debt and Equity Securities (Continued)

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

Amounts maturing:	December 31, 2019			
	Securities Held-to-Maturity		Securities Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
One year or less	\$ -	\$ -	\$ 5,816,102	\$ 5,824,965
After one year through five years	-	-	18,249,010	18,304,241
After five years through ten years	-	-	5,293,842	5,409,133
After ten years	-	-	-	-
Mutual funds	-	-	3,500,000	3,516,262
	\$ -	\$ -	\$ 32,858,954	\$ 33,054,601

The Bank has pledged certain debt securities as collateral for deposits of certain government agencies and municipalities. The carrying value of these securities totaled **\$22,805,562** and \$24,217,099 at December 31, 2019 and 2018, 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 **\$12,649,382** and \$12,308,652 at December 31, 2019 and 2018, 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:

	2019	2018
Real estate loans:		
Construction	\$ 79,750,634	\$ 77,670,020
Residential Mortgages	203,999,616	212,464,232
Commercial Mortgages	156,107,481	157,522,711
	439,857,731	447,656,963
Commercial & industrial loans	67,504,459	68,439,962
Consumer loans	4,672,936	2,889,946
	512,035,126	518,986,871
Less: unearned income on loans	-	-
	512,035,126	518,986,871
Less: allowance for credit losses	8,825,000	8,700,000
	\$ 503,210,126	\$ 510,286,871

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

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.

In accordance with FAS 114 (ASC Topic 310), significantly-impaired loans are specifically identified and individually analyzed to determine the amount of their expected loss. All nonaccrual and troubled debt restructured loans are considered to be impaired and are individually analyzed to determine their valuation and reserve amounts. Other loans risk rated “6”, “7”, or “8” (excluding nonaccrual and troubled debt restructured loans) are individually evaluated for impairment. Following such evaluation, any loans determined to be impaired are specifically identified and individually analyzed; any loans determined to be unimpaired are evaluated on a pooled basis under FAS 5 (ASC Topic 450). The establishment of a specific reserve does not necessarily mean that the loan 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, 2019.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The activity in the allowance for loan losses for 2019 and 2018 is as follows:

December 31, 2019							
	Real Estate Loans			Commercial and			
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Unallocated	Total
<b>Beginning Balance</b>	\$ 1,406,797	\$ 3,970,036	\$ 1,765,132	\$ 1,277,705	\$ 187,667	\$ 92,663	\$ 8,700,000
<b>Charge-offs</b>	(13,250)	(603,663)	(276,505)	(968,159)	(78,880)	-	(1,940,457)
<b>Recoveries</b>	143,391	365,027	90,328	16,258	36,406	-	651,410
<b>Provision</b>	(173,645)	(277,548)	658,739	1,216,857	4,037	(14,393)	1,414,047
<b>Ending Balance</b>	<b>1,363,293</b>	<b>3,453,852</b>	<b>2,237,694</b>	<b>1,542,661</b>	<b>149,230</b>	<b>78,270</b>	<b>8,825,000</b>

**Ending Balance of:**

**Individually evaluated for impairment:**

Related loan balance	4,766,931	14,422,551	4,318,375	1,427,824	178,993	-	25,114,674
Balance in allowance	398,548	1,070,007	281,421	386,891	64,573	-	2,201,440

**Collectively evaluated for impairment:**

Related loan balance	74,983,703	189,577,065	151,789,106	66,076,635	4,493,943	-	486,920,452
Balance in allowance	964,745	2,383,845	1,956,273	1,155,770	84,657	78,270	6,623,560

**Total**

Related loan balance	79,750,634	203,999,616	156,107,481	67,504,459	4,672,936	-	512,035,126
Balance in allowance	1,363,293	3,453,852	2,237,694	1,542,661	149,230	78,270	8,825,000

