

**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 September 30, 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.
1,432,996 shares of common stock as of October 29, 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. For a discussion of these risks and uncertainties, see the section of the periodic reports that the Bank files with the Federal Deposit Insurance Corporation (“FDIC”) entitled “Risk Factors”, including the risk factor set forth in the Bank’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2020 entitled “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”, and any updates thereto that might be contained in subsequent reports filed by the Bank. 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 of which are located 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, Visa credit cards issued through a third-party provider, and expanded mortgage lending offerings 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.

COVID-19 PANDEMIC

On March 11, 2020, the World Health Organization declared a pandemic as a result of the global spread of the coronavirus, commonly referred to as COVID-19. The spread of the disease quickly accelerated in the United States and to date, all 50 states have reported cases. The U.S. and state governments reacted to the pandemic by issuing shelter-at-home orders and requiring that non-essential businesses be closed to prevent spread of the virus. The health crisis quickly turned into a financial crisis resulting in guidance and mandates regarding foreclosures and repossessions and accounting and regulatory changes designed to encourage banks to work with customers suffering detrimental financial impact.

As a result of the pandemic effecting the states and local markets in which it operates, the Bank successfully implemented its Pandemic Contingency Plan with the goal of protecting the health, safety and financial well-being of its associates and customers. As part of its plan to protect the financial well-being of its customers, the Bank chose to participate and educate its customers on the government sponsored plans established to provide financial assistance to businesses.

Although states, including Maryland, have eased several of the COVID-19 restrictions, including stay-at-home orders and the required closure of non-essential businesses, there appears to be a resurgence of COVID-19 cases in many states, including Maryland. As a result, it is possible that states, including Maryland, will re-implement some or all of the COVID-19 related restrictions and again require some or all non-essential businesses to close or drastically alter their business operations, which could have a material adverse impact on our customers and, thus, our financial condition and results of operations.

PAYCHECK PROTECTION PROGRAM

The U.S. Government's Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") established the Small Business Administration ("SBA") Paycheck Protection Program ("PPP") which provides small businesses with resources to maintain payroll, hire back employees who may have been laid off, and to cover applicable overhead expenses. Following the enactment of the CARES Act and the establishment of the PPP, the Bank acted expeditiously to prepare its associates so they could guide customers on the proper procedures necessary to enable them to take advantage of this program. The Bank developed an SBA PPP specific information site within our website that provided detailed information, links and materials for eligible customers to access. Internally, the Bank reallocated resources to review, process and data enter customer applications, working tirelessly over extended hours to provide access to as many local business owners as possible. The Bank was able to fund approximately 365 loan applications for approximately \$41.6 million from the first tranche of PPP designated funds. Congress allocated additional funding to the PPP on April 23, 2020. Due to the Bank's advance preparation and software implementation, the Bank was able to quickly gain approval for an additional approximately 575 loan applications for approximately \$27.6 million through September 30, 2020. In total, the Bank has gained approval for over \$69 million in loans to approximately 940 small businesses. Approximately 88% of the loans were under \$150,000 in size. These loans are 100% guaranteed by the SBA, have up to a two-year maturity, provide for a six-month deferral period, and have an interest rate of 1%. These loans may be forgiven by the SBA if the borrower meets certain conditions, including by using at least 75% of the loan proceeds

for payroll costs. The SBA also established processing fees from 1% to 5%, depending on the loan amount. The Bank anticipates receiving approximately \$3 million in fees.

RESULTS OF OPERATIONS

Summary

For the three-month period ended September 30, 2020, the Bank reported net income of \$973,788, compared to \$900,049 for the same period of 2019, an increase of \$73,739, or 8.2%. Both basic and diluted net income per share of common stock for the three-month period ended September 30, 2020 were \$0.68, compared to \$0.63 for the same period in 2019.

For the nine-month period ended September 30, 2020, the Bank reported net income of \$1,991,386, compared to \$2,591,318 for the same period of 2019, a decrease of \$599,932, or 23.2%. Basic net income per share of common stock for the nine-month period ended September 30, 2020 was \$1.39, compared to \$1.83 for the same period in 2019. Diluted net income per share of common stock for the nine-month period ended September 30, 2020 was \$1.39, compared to \$1.81 for the same period in 2019.

