

**FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, DC 20429**

FORM 10-Q

(Mark One)

☒ **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2020

☐ **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

FDIC Certificate Number: 19101

HARFORD BANK

(Name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
organization)

52-0799113
(IRS Employer incorporation or
Identification No.)

8 West Bel Air Avenue, Aberdeen, Maryland 21001
(Address of principal executive offices)

(410) 272-5000
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☐ No ☐ (Not Applicable)

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☒

Emerging growth company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date.
1,430,598 shares of common stock as of April 30, 2020.

This Quarterly Report of Harford Bank (the “Bank”) on Form 10-Q may contain forward-looking statements within the meaning of The Private Securities Litigation Reform Act of 1995. Readers of this report should be aware of the speculative nature of “forward-looking statements”. Statements that are not historical in nature, including those that include the words “anticipate”, “estimate”, “should”, “expect”, “believe”, “intend”, and similar expressions, are forward-looking statements and are based on current expectations, estimates and projections about, among other things, the industry and the markets in which the Bank operates, and they are not guarantees of future performance. Whether actual results will conform to expectations and predictions is subject to known and unknown risks and uncertainties, including risks and uncertainties discussed in this report; general economic, market, or business conditions; changes in interest rates, deposit flow, the cost of funds, and demand for loan products and financial services; changes in the Bank’s competitive position or competitive actions by other companies; changes in the quality or composition of loan and investment portfolios; the ability to manage growth; changes in laws or regulations or policies of federal and state regulators and agencies; and other circumstances beyond the Bank’s control. Consequently, all of the forward-looking statements made in this document are qualified by these cautionary statements, and there can be no assurance that the actual results anticipated will be realized, or if substantially realized, will have the expected consequences on the Bank’s business or operations. These and other risks are discussed in detail in the periodic reports that the Bank files with the Federal Deposit Insurance Corporation (“FDIC”) (see Item 1A of Part II of this report for further information). Except as required by applicable laws, the Bank does not intend to publish updates or revisions of forward-looking statements it makes to reflect new information, future events or otherwise.

PART I

Item 1. Financial Statements

The information required by this item can be found beginning on page F-1 immediately following the signatures to this report and is incorporated herein by reference.

AVAILABLE INFORMATION

The Bank maintains an internet website at www.HarfordBank.com on which it makes available its most recent periodic report filed with the FDIC pursuant to the Exchange Act. All of the periodic and other reports filed by the Bank with the FDIC pursuant to the Exchange Act are generally available for public inspection at: Federal Deposit Insurance Corporation, Accounting and Securities Disclosure Section, Division of Supervision and Consumer Protection, 550 17th Street, NW, Washington, DC 20429.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read and reviewed in conjunction with the interim consolidated financial statements and the notes thereto included elsewhere in this report, and with Management’s Discussion and Analysis of Financial Condition and Results of Operations, the audited consolidated financial statements and notes thereto, and the other statistical information contained in the Bank’s Annual Report on Form 10-K for the year ended December 31, 2019.

The Bank is a Maryland-chartered bank with its principal office in Aberdeen, Harford County, Maryland. Through its nine branches, seven of which are located throughout Harford County and two in Cecil County, the Bank offers a full range of deposit services that are typically offered by most banks, savings and loan associations, and credit unions, including checking accounts, NOW accounts, savings accounts and other time deposits of various types, ranging from money market accounts to longer-term certificates of deposit. In addition, the Bank offers Individual Retirement Accounts. The Bank also offers a full range of commercial and personal loans, including fixed-rate consumer mortgage loans, variable rate home equity lines of credit and fixed rate home equity loans, commercial lines of credit, commercial mortgage loans, and real estate construction loans. Other banking services include safe deposit boxes, direct deposit of payroll and social security checks, Internet banking with bill pay service, mobile banking, ATM services, Visa debit cards, Visa gift cards, and Visa credit cards issued through a third-party provider.

APPLICATION OF CRITICAL ACCOUNTING POLICIES

The Bank’s consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and follow general practices within the industry in which the Bank operates. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the consolidated financial statements; accordingly, as this information changes, the consolidated financial statements could reflect different estimates, assumptions, and judgments. Certain policies inherently have a greater reliance on the use of estimates, assumptions, and judgments and as such have a greater possibility of producing results that could be materially different than originally reported. Estimates, assumptions, and judgments are necessary when assets and liabilities are required to be recorded at fair value, when a decline in the value of an asset not carried on the consolidated financial statements at fair value warrants an impairment write-down or valuation reserve to be established, or when an asset or liability needs to be recorded contingent upon a future event. Carrying assets and liabilities

at fair value inherently results in more financial statement volatility. The fair values and information used to record valuation adjustments for certain assets and liabilities are based on quoted market prices or are provided by other third-party sources, whenever available.

The most significant accounting policies followed by the Bank are presented in Note 1 to the consolidated financial statements appearing elsewhere in this report. These policies, along with the disclosures presented in the other notes to the consolidated financial statements and in this financial review, provide information on how significant assets and liabilities are valued in the consolidated financial statements and how those values are determined. Based on the valuation techniques used and the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, management has identified the determination of the allowance for loan losses as the accounting area that requires the most subjective or complex judgments, and as such may be most subject to revision as new information becomes available.

The allowance for loan losses represents management's estimate of probable loan losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of estimates related to the amount and timing of expected future cash flows on impaired loans, estimated losses on pools of homogeneous loans based on historical loss experience, and consideration of current economic trends and conditions, all of which may be susceptible to significant change. The loan portfolio also represents the largest asset type on the balance sheets. Note 1 to the consolidated financial statements describes the methodology used to determine the allowance for loan losses.

RESULTS OF OPERATIONS

Summary

For the three-month period ended March 31, 2020, the Bank reported net income of \$513,501, compared to \$893,749 for the same period of 2019, a decrease of \$380,248, or 42.5%. Basic net income per share of common stock for the three-month period ended March 31, 2020 was \$0.36, compared to \$0.63 for the same period in 2019. Diluted net income per share of common stock for the three-month period ended March 31, 2020 was \$0.36, compared to \$0.62 for the same period in 2019.

Annualized return on average assets was 0.55% for the three-month period ended March 31, 2020, compared to 1.00% for the same period in 2019. Annualized return on average stockholders' equity for the three months ended March 31, 2020 was 4.81%, compared to 8.99% for the same period in 2019.

Details of the changes in the various components of net income are discussed below.

Net Interest Income and Net Interest Margin

The primary source of income for the Bank is net interest income, which is the difference between interest earned on interest-earning assets, such as investment securities and loans, and interest paid on interest-bearing sources of funds, such as deposits and borrowings. The level of net interest income is determined primarily by the average balance of interest-earning assets and funding sources and the various rate spreads between the interest-earning assets and the Bank's funding sources. The table below entitled "Average Balances, Interest, and Yields" shows the Bank's average volume of interest-earning assets and interest-bearing liabilities for the three-month periods ended March 31, 2020 and 2019 and related interest income, interest expense, and yields. Changes in net interest income from period to period result from increases or decreases in the volumes of interest-earning assets and interest-bearing liabilities, and increases or decreases in the average rates earned and paid on such assets and liabilities. The volumes of interest-earning assets and interest-bearing liabilities are affected by management's ability to effectively and efficiently manage the earning-asset portfolio (which includes loans), and the availability of particular sources of funds, such as noninterest-bearing deposits.

Interest income, on a fully taxable equivalent basis, for the three-month period ended March 31, 2020 was \$3,875,211, compared to \$3,898,151 for the same period in 2019, representing a decrease of \$22,940, or 0.6%.

Interest income, on a fully taxable equivalent basis, on loans increased \$42,445, or 1.2%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. Average balances of loans increased \$8,641,566, or 3.1%, for the first quarter of 2020 when compared to the same period in 2019. The weighted average rate earned on loans, on a fully taxable equivalent basis, decreased 13 basis points to 4.93% for the three-month period ended March 31, 2020 when compared to the same period in 2019.

Average Balances, Interest, and Yields

	For the three months ended March 31, 2020			For the three months ended March 31, 2019		
	Average balance	Interest	Yield	Average balance	Interest	Yield
Assets						
FRB interest-bearing deposits	\$ 18,336,674	\$ 72,916	1.60%	\$ 19,899,666	\$ 140,018	2.85%
FHLBA interest-bearing deposits	171,541	360	0.84%	138,261	838	2.46%
Federal funds sold	334,214	1,269	1.53%	144,321	858	2.41%
Time deposits in other banks	1,596,154	8,443	2.13%	19,445	140	2.92%
Other	1,165,786	17,308	5.97%	1,423,422	27,174	7.74%
Investment securities:						
U.S. Treasury securities	5,242,061	26,541	2.04%	3,942,061	28,176	2.90%
U.S. government agency securities	14,493,117	70,717	1.96%	14,582,356	94,562	2.63%
Mortgage-backed securities	15,893,398	81,949	2.07%	10,920,114	59,087	2.19%
SBA asset-backed securities	4,487,996	28,392	2.54%	3,592,154	20,402	2.30%
State and municipal securities	653,056	2,995	1.84%	1,110,042	5,020	1.83%
Total investment securities	40,769,628	210,594	2.08%	34,146,727	207,247	2.46%
Loans:						
Overdrafts	143,568	-	0.00%	67,542	-	0.00%
Consumer	7,666,548	109,873	5.76%	8,226,297	112,835	5.56%
Credit lines	11,078,147	127,779	4.64%	11,912,695	158,852	5.41%
Commercial	33,247,769	442,017	5.35%	33,604,058	475,709	5.74%
Real estate	242,054,220	2,884,652	4.79%	231,486,686	2,774,480	4.86%
Total loans *	294,190,252	3,564,321	4.87%	285,297,278	3,521,876	5.01%
Allowance for loan losses	(3,306,810)			(3,055,402)		
Total loans, net of allowance *	290,883,442	3,564,321	4.93%	282,241,876	3,521,876	5.06%
Total interest-earning assets	353,257,439	3,875,211	4.41%	338,013,718	3,898,151	4.68%
Noninterest-bearing cash	6,743,891			7,062,974		
Bank premises and equipment	8,752,508			8,392,862		
Other assets	10,084,267			9,860,467		
Total assets	\$ 378,838,105			\$ 363,330,021		
Liabilities and Stockholders' Equity						
Interest-bearing deposits						
NOW deposits	\$ 67,048,784	\$14,126	0.08%	\$ 70,136,137	14,242	0.08%
Savings	40,635,308	14,255	0.14%	38,965,192	13,593	0.14%
Money market	14,330,862	5,472	0.15%	15,986,401	5,763	0.15%
Personal investment	22,364,700	21,262	0.38%	22,362,836	20,877	0.38%
Time deposits	90,086,875	410,076	1.83%	74,859,613	274,119	1.49%
Total interest-bearing deposits	234,466,529	465,191	0.80%	222,310,179	328,594	0.60%
Borrowed overnight funds	-	-	0.00%	144,445	958	2.69%
FHLBA term borrowings	18,802,198	118,009	2.52%	25,855,556	154,215	2.42%
Total borrowed funds	18,802,198	118,009	2.52%	26,000,001	155,173	2.42%
Total interest-bearing deposits and borrowed funds	253,268,727	583,200	0.93%	248,310,180	483,767	0.79%
Noninterest-bearing deposits	79,880,770			72,377,580		
Other liabilities	2,715,376			2,313,850		
Stockholders' equity	42,973,232			40,328,411		
Total liabilities and stockholders' equity	\$ 378,838,105			\$ 363,330,021		
Net interest spread			3.48%			3.89%
Net interest income		\$ 3,292,011			\$ 3,414,384	
Net margin on interest-earning assets			3.75%			4.10%

Interest on tax-exempt securities, loans and dividends are reported on fully taxable equivalent basis, and excludes fee income.

* Includes non-accrual loans.

Interest income, on a fully taxable equivalent basis, for interest-bearing deposits in the Federal Reserve Bank (“FRB”) and the Federal Home Loan Bank of Atlanta (“FHLBA”), federal funds sold, and time deposits in other banks decreased \$58,866, or 41.5%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. Average balances for these instruments increased \$236,890, or 1.2%, for the first quarter of 2020 when compared to the same period in 2019. The weighted average rate earned on these holdings, on a fully taxable equivalent basis, decreased 122 basis points to 1.63% for the three-month period ended March 31, 2020 when compared to the same period in 2019.

Interest income on investment securities, on a fully taxable equivalent basis, for the three-month period ended March 31, 2020 increased \$3,347, or 1.6%, when compared to the same period in 2019. Average balances of investment securities for the three-month period ended March 31, 2020 increased \$6,622,901, or 19.4%, when compared to the same period in 2019. The weighted average rate earned on investment securities, on a fully taxable equivalent basis, decreased 38 basis points to 2.08% for the three-month period ended March 31, 2020 when compared to the same period in 2019.

The Bank is a member of the FHLBA and is required to purchase capital stock of the FHLBA as a condition to obtaining a line of credit. Dividends on FHLBA capital stock may be paid to member banks subject to the discretion of the Board of Directors of the FHLBA. For the three months ended March 31, 2020, the Bank recorded dividends received or accrued on stock issued by the FHLBA in the amount of \$17,308 on a fully taxable equivalent basis, compared to \$27,174 for the same period in 2019, a decrease of \$9,866, or 36.3%. The average balance of FHLBA capital stock for the three-month period ended March 31, 2020 decreased \$257,636, or 18.1%, when compared to the same period in 2019. The weighted average rate earned on FHLBA capital stock, on a fully taxable equivalent basis, decreased 177 basis points to 5.97% for the three-month period ended March 31, 2020 when compared to the same period in 2019.

Interest expense on interest-bearing deposit liabilities increased \$136,597, or 41.6%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. The average balance of interest-bearing deposit liabilities increased \$12,156,350, or 5.5%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. The weighted-average rate paid on these deposits increased 20 basis points to 0.80% for the three-month period ended March 31, 2020 when compared to the same period of 2019.

Interest expense on total borrowed funds decreased \$37,164, or 24.0%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. The average balance of total borrowed funds decreased \$7,197,803, or 27.7%, for the three-month period ended March 31, 2020 when compared to the same period in 2019. The weighted-average rate paid on total borrowed funds increased 10 basis points to 2.52% for the three-month period ended March 31, 2020 when compared to the same period of 2019.