December 31, 2018							
	Real Estate Loans			Commercial and			
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Unallocated	Total
<b>Beginning Balance</b>	\$ 1,511,817	\$ 3,713,048	\$ 1,500,276	\$ 778,030	\$ 110,699	\$ 86,130	\$ 7,700,000
<b>Charge-offs</b>	(438,675)	(632,045)	(221,722)	(223,178)	(104,442)	-	(1,620,062)
<b>Recoveries</b>	69,442	21,189	153,471	6,227	17,699	-	268,028
<b>Provision</b>	264,213	867,844	333,107	716,626	163,711	6,533	2,352,034
<b>Ending Balance</b>	<b>1,406,797</b>	<b>3,970,036</b>	<b>1,765,132</b>	<b>1,277,705</b>	<b>187,667</b>	<b>92,663</b>	<b>8,700,000</b>

**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

As of December 31, 2019 and 2018, the allowance for loan losses included an unallocated excess of **\$78,270** and **\$92,663**, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Following is an aging analysis by loan class and amount as of December 31, 2019 and 2018:

December 31, 2019						
	Real Estate Loans			Commercial and		Total
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	
30-89 Days Past Due	\$ 239,230	\$ 2,064,890	\$ 1,015,777	\$ -	\$ 9,364	\$ 3,329,261
Greater than 90 Days Past Due	-	-	-	-	-	-
Nonaccrual loans - non current	1,872,236	3,552,455	1,285,616	596,326	4,478	7,311,111
<b>Total Past Due</b>	<b>2,111,466</b>	<b>5,617,345</b>	<b>2,301,393</b>	<b>596,326</b>	<b>13,842</b>	<b>10,640,372</b>
Current nonaccrual loans	1,006,487	944,096	783,570	301,004	-	3,035,157
Current accrual loans	76,632,681	197,438,175	153,022,518	66,607,129	4,659,094	498,359,597
<b>Total Loans</b>	<b>\$ 79,750,634</b>	<b>\$ 203,999,616</b>	<b>\$ 156,107,481</b>	<b>\$ 67,504,459</b>	<b>\$ 4,672,936</b>	<b>\$ 512,035,126</b>

December 31, 2018						
	Real Estate Loans			Commercial and		Total
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	
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
<b>Total Past Due</b>	<b>2,812,660</b>	<b>8,015,662</b>	<b>3,260,537</b>	<b>1,577,011</b>	<b>33,830</b>	<b>15,699,700</b>
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
<b>Total Loans</b>	<b>\$ 77,670,020</b>	<b>\$ 212,464,232</b>	<b>\$ 157,522,711</b>	<b>\$ 68,439,962</b>	<b>\$ 2,889,946</b>	<b>\$ 518,986,871</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019 and 2018 is as follows:

December 31, 2019						
	Real Estate Loans			Commercial		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	and Consumer	Total
Pass	\$ 69,253,369	\$ 190,417,692	\$ 148,999,469	\$ 65,971,636	\$ 4,611,429	\$ 479,253,595
Special Mention	5,730,334	1,483,821	543,373	376,835	-	8,134,363
Substandard	4,766,931	12,098,103	6,564,639	1,155,988	61,507	24,647,168
Doubtful	-	-	-	-	-	-
	\$ 79,750,634	\$ 203,999,616	\$ 156,107,481	\$ 67,504,459	\$ 4,672,936	\$ 512,035,126

December 31, 2018						
	Real Estate Loans			Commercial		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	and 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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019.