Annualized return on average assets was 0.62% for the nine-month period ended September 30, 2020, compared to 0.94% for the same period in 2019. Annualized return on average stockholders' equity was 6.13% for the nine-month period ended September 30, 2020, compared to 8.43% 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- and nine-month periods ended September 30, 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 September 30, 2020 was \$4,553,636, compared to \$4,006,907 for the same period in 2019, representing an increase of \$546,729, or 13.6%. Interest income, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2020 was \$12,759,751, compared to \$11,842,690 for the same period in 2019, representing an increase of \$917,061, or 7.7%.

Interest income, on a fully taxable equivalent basis, on loans increased by \$815,616, or 23.0%, for the three-month period ended September 30, 2020 when compared to the same period in 2019. The increase was primarily due to the \$90,536,013, or 32.3%, increase in average balances of loans for the three-month period ended September 30, 2020 when compared to the same period in 2019, partially offset by the decrease in the weighted average rate earned on loans, on a fully taxable equivalent basis, of 34 basis points to 4.69% for the three-month period ended September 30, 2020 when compared to the same period in 2019. Interest income, on a fully taxable equivalent basis, on loans increased by \$1,446,444, or 13.7%, for the nine-month period ended September 30, 2020 when compared to the same period in 2019. The increase was primarily due to the \$55,805,375, or 19.9%, increase in average balances of loans for the nine-month period ended September 30, 2020 when compared to the same period in 2019, partially offset by the decrease in the weighted average rate earned on loans, on a fully taxable equivalent basis, of 27 basis points to 4.79% for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