Net interest income, on a fully taxable equivalent basis, for the three-month period ended March 31, 2020 was \$3,292,011, a decrease of \$122,373, or 3.6%, when compared to the same period in 2019. The key performance measure for net interest income is the “net margin on interest-earning assets,” or annualized net interest income divided by average interest-earning assets. The Bank’s net interest margin, on a fully taxable equivalent basis, decreased 35 basis points to 3.75% for the three months ended March 31, 2020 when compared to the same period in 2019. The net margin may be adversely affected by increases in competition, volatile interest rates, decreases in loan demand, changes in the mix of earning assets, the Bank’s cost of funds where it outpaces the return on the Bank’s loans and investment securities, and other unpredictable changes in the marketplace. The “net interest spread” is the rate earned on interest-earning assets less the rate paid on interest-bearing liabilities. The net interest spread decreased 41 basis points to 3.48% for the three months ended March 31, 2020 when compared to the same period in 2019.

Provision for Loan Losses

The provision for or recovery of loan losses is determined by management as the amount to be added to or subtracted from, respectively, the allowance for loan losses after net charge-offs (charge-offs less recoveries) have been deducted to bring the allowance for loan losses to a level which, in management’s best estimation, is necessary to absorb probable losses inherent in the existing loan portfolio. The Bank recorded provision expense for the three-month period ended March 31, 2020 of \$463,000, compared to provision expense of \$20,000 recorded for the same period of 2019, an increase of \$443,000. The difference in the amount of the provision for loan losses between the 2020 and 2019 periods resulted from changes in loan volume and mix and management’s assessment of the current market conditions and analysis of inherent risk within the loan portfolio.

Noninterest Revenue

Noninterest revenue for the three-month period ended March 31, 2020 was \$405,390, compared to \$331,045 for the same period in 2019, an increase of \$74,345, or 22.5%. The increase was due to increases of \$34,859 in service charges on deposit accounts, \$363 in earnings on bank owned life insurance, and \$39,123 in other fees and commissions for the three months ended March 31, 2020 when compared to the same period in 2019.

Noninterest Expenses

Noninterest expenses for the three-month period ended March 31, 2020 were \$2,631,928, compared to \$2,533,818 for the same period in 2019, representing an increase of \$98,110, or 3.9%. Comparing the first quarter of 2020 to the first quarter of 2019, the increase in noninterest expenses was mainly attributable to increases in salaries and benefits expense of \$17,183, occupancy expense of \$32,055, data processing expense of \$39,412, and other operating expenses of \$31,086, partially offset by decreases in FDIC and state assessment expense of \$24,327 and advertising expense of \$7,873.

Income Tax Expense

Income tax expense for the three-month period ended March 31, 2020 was \$164,989, compared to \$303,808 for the same period of 2019, a decrease of \$138,819. The decrease was primarily due to lower income before income taxes earned for the three months ended March 31, 2020 when compared to the same period of 2019. The Bank's effective income tax rate was 24.3% for the three-month period ended March 31, 2020, compared to 25.4% for the same period in 2019.

FINANCIAL CONDITION

Assets

Total assets at March 31, 2020 increased \$8,120,843, or 2.2%, to \$385,408,509, from \$377,287,666 at December 31, 2019.

The Bank invests excess cash balances in interest-bearing accounts at other banks and federal funds sold to correspondent banks. These balances decreased \$5,152,911, or 19.7%, to \$21,004,458 at March 31, 2020, from \$26,157,369 at December 31, 2019.

Investment securities decreased \$1,884,567, or 4.5%, to \$40,192,708 at March 31, 2020, from \$42,077,275 at December 31, 2019.

Loans

Loans, net of the allowance for loan losses, increased \$15,266,420, or 5.4%, to \$298,946,343 at March 31, 2020, from \$283,679,923 at December 31, 2019. The average net loan portfolio represented 82.3% of average earning assets for the three-month period ended March 31, 2020, compared to 83.5% for the same period in 2019.

The following table sets forth the major classifications of the Bank's loan portfolio.

	March 31, 2020		December 31, 2019	
	Amount	% of Total	Amount	% of Total
Real estate				
Construction, development and other land	\$ 12,075,975	3.99%	\$ 10,417,218	3.63%
Secured by farmland	5,542,702	1.83%	5,918,714	2.06%
Commercial	176,862,956	58.39%	168,773,371	58.78%
Residential	82,984,036	27.40%	77,563,922	27.02%
Commercial	16,895,646	5.58%	15,516,630	5.40%
Mobile home	4,295,093	1.42%	4,526,036	1.58%
Other consumer	4,154,434	1.37%	4,275,494	1.49%
Overdrafts	72,464	0.02%	118,583	0.04%
Gross loans	302,883,306	100.00%	287,109,968	100.00%
Net deferred (fees) costs	(221,851)		(175,839)	
Allowance for loan losses	(3,715,112)		(3,254,206)	
Net loans	<u>\$ 298,946,343</u>		<u>\$ 283,679,923</u>	
Allowance for loan losses to gross loans	<u>1.23%</u>		<u>1.13%</u>	

Loan Credit Risk Management

The Bank's loan portfolio is subject to varying degrees of credit risk. The Bank seeks to mitigate credit risk through portfolio diversification, limiting exposure to any single industry or customer, collateral protection and strong underwriting criteria. The following discussion provides information and statistics on the overall quality of the Bank's loan portfolio. Notes 1 and 4 to the consolidated financial statements included elsewhere in this report describe the accounting policies related to nonperforming loans and charge-offs, and foreclosed and repossessed assets, and describes the methodologies used to develop the allowance for loan losses.

Management believes the policies governing nonperforming loans and charge-offs are consistent with industry and regulatory standards. The amount of the allowance for loan losses and the resulting provision for loan losses are reviewed and approved quarterly by the Board of Directors.

The following table provides a comprehensive view of the allowance for loan losses activity including the periodic activity of charge-offs and recoveries allocated by loan class for the three- and twelve-month periods ended March 31, 2020 and December 31, 2019, respectively, and the allocation of allowance for loan losses and the balances of loans that were individually and collectively evaluated for impairment at March 31, 2020 and December 31, 2019.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial	Mobile Home	Other Consumer	Overdrafts	Total
March 31, 2020									
Allowance for loan losses:									
Beginning balance	\$ 45,780	\$ 213,426	\$ 1,860,385	\$ 655,669	\$ 244,912	\$ 182,609	\$ 32,136	\$ 19,289	\$ 3,254,206
Charge-offs	-	-	-	-	-	-	-	(7,708)	(7,708)
Recoveries	-	-	-	2,000	1,800	600	-	1,214	5,614
Provision or (recovery of provision)	(42,671)	37,836	393,288	57,285	23,263	(11,313)	(48)	5,360	463,000
Ending balance	<u>\$ 3,109</u>	<u>\$ 251,262</u>	<u>\$ 2,253,673</u>	<u>\$ 714,954</u>	<u>\$ 269,975</u>	<u>\$ 171,896</u>	<u>\$ 32,088</u>	<u>\$ 18,155</u>	<u>\$ 3,715,112</u>
Allowance balance allocated to loans:									
Individually evaluated for impairment	\$ -	\$ -	\$ 524,000	\$ 5,000	\$ 3,741	\$ 2,000	\$ -	\$ -	\$ 534,741
Collectively evaluated for impairment	<u>3,109</u>	<u>251,262</u>	<u>1,729,673</u>	<u>709,954</u>	<u>266,234</u>	<u>169,896</u>	<u>32,088</u>	<u>18,155</u>	<u>3,180,371</u>
	<u>\$ 3,109</u>	<u>\$ 251,262</u>	<u>\$ 2,253,673</u>	<u>\$ 714,954</u>	<u>\$ 269,975</u>	<u>\$ 171,896</u>	<u>\$ 32,088</u>	<u>\$ 18,155</u>	<u>\$ 3,715,112</u>
Loan balances:									
Individually evaluated for impairment		<u>\$ 251,881</u>	<u>\$ 11,311,724</u>	<u>\$ 702,048</u>	<u>\$ 330,187</u>	<u>\$ 87,662</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,683,502</u>
Collectively evaluated for impairment		<u>\$ 11,824,094</u>	<u>\$ 171,093,934</u>	<u>\$82,281,988</u>	<u>\$ 16,565,459</u>	<u>\$ 4,207,431</u>	<u>\$4,154,434</u>	<u>\$ 72,464</u>	<u>\$ 290,199,804</u>
December 31, 2019									
Allowance for loan losses:									
Beginning balance	\$ 150,049	\$ 187,984	\$ 1,554,315	\$ 674,601	\$ 232,097	\$ 214,548	\$ 29,675	\$ 11,493	\$ 3,054,762
Charge-offs	-	-	-	(16,119)	-	(32,892)	(4,705)	(17,168)	(70,884)
Recoveries	-	51,459	-	12,000	7,066	2,200	-	2,603	75,328
Provision or (recovery of provision)	(104,269)	(26,017)	306,070	(14,813)	5,749	(1,247)	7,166	22,361	195,000
Ending balance	<u>\$ 45,780</u>	<u>\$ 213,426</u>	<u>\$ 1,860,385</u>	<u>\$ 655,669</u>	<u>\$ 244,912</u>	<u>\$ 182,609</u>	<u>\$ 32,136</u>	<u>\$ 19,289</u>	<u>\$ 3,254,206</u>
Allowance balance allocated to loans:									
Individually evaluated for impairment	\$ -	\$ -	\$ 250,000	\$ 10,000	\$ 3,689	\$ 4,000	\$ -	\$ -	\$ 267,689
Collectively evaluated for impairment	<u>45,780</u>	<u>213,426</u>	<u>1,610,385</u>	<u>645,669</u>	<u>241,223</u>	<u>178,609</u>	<u>32,136</u>	<u>19,289</u>	<u>2,986,517</u>
	<u>\$ 45,780</u>	<u>\$ 213,426</u>	<u>\$ 1,860,385</u>	<u>\$ 655,669</u>	<u>\$ 244,912</u>	<u>\$ 182,609</u>	<u>\$ 32,136</u>	<u>\$ 19,289</u>	<u>\$ 3,254,206</u>
Loan balances:									
Individually evaluated for impairment		<u>\$ 254,071</u>	<u>\$ 11,066,347</u>	<u>\$ 726,758</u>	<u>\$ 230,533</u>	<u>\$ 60,800</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,338,509</u>
Collectively evaluated for impairment		<u>\$ 10,163,147</u>	<u>\$ 163,625,738</u>	<u>\$76,837,164</u>	<u>\$ 15,286,097</u>	<u>\$ 4,465,236</u>	<u>\$4,275,494</u>	<u>\$118,583</u>	<u>\$ 274,771,459</u>

The allowance for loan losses is increased by provisions for loan losses charged to expense and recoveries of loans previously charged-off. The allowance for loan losses is decreased by loan charge-offs and recovery of provision for loan losses expense. Recovery of or provisions for loan losses are made to bring the allowance for loan losses within the range of balances that are considered appropriate based upon the allowance methodology and to reflect losses inherent in the loan portfolio as of the balance sheet date. The allowance for loan losses methodology includes allowance allocations calculated in accordance with Financial Accounting Standards Board Accounting Standards Codification (“ASC”) Topic 310, “Receivables” and allowance allocations calculated in accordance with ASC Topic 450, “Contingencies.” Accordingly, the methodology is based on historical loss experience by loan classification and on specific

loss allocations, with adjustments for current events and conditions. Management's process for determining the appropriate level of the allowance for loan losses is designed to account for credit deterioration as it occurs. The recovery of or provision for loan losses reflects loan quality trends, including the levels of and trends related to non-accrual loans, past due loans, potential problem loans, and net charge-offs or recoveries, among other factors. The recovery of or provision for loan losses also reflect the totality of actions taken on all loans for a particular period. The amount of the recovery of or provision for loan losses reflects not only the necessary decreases or increases in the allowance for loan losses related to newly identified rated loans, but it also reflects actions taken related to other loans including, among other things, any necessary increases or decreases in required allowances for specific loans or loan pools.

The allowance for loan losses was \$3,715,112 at March 31, 2020, compared to \$3,254,206 at December 31, 2019, an increase of \$460,906. The increase was due to the provision for loan losses of \$463,000 plus recoveries of amounts previously charged-off of \$5,614, partially offset by amounts charged-off of \$7,708. The "Allowance for Loan Losses to Gross Loans" ratio at March 31, 2020 was 1.23%, compared to 1.13% at December 31, 2019. The allowance level reflects the results of management's assessment of the current market conditions and analysis of inherent risk within the loan portfolio performed during the quarter.

The adequacy of the allowance for loan losses is determined based upon management's estimate of the inherent risks associated with lending activities, estimated fair value of collateral, past experience and present indicators such as loan delinquency trends, nonaccrual loans and current market conditions. Management believes that the allowance is adequate as of March 31, 2020; however, future changes in the composition of the loan portfolio and financial condition of borrowers may result in additions to or subtractions from the allowance. Examination of the loan portfolio and allowance for loan losses by regulatory agencies, auditors and consultants engaged by the Bank may result in the need for additional provisions or reversals of provision based upon information available at the time of examination.

Risk Elements of Loan Portfolio

The following table analyzes the status of loans by loan classification at the dates indicated.

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Over Past Due	Total Past Due	Current	Total Loans	Loans over 90 Days and Accruing
March 31, 2020							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 12,075,975	\$ 12,075,975	\$ -
Commercial real estate and farmland	298,872	-	447,830	746,702	181,658,956	182,405,658	-
Residential real estate	177,685	-	-	177,685	82,806,351	82,984,036	-
Commercial	42,854	-	-	42,854	16,852,792	16,895,646	-
Mobile homes	342,213	32,206	-	374,419	3,920,674	4,295,093	-
Other consumer and overdrafts	46,146	-	-	46,146	4,180,752	4,226,898	-
Total	<u>\$ 907,770</u>	<u>\$ 32,206</u>	<u>\$ 447,830</u>	<u>\$ 1,387,806</u>	<u>\$ 301,495,500</u>	<u>\$ 302,883,306</u>	<u>\$ -</u>
December 31, 2019							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 10,417,218	\$ 10,417,218	\$ -
Commercial real estate and farmland	175,364	381,108	-	556,472	174,135,613	174,692,085	-
Residential real estate	-	11,650	72,379	84,029	77,479,893	77,563,922	-
Commercial	-	-	-	-	15,516,630	15,516,630	-
Mobile homes	299,296	9,508	-	308,804	4,217,232	4,526,036	-
Other consumer and overdrafts	16,599	-	-	16,599	4,377,478	4,394,077	-
Total	<u>\$ 491,259</u>	<u>\$ 402,266</u>	<u>\$ 72,379</u>	<u>\$ 965,904</u>	<u>\$ 286,144,064</u>	<u>\$ 287,109,968</u>	<u>\$ -</u>

The following table summarizes nonaccrual loans and other non-performing assets for the dates indicated.