Impaired loans, which include loans on non-accrual status, TDRs and other specifically identified loans, as of December 31, 2019 and 2018, are as follows:

December 31, 2019						
	Real Estate Loans			Commercial and Consumer		Total
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	
Recorded Investment with a related allowance	\$ 2,083,394	\$ 5,584,178	\$ 2,056,932	\$ 1,425,193	\$ 178,993	\$ 11,328,690
Recorded Investment with no related allowance	2,683,537	8,838,373	2,261,443	2,631	-	13,785,984
<b>Total Recorded Investment</b>	<b>\$ 4,766,931</b>	<b>\$ 14,422,551</b>	<b>\$ 4,318,375</b>	<b>\$ 1,427,824</b>	<b>\$ 178,993</b>	<b>\$ 25,114,674</b>
Unpaid Principal Balance	\$ 4,953,466	\$ 16,193,162	\$ 4,649,255	\$ 1,500,826	\$ 178,993	\$ 27,475,702
Related Allowance	398,548	1,070,007	281,421	386,891	64,573	2,201,440
Average Recorded Investment	4,484,812	14,595,620	4,219,726	1,246,628	160,046	24,706,832
Interest Income Recognized	139,687	603,577	192,654	50,707	5,293	991,918

December 31, 2018						
	Real Estate Loans			Commercial and Consumer		Total
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	
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
<b>Total Recorded Investment</b>	<b>\$ 11,377,519</b>	<b>\$ 22,264,893</b>	<b>\$ 14,133,820</b>	<b>\$ 2,024,981</b>	<b>\$ 134,512</b>	<b>\$ 49,935,725</b>
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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019 and 2018 is summarized as follows:

	Real Estate Loans			Commercial and Industrial Consumer Total		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
<b>December 31, 2019</b>	\$ 2,878,723	\$ 4,496,551	\$ 2,069,186	\$ 897,330	\$ 4,478	\$ 10,346,268
December 31, 2018	\$ 2,406,181	\$ 5,379,630	\$ 1,414,268	\$ 492,918	\$ -	\$ 9,692,997

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, 2019						
	Real Estate Loans			Commercial and Industrial Consumer Total		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
<b>Number of modifications</b>	4	63	6	8	9	90
<b>Recorded investment prior to modification</b>	\$ 3,378,237	\$ 11,588,903	\$ 3,555,192	\$ 710,858	\$ 200,629	\$ 19,433,819
<b>Recorded investment after modification</b>	\$ 1,916,938	\$ 8,879,224	\$ 3,139,308	\$ 614,958	\$ 163,597	\$ 14,714,025

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019						
	Real Estate Loans			Commercial and		Total
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	
Number of modifications	4	21	4	5	-	34
Recorded investment	\$ 1,916,937	\$ 2,314,207	\$ 2,114,366	\$ 301,006	\$ -	\$ 6,646,516

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

Troubled debt restructurings (TDRs) with a commitment to lend additional funds were \$0 at December 31, 2019 and 2018.

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, 2019 and 2018 are summarized as follows:

	2019	2018
Loans, beginning	\$ 15,629,000	\$ 13,942,000
Additions	10,066,000	6,408,000
Repayments/eliminations	(5,893,000)	(4,721,000)
Loans, ending	\$ 19,802,000	\$ 15,629,000

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

	2019	2018
Loan commitments, including approved loans and unused lines of credit	\$ 111,535,000	\$ 109,783,000
Letters of credit	5,813,000	6,173,000

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 **\$375,000** and \$300,000, related to these financial instruments with off-balance sheet risk in other liabilities at December 31, 2019 and 2018, respectively.

### Note 5. Premises, Equipment, and Depreciation

Bank premises and equipment are as follows:

December 31, 2019			
	Cost	Accumulated Depreciation	Net
Land	\$ 4,551,538	\$ -	\$ 4,551,538
Buildings and land improvements	9,363,513	3,248,062	6,115,451
Furniture and equipment	8,665,268	7,161,596	1,503,672
	\$ 22,580,319	\$ 10,409,658	\$ 12,170,661
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

Depreciation expense totaled **\$679,982** and \$648,731 for the years ended December 31, 2019 and 2018, respectively.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 6. Income Taxes

Components of income tax expense for the years ended December 31, 2019 and 2018 are as follows:

	2019	2018
Currently payable		
Federal	\$ 1,246,954	\$ 1,213,410
State	536,709	523,215
<b>Total current</b>	<b>1,783,663</b>	<b>1,736,625</b>
Deferred income (benefits) taxes		
Federal	(59,000)	(22,331)
State	(25,263)	(26,350)
<b>Total deferred</b>	<b>(84,263)</b>	<b>(48,681)</b>
	<b>\$ 1,699,400</b>	<b>\$ 1,687,944</b>

A reconciliation of tax computed at the federal statutory tax rate of 21% for the years ended December 31, 2019 and 2018 to the actual tax expense is as follows:

	2019	2018
Tax at federal statutory rate	\$ 1,516,058	\$ 1,461,131
Tax effect of:		
Tax exempt income	(226,722)	(211,607)
Reclassification adjustment for stranded income tax effects in accumulated other comprehensive income	-	39,205
Other	6,007	6,725
State income taxes, net of federal benefit	404,057	392,490
	<b>\$ 1,699,400</b>	<b>\$ 1,687,944</b>

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

	2019	2018
<b>Federal income tax refund claims</b>	<b>\$ 90,103</b>	<b>\$ 437,057</b>
<b>State income tax refund claims</b>	<b>72,645</b>	<b>59,354</b>
Deferred tax benefits:		
Allowance for credit losses	\$ 2,428,418	\$ 2,394,022
Deferred subcontractor costs	28,702	36,707
OREO property	259,478	211,772
Accrued vacation	136,576	118,374
Net unrealized depreciation on securities available-for-sale	-	148,177
	<b>2,853,174</b>	<b>2,909,052</b>
Deferred tax liabilities:		
Accumulated depreciation	120,061	106,523
Unearned income on loans	9,500	15,002
Net unrealized appreciation on securities available-for-sale	53,837	-
	<b>183,398</b>	<b>121,525</b>
<b>Net deferred income tax benefits</b>	<b>\$ 2,669,776</b>	<b>\$ 2,787,527</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 6. Income Taxes (Continued)

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, 2019 and 2018, management believes there are no uncertain tax positions under ASC Topic 740 Income Taxes. The Bank's federal and state income tax returns for 2016, 2017, and 2018 are subject to examination by the IRS and/or state tax authorities, generally for three years after they were filed. The 2019 income returns will be filed in 2020.

### 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 8. Deposits

Time deposits and their remaining maturities at December 31, 2019 are approximately as follows:

2020	\$	63,351,000
2021		32,992,000
2022		46,803,000
2023		27,122,000
2024 and thereafter		45,941,000
	\$	216,209,000

Interest expense on deposits for the years ended December 31, 2019 and 2018 is as follows:

	2019		2018
NOW, Super NOW and money market	\$ 247,167	\$	138,265
Savings	115,907		104,658
Time, more than \$250,000	882,637		670,972
Other time	3,537,434		2,728,179
	\$ 4,783,145	\$	3,642,074

Deposit balances of senior officers and directors and their affiliated interests totaled **\$15,391,364** and \$14,575,383 at December 31, 2019 and 2018, respectively.

Overdraft deposit balances, included in loans, totaled **\$177,040** and \$104,539 at December 31, 2019 and 2018, respectively.

The Bank began offering time deposits through the Certificate of Deposit Account Registry Service (CDARS) in 2019 through a third-party provider. These deposits totaled **\$4,310,731** at December 31, 2019 and are included in other time deposits on the balance sheet.

### 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 **\$227,270** and \$214,426 for the years ended December 31, 2019 and 2018, 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 2022. The Bank also leases a portion of a parking lot adjacent to one of its branch facilities under an operating lease through 2020.

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

2020	\$	88,000
2021		52,000
2022		36,000
2023		-
2024		-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 10. Lease Commitments (Continued)

Rent expense under these arrangements totaled **\$89,320** and \$87,714 for the years ended December 31, 2019 and 2018, respectively.