Average Balances, Interest, and Yields

	For the three months ended September 30, 2020 Average			For the three months ended September 30, 2019 Average			For the nine months ended September 30, 2020 Average			For the nine months ended September 30, 2019 Average		
	balance	Interest	Yield	balance	Interest	Yield	balance	Interest	Yield	balance	Interest	Yield
Assets												
FRB interest-bearing deposits	\$ 29,207,588	\$ 7,992	0.11%	\$ 30,100,712	\$ 184,825	2.44%	\$ 21,559,610	\$ 90,082	0.56%	\$ 25,785,258	\$ 484,278	2.51%
FHLBA interest-bearing deposits	114,144	3	0.01%	207,280	1,202	2.30%	130,457	388	0.40%	158,077	2,794	2.36%
Federal funds sold	-	-	0.00%	343,474	1,765	2.04%	110,998	1,269	1.53%	253,367	4,202	2.22%
Time deposits in other banks	2,250,000	10,547	1.86%	1,000,000	5,765	2.29%	1,995,438	29,167	1.95%	426,740	7,779	2.44%
Other	977,100	11,024	4.49%	1,305,700	22,614	6.87%	1,074,294	41,606	5.17%	1,381,872	74,492	7.21%
Investment securities:												
U.S. Treasury securities	3,798,069	18,180	1.90%	4,016,128	28,404	2.81%	4,573,020	70,215	2.05%	3,971,688	84,930	2.86%
U. S. government agency securities	13,758,314	40,286	1.16%	16,665,009	99,557	2.37%	13,632,290	168,717	1.65%	16,122,088	306,270	2.54%
Mortgage-backed securities	16,694,114	62,333	1.49%	13,861,721	77,041	2.21%	16,459,637	222,152	1.80%	11,812,451	193,338	2.19%
SBA asset-backed securities	4,723,342	35,171	2.96%	3,952,143	30,293	3.04%	4,549,459	87,049	2.56%	3,825,050	75,264	2.63%
State and municipal securities	314,539	2,118	2.68%	924,631	5,075	2.18%	471,736	8,752	2.48%	1,004,486	15,433	2.05%
Total investment securities	39,288,378	158,088	1.60%	39,419,632	240,370	2.42%	39,686,142	556,885	1.87%	36,735,763	675,235	2.46%
Loans:												
Overdrafts	55,943	-	0.00%	123,906	-	0.00%	89,545	-	0.00%	91,923	-	0.00%
Consumer	7,848,259	107,961	5.47%	7,993,885	116,158	5.76%	7,683,310	326,349	5.67%	8,081,937	323,634	5.35%
Credit lines	10,315,066	80,988	3.12%	11,684,497	154,753	5.25%	10,656,045	291,861	3.66%	11,784,529	472,563	5.36%
Commercial	96,890,565	1,121,588	4.61%	31,990,332	457,003	5.67%	69,619,393	2,484,935	4.77%	32,832,485	1,408,756	5.74%
Real estate	260,390,661	3,055,445	4.67%	231,345,601	2,822,452	4.84%	251,963,663	8,937,209	4.74%	230,421,298	8,388,957	4.87%
Total loans *	375,500,494	4,365,982	4.63%	283,138,221	3,550,366	4.97%	340,011,956	12,040,354	4.73%	283,212,172	10,593,910	5.00%
Allowance for loan losses	(4,931,612)			(3,105,352)			(4,070,658)			(3,076,249)		
Total loans, net of allowance *	370,568,882	4,365,982	4.69%	280,032,869	3,550,366	5.03%	335,941,298	12,040,354	4.79%	280,135,923	10,593,910	5.06%
Total interest-earning assets	442,406,092	4,553,636	4.09%	352,409,667	4,006,907	4.51%	400,498,237	12,759,751	4.26%	344,877,000	11,842,690	4.59%
Noninterest-bearing cash	7,232,403			6,469,351			6,952,893			6,519,092		
Net bank premises and equipment	9,777,183			8,471,512			8,788,952			8,413,443		
Other assets	9,299,967			9,966,422			10,719,227			9,913,228		
Total assets	\$ 468,715,645			\$ 377,316,952			\$ 426,959,309			\$ 369,722,763		
Liabilities and Stockholders' Equity												
Interest-bearing deposits												
Checking	\$ 85,935,057	19,109	0.09%	\$ 69,835,667	15,333	0.09%	\$ 75,746,872	50,324	0.09%	\$ 69,166,467	44,767	0.09%
Savings	49,575,253	17,178	0.14%	38,656,073	13,753	0.14%	45,148,692	46,991	0.14%	38,605,524	40,771	0.14%
Money market	18,730,665	7,368	0.16%	15,589,125	5,786	0.15%	16,789,968	19,530	0.16%	15,875,651	17,411	0.15%
Personal investment	25,299,665	21,059	0.33%	22,123,953	21,285	0.38%	24,021,464	65,549	0.36%	22,379,262	63,792	0.38%
Time deposits	103,979,672	447,795	1.71%	83,349,613	379,335	1.81%	96,915,306	1,295,203	1.79%	78,627,572	980,009	1.67%
Total interest-bearing deposits	283,520,312	512,509	0.72%	229,554,431	435,492	0.75%	258,622,302	1,477,597	0.76%	224,654,476	1,146,750	0.68%
Borrowed overnight funds	-	-	0.00%	11	-	0.00%	-	-	0.00%	51,286	1,032	2.69%
FRB PPPLF advances	3,933,375	3,469	0.35%	-	-	0.00%	1,988,812	5,225	0.35%	-	-	0.00%
FHLBA term borrowings	14,836,957	97,852	2.62%	23,000,000	139,943	2.41%	17,020,073	324,254	2.54%	24,527,473	443,255	2.42%
Total borrowed funds	18,770,332	101,321	2.15%	23,000,011	139,943	2.41%	19,008,885	329,479	2.32%	24,578,759	444,287	2.42%
Total interest-bearing deposits and borrowed funds	302,290,644	613,830	0.81%	252,554,442	575,435	0.90%	277,631,187	1,807,076	0.87%	249,233,235	1,591,037	0.85%
Noninterest-bearing deposits	119,969,372			80,595,308			103,368,036			77,116,718		
Other liabilities	2,458,010			2,324,270			2,583,274			2,275,921		
Stockholders' equity	43,997,619			41,842,932			43,376,812			41,096,889		
Total liabilities and stockholders' equity	\$ 468,715,645			\$ 377,316,952			\$ 426,959,309			\$ 369,722,763		
Net interest spread			3.28%			3.61%			3.39%			3.74%
Net interest income		\$ 3,939,806			\$ 3,431,472			\$ 10,952,675			\$ 10,251,653	
Net margin on interest-earning assets			3.54%			3.86%			3.65%			3.97%