Non-performing Assets	March 31, 2020	December 31, 2019
Non-accrual loans by class		
Real estate		
Commercial real estate and farmland	\$ 5,169,986	\$ 4,786,464
Residential real estate	166,965	176,146
Mobile home	47,635	51,293
Total non-accrual loans	5,384,586	5,013,903
Foreclosed real estate	-	58,500
Repossessed assets	-	-
Total non-performing assets	\$ 5,384,586	\$ 5,072,403

The following table summarizes troubled debt restructured loans by loan classification for the dates indicated.

	March 31, 2020		December 31, 2019	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	5	\$ 4,634,510	5	\$ 4,699,422
Residential real estate	-	-	-	-
Commercial	-	-	-	-
	5	\$ 4,634,510	5	\$ 4,699,422

Further information about the loan portfolio is provided in Note 4 to the consolidated financial statements included elsewhere in this report.

Off-Balance Sheet Arrangements

In the normal course of business, to meet the financing needs of its customers, the Bank is a party to financial instruments with off-balance sheet risk. These financial instruments include commitments to extend credit, lines of credit, and standby letters of credit. The Bank's exposure to credit loss in the event of nonperformance by the other party to these financial instruments is represented by the contractual amount of the instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments. The Bank generally requires collateral or other security to support the financial instruments with credit risk. The amount of collateral or other security is determined based on management's credit evaluation of the counterparty. The Bank evaluates each customer's creditworthiness on a case-by-case basis.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Letters of credit and other commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Because many of the letters of credit and commitments are expected to expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements.

Management does not believe that any of the foregoing arrangements are reasonably likely to have an impact on the Bank's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Further information about these arrangements is provided in Note 5 to the consolidated financial statements included elsewhere in this report.

Deposit Liabilities

Total deposit liabilities at March 31, 2020 were \$322,410,384, an increase of \$9,569,448, or 3.1%, when compared to total deposit liabilities at December 31, 2019. Interest-bearing deposit liabilities at March 31, 2020 were \$239,196,758, an increase of \$5,613,246, or 2.4%, when compared to December 31, 2019. The Bank utilizes core deposits primarily to fund its earning assets. During the three-month period ended March 31, 2020, average deposit liabilities provided funding for approximately 89.0% of average earning assets, compared to 87.2% for the comparable period of 2019.

Certificates of deposit greater than the FDIC deposit insurance limit of \$250,000 at March 31, 2020 were \$27,535,438, compared to \$26,087,312 at December 31, 2019.

Borrowings

The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the FHLBA. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans.

The following table summarizes the Bank's fixed rate FHLBA advances.

Maturity Date	Interest Rate	Interest Frequency	March 31, 2020	December 31, 2019
March 20, 2020	2.8500%	Quarterly	\$ -	\$ 1,500,000
June 29, 2020	1.7100%	Monthly	2,500,000	2,500,000
September 21, 2020	2.9385%	Quarterly	1,500,000	1,500,000
December 29, 2020	2.2500%	Monthly	1,000,000	1,000,000
March 22, 2021	3.0195%	Quarterly	1,500,000	1,500,000
June 21, 2021	3.0535%	Quarterly	1,500,000	1,500,000
October 29, 2021	2.1300%	Monthly	3,000,000	3,000,000
December 29, 2021	2.3800%	Monthly	1,000,000	1,000,000
March 21, 2022	3.1155%	Quarterly	3,000,000	3,000,000
June 28, 2022	2.0600%	Monthly	2,500,000	2,500,000
			<u>\$ 17,500,000</u>	<u>\$ 19,000,000</u>

Further information about these advances is provided in Note 9 to the consolidated financial statements included elsewhere in this report.

Capital

Total stockholders' equity was \$42,897,935 at March 31, 2020, an increase of \$369,785, or 0.9%, when compared to total stockholders' equity at December 31, 2019. The increase was due to earnings in the amount of \$513,501 and stock transactions netting \$98,513, partially offset by dividends declared and paid of \$242,229.

In July 2013, the Board of Governors of the FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and fully phased-in as of January 1, 2019, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new minimum Common Equity Tier 1 capital ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which are now fully phased-in, effectively resulting in a minimum CET1 ratio of 7.0%. Basel III raised the minimum Tier 1 capital ratio from 4.0% to 6.0% which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%. Basel III maintained the minimum total capital ratio of 8.0%, which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 10.5%. Basel III maintains the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

The Bank continues to maintain capital at levels in excess of the minimum risk-based capital requirements adopted by the federal banking agencies and was considered to be "well capitalized" as of March 31, 2020. One measure of capital adequacy is the risk-based capital ratio, or the ratio of total capital to risk adjusted assets. Total capital is composed of both core capital (Tier 1) and supplemental capital (Tier 2). Total assets are adjusted for off-balance sheet items, such as letters of credit, and the different degrees of risk among various assets. Regulators require a minimum risk-based capital ratio of 10.50% including the fully phased-in amount of the capital conservation buffer, with 10.00% being the regulatory minimum for well-capitalized banks. At March 31, 2020, the Bank's risk-based capital ratio was 15.58%.

The CET1 capital ratio, which became effective for the Bank January 1, 2015, is the ratio of CET1 to risk adjusted assets. CET1 capital consists of common stock, surplus and undivided profits. Regulators require a minimum CET1 ratio of 7.00% including the fully phased-in amount of the capital conservation buffer, with 6.50% being the regulatory minimum for well-capitalized banks. At March 31, 2020, the Bank's CET1 ratio was 14.34%.

Tier 1 capital consists of CET1 capital plus certain additional Tier 1 capital instruments. The Tier 1 capital ratio is the ratio of Tier 1 capital to risk adjusted assets. The Bank had no additional Tier 1 capital instruments. Regulators require a minimum Tier 1 capital ratio of 8.50% including the fully phased-in amount of the capital conservation buffer, with 8.00% being the regulatory minimum for well-capitalized banks. At March 31, 2020, the Bank's Tier 1 capital ratio was 14.34%.

Another measure of capital adequacy is the leverage capital ratio, which is calculated by dividing average total assets for the most recent quarter into Tier 1 capital outstanding at the end of the quarter. The regulatory minimum for this ratio is 4.00%, with 5.00% being the regulatory minimum for well-capitalized banks. The Bank's leverage capital ratio as of March 31, 2020 was 11.32%.

Management is not aware of any trends, favorable or unfavorable, that are likely to have a material effect on our financial condition or on our earnings. Further information about these capital standards is provided in Note 14 to the consolidated financial statements included elsewhere in this report.

Liquidity

Liquidity describes the ability of the Bank to meet financial obligations that arise during the normal course of business. Liquidity is primarily needed to meet the borrowing and deposit withdrawal requirements of customers and to fund current and planned expenditures. Liquidity is derived through increased customer deposits, maturities in the investment portfolio, loan repayments and income from earning assets. To the extent that deposits are not adequate to fund customer loan demand, liquidity needs can be met in short-term funds markets. The Bank has arrangements with correspondent banks whereby it has \$3,000,000 available in unsecured federal funds lines of credit, and \$5,000,000 available through a secured credit facility.

The Bank is also a member of the FHLBA, which provides another source of liquidity. The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the lender. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans. The Bank is required to purchase shares of capital stock in the FHLBA as a condition to obtaining the line of credit. Based on the value of available collateral as of March 31, 2020, the Bank could borrow an additional \$59,880,623 from the FHLBA.

The Bank is eligible to borrow from the Federal Reserve Bank ("FRB") Discount Window. This credit line is secured by the Bank's eligible consumer loan portfolio. Based on the value of available collateral as of March 31, 2020, the Bank could borrow \$4,936,793 from the FRB Discount Window.

The Certificate of Deposit Account Registry Service ("CDARS") network is a form of brokered deposit program in which the Bank has been a participant in since June 2005. In addition to providing Bank clients enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through the One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes that this arrangement would be a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may borrow up to 10% of its reported total assets as of March 31, 2020, or \$38,540,850.

Further information about borrowings and available lines of credit is provided in Note 9 to the consolidated financial statements included elsewhere in this report.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Bank's principal market risk is the fluctuation of interest rates and the impact such fluctuation would have on the Bank's lending, investing and deposit activities. Management has adopted procedures to evaluate and mitigate this risk. This risk and management's procedures are discussed in detail in Item 7 of Part II of the Bank's Annual Report on Form 10-K for the year ended December 31, 2019 under the caption "Market Risk Management". Management believes that there have been no material changes in the Bank's market risks, or the procedures used to evaluate and mitigate these risks since December 31, 2019. At March 31, 2020, the model simulations projected the following percentage changes in net interest income from the base case (no change in rates) over the next 12 months for the various interest rate change scenarios listed in the table below. Given prevailing interest rates at March 31, 2020, the likelihood that interest rates will decrease by more than 200 basis points in the foreseeable future is considered remote.

	+300	+200	+100	-100	-200	-300
Change in interest rates:	Basis points	Basis points	Basis points	Basis points	Basis points	Basis points
Projected change in net interest income	0.69%	0.70%	0.50%	-0.20%	-0.33%	N/A

Item 4. Controls and Procedures.

The Bank maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Bank's reports filed under the Securities Exchange Act of 1934 with the FDIC, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in those rules and forms, and that such information is accumulated and communicated to the Bank's management, including its principal executive officer ("PEO") and its principal financial officer ("PFO"), as appropriate, to allow for timely decisions regarding required disclosure. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate.

An evaluation of the effectiveness of these disclosure controls as of March 31, 2020 was carried out under the supervision and with the participation of the Bank's management, including the PEO and PFO. Based on that evaluation, the Bank's management, including the PEO and PFO, has concluded that the Bank's disclosure controls and procedures are, in fact, effective at the reasonable assurance level.

During the quarter ended March 31, 2020, there was no change in the Bank's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Bank's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Bank is party to various legal actions normally associated with a financial institution. In management's opinion, none of these actions is likely to have a material effect on the Bank's financial condition or future results of operations.

Item 1A. Risk Factors.

The risks and uncertainties to which the Bank's financial condition and operations are subject are discussed in detail in Item 1A of Part I of the Bank's Annual Report on Form 10-K for the year ended December 31, 2019. Management does not believe that any material changes in the Bank's risk factors have occurred since these risks were last discussed, with the exception of:

The ongoing COVID-19 pandemic and measures intended to prevent its spread could have a material adverse effect on the Bank's business, results of operations and financial condition, and such effects will depend on future developments, which are highly uncertain and are difficult to predict.

Global health concerns relating to the COVID-19 outbreak and related government actions taken to reduce the spread of the virus have been weighing on the macroeconomic environment, and the outbreak has significantly increased economic uncertainty and reduced economic activity. The outbreak has resulted in authorities implementing numerous measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter in place or total lock-down orders and business limitations and shutdowns. Such measures

have significantly contributed to rising unemployment and negatively impacted consumer and business spending. The governments of the United States and the State of Maryland have taken steps to attempt to mitigate some of the more severe anticipated economic effects of the virus, including the passage of the CARES Act, but there can be no assurance that such steps will be effective or achieve their desired results in a timely fashion.

The outbreak has adversely impacted and is likely to further adversely impact the Bank's workforce and operations and the operations of the Bank's borrowers, customers and business partners. In particular, the Bank may experience financial losses due to a number of operational factors impacting the Bank or the Bank's borrowers, customers or business partners, including but not limited to:

- Credit losses resulting from financial stress being experienced by borrowers as a result of the outbreak and related governmental actions, particularly in the hospitality, retail and restaurant industries, but across other industries as well;
- Declines in collateral values;
- Third party disruptions, including outages at network providers and other suppliers;
- Increased cyber and payment fraud risk, as cybercriminals attempt to profit from the disruption, given increased online and remote activity; and
- Operational failures due to changes in the Bank's normal business practices necessitated by the outbreak and related governmental actions.

These factors may remain prevalent for a significant period of time and may continue to adversely affect our business, results of operations and financial condition even after the COVID-19 outbreak has subsided.

The spread of COVID-19 has caused the Bank to modify business practices (including restricting employee travel, and developing work from home and social distancing plans for employees), and the Bank may take further actions as may be required by government authorities or if the Bank determines such actions are in the best interests of our employees, customers and business partners. There is no certainty that such measures will be sufficient to mitigate the risks posed by the virus or will otherwise be satisfactory to government authorities.

The extent to which the COVID-19 outbreak impacts the Bank's business, results of operations and financial condition will depend on future developments, which are highly uncertain and are difficult to predict, including, but not limited to, the duration and spread of the outbreak, its severity, the actions to contain the virus or treat its impact, and how quickly and to what extent normal economic and operating conditions can resume. Even after the COVID-19 outbreak has subsided, the Bank may continue to experience materially adverse impacts to the Bank's business as a result of the virus's global economic impact, including the availability of credit, adverse impacts on the Bank's liquidity and any recession that has occurred or may occur in the future.

There are no comparable recent events that provide guidance as to the effect the spread of COVID-19 as a global pandemic may have, and, as a result, the ultimate impact of the outbreak is highly uncertain and subject to change. The Bank does not yet know the full extent of the impacts on the Bank's business or operations, or on the business or operations of the Bank's borrowers and customers, or on the economy as a whole. However, the effects could have a material impact on the Bank's results of operations and heighten many of the risks described in the "Risk Factors" section of our Annual Report on Form 10-K for the year ended December 31, 2019.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Section 3(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"), exempts from the definition of "security" any securities issued by a bank, and the FDIC, as the Bank's primary federal regulator, does not require the registration of the Bank's securities prior to offer or sale. From time to time, the Bank sells shares of its common stock pursuant to its dividend reinvestment plan ("DRIP") and upon exercise of options granted under its Director Stock Purchase Plan, Incentive Stock Option Plan, 2004 Director Non-Qualified Stock Option Plan (the "2004 Plan"), 2008 Employee Stock Purchase Plan (the "2008 Employee Plan") and the 2008 Key Employee Stock Option Plan (the 2008 "Key Employee Plan"). The DRIP and all equity compensation plans other than the 2004 Director Plan, 2008 Employee Plan and the 2008 Key Employee Plan were adopted before the Bank converted from a national banking association into a state chartered bank, and the Office of the Comptroller of the Currency required that the shares issuable under such plans be registered under the Securities Act prior to their offer and sale. The 2004 Plan expired in April 2014, and, on April 9, 2015, the Bank's Board of Directors adopted the Harford Bank 2015 Director Stock Option Plan (the "2015 Plan") so that the Bank may continue to incent non-employee directors through the grant of non-qualified stock options. The 2008 Employee Plan and the 2008 Key Employee Plan expired in April 2018, and no further grants may be made under those plans. Granted options remain outstanding and subject to exercise until July 2020 under the 2008 Employee Plan. Granted options remain outstanding and subject to exercise until April 2028 under the 2008 Key Employee Plan.