### Note 11. Other Operating Expenses

Other operating expenses include the following:

	2019	2018
Advertising and marketing	\$ 149,052	\$ 121,674
ATM and debit card processing	562,518	508,358
Bank service charges	86,392	89,487
Courier and travel	178,737	173,306
Data processing outsourced	286,517	261,601
Directors' fees	305,569	286,067
Donations	83,646	78,661
Dues and subscriptions	81,387	84,990
FDIC and Maryland assessments	365,488	530,275
Insurance	110,285	110,222
Loan collection and OREO operating	284,116	198,511
Long and short	26,692	32,805
Other fees	2,223	-
Postage	168,827	167,148
Professional services	605,233	314,044
Seminars	34,785	34,510
Stationery, printing, and supplies	309,301	324,344
Telephone	259,911	252,351
Provision for unfunded commitments	75,000	50,000
	<b>\$ 3,975,679</b>	<b>\$ 3,618,354</b>

### Note 12. Borrowings and Credit Facilities

The Bank has borrowings from the FHLB totaling **\$31,093,217** and \$34,599,881 at December 31, 2019 and 2018, respectively, with fixed and variable interest rates ranging from 1.53% to 5.94%, maturing at various dates through August 2038. Based on lendable collateral value, the Bank has available for future borrowings approximately **\$64,000,000** and \$57,000,000 at December 31, 2019 and 2018, respectively. The Bank has pledged approximately **\$121,000,000** and \$122,000,000 at December 31, 2019 and 2018, 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, 2019, the scheduled maturities of borrowings are approximately as follows:

2020	\$ 141,000
2021	1,915,000
2022	8,250,000
2023	2,882,000
2024	7,621,000
2025 and thereafter	10,284,000
	<b>\$ 31,093,000</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 12. Borrowings and Credit Facilities (Continued)

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, 2019 and 2018, there were no borrowings outstanding under any of the credit facilities. At December 31, 2019, securities pledged under the secured credit facility had an amortized cost and fair value of **\$197,728** and **\$195,241**, respectively. At December 31, 2018, securities pledged under the secured credit facilities had an amortized cost and fair value of \$245,712 and \$235,190, 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.

The Bank is subject to the Basel III Capital Rules. The Basel III Capital Rules require the 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, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0%), (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, effectively resulting in a minimum Tier 1 capital ratio of 8.5%), (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, effectively resulting in a minimum Total capital ratio of 10.5%) 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 and was phased in over a four-year period (increasing by 0.625% on January 1, 2016 and by 0.625% on each subsequent January 1, until it reached 2.5% on January 1, 2019). 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. 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. 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, 2019 and 2018, 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 13. Regulatory Capital Requirements (Continued)

A comparison of capital as of December 31, 2019 and 2018 for the Company and Bank is presented below. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2019 and December 31, 2018. Capital amounts and ratios for minimum capital adequacy presented in the following table do not include capital conservation buffers. 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, 2019	Actual		For Minimum Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total Capital (to Risk-Weighted Assets)</b>						
Company	\$ 66,189,000	12.5%	\$ 42,226,000	8.0%	\$ -	N/A
Bank	66,160,000	12.5%	42,241,000	8.0%	52,801,000	10.0%
<b>Tier I Capital (to Risk-Weighted Assets)</b>						
Company	59,553,000	11.3%	31,677,000	6.0%	-	N/A
Bank	59,519,000	11.3%	31,687,000	6.0%	42,250,000	8.0%
<b>Common Equity Tier I Capital (to Risk-Weighted Assets)</b>						
Company	56,553,000	10.7%	23,740,000	4.5%	-	N/A
Bank	59,519,000	11.3%	23,765,000	4.5%	34,328,000	6.5%
<b>Tier I Capital (to Average Assets)</b>						
Company	59,553,000	9.7%	24,507,000	4.0%	-	N/A
Bank	59,519,000	9.7%	24,519,000	4.0%	30,648,000	5.0%
<hr/>						
As of December 31, 2018						
	Amount	Ratio	Amount	Ratio	Amount	Ratio
<b>Total Capital (to Risk-Weighted Assets)</b>						
Company	\$ 62,063,000	11.7%	\$ 42,400,000	8.0%	\$ -	N/A
Bank	61,987,000	11.7%	42,384,000	8.0%	52,980,000	10.0%
<b>Tier I Capital (to Risk-Weighted Assets)</b>						
Company	55,408,000	10.5%	31,813,000	6.0%	-	N/A
Bank	55,333,000	10.4%	31,801,000	6.0%	42,401,000	8.0%
<b>Common Equity Tier I Capital (to Risk-Weighted Assets)</b>						
Company	52,408,000	9.9%	23,846,000	4.5%	-	N/A
Bank	55,333,000	10.4%	23,850,000	4.5%	34,451,000	6.5%
<b>Tier I Capital (to Average Assets)</b>						
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%