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 by \$175,015, or 90.4%, for the three-month period ended September 30, 2020 when compared to the same period in 2019. The decrease was primarily due to the decrease in the weighted average rate earned on these holdings, on a fully taxable equivalent basis, of 220 basis points to 0.23% for the three-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease of \$79,734, or 0.3%, in average balances for these instruments for the three-month period ended September 30, 2020 when compared to the same period in 2019. Interest income, on a fully taxable equivalent basis, for interest-bearing deposits in the FRB and the FHLBA, federal funds sold, and time deposits in other banks decreased by \$378,147, or 75.8%, for the nine-month period ended September 30, 2020 when compared to the same period in 2019. The decrease was primarily due to the decrease in the weighted average rate earned on these holdings, on a fully taxable equivalent basis, of 183 basis points to 0.68% for the nine-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease of \$2,826,939, or 10.6%, in average balances for these instruments for the nine-month period ended September 30, 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 September 30, 2020 decreased by \$82,282, or 34.2%, when compared to the same period in 2019. The decrease was primarily due to the decrease in the weighted average rate earned on investment securities, on a fully taxable equivalent basis, of 82 basis points to 1.60% for the three-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease of \$131,254, or 0.3%, in average balances for investment securities for the three-month period ended September 30, 2020 when compared to the same period in 2019. Interest income on investment securities, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2020 decreased by \$118,350, or 17.5%, when compared to the same period in 2019. The decrease was primarily due to the decrease in the weighted average rate earned on investment securities, on a fully taxable equivalent basis, of 59 basis points to 1.87% for the nine-month period ended September 30, 2020 when compared to the same period in 2019, partially offset by the increase of \$2,950,379, or 8.0%, in average balances for investment securities for the nine-month period ended September 30, 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 September 30, 2020, the Bank recorded dividends received or accrued on stock issued by the FHLBA in the amount of \$11,024 on a fully taxable equivalent basis, compared to \$22,614 for the same period in 2019, a decrease of \$11,590, or 51.3%. The decrease was primarily due to the decrease of \$328,600, or 25.2%, in the average balance of FHLBA capital stock for the three-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease in the weighted average rate earned on FHLBA capital stock, on a fully taxable equivalent basis, of 238 basis points to 4.49% for the three-month period ended September 30, 2020 when compared to the same period in 2019. For the nine months ended September 30, 2020, the Bank recorded dividends received or accrued on stock issued by the FHLBA in the amount of \$41,606 on a fully taxable equivalent basis, compared to \$74,492 for the same period in 2019, a decrease of \$32,886, or 44.1%. The decrease was primarily due to the decrease of \$307,578, or 22.3%, in the average balance of FHLBA capital stock for the nine-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease in the weighted average rate earned on FHLBA capital stock, on a fully taxable equivalent basis, of 204 basis points to 5.17% for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

Interest expense on interest-bearing deposit liabilities increased by \$77,017, or 17.7%, for the three-month period ended September 30, 2020 when compared to the same period in 2019. The increase was primarily due to the increase of \$53,965,881, or 23.5%, in the average balance of interest-bearing deposit liabilities for the three-month period ended September 30, 2020 when compared to the same period in 2019, partially offset by the decrease in the weighted average rate paid on these deposits of three basis points to 0.72% for the three-month period ended September 30, 2020 when compared to the same period in 2019. Interest expense on interest-bearing deposit liabilities increased by \$330,847, or 28.9%, for the nine-month period ended September 30, 2020 when compared to the same period in 2019. The increase was primarily due to the increase of \$33,967,826, or 15.1%, in the average balance of interest-bearing deposit liabilities for the nine-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the increase in the weighted average rate paid on these deposits of eight basis points to 0.76% for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