During the first quarter of 2020, a net total of 3,224 shares of common stock were sold pursuant to the DRIP at \$23.00 per share. During the first quarter of 2020, a total of 2,512 shares of common stock issued pursuant to the exercise of options at an average exercise price of \$12.92 per share.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The exhibits filed or furnished herewith are listed in the following Exhibit Index:

<u>Exhibit No.</u>	<u>Description</u>
Exhibit 31.1	Certifications of the Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 31.2	Certifications of the Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
Exhibit 32.1	Certification of the Periodic Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

SIGNATURES

Pursuant to the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HARFORD BANK

Date: May 6, 2020

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: May 6, 2020

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer & Principal Accounting Officer)

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CONDITION

At:	March 31, 2020	December 31, 2019
ASSETS	(Unaudited)	
Cash and due from banks	\$ 5,331,268	\$ 6,064,958
Federal Reserve Bank deposit	19,137,198	24,784,162
Federal funds sold and Federal Home Loan Bank deposit	<u>117,260</u>	<u>123,207</u>
Cash and cash equivalents	24,585,726	30,972,327
Time deposits in other banks	1,750,000	1,250,000
Investment securities held to maturity (fair value of \$41,000,999 in 2020 and \$42,306,343 in 2019)	40,192,708	42,077,275
Federal Home Loan Bank stock, at cost	1,083,400	1,178,300
Total loans, including deferred fees net of costs	302,661,455	286,934,129
Less: Allowance for loan losses	<u>(3,715,112)</u>	<u>(3,254,206)</u>
Net loans	298,946,343	283,679,923
Bank premises and equipment, net	8,788,417	8,709,600
Income taxes refundable	-	153,264
Accrued interest receivable	895,714	870,208
Deferred income taxes	587,400	587,400
Bank owned life insurance	6,529,704	6,493,400
Foreclosed real estate	-	58,500
Other assets	<u>2,049,097</u>	<u>1,257,469</u>
Total assets	<u>\$ 385,408,509</u>	<u>\$ 377,287,666</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 83,213,626	\$ 79,257,424
Interest-bearing	<u>239,196,758</u>	<u>233,583,512</u>
Total deposits	322,410,384	312,840,936
Federal Home Loan Bank advances	17,500,000	19,000,000
Accrued interest payable	218,476	213,909
Income taxes payable	11,725	-
Other liabilities	<u>2,369,989</u>	<u>2,704,671</u>
	<u>342,510,574</u>	<u>334,759,516</u>
Stockholders' equity		
Common stock, par value \$10 per share; authorized 5,000,000 shares; issued and outstanding 1,429,618 shares in 2020, and 1,423,882 shares in 2019	14,296,180	14,238,820
Surplus	16,987,820	16,946,667
Undivided profits	<u>11,613,935</u>	<u>11,342,663</u>
Total stockholders' equity	<u>42,897,935</u>	<u>42,528,150</u>
Total liabilities and stockholders' equity	<u>\$ 385,408,509</u>	<u>\$ 377,287,666</u>

The accompanying notes are an integral part of these consolidated financial statements.

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

	For the three months ended March 31,	
	2020	2019
Interest revenue		
Loans, including fees	\$ 3,640,335	\$ 3,547,844
Investment securities held to maturity	210,596	198,177
Federal funds sold and Federal Home Loan Bank deposit	1,630	1,641
Federal Reserve Bank deposit	72,916	130,892
Time deposits in other banks	8,443	140
Other	17,308	25,403
Total interest revenue	<u>3,951,228</u>	<u>3,904,097</u>
Interest expense		
Deposits	465,191	328,594
Borrowed funds	118,009	155,173
Total interest expense	<u>583,200</u>	<u>483,767</u>
Net interest income	<u>3,368,028</u>	<u>3,420,330</u>
Provision for loan losses	<u>463,000</u>	<u>20,000</u>
Net interest income after provision for loan losses	<u>2,905,028</u>	<u>3,400,330</u>
Noninterest revenue		
Service charges on deposit accounts	182,080	147,221
Earnings on bank owned life insurance	36,303	35,940
Other fees and commissions	187,007	147,884
Total noninterest revenue	<u>405,390</u>	<u>331,045</u>
Noninterest expense		
Salaries and benefits	1,467,477	1,450,294
Occupancy	227,334	195,279
Furniture and equipment	131,722	128,137
Data processing expense	226,087	186,675
Professional fees	110,706	111,109
Director and committee fees	55,350	56,500
Stationery and supplies	50,698	49,276
FDIC and state assessments	11,185	35,512
Advertising	39,259	47,132
Net expenses, losses and write-downs on repossessed assets and foreclosed real estate	2,800	(4,320)
Other operating	309,310	278,224
Total noninterest expense	<u>2,631,928</u>	<u>2,533,818</u>
Income before income taxes	678,490	1,197,557
Income taxes	<u>164,989</u>	<u>303,808</u>
Net income	<u>\$ 513,501</u>	<u>\$ 893,749</u>
Basic net income per share	\$ 0.36	\$ 0.63
Diluted net income per share	\$ 0.36	\$ 0.62

The accompanying notes are an integral part of these consolidated financial statements.

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

Three Months Ended March 31, 2020 and 2019

	Common stock			Undivided	Total
	Shares	Par value	Surplus	profits	Stockholders' Equity
Balance, January 1, 2019	1,410,371	\$ 14,103,710	\$ 16,719,667	\$ 8,774,102	\$ 39,597,479
Net income				893,749	893,749
Cash dividends, \$0.00 per share				-	-
Common stock issued					
Shares issued under stock-based compensation					
plans and related tax effects	997	9,970	12,510	-	22,480
Stock sold and dividend reinvestment plan (DRIP)	3,111	31,110	54,131	-	85,241
Stock-based compensation expense	-	-	7,400	-	7,400
Stock acquired for DRIP administration	-	-	-	-	-
Balance, March 31, 2019	<u>1,414,479</u>	<u>\$ 14,144,790</u>	<u>\$ 16,793,708</u>	<u>\$ 9,667,851</u>	<u>\$ 40,606,349</u>
Balance, January 1, 2020	1,423,882	\$ 14,238,820	\$ 16,946,667	\$ 11,342,663	\$ 42,528,150
Net income				513,501	513,501
Cash dividends, \$0.17 per share				(242,229)	(242,229)
Common stock issued					
Shares issued under stock-based compensation					
plans and related tax effects	2,512	25,120	(7,728)	-	17,392
Stock sold and dividend reinvestment plan (DRIP)	3,224	32,240	41,912	-	74,152
Stock-based compensation expense	-	-	6,969	-	6,969
Stock acquired for DRIP administration	-	-	-	-	-
Balance, March 31, 2020	<u>1,429,618</u>	<u>\$ 14,296,180</u>	<u>\$ 16,987,820</u>	<u>\$ 11,613,935</u>	<u>\$ 42,897,935</u>

The accompanying notes are an integral part of these consolidated financial statements.

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For the Three Months Ended March 31,	2020	2019
Cash flows provided by (used in) operating activities		
Interest received	\$ 3,942,268	\$ 3,816,785
Fees and commissions received	464,698	374,738
Interest paid	(578,633)	(455,918)
Cash paid to suppliers and employees	(3,662,430)	(3,271,145)
Net cash provided by (used in) operating activities	<u>165,903</u>	<u>464,460</u>
Cash flows provided by (used in) investing activities		
Purchases of time deposits in other banks	(500,000)	(250,000)
Proceeds from calls and maturities of investment securities	6,977,429	3,414,189
Purchases of investment securities	(5,122,705)	(4,410,935)
Redemption (purchase) of FHLB stock	94,900	(11,000)
Loans originated, net of principal repayments	(15,775,431)	855,262
Proceeds from sale of foreclosed real estate	56,486	-
Purchases of bank premises and equipment	(201,946)	(114,313)
Net cash provided by (used in) investing activities	<u>(14,471,267)</u>	<u>(516,797)</u>
Cash flows provided by (used in) financing activities		
Net (decrease) increase in time deposits	2,882,120	3,490,081
Net (decrease) increase in other deposits	6,687,328	(546,636)
Net (decrease) increase in borrowed funds	(1,500,000)	-
Dividends paid	(242,229)	(239,763)
Dividends reinvested	74,152	85,241
Shares issued under stock-based compensation plans and related tax effects	17,392	22,480
Net cash provided by (used in) financing activities	<u>7,918,763</u>	<u>2,811,403</u>
Net increase (decrease) in cash and cash equivalents	(6,386,601)	2,759,066
Cash and cash equivalents at beginning of period	<u>30,972,327</u>	<u>29,291,815</u>
Cash and cash equivalents at end of period	<u>\$ 24,585,726</u>	<u>\$ 32,050,881</u>

The accompanying notes are an integral part of these consolidated financial statements.

HARFORD BANK AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited - continued)

For the Three Months Ended March 31,	2020	2019
Reconciliation of net income to net cash provided by operating activities		
Net income	\$ 513,501	\$ 893,749
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	123,396	104,439
Provision for loan losses	463,000	20,000
Amortization of premiums and accretion of discounts, net	29,843	20,810
Loss (gain) on foreclosed real estate	2,014	-
Stock-based compensation expense	6,969	7,400
Decrease (increase) in		
Deferred loan fees and costs	46,011	9,553
Cash surrender value of BOLI	(36,304)	(35,940)
Accrued interest refundable	(25,506)	(73,982)
Income taxes refundable	153,264	59,558
Other assets	(791,895)	(1,007,096)
Increase (decrease) in		
Accrued interest payable	4,567	27,849
Income taxes payable	11,725	244,250
Other liabilities	(334,682)	193,870
	<u>\$ 165,903</u>	<u>\$ 464,460</u>
Non-Cash Transactions:		
Transfer of foreclosed real estate to loans	<u>\$ 69,500</u>	<u>\$ -</u>

The accompanying notes are an integral part of these consolidated financial statements.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

Nature of operations

Harford Bank (the “Bank”) provides a full range of banking services to customers located in Harford and Cecil Counties and surrounding areas of northeastern Maryland.

Basis of presentation

The accounting and reporting policies reflected in the consolidated financial statements conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry, and, in the opinion of management, the consolidated financial statements reflect all adjustments necessary for a fair presentation of the Bank's financial position and results of operations. Management has evaluated subsequent events for potential recognition and/or disclosure through the date of issuance of the consolidated financial statements.

Principles of consolidation

The consolidated financial statements include the accounts of Harford Bank and its subsidiary, HB Trust, a Maryland Statutory Trust. Intercompany accounts and entries have been eliminated in the consolidated financial statements.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements. These estimates and assumptions may affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to the 2019 consolidated financial statement presentation to conform to the current year's format. Total equity and net income are unchanged due to these reclassifications.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, deposits with other financial institutions that have an initial maturity of less than 90 days when acquired, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Time deposits in other banks

Negotiable time deposits in other banks are carried at cost and are placed in amounts of \$250,000 or less to qualify for Federal Deposit Insurance Corporation (“FDIC”) deposit insurance coverage. Non-negotiable time deposits placed with correspondent banks may exceed the \$250,000 limit.

Investment securities

Management has classified all investment securities as held to maturity. Management has the intent and ability to hold all investment securities to maturity. These investment securities are recorded at amortized cost which is cost adjusted for amortization of premiums and accretion of discounts to maturity. Premiums and discounts are recognized in interest revenue using the interest method over the term of the securities, except that premiums on callable securities are amortized to the call price at the first call date.

Credit declines in the fair value of individual held to maturity investment securities below their amortized cost that are determined to be other than temporary result in write-downs of the individual securities to their fair value. The related write downs are included in earnings as realized losses. Factors that management considers in determining if other than temporary impairment has been incurred include the length of time and the extent to which the fair value has been less than amortized cost, the financial condition and prospects of the issuer, and the intent and ability of the Bank to hold the investment securities for a period of time sufficient to allow for recovery in fair value.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Restricted equity securities

As a member of the Federal Home Loan Bank of Atlanta (“FHLB”), the Bank is required to hold FHLB of Atlanta stock as a condition of membership as well as in relation to the Bank’s use of products and services. FHLB of Atlanta stock is not publicly-traded and is sold and redeemed by the FHLB of Atlanta at par. The Bank views its investment in FHLB of Atlanta stock as a long-term investment and as a restricted equity security, which is carried at cost, because there is a minimal market for the stock. Therefore, when evaluating FHLB of Atlanta stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The Bank does not consider this investment to be other-than-temporarily impaired at March 31, 2020, and no impairment has been recognized.

The Bank owns stock in an area banker’s bank. This stock is not publicly traded and there is a minimal market for the stock. The Bank views this stock as a long-term investment and as a restricted equity security, which is carried at cost adjusted for other than temporary impairment, and grouped with other assets. The Bank recognized \$67,500 of impairment in the twelve-month period ended December 31, 2018, which resulted in the full write-off of the Bank’s investment. This entity is in the process of dissolution, after which any remaining proceeds will be distributed to its stockholders. Any recovery is expected to be de minimis.

Loans and allowance for loan losses

Loans are stated at unpaid principal balance adjusted for any amounts partially charged-off, the allowance for loan losses, and deferred origination fees and costs.

Interest on loans is accrued based on the principal amounts outstanding. Origination fees and costs are recognized as an adjustment to the related loan yield using an approximate interest method. The accrual of interest is discontinued when any portion of the principal or interest is 90 days past due and collateral is insufficient to discharge the debt in full. Past due status is based on the contractual terms of the loan. If collection of principal is evaluated as doubtful, all payments are applied to principal.