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### **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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019 and 2018. Items that are not financial instruments are not included.

	2019		2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
<b>Financial assets:</b>				
Cash and due from banks	\$ 11,741,404	\$ 11,741,404	\$ 9,915,616	\$ 9,915,616
Interest-bearing deposits in other banks	23,429,370	23,429,370	10,204,095	10,204,095
Securities held-to-maturity	-	-	14,453,263	14,258,590
Securities available-for-sale	33,054,601	33,054,601	16,582,880	16,582,880
Loans, net of allowance for credit losses	503,210,126	522,155,168	510,286,871	516,690,869
Accrued interest receivable	1,550,657	1,550,657	1,585,735	1,585,735
Federal Home Loan Bank stock	1,893,700	1,893,700	2,024,800	2,024,800
Common stock-Statutory Trust I	93,000	93,000	93,000	93,000
Cash value of life insurance	12,649,382	12,649,382	12,308,652	12,308,652
<b>Financial liabilities:</b>				
Deposits	\$ 511,080,495	\$ 511,812,496	\$ 502,418,620	\$ 486,883,632
Accrued interest payable	610,158	610,158	520,604	520,604
Short-term borrowings	141,057	141,057	896,333	896,333
Long-term borrowings	30,952,160	32,035,166	33,703,548	33,620,549
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	2,065,815	3,093,000	1,868,252
<b>Unrecognized financial instruments:</b>				
Commitments to extend credit	111,535,000	111,535,000	109,783,000	109,783,000
Standby letters of credit	5,813,000	5,813,000	6,173,000	6,173,000

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019. 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	\$ 503,210,126	\$ 522,155,168	-	-	\$ 522,155,168
Financial Liabilities:					
Deposits	511,080,495	511,812,496	-	511,812,496	-
Long-term borrowings	30,952,160	32,035,166	-	32,035,166	-
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	2,065,815	-	2,065,815	-

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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, 2019:

	Level 1	Level 2	Level 3	Fair Value
Securities available-for-sale:				
Obligations of U.S.				
Government agencies	\$ -	\$ 3,293,221	\$ -	\$ 3,293,221
Obligations of States and political subdivisions	-	10,925,757	-	10,925,757
Mortgage-backed securities and CMOs	-	15,319,361	-	15,319,361
Mutual funds	-	3,516,262	-	3,516,262
<b>Total</b>	<b>\$ -</b>	<b>\$ 33,054,601</b>	<b>\$ -</b>	<b>\$ 33,054,601</b>

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, 2019.