Loans are considered impaired when, based on current information, management considers it unlikely that the collection of principal and interest payments will be made according to contractual terms. Generally, loans are reviewed for impairment when rated 4, Special Mention, or 5, Substandard, when 60 or more days past due, when the accrual of interest has been discontinued, and when the loan has been restructured in a troubled debt restructuring (a “TDR”). A TDR is the restructuring of a loan in which a concession is granted to a borrower experiencing financial difficulty.

The allowance for loan losses represents an amount which, in management's judgment, will be adequate to absorb losses inherent in the loan portfolio. Management's judgment in determining the adequacy of the allowance is based on evaluations of the collectability of loans. These evaluations take into consideration such factors as changes in the nature and volume of the loan portfolio, current economic conditions that may affect the borrower’s ability to pay, overall portfolio quality, and review of specific problem areas. If the economy or real estate market were to suffer a severe downturn, then the estimate for uncollectible accounts would need to be increased. Loan losses are charged against the allowance when management believes the uncollectability of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance consists of specific, general and unallocated components. The specific component relates to loans that are individually evaluated for impairment and for which impairment is determined to exist. The general component covers the remaining loan portfolio and is based on historical loss experience adjusted for qualitative factors. An unallocated component may be maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

Bank premises and equipment

Land is carried at cost. Buildings and improvements, and furniture and equipment are recorded at cost, less accumulated depreciation computed principally by the straight-line method over the estimated useful lives of the assets. Leasehold improvements are generally depreciated over the lesser of the term of the respective leases or the estimated useful lives of the improvements. Software is recorded in other assets at cost and amortized by the straight-line method over three years.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Leases

The Bank leases certain branch facilities under operating leases. The Bank recognizes a liability to make lease payments during the lease term as a lease liability recorded in other liabilities, and the asset representing the right to use the underlying asset during the lease term as a right-of-use lease asset recorded in other assets. The lease liability is measured at the present value of the remaining lease payments, discounted at the Bank's incremental borrowing rate. The right-to-use lease asset is recorded at amount of the lease liability adjusted for any lease incentives. The right-to-use lease asset is amortized and the lease liability is accreted over the remaining lease term.

Other real estate owned

Real estate acquired through foreclosure or by deed in lieu of foreclosure is recorded on the date acquired at the fair value less estimated costs to sell. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in noninterest expense.

Other repossessed assets

Loan collateral other than real estate acquired through or in lieu of foreclosure is recorded in other assets on the date acquired at the fair value less estimated costs to sell. Losses incurred at the time of acquisition of the collateral are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the collateral are included in noninterest expense.

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Interest and penalties incurred related to income taxes are included in income tax expense.

Management considers the likelihood of changes by taxing authorities in its filed income tax returns and recognizes a liability for or discloses potential changes that management believes are more likely than not to occur upon examination by tax authorities. Management has not identified any uncertain tax positions in filed income tax returns that require recognition or disclosure in the accompanying financial statements. The Bank's income tax returns for the past three years are subject to examination by tax authorities and may change upon examination.

Advertising costs

Advertising costs are expensed as incurred.

Earnings per common share

Basic earnings per common share is determined by dividing net income by the weighted-average number of shares of common stock outstanding after giving retroactive effect to stock dividends for all periods presented. Diluted earnings per common share is computed using the weighted-average number of common shares determined for the basic earnings per common share computation plus the dilutive effect of common stock equivalents using the treasury stock method.

Stock-based compensation

The Bank accounts for employee and director stock options under the fair value method of accounting using a Black-Scholes valuation model to measure stock based compensation at the date of grant. The Bank accounts for stock-based compensation in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 718, *Stock Compensation* under the modified prospective method. This standard requires public companies to recognize compensation expense related to stock based compensation awards in their income statements over the period during which an individual is required to provide service in exchange for such award.

Segment reporting

FASB ASC Topic 280, *Segment Reporting*, requires reporting of selected information about operating segments in its financial reports issued to stockholders. Management has performed an analysis and determined that the Bank has only one operating segment, which is commercial banking. The Bank's chief operating decision makers use combined results to make operating and strategic decisions and therefore the Bank is not required to disclose any additional segment information.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

2. Cash and Cash Equivalents

The Bank normally carries balances with other banks that exceed the federally insured limit.

Banks are required to carry noninterest-bearing cash reserves at specified percentages of deposit balances. The Bank's normal amount of cash on hand and on deposit with other banks is sufficient to satisfy the reserve requirements.

3. Investment Securities Held to Maturity

The amortized cost and estimated fair value of the investment securities portfolio for the respective periods are shown below. The Bank's mortgage-backed investment security holdings are residential and issued and guaranteed by the Government National Mortgage Association ("GNMA"), the Federal National Mortgage Association ("FNMA"), and the Federal Home Loan Mortgage Corporation ("FHLMC"). The asset-backed investment security holdings are issued and guaranteed by the Small Business Administration ("SBA").

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2020				
U.S. Treasury securities	\$ 5,455,302	\$ 95,381	\$ -	\$ 5,550,683
U.S. government agency securities	12,251,644	176,667	-	12,428,311
Mortgage-backed securities	17,366,319	403,498	-	17,769,817
Asset-backed securities	4,603,756	127,988	1,713	4,730,031
State and municipal securities	515,687	6,470	-	522,157
	<u>\$ 40,192,708</u>	<u>\$ 810,004</u>	<u>\$ 1,713</u>	<u>\$ 41,000,999</u>
December 31, 2019				
U.S. Treasury securities	\$ 5,103,103	\$ 12,694	\$ 230	\$ 5,115,567
U.S. government agency securities	15,636,750	56,596	6,390	15,686,956
Mortgage-backed securities	16,105,394	93,914	11,435	16,187,873
Asset-backed securities	4,314,172	84,769	8,298	4,390,643
State and municipal securities	917,856	7,616	168	925,304
	<u>\$ 42,077,275</u>	<u>\$ 255,589</u>	<u>\$ 26,521</u>	<u>\$ 42,306,343</u>

Contractual maturities and the amount of pledged investment securities for the respective periods are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Investment securities are pledged to secure deposits of federal and local governments.

	March 31, 2020		December 31, 2019	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing				
In one year or less	\$ 4,826,642	\$ 4,867,917	\$ 4,609,750	\$ 4,625,893
Over one to five years	13,080,764	13,311,709	16,732,215	16,779,012
Greater than five years	315,227	321,525	315,744	322,922
Mortgage-backed and asset-backed securities	<u>21,970,075</u>	<u>22,499,848</u>	<u>20,419,566</u>	<u>20,578,516</u>
	<u>\$ 40,192,708</u>	<u>\$ 41,000,999</u>	<u>\$ 42,077,275</u>	<u>\$ 42,306,343</u>
 Pledged securities	 <u>\$ 13,676,378</u>	 <u>\$ 13,963,622</u>	 <u>\$ 18,283,092</u>	 <u>\$ 18,388,811</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

3. Investment Securities Held to Maturity - continued

Investment securities with unrealized losses as of the respective periods are shown below.

	Less than 12 Months		12 Months or Longer		Total	
	Fair	Gross	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized	Value	Unrealized
		Losses		Losses		Losses
March 31, 2020						
U.S. Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
U.S. government agency securities	-	-	-	-	-	-
Mortgage-backed securities	-	-	-	-	-	-
Asset-backed securities	863,414	1,713	-	-	863,414	1,713
State and municipal securities	-	-	-	-	-	-
	<u>\$ 863,414</u>	<u>\$ 1,713</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 863,414</u>	<u>\$ 1,713</u>
December 31, 2019						
U.S. Treasury securities	\$ 1,008,710	\$ 230	\$ -	\$ -	\$ 1,008,710	\$ 230
U.S. government agency securities	3,992,330	6,390	-	-	3,992,330	6,390
Mortgage-backed securities	1,614,451	2,619	1,413,184	8,816	3,027,635	11,435
Asset-backed securities	869,703	8,298	-	-	869,703	8,298
State and municipal securities	-	-	400,788	168	400,788	168
	<u>\$ 7,485,194</u>	<u>\$ 17,537</u>	<u>\$ 1,813,972</u>	<u>\$ 8,984</u>	<u>\$ 9,299,166</u>	<u>\$ 26,521</u>

The investment securities experiencing unrealized losses as of March 31, 2020 are considered to be temporarily impaired. Management has the intent and ability to hold and does not believe they will be required to sell these investment securities until maturity. Unrealized losses are largely due to increases in market interest rates over the yields available at the time the underlying investments were purchased. The fair value is expected to recover as the securities approach their maturity date or if market interest rates for such securities decline. The U.S. Treasury securities the Bank owns are backed by the full faith and credit of the U.S. government. The U.S. government agency securities the Bank owns are issued by FNMA and FHLMC, which the U.S. government has affirmed its commitment to support, and by the FHLB and the Federal Farm Credit system ("FFCB"), which are government-sponsored enterprises. The mortgage-backed securities owned by the Bank are issued by GNMA, which carry U.S. government guarantees, and FNMA and FHLMC, which the U.S. government has affirmed its commitment to support. The asset-backed securities owned by the Bank are issued by the SBA and carry U.S. government guarantees. The state and municipal securities owned by the Bank are all general obligation bonds, with unlimited and limited taxing authority. Management does not believe that any of the securities are experiencing unrealized losses due to reasons of credit quality, and concludes the unrealized losses detailed in the above table are temporary.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans

The Bank makes loans to customers located primarily in Harford and Cecil Counties and surrounding areas. The performance of the loan portfolio will be influenced by the regional real estate market and economy.

Major classifications of loans are as follows for the periods indicated:

	March 31, 2020	December 31, 2019
Real estate		
Construction, development and other land	\$ 12,075,975	\$ 10,417,218
Secured by farmland	5,542,702	5,918,714
Commercial	176,862,956	168,773,371
Residential	82,984,036	77,563,922
Commercial	16,895,646	15,516,630
Mobile home	4,295,093	4,526,036
Other consumer	4,154,434	4,275,494
Overdrafts	72,464	118,583
Gross loans	302,883,306	287,109,968
Net deferred (fees) costs	(221,851)	(175,839)
Allowance for loan losses	(3,715,112)	(3,254,206)
Net loans	<u>\$ 298,946,343</u>	<u>\$ 283,679,923</u>
Principal balance of pledged loans	<u>\$ 112,435,383</u>	<u>\$ 109,115,515</u>

Substantial portions of the Bank's loans are secured by residential and commercial real estate. Loans secured by commercial real estate and farmland generally involve larger principal amounts and a higher degree of risk than loans secured by residential one- to four-family mortgages. Repayment of loans secured by commercial real estate and farmland is often dependent on the successful operation or management of the properties, making collectability of such loans subject to adverse economic or real estate market conditions. The Bank seeks to mitigate these risks through its underwriting standards which require that loans be qualified on the basis of the property's value and debt service coverage ratios, and additional collateral may be required under certain circumstances. The Bank generally obtains personal guarantees.

The Bank originates one- to four-family residential mortgage loans in amounts typically up to 80% of the lower of the appraised value or purchase price of the property securing the loan. The predominance of the Bank's residential mortgage portfolio consists of fixed rate mortgages with original maturities ranging from 15 to 30 years. Fixed rate lending can expose the Bank to interest rate risk in a rising rate environment.

Construction lending is generally considered to present a higher degree of credit risk than other types of real estate lending. Risks of loss include the accuracy of the borrower's estimate of construction costs, timing, and ultimate completion value, and the borrower's ability to complete the project in a workmanlike manner. These risks may result in a project whose value is insufficient to ensure full repayment.

Commercial loans are generally secured by inventories, equipment and other assets of the business. Personal guarantees of the borrowers are generally required.

The Bank makes mobile home loans in amounts up to 90% of the lower of the purchase price or the National Appraisal Guides value with original maturities of up to 20 years. To mitigate the risk of loss, the Bank makes loans only for mobile homes located in a mobile home park or sited on land owned by the borrower.

Eligible consumer installment loans are pledged to secure borrowing facilities at the Federal Reserve Discount Window. The Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans are pledged to secure borrowing facilities at the FHLBA.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The maturity distribution of the loan portfolio is as follows for the periods indicated:

	March 31, 2020	December 31, 2019
<i>Maturing</i>		
In one year or less	\$ 16,385,054	\$ 14,758,993
Over one to three years	12,827,169	13,281,289
Over three to five years	17,776,864	17,976,003
Over five to fifteen years	101,398,329	98,732,816
Over fifteen years	154,495,890	142,360,867
	<u>\$ 302,883,306</u>	<u>\$ 287,109,968</u>
Variable rate loans included above	<u>\$ 222,664,966</u>	<u>\$ 215,203,234</u>

The following table analyzes the status of loans for the periods indicated:

	30-59 Days	60-89 Days	90 Days and Over	Total		Total	Loans over 90 Days and
March 31, 2020	Past Due	Past Due	Past Due	Past Due	Current	Loans	Accruing
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 12,075,975	\$ 12,075,975	\$ -
Commercial real estate and farmland	298,872	-	447,830	746,702	181,658,956	182,405,658	-
Residential real estate	177,685	-	-	177,685	82,806,351	82,984,036	-
Commercial	42,854	-	-	42,854	16,852,792	16,895,646	-
Mobile homes	342,213	32,206	-	374,419	3,920,674	4,295,093	-
Other consumer and overdrafts	46,146	-	-	46,146	4,180,752	4,226,898	-
Total	<u>\$ 907,770</u>	<u>\$ 32,206</u>	<u>\$ 447,830</u>	<u>\$ 1,387,806</u>	<u>\$ 301,495,500</u>	<u>\$ 302,883,306</u>	<u>\$ -</u>
December 31, 2019							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 10,417,218	\$ 10,417,218	\$ -
Commercial real estate and farmland	175,364	381,108	-	556,472	174,135,613	174,692,085	-
Residential real estate	-	11,650	72,379	84,029	77,479,893	77,563,922	-
Commercial	-	-	-	-	15,516,630	15,516,630	-
Mobile homes	299,296	9,508	-	308,804	4,217,232	4,526,036	-
Other consumer and overdrafts	16,599	-	-	16,599	4,377,478	4,394,077	-
Total	<u>\$ 491,259</u>	<u>\$ 402,266</u>	<u>\$ 72,379</u>	<u>\$ 965,904</u>	<u>\$ 286,144,064</u>	<u>\$ 287,109,968</u>	<u>\$ -</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Credit Quality Indicators. As part of the on-going monitoring of the quality of the Bank's loan portfolio, management tracks certain credit quality indicators.

The Bank does not credit score new loans but does utilize a risk grading system for non-consumer loans. Loans are risk rated on the scale listed below:

Grade 1, 2 and 3A – These grades include “pass grade” loans to borrowers of acceptable credit quality and risk.

Grade 3W – This grade includes loans that are on management's “watch list” and are classified as “Pass Watch”. It is management's intent to utilize this rating on a temporary basis for pass grade borrowers where a significant risk-modifying action is anticipated in the near future.

Grade 4 – This grade is for “Other Assets Especially Mentioned” or “Special Mention” in accordance with regulatory guidelines. This grade is intended to be temporary and includes loans to borrowers whose credit quality has clearly deteriorated and are at risk of further decline unless active measures are taken to correct the situation. This grade may include loans not fully secured where a specific valuation allowance may be warranted.

Grade 5 – This grade includes “Substandard” loans, in accordance with regulatory guidelines, for which accrual of interest may have stopped. This grade includes loans that are past due or not fully secured where a specific valuation allowance may be warranted.

The following table illustrates classified loans for the periods indicated. Classified loans include loans in Risk Grades 3W, 4, and 5.

	Pass Watch Grade 3W	Special Mention Grade 4	Substandard Grade 5	Total
March 31, 2020				
Construction, development and other land	\$ 2,113,345	\$ -	\$ 251,880	\$ 2,365,225
Commercial real estate and farmland	30,161,498	553,676	11,311,724	42,026,898
Residential real estate	5,265,429	-	702,048	5,967,477
Commercial	1,003,770	-	328,234	1,332,004
Mobile home	-	-	55,456	55,456
Other consumer	53,804	-	-	53,804
	<u>\$ 38,597,846</u>	<u>\$ 553,676</u>	<u>\$ 12,649,342</u>	<u>\$ 51,800,864</u>
December 31, 2019				
Construction, development and other land	\$ 4,083,929	\$ -	\$ 254,071	\$ 4,338,000
Commercial real estate and farmland	26,041,266	3,292,043	11,066,347	40,399,656
Residential real estate	5,052,937	-	726,757	5,779,694
Commercial	987,332	82,170	230,533	1,300,035
Mobile home	-	-	60,800	60,800
Other consumer	50,992	-	-	50,992
	<u>\$ 36,216,456</u>	<u>\$ 3,374,213</u>	<u>\$ 12,338,508</u>	<u>\$ 51,929,177</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents allowance for loan losses activity allocated by loan class for three- and 12-month periods ended March 31, 2020 and December 31, 2019, respectively, the allocation of allowance for loan losses for loans that were individually and collectively evaluated for impairment at March 31, 2020 and December 31, 2019, and the loan balances by loan class for loans that were individually and collectively evaluated for impairment at March 31, 2020 and December 31, 2019.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial	Mobile Home	Other Consumer	Overdrafts	Total
March 31, 2020									
Allowance for loan losses:									
Beginning balance	\$ 45,780	\$ 213,426	\$ 1,860,385	\$ 655,669	\$ 244,912	\$ 182,609	\$ 32,136	\$ 19,289	\$ 3,254,206
Charge-offs	-	-	-	-	-	-	-	(7,708)	(7,708)
Recoveries	-	-	-	2,000	1,800	600	-	1,214	5,614
Provision or (recovery of provision)	(42,671)	37,836	393,288	57,285	23,263	(11,313)	(48)	5,360	463,000
Ending balance	<u>\$ 3,109</u>	<u>\$ 251,262</u>	<u>\$ 2,253,673</u>	<u>\$ 714,954</u>	<u>\$ 269,975</u>	<u>\$ 171,896</u>	<u>\$ 32,088</u>	<u>\$ 18,155</u>	<u>\$ 3,715,112</u>
Allowance balance allocated to loans:									
Individually evaluated for impairment	\$ -	\$ -	\$ 524,000	\$ 5,000	\$ 3,741	\$ 2,000	\$ -	\$ -	\$ 534,741
Collectively evaluated for impairment	<u>3,109</u>	<u>251,262</u>	<u>1,729,673</u>	<u>709,954</u>	<u>266,234</u>	<u>169,896</u>	<u>32,088</u>	<u>18,155</u>	<u>3,180,371</u>
	<u>\$ 3,109</u>	<u>\$ 251,262</u>	<u>\$ 2,253,673</u>	<u>\$ 714,954</u>	<u>\$ 269,975</u>	<u>\$ 171,896</u>	<u>\$ 32,088</u>	<u>\$ 18,155</u>	<u>\$ 3,715,112</u>
Loan balances:									
Individually evaluated for impairment		<u>\$ 251,881</u>	<u>\$ 11,311,724</u>	<u>\$ 702,048</u>	<u>\$ 330,187</u>	<u>\$ 87,662</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,683,502</u>
Collectively evaluated for impairment		<u>\$ 11,824,094</u>	<u>\$ 171,093,934</u>	<u>\$82,281,988</u>	<u>\$ 16,565,459</u>	<u>\$ 4,207,431</u>	<u>\$4,154,434</u>	<u>\$ 72,464</u>	<u>\$ 290,199,804</u>
December 31, 2019									
Allowance for loan losses:									
Beginning balance	\$ 150,049	\$ 187,984	\$ 1,554,315	\$ 674,601	\$ 232,097	\$ 214,548	\$ 29,675	\$ 11,493	\$ 3,054,762
Charge-offs	-	-	-	(16,119)	-	(32,892)	(4,705)	(17,168)	(70,884)
Recoveries	-	51,459	-	12,000	7,066	2,200	-	2,603	75,328
Provision or (recovery of provision)	(104,269)	(26,017)	306,070	(14,813)	5,749	(1,247)	7,166	22,361	195,000
Ending balance	<u>\$ 45,780</u>	<u>\$ 213,426</u>	<u>\$ 1,860,385</u>	<u>\$ 655,669</u>	<u>\$ 244,912</u>	<u>\$ 182,609</u>	<u>\$ 32,136</u>	<u>\$ 19,289</u>	<u>\$ 3,254,206</u>
Allowance balance allocated to loans:									
Individually evaluated for impairment	\$ -	\$ -	\$ 250,000	\$ 10,000	\$ 3,689	\$ 4,000	\$ -	\$ -	\$ 267,689
Collectively evaluated for impairment	<u>45,780</u>	<u>213,426</u>	<u>1,610,385</u>	<u>645,669</u>	<u>241,223</u>	<u>178,609</u>	<u>32,136</u>	<u>19,289</u>	<u>2,986,517</u>
	<u>\$ 45,780</u>	<u>\$ 213,426</u>	<u>\$ 1,860,385</u>	<u>\$ 655,669</u>	<u>\$ 244,912</u>	<u>\$ 182,609</u>	<u>\$ 32,136</u>	<u>\$ 19,289</u>	<u>\$ 3,254,206</u>
Loan balances:									
Individually evaluated for impairment		<u>\$ 254,071</u>	<u>\$ 11,066,347</u>	<u>\$ 726,758</u>	<u>\$ 230,533</u>	<u>\$ 60,800</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 12,338,509</u>
Collectively evaluated for impairment		<u>\$ 10,163,147</u>	<u>\$ 163,625,738</u>	<u>\$76,837,164</u>	<u>\$ 15,286,097</u>	<u>\$ 4,465,236</u>	<u>\$4,275,494</u>	<u>\$118,583</u>	<u>\$ 274,771,459</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents the recorded investment, and the current balance of impaired loans segmented by those with and without a related allowance recorded at March 31, 2020 and December 31, 2019. The average recorded investment and interest income recognized is presented for the time during which the loans were impaired within the three- and 12-month periods then ended.

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
March 31, 2020					
With no related allowance recorded:					
Construction, development and other land	\$ 251,881	\$ 251,881	\$ -	\$ 252,707	\$ 3,666
Commercial real estate and farmland	7,446,594	6,947,688	-	7,109,463	83,097
Residential real estate	645,086	487,609	-	496,608	4,770
Commercial	100,000	100,000	-	66,667	586
Mobile home	96,825	79,417	-	81,505	862
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	4,543,281	4,364,036	524,000	4,377,763	-
Residential real estate	214,438	214,439	5,000	216,692	2,739
Commercial	230,126	230,187	3,741	228,950	3,383
Mobile home	13,117	8,245	2,000	8,612	-
Other consumer	-	-	-	-	-
Total:					
Construction, development and other land	251,881	251,881	-	252,707	3,666
Commercial real estate and farmland	11,989,875	11,311,724	524,000	11,487,226	83,097
Residential real estate	859,524	702,048	5,000	713,300	7,509
Commercial	330,126	330,187	3,741	295,617	3,969
Mobile home	109,942	87,662	2,000	90,117	862
Other consumer	-	-	-	-	-
	<u>\$ 13,541,348</u>	<u>\$ 12,683,502</u>	<u>\$ 534,741</u>	<u>\$ 12,838,967</u>	<u>\$ 99,103</u>
December 31, 2019					
With no related allowance recorded:					
Construction, development and other land	\$ 254,071	\$ 254,071	\$ -	\$ 257,582	\$ 16,523
Commercial real estate and farmland	7,592,685	7,108,958	-	7,119,689	289,517
Residential real estate	658,490	507,233	-	537,835	19,223
Commercial	-	-	-	-	-
Mobile home	68,158	51,640	-	57,479	1,085
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	4,116,375	3,957,389	250,000	4,032,974	-
Residential real estate	219,525	219,525	10,000	229,975	11,656
Commercial	230,533	230,533	3,689	233,713	8,412
Mobile home	13,516	9,160	4,000	10,016	-
Other consumer	-	-	-	-	-
Total:					
Construction, development and other land	254,071	254,071	-	257,582	16,523
Commercial real estate and farmland	11,709,060	11,066,347	250,000	11,152,663	289,517
Residential real estate	878,015	726,758	10,000	767,810	30,879
Commercial	230,533	230,533	3,689	233,713	8,412
Mobile home	81,674	60,800	4,000	67,495	1,085
Other consumer	-	-	-	-	-
	<u>\$ 13,153,353</u>	<u>\$ 12,338,509</u>	<u>\$ 267,689</u>	<u>\$ 12,479,263</u>	<u>\$ 346,416</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

Under a TDR, the Bank has granted a concession that it would not otherwise make to a borrower who has experienced financial difficulty. At the time of the restructuring, the borrower is expected to pay the amounts due under the renegotiated terms.

The table below shows trouble debt restructured loans outstanding by classification included in impaired loans at the respective dates. The Bank is committed to lend additional funds under a line of credit arrangement to one borrower who has received a TDR.

	March 31, 2020		December 31, 2019	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	5	\$ 4,634,510	5	\$ 4,699,422
Residential real estate	-	-	-	-
Commercial	-	-	-	-
	<u>5</u>	<u>\$ 4,634,510</u>	<u>5</u>	<u>\$ 4,699,422</u>

The Bank did not modify or remodify any loans during the three-month period ended March 31, 2020 or during the 12-month period ended December 31, 2019.

There were no loans that the Bank modified in the 12 months preceding the period ended March 31, 2020 for which there was a payment default during the three-month period ended March 31, 2020. There were no loans that the Bank modified in the 12 months preceding the period ended December 31, 2019 for which there was a payment default during the 12-month period ended December 31, 2019. Payment default is defined as any time the loan was more than 60 days past due.

The following table summarizes nonaccrual loans and other non-performing assets at March 31, 2020 and December 31, 2019, and the amount of gross interest income that would have been recorded during the three-month periods ended March 31, 2020 and 2019 had the nonaccrual loans been current and performing according to terms.

Non-performing Assets	March 31, 2020	December 31, 2019
Non-accrual loans by class		
Real estate		
Commercial real estate and farmland	\$ 5,169,986	\$ 4,786,464
Residential real estate	166,965	176,146
Mobile home	<u>47,635</u>	<u>51,293</u>
Total non-accrual loans	5,384,586	5,013,903
Foreclosed real estate	-	58,500
Reposessed assets	-	-
Total non-performing assets	<u>\$ 5,384,586</u>	<u>\$ 5,072,403</u>

Year to Date Through:

	March 31, 2020	March 31, 2019
Interest not accrued on non-accrual loans	<u>\$ 52,607</u>	<u>\$ 46,728</u>

There was one consumer mortgage loan secured by residential real estate with a recorded investment totaling \$65,107 that was in the process of foreclosure as of March 31, 2020.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

5. Credit Commitments

The table below shows outstanding loan commitments, unused lines of credit, and letters of credit.

At:	March 31, 2020	December 31, 2019
Commitments to extend credit		
Loan origination commitments	\$ 10,675,287	\$ 8,070,043
Unused consumer real estate construction	310,665	477,660
Unused home equity lines of credit	11,128,298	11,321,186
Unused overdraft lines of credit	5,208,274	5,099,625
Unused commercial lines of credit	45,608,284	45,843,242
	<u>\$ 72,930,808</u>	<u>\$ 70,811,756</u>
Letters of credit	<u>\$ 3,530,825</u>	<u>\$ 3,854,183</u>

Loan commitments and lines of credit are agreements to lend to a customer as long as there is no violation of any condition to the contract. Loan commitments generally have variable interest rates, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Such lines do not represent future cash requirements because it is unlikely that all customers will draw upon their lines in full at any time. Letters of credit are commitments issued to guarantee the performance of a customer to a third party.

The Bank's exposure to credit loss in the event of nonperformance by the customer is the contractual amount of the commitment. Loan commitments, lines of credit, and letters of credit are made on the same terms, including collateral, as outstanding loans. Management is not aware of any accounting loss to be incurred by funding these commitments.

6. Related Party Transactions

In the normal course of business, the Bank's executive officers and directors enter into loan transactions with the Bank. Loans to these related parties are made on the same terms, including interest rates and collateral, as those prevailing at the time for comparable loans with borrowers who are not related to the Bank. The following table shows the activity in related party loans for the periods indicated.

Year to Date Through:	March 31, 2020	December 31, 2019
Beginning balance	\$ 15,652,992	\$ 16,425,113
Advances	492,228	4,998,284
Change in related party	-	(12,353)
Payments	(973,816)	(5,758,052)
Ending balance	<u>\$ 15,171,404</u>	<u>\$ 15,652,992</u>

The change in related party was due to the retirement of a related party that occurred in May 2019.