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, 2019:

	Level 1	Level 2	Level 3	Fair Value
Impaired loans	\$ -	-	\$ 22,913,234	\$ 22,913,234
OREO	-	922,632	-	922,632
<b>Total</b>	<b>\$ -</b>	<b>\$ 922,632</b>	<b>\$ 22,913,234</b>	<b>\$ 23,835,866</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 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 February 3, 2020, 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, 2019 and 2018

	<b>2019</b>	<b>2018</b>
<b>ASSETS</b>		
Cash and due from banks	\$ 64,693	\$ 52,085
Investment in Bank	59,660,341	54,997,947
Investment in the HSB Statutory Trust I	93,000	93,000
Other assets	31,038	29,660
Total assets	\$ 59,849,072	\$ 55,172,692
<b>LIABILITIES</b>		
Borrowed funds from subsidiary	\$ 3,093,000	\$ 3,093,000
Accrued interest payable on borrowed funds	4,825	5,977
Total liabilities	3,097,825	3,098,977
<b>STOCKHOLDERS' EQUITY</b>		
Common stock	15,467	15,467
Series A Preferred stock	704	704
Surplus	6,201,001	6,201,001
Retained earnings	50,392,266	46,246,851
Accumulated other comprehensive loss	141,809	(390,308)
Total stockholders' equity	56,751,247	52,073,715
Total liabilities and stockholders' equity	\$ 59,849,072	\$ 55,172,692

## 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, 2019 (see Note 7 for further discussions on FIN 46R).

#### STATEMENTS OF INCOME Years Ended December 31, 2019 and 2018

	2019	2018
Dividend income from bank	\$ 1,505,866	\$ 1,414,472
Undistributed net income of bank	4,130,277	3,966,256
Other operating income	4,038	3,793
Other operating expenses	(151,151)	(144,177)
Income before taxes	5,489,030	5,240,344
Income tax benefits (*)	(30,894)	(29,480)
<b>NET INCOME</b>	<b>\$ 5,519,924</b>	<b>\$ 5,269,824</b>

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

#### STATEMENTS OF CASH FLOWS Years Ended December 31, 2019 and 2018

	2019	2018
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 5,519,924	\$ 5,269,824
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed net income of subsidiary	(4,130,277)	(3,966,256)
Changes in assets or liabilities:		
(Increase) decrease in other assets	(1,378)	9,247
(Decrease) increase in liabilities	(1,152)	1,545
Net cash provided by operating activities	1,387,117	1,314,360
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Dividends paid	(1,374,509)	(1,293,655)
Net cash used in financing activities	(1,374,509)	(1,293,655)
<b>Net increase in cash</b>	<b>12,608</b>	<b>20,705</b>
<b>Cash, beginning of year</b>	<b>52,085</b>	<b>31,380</b>
<b>Cash, end of year</b>	<b>\$ 64,693</b>	<b>\$ 52,085</b>

# OFFICERS & DIRECTORS

## OFFICERS – HSB BANCORP, INC.

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**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. VANDEGRIFT, Vice-President**

## SENIOR OFFICERS – HEBRON SAVINGS BANK

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**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**  
**JOHN A. CRAIG, Senior Vice-President & Chief Technology Officer**  
**LORANCE J. ROHLFING, Senior Vice-President & Chief Credit Officer**  
**ELLEN P. VANDEGRIFT, Senior Vice-President & Chief Retail Lending Officer**

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

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<b>VICTOR H. LAWS, III, Chairman of the Board</b>	<b>BRENT C. MILLER</b>
<b>JOSEPH L. GAST</b>	<b>E. SCOTT TAWES</b>
<b>MARK S. HOLLOWAY</b>	<b>THOMAS C. THOMPSON</b>
<b>ROBERT E. HOLLOWAY</b>	<b>SUSAN WILGUS-MURPHY</b>
<b>CHARLES W. KELLY</b>	

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

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<b>CHARLES R. SMITH, III</b>	<b>EDWARD C. WRIGHT</b>
<b>EDWARD Q. WILGUS</b>	

*This annual report has not been reviewed, or confirmed for accuracy or relevance, by the Federal Deposit Insurance Corporation.*

*More Than 100 Years of Personal Banking Services*

## ***Branch Locations***

### **HEBRON**

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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**

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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**

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