In addition to the outstanding balances listed above, the Bank's related parties had \$2,561,398 in unused loans committed but not funded as of March 31, 2020. As of December 31, 2019, the Bank's related parties had \$2,882,319 in unused loans committed but not funded.

The Bank obtains goods and services from firms of which owners are also members of the Bank's Board of Directors. Prices paid for these goods and fees charged for these services are at rates for similar materials and work that are substantially similar to prices and fees charged by persons who are not related to the Bank. The Bank paid \$2,665 to these related parties during the three months ended March 31, 2020. The Bank paid \$1,532 to these related parties during the three months ended March 31, 2019.

Harford Bank and Subsidiary
Notes to Consolidated Financial Statements (Unaudited)

6. Related Party Transactions (continued)

Deposits of executive officers and directors of the Bank totaled \$4,175,976 at March 31, 2020. Deposits of executive officers and directors of the Bank totaled \$3,028,697 at December 31, 2019.

7. Bank Premises and Equipment

Bank premises and equipment and the related depreciation are as follows:

	Useful Lives	March 31, 2020	December 31, 2019
Land		\$ 3,174,756	\$ 3,174,756
Building and improvements	15 - 39 years	7,517,360	7,430,474
Leasehold improvements	10 - 19 years	528,940	518,660
Furniture, fixtures, and equipment	3 - 10 years	2,566,617	2,479,288
		13,787,673	13,603,178
Accumulated depreciation		4,999,256	4,893,578
Net bank premises and equipment		\$ 8,788,417	\$ 8,709,600

Year to Date Through:

	March 31, 2020	March 31, 2019
Depreciation expense	\$ 121,707	\$ 102,621

Computer software included in other assets and the related amortization are as follows:

	Useful Life	March 31, 2020	December 31, 2019
Computer software	3 years	\$ 263,071	\$ 261,649
Accumulated amortization		250,994	249,305
Net computer software		\$ 12,077	\$ 12,344

Year to Date Through:

	March 31, 2020	March 31, 2019
Amortization expense	\$ 1,689	\$ 1,819

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

8. Leases

The Bank leases certain banking facilities under operating leases expiring on various dates through 2026. At March 31, 2020, the Bank had lease liabilities totaling \$645,526 included in other liabilities and right-of-use lease assets totaling \$645,526 included in other assets related to these leases. At December 31, 2019, the Bank had lease liabilities totaling \$687,135 included in other liabilities and right-of-use lease assets totaling \$687,135 included in other assets related to these leases. The right-of-use asset is amortized and the operating lease liability is accreted over the applicable lease terms.

The weighted-average discount rate on operating lease balances outstanding at March 31, 2020 was 2.42%. The weighted-average remaining lease term of operating leases outstanding at March 31, 2020 was 4.9 years.

Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the three months ended March 31, 2020 was \$55,338. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the three months ended March 31, 2019 was \$33,861.

As of March 31, 2020, future minimum payments, by year and in the aggregate, of operating leases are as follows:

Year	Amount
Remainder of 2020	\$ 129,270
2021	158,704
2022	116,529
2023	117,333
2024	112,091
2025 and thereafter	<u>77,193</u>
Total undiscounted lease payments	711,120
Discount on cash flows	<u>(65,594)</u>
Total lease liability	<u><u>\$ 645,526</u></u>

9. Borrowings and Available Lines of Credit

FHLBA fixed rate term advances are summarized as follows:

Maturity Date	Interest Rate	Interest Frequency	March 31, 2020	December 31, 2019
March 20, 2020	2.8500%	Quarterly	\$ -	\$ 1,500,000
June 29, 2020	1.7100%	Monthly	2,500,000	2,500,000
September 21, 2020	2.9385%	Quarterly	1,500,000	1,500,000
December 29, 2020	2.2500%	Monthly	1,000,000	1,000,000
March 22, 2021	3.0195%	Quarterly	1,500,000	1,500,000
June 21, 2021	3.0535%	Quarterly	1,500,000	1,500,000
October 29, 2021	2.1300%	Monthly	3,000,000	3,000,000
December 29, 2021	2.3800%	Monthly	1,000,000	1,000,000
March 21, 2022	3.1155%	Quarterly	3,000,000	3,000,000
June 28, 2022	2.0600%	Monthly	2,500,000	2,500,000
			<u><u>\$ 17,500,000</u></u>	<u><u>\$ 19,000,000</u></u>

Harford Bank and Subsidiary **Notes to Consolidated Financial Statements (Unaudited)**

9. Borrowings and Available Lines of Credit (continued)

FHLBA term advances as of March 31, 2020 will require principal repayments as follows:

Year	Principal Reduction
Remainder of 2020	\$ 5,000,000
2021	7,000,000
2022	5,500,000
	<u>\$ 17,500,000</u>

The Bank may borrow up to 25% of its reported total assets from the FHLBA through any combination of notes or line of credit advances. The line of credit interest rate is a variable rate set daily by the lender. The notes payable and the line of credit are secured by a floating lien on all of the Bank's eligible residential first mortgage loans, home equity loans and commercial real estate loans. The Bank is required to purchase shares of capital stock in the FHLB as a condition to obtaining the line of credit. Based on the value of available collateral as of March 31, 2020, the Bank could borrow an additional \$59,880,623 from the FHLBA.

The Bank is eligible to borrow from the Federal Reserve Bank (FRB) Discount Window. This credit line is secured by the Bank's eligible consumer loan portfolio. Based on the value of available collateral as of March 31, 2020, the Bank could borrow \$4,936,793 from the FRB Discount Window.

The Certificate of Deposit Account Registry Service ("CDARS") is a form of brokered deposit program in which the Bank has been a participant since June 2005. In addition to offering depositors enhanced FDIC insurance coverage, being a participant in CDARS allows the Bank to fund its balance sheet through their One-Way Buy program. This program uses a competitive bid process to allocate funding. Management believes this arrangement would be a viable source of funding provided that the Bank maintains its well-capitalized status. The Bank may borrow up to 10% of reported total assets as of March 31, 2020, or \$38,540,850.

The Bank has secured and unsecured credit lines with correspondent banks, which are subject to periodic review. Based on the last review performed in the second quarter of 2019, the amount available under the secured line is \$5,000,000 and the amount available under the unsecured line is \$3,000,000.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

10. Retirement Plan

The Bank has a profit sharing plan qualifying under section 401(k) of the Internal Revenue Code. The plan covers all full-time employees with one year of service who have reached 21 years of age. The Bank's discretionary contribution is determined annually by the Board of Directors.

In 2006, and in the second quarter of 2017, the Bank entered into agreements under its Supplemental Executive Retirement Plans ("SERP") with certain executive officers to provide for retirement income benefits. The Bank accrues the present value of these benefits over the remaining number of years to the executives' retirement dates. The Bank has recorded a liability of \$1,207,092 related to these benefits at March 31, 2020. SERP expense for the three months ended March 31, 2020 was \$23,894. SERP expense for the three months ended March 31, 2019 was \$42,976.

11. Interest-Bearing Deposits

Major classifications of interest-bearing deposits at:	March 31, 2020	December 31, 2019
Money market and NOW	\$ 105,047,046	\$ 103,856,879
Savings	41,589,574	40,048,615
Certificates of deposit	<u>92,560,138</u>	<u>89,678,018</u>
	<u>\$ 239,196,758</u>	<u>\$ 233,583,512</u>
Interest expense year to date through:	March 31, 2020	March 31, 2019
Money market and NOW	\$ 40,860	\$ 40,882
Savings	14,255	13,593
Certificates of deposit	<u>410,076</u>	<u>274,119</u>
	<u>\$ 465,191</u>	<u>\$ 328,594</u>
Maturities of certificates of deposit at:	March 31, 2020	December 31, 2019
Maturing within twelve months	\$ 51,949,953	\$ 48,257,310
Maturing over one to three years	29,307,136	29,429,742
Maturing over three to five years	<u>11,303,049</u>	<u>11,990,966</u>
	<u>\$ 92,560,138</u>	<u>\$ 89,678,018</u>
Certificates of deposit over \$250,000 included above:	<u>\$ 27,535,438</u>	<u>\$ 26,087,312</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

12. Income Taxes

The components of income tax expense are as follows:

Year to date through:	March 31, 2020	March 31, 2019
Federal	\$ 128,390	\$ 230,318
State	36,599	73,490
	<u>\$ 164,989</u>	<u>\$ 303,808</u>

The differences between the statutory federal income tax rate in effect during the periods indicated and the effective tax rate for the Bank are reconciled as follows:

Year to date through:	March 31, 2020	March 31, 2019
Statutory federal income tax rate	21.0 %	21.0 %
Increase (decrease) resulting from		
State income taxes, net of federal income tax benefit	4.3	4.9
Tax-exempt income	(1.5)	(0.9)
Nondeductible expenses	0.5	0.4
	<u>24.3 %</u>	<u>25.4 %</u>

13. Stock Option and Stock Purchase Plans

The Bank has adopted stock option plans for directors and officers. Option exercise prices are equal to the fair market value of the stock on the date of grant. Options granted under the director plan fully vest at the time of grant. Options granted under the officer plan vest three years after their grant dates. On April 23, 2018, the officer plan expired, eliminating the Bank's ability to make future grants, although options granted remain outstanding and subject to exercise through April 2028.

The Bank has also adopted a qualified employee stock purchase plan that allows the Bank to grant options to eligible employees to acquire shares of common stock through direct payment or payroll deductions over a maximum 27-month period from the date of the grant. Options granted under the employee stock purchase plan fully vest at the time of grant. On April 23, 2018, the employee plan expired, eliminating the Bank's ability to make future grants, although options granted remain outstanding and subject to exercise through July 2020.

The total number of shares originally authorized for active stock option plans and plans with outstanding options was 283,488. At March 31, 2020, a total of 56,102 shares remain available for grant.

A summary of activity for stock option activity for the three months ended March 31, 2020 is as follows:

Options	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2020	83,279	\$ 22.90		
Options granted	-	\$ -		
Options exercised	(10,134)	\$ 23.23		
Options forfeited or expired	(48)	\$ 22.42		
Outstanding at March 31, 2020	<u>73,097</u>	<u>\$ 22.86</u>	<u>5.46 years</u>	<u>\$ 227,406</u>
Exercisable at March 31, 2020	<u>60,157</u>	<u>\$ 22.33</u>	<u>4.98 years</u>	<u>\$ 219,090</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

13. Stock Option and Stock Purchase Plans - continued

A summary of activity for nonvested stock options for the three months ended March 31, 2020 is as follows:

Nonvested Options	Number of Shares	Average Grant Date Fair Value
Outstanding at January 1, 2020	17,372	\$ 5.07
Options granted	-	\$ -
Options vested	(4,431)	\$ 5.07
Options forfeited or expired	<u>(1)</u>	\$ 5.11
Outstanding at March 31, 2020	<u>12,940</u>	\$ 5.06

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The service period generally matches the vesting period. At March 31, 2020, unrecognized stock-based compensation expense related to nonvested stock options will be recognized as follows, by year and in the aggregate:

Year	Stock-Based Compensation Expense
Remainder of 2020	\$ 13,398
2021	<u>5,001</u>
	<u>\$ 18,399</u>

For the three months ended March 31, 2020, the Bank recorded stock-based compensation expense of \$6,969. For the three months ended March 31, 2019, the Bank recorded stock-based compensation expense of \$7,400.

The intrinsic value of options exercised during the three months ended March 31, 2020 was \$48,693. The intrinsic value of options exercised during the three months ended March 31, 2019 was \$6,180.

14. Capital Standards

The FRB and the FDIC have adopted risk-based capital standards for banking organizations. These standards require ratios of capital to assets for minimum capital adequacy and to be classified as well capitalized under prompt corrective action provisions.

In July 2013, the Board of Governors of the FRB and the FDIC approved the final rules implementing the Basel Committee on Banking Supervision's capital guidelines for U.S. banks ("Basel III"). Under the final rules, which became effective for the Bank on January 1, 2015 and fully phased-in as of January 1, 2019, minimum requirements increased for both the quantity and quality of capital held by the Bank. The rules include a new minimum Common Equity Tier 1 capital ratio ("CET1 ratio") of 4.5% and a capital conservation buffer of 2.5% of risk-weighted assets, which are now fully phased-in, effectively resulting in a minimum CET1 ratio of 7.0%. Basel III raised the minimum Tier 1 capital ratio from 4.0% to 6.0% which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 8.5%. Basel III maintained the minimum total capital ratio of 8.0%, which, with the capital conservation buffer now fully phased-in, effectively results in a minimum Tier 1 capital ratio of 10.5%. Basel III maintains the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also makes changes to risk weights for certain assets and off-balance sheet exposures.

The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall and the institution's "eligible retained income" (that is, four quarter trailing net income, net of distributions and tax effects not reflected in net income).

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

14. Capital Standards - continued

Under Basel III, Total capital consists of two tiers of capital, Tier 1 and Tier 2. Tier 1 capital is further composed of Common equity Tier 1 capital and additional Tier 1 capital. For the Bank, Common equity Tier 1 capital consists of common stock, surplus and undivided profits. The Bank has no additional Tier 1 capital items. The Bank's Tier 2 capital consists of a limited amount of the allowance for loan losses. The Bank's Total capital is the sum of Tier 1 capital plus Tier 2 capital.

The Total capital ratio, the Tier 1 capital ratio and the Common equity Tier 1 capital ratio are calculated using end of period risk-weighted assets. In calculating risk-weighted assets, specified risk percentages are applied to each category of asset and off-balance sheet items based on regulatory requirements. The Tier 1 leverage capital ratio is calculated using quarterly average assets.

The Bank's actual capital ratios, the required regulatory capital ratios to be considered well capitalized, the regulatory minimum capital ratios, and the regulatory minimum capital ratios with the 2.5% capital conservation buffer added based on the Basel III Capital Rules are as follows for the periods indicated:

(\$ in thousands)	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
March 31, 2020	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 46,613	15.58%	\$ 29,918	10.00%	\$ 23,934	8.00%	\$ 31,413	10.50%
Tier 1 capital	42,898	14.34%	23,934	8.00%	17,951	6.00%	25,430	8.50%
Common equity Tier 1 capital	42,898	14.34%	19,446	6.50%	13,463	4.50%	20,942	7.00%
Tier 1 leverage capital	42,898	11.32%	18,942	5.00%	15,154	4.00%	15,154	4.00%

December 31, 2019	Actual		Required To be Well Capitalized		Minimum Capital		Minimum Capital With Capital Conservation Buffer	
			Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital	\$ 45,782	15.97%	\$ 28,659	10.000%	\$ 22,927	8.00%	\$ 30,092	10.50%
Tier 1 capital	42,528	14.84%	22,927	8.000%	17,196	6.00%	24,360	8.50%
Common equity Tier 1 capital	42,528	14.84%	18,629	6.500%	12,897	4.50%	20,062	7.00%
Tier 1 leverage capital	42,528	11.18%	19,015	5.000%	15,212	4.00%	15,212	4.00%

As of March 31, 2020, capital levels at the Bank exceed all capital adequacy requirements under the Basel III Capital Rules on a fully phased-in basis. Based on the ratios presented above, capital levels of the Bank exceed the minimum levels necessary to be considered well capitalized.

Failure to meet the capital requirements could affect the Bank's ability to pay dividends and accept deposits and may significantly affect the operations of the Bank.

In its most recent regulatory report the Bank was categorized as well capitalized under the prompt corrective action regulations. Management knows of no events or conditions that should change this classification.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

15. Net Income per Common Share

The calculations of basic and diluted net income per common share are presented in the following table.

	For the Three Months Ended March 31,	
	2020	2019
Basic:		
Net income	\$ 513,501	\$ 893,749
Weighted-average common shares outstanding	1,425,271	1,412,879
Basic net income per common share	<u>\$ 0.36</u>	<u>\$ 0.63</u>
Diluted:		
Net income	\$ 513,501	\$ 893,749
Weighted-average common shares outstanding	1,425,271	1,412,879
Dilutive common stock equivalents	11,795	19,329
Dilutive EPS shares	<u>1,437,066</u>	<u>1,432,208</u>
Diluted net income per common share	<u>\$ 0.36</u>	<u>\$ 0.62</u>
Anti-dilutive shares	<u>15,557</u>	<u>-</u>

16. Fair Value Measurements

FASB ASC Topic 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value. FASB ASC Topic 820 also establishes a hierarchy for determining fair value measurement. The hierarchy includes three levels and is based upon the valuation techniques used to measure assets and liabilities.

The fair value hierarchy is as follows:

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

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

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

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

During the three- and 12-month periods ended March 31, 2020 and December 31, 2019, respectively, the Bank did not measure any assets or liabilities at fair value on a recurring basis. Assets measured at fair value on a nonrecurring basis are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
March 31, 2020				
Impaired loans (net of impairment)	\$ -	\$ 11,922,315	\$ 226,446	\$ 12,148,761
Other real estate owned	-	-	-	-
Reposessed assets	-	-	-	-
Total	<u>\$ -</u>	<u>\$ 11,922,315</u>	<u>\$ 226,446</u>	<u>\$ 12,148,761</u>
December 31, 2019				
Impaired loans (net of impairment)	\$ -	\$ 11,843,976	\$ 226,844	\$ 12,070,820
Other real estate owned	-	58,500	-	58,500
Reposessed assets	-	-	-	-
Total	<u>\$ -</u>	<u>\$ 11,902,476</u>	<u>\$ 226,844</u>	<u>\$ 12,129,320</u>

At March 31, 2020, impaired loans totaling \$12,683,502 had specific loan loss allowances of \$534,741 carried in the allowance for loan losses, resulting in a fair value of impaired loans (net of impairment) measured on a nonrecurring basis of \$12,148,761. At December 31, 2019, impaired loans totaling \$12,338,509 had specific loan loss allowances of \$267,689 carried in the allowance for loan losses, resulting in a fair value of impaired loans (net of impairment) measured on a nonrecurring basis of \$12,070,820.

Nonrecurring fair value adjustments to collateral dependent impaired loans through a specific valuation allowance or through charge-off reflect values that are based principally on the collateral's observable market price or current appraised value of the collateral less estimated selling costs. Fair value adjustments based principally on the appraised value of the collateral less costs to sell are classified as Level 2.

Nonrecurring fair value adjustments to non-collateral dependent impaired loans through a specific valuation allowance reflect values based on the present value of expected cash flows. Since present value calculation techniques do not utilize quoted prices in active markets or significant other observable market inputs in measuring fair value, non-collateral dependent loan fair values are classified as Level 3.

Nonrecurring fair value adjustments to foreclosed real estate owned reflect values that are based principally on the real estate's observable market price or current appraised value of the collateral. Fair value adjustments based principally on the observable market price or appraised value of the collateral less costs to sell are classified as Level 2.

Nonrecurring fair value adjustments to reposessed assets reflect values that are based principally on the collateral's observable market price or current National Appraisal Guides value of the collateral. Fair value adjustments based principally on the observable market price or appraised value of the collateral less costs to sell are classified as Level 2.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

The estimated fair value of the Bank's financial instruments equals the carrying value of the instruments except as follows. In estimating fair values, the Bank utilizes valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Such valuation techniques are consistently applied. Inputs to valuation techniques include the assumptions that market participants would use in pricing an asset or liability. Also, the calculation of estimated fair values is based on market conditions at a specific point in time and may not reflect current or future fair values.

	Carrying Amount	Estimated Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
March 31, 2020					
Financial assets:					
Time deposits in other banks	\$ 1,250,000	\$ 1,272,118	\$ -	\$ -	\$ 1,272,118
Investment securities held to maturity					
U.S. Treasury securities	5,455,302	5,550,683	-	5,550,683	-
U.S. government agencies	12,251,644	12,428,311	-	12,428,311	-
Mortgage-backed securities	17,366,319	17,769,817	-	17,769,817	-
Asset-backed securities	4,603,756	4,730,031	-	4,730,031	-
State and municipal securities	515,687	522,157	-	522,157	-
Loans, net	298,946,343	303,160,769	-	11,922,315	291,238,454
Bank owned life insurance	6,529,704	6,529,704	-	6,529,704	-
Financial liabilities:					
Interest-bearing deposits	239,196,758	241,138,358	-	-	241,138,358
FHLB advances	17,500,000	17,958,981	-	-	17,958,981
December 31, 2019					
Financial assets:					
Time deposits in other banks	\$ 1,250,000	\$ 1,264,994	\$ -	\$ -	\$ 1,264,994
Investment securities held to maturity					
U.S. Treasury securities	5,103,103	5,115,567	-	5,115,567	-
U.S. government agencies	15,636,750	15,686,956	-	15,686,956	-
Mortgage-backed securities	16,105,394	16,187,873	-	16,187,873	-
Asset-backed securities	4,314,172	4,390,643	-	4,390,643	-
State and municipal securities	917,856	925,304	-	925,304	-
Loans, net	283,679,923	287,679,129	-	11,843,976	275,835,153
Bank owned life insurance	6,493,400	6,493,400	-	6,493,400	-
Financial liabilities:					
Interest-bearing deposits	233,583,512	234,307,530	-	-	234,307,530
FHLB advances	19,000,000	19,203,162	-	-	19,203,162

Time deposits in other banks

The fair value of non-negotiable time deposits in correspondent banks is estimated based on interest rates currently offered for deposits of similar remaining maturities, as there is no demonstrable market for non-negotiable time deposits.

Investment securities held to maturity

The fair value of investment securities held to maturity is estimated based on quoted market prices, when available. If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

16. Fair Value Measurements - continued

Loans, net

The carrying value of loans is net of deferred fees and costs and the allowance for loan and lease losses. In accordance with the adoption of Accounting Standards Update (“ASU”) 2016-01, the fair value of loans was measured using an exit price notion.

Bank owned life insurance

The fair value of bank owned life insurance is estimated to equal the carrying amount, which is the cash surrender value.

Interest-bearing deposits

The fair value of interest-bearing checking, savings, and money market deposit accounts is estimated to equal the carrying amount. The fair value of fixed-maturity time deposits is estimated based on interest rates currently offered for deposits of similar remaining maturities.

FHLB advances

The fair value of FHLB of Atlanta advances is obtained directly from the FHLB of Atlanta where possible, and represent mathematical approximations of exit values derived from its proprietary models. The fair value of FHLB of Atlanta advances for which the FHLB of Atlanta does not provide estimations of exit value is estimated based on interest rates currently offered for advances of similar remaining maturities.

Fed Funds Sold and Fed Funds Purchased

Due to the overnight nature of Fed Funds Sold and Fed Funds Purchased, the fair value of these instruments is estimated to equal the carrying amount.

Commitments to extend credit, lines of credit, and letters of credit

It is not practicable to estimate the fair value of outstanding loan commitments, unused lines of credit, and letters of credit.

17. Legal Proceedings

The Bank is party to various legal actions normally associated with a financial institution. In management's opinion, the effect of these actions will not be material to the financial condition of the Bank.

18. Accounting Standard Updates

ASU 2016-02, “Leases (Topic 842).” ASU 2016-02 requires that lessees and lessors recognize lease assets and lease liabilities on the balance sheet and disclose key information about leasing arrangements. ASU 2016-02 was effective for the Bank on January 1, 2019. ASU 2016-02 provides for a modified retrospective transition approach requiring lessees to recognize and measure leases on the balance sheet at the beginning of either the earliest period presented or as of the beginning of the period of adoption with the option to elect certain practical expedients. The Bank has elected to apply ASU 2016-02 as of the beginning of the period of adoption (January 1, 2019) and has not restated comparative periods. Of the optional practical expedients available under ASU 2016-02, all have been adopted except for the hindsight practical expedient. The Bank’s operating leases relate to bank branches. As a result of implementing ASU 2016-02, the Bank recognized an operating lease right-of-use asset of \$456,311 and an operating lease liability of \$456,311 on January 1, 2019, with no impact on our consolidated statement of income or consolidated statement of cash flows compared to the prior lease accounting model. The operating lease right-of-use asset and operating lease liability are recorded in other assets and other liabilities, respectively, in the consolidated balance sheets. The Bank elected to apply certain practical expedients provided under ASU 2016-02 whereby we will not reassess (i) whether any expired or existing contracts are or contain leases, (ii) the lease classification for any expired or existing leases and (iii) initial direct costs for any existing leases. The Bank will not apply the recognition requirements of ASU 2016-02 to any short-term leases (as defined by related accounting guidance). The Bank will account for lease and non-lease components separately because such amounts are readily determinable under our lease contracts and because we expect this election will result in a lower impact on our balance sheet. The Bank elected to utilize the modified-retrospective transition approach prescribed by ASU 2018-11.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

18. Accounting Standard Updates - continued

ASU 2016-13, *“Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.”* ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts and requires enhanced disclosures related to the significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization’s portfolio. In addition, ASU 2016-13 amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Management has formed an implementation team led the CFO that also includes other functional areas of the Bank which is currently evaluating the potential impact of ASU 2016-13 on the Bank’s financial statements. While management is currently unable to reasonably estimate the impact of adopting ASU 2016-13, the Bank expects that the impact of adoption could be significantly influenced by the composition, characteristics and quality of the Bank’s loan portfolio as well as the prevailing economic conditions and forecasts as of the adoption date. As part of management’s evaluation process and implementation process, the Bank has focused on data capture and portfolio segmentation with continued progress toward model validation and testing. In July 2019, the FASB proposed changes to the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities. The proposal would delay the effective date to fiscal years beginning after December 15, 2022, including interim periods within those fiscal periods. On October 16, 2019, the FASB approved its proposal to delay the effective date for smaller reporting companies, as defined by the SEC, and other non-SEC reporting entities, and subsequently issued ASU 2019-10 *“Financial Instruments – Credit Losses (Topic 326), Derivatives and hedging (Topic 815), and Leases (Topic 842): Effective Dates”* which extended the implementation date to 2023 for SEC registered smaller reporting companies and private companies. As the Bank is a smaller reporting company, the proposed delay would be applicable.

ASU 2018-07, *“Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting.”* ASU 2018-07 expands the scope of Topic 718, Compensation – Stock Compensation (which currently only includes share-based payments to employees) to include share-based payments issued to nonemployees for goods or services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially aligned. The ASU supersedes Subtopic 505-50, Equity – Equity-Based Payments to Non-Employees. ASU 2018-07 became effective for the Bank on January 1, 2019, and did not have a significant impact on the Bank’s financial statements.

ASU 2018-13, *“Fair Value Measurement (Topic 820) - Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement.”* ASU 2018-13 modifies the disclosure requirements on fair value measurements in Topic 820. The amendments in this update remove disclosures that no longer are considered cost beneficial, modify/clarify the specific requirements of certain disclosures, and add disclosure requirements identified as relevant. ASU 2018-13 became effective for the Bank on January 1, 2020, and did not have a significant impact on the Bank’s financial statements.

ASU 2019-12, *“Income Taxes (Topic 740) - Simplifying the Accounting for Income Taxes.”* The guidance issued in this update simplifies the accounting for income taxes by eliminating certain exceptions to the guidance in ASC 740 related to the approach for intraperiod tax allocation, the methodology for calculating income taxes in an interim period and the recognition for deferred tax liabilities for outside basis differences. ASU 2019-12 also simplifies aspects of the accounting for franchise taxes and enacted changes in tax laws or rates and clarifies the accounting for transactions that result in a step-up in the tax basis of goodwill. ASU 2019-12 will be effective for the Bank on January 1, 2021, with early adoption permitted, and is not expected to have a significant impact on the Bank’s financial statements.

CERTIFICATIONS OF THE PRINCIPAL EXECUTIVE OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Michael F. Allen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harford Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

CERTIFICATIONS OF THE PRINCIPAL FINANCIAL OFFICER
Pursuant to Securities Exchange Act Rules 13a-1 and 15d-14
As adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Neil L. Christ, CPA, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harford Bank;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles; and
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 6, 2020

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

CERTIFICATION OF THE PERIODIC REPORT
Pursuant to 18 U.S.C. Section 1350
As adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Pursuant to, and for purposes only of, 18 U.S.C. § 1350, each of the undersigned hereby certifies that (i) the Quarterly Report of Harford Bank on Form 10-Q for the quarter ended March 31, 2020, filed with the Federal Deposit Insurance Corporation (the “Report”) fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, and (ii) information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Harford Bank.

Date: May 6, 2020

/s/ Michael F. Allen
Michael F. Allen
President
(Principal Executive Officer)

Date: May 6, 2020

/s/ Neil L. Christ, CPA
Neil L. Christ, CPA
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)