Interest expense on total borrowed funds decreased by \$38,622, or 27.6%, for the three-month period ended September 30, 2020 when compared to the same period in 2019. The decrease was primarily due to the decrease of \$4,229,679, or 18.4%, in average balance of total borrowed funds for the three-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease in the weighted average rate paid on total borrowed funds of 26 basis points to 2.15% for the three-month period ended September 30, 2020 when compared to the same period in 2019. Interest expense on total borrowed funds decreased by \$114,808, or 25.8%, for the nine-month period ended September 30, 2020 when compared to the same period in 2019. The decrease was primarily due to the decrease of \$5,569,874, or 22.7%, in average balance of total borrowed funds for the nine-month period ended September 30, 2020 when compared to the same period in 2019, coupled with the decrease in the weighted average rate paid on total borrowed funds of 10 basis points to 2.32% for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

Net interest income, on a fully taxable equivalent basis, for the three-month period ended September 30, 2020 was \$3,939,806, an increase of \$508,334, or 14.8%, when compared to the same period in 2019. Net interest income, on a fully taxable equivalent basis, for the nine-month period ended September 30, 2020 was \$10,952,675, an increase of \$701,022, or 6.8%, 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 net margin on interest earning assets 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 Bank’s net margin on interest-earning assets, on a fully taxable equivalent basis, decreased by 32 basis points to 3.54% for the three-month period ended September 30, 2020 when compared to the same period in 2019. The Bank’s net margin on interest-earning assets, on a fully taxable equivalent basis, decreased by 32 basis points to 3.65% for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

The “net interest spread” is the rate earned on interest-earning assets less the rate paid on interest-bearing liabilities. The net interest spread for the three-month period ended September 30, 2020 decreased by 33 basis points to 3.28% when compared to the same period in 2019. The net interest spread for the nine-month period ended September 30, 2020 decreased by 35 basis points to 3.39% 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 September 30, 2020 of \$325,000, compared to provision expense of \$60,000 recorded for the same period of 2019, an increase of \$265,000. The Bank recorded provision expense for the nine-month period ended September 30, 2020 of \$1,828,000, compared to provision expense of \$90,000 recorded for the same period of 2019, an increase of \$1,738,000. The difference in the amounts of the provision for loan losses between the 2020 and 2019 periods resulted from changes in loan volume and mix, management’s assessment of the current market conditions and analysis of inherent risk within the loan portfolio, including an assessment of the impact that the economic uncertainty created by the COVID-19 pandemic could have on the loan portfolio, and the allocation of provision to a specific large commercial real estate relationship.

Noninterest Revenue

Noninterest revenue for the three-month period ended September 30, 2020 was \$418,762, compared to \$400,182 for the same period in 2019, an increase of \$18,580, or 4.6%. The increase was due to the increase of \$101,784 in other fees and commissions, partially offset by decreases of \$80,108 in service charges on deposit accounts and \$3,096 in earnings on bank owned life insurance for the three-month period ended September 30, 2020 when compared to the same period in 2019. Noninterest revenue for the nine-month period ended September 30, 2020 was \$1,330,492, compared to \$1,062,289 for the same period in 2019, an increase of \$268,203, or 25.2%. The increase was due to the increase of \$374,325 in other fees and commissions, partially offset by decreases of \$97,834 in service charges on deposit accounts and \$8,288 in earnings on bank owned life insurance for the nine-month period ended September 30, 2020 when compared to the same period in 2019.

Noninterest Expenses

Noninterest expenses for the three-month period ended September 30, 2020 were \$2,773,332, compared to \$2,575,322 for the same period in 2019, representing an increase of \$198,010, or 7.7%. Comparing the three-month period ended September 30, 2020 to the same period in 2019, the increase in noninterest expenses was mainly attributable to increases in salaries and benefits expense of \$95,155, occupancy expense of \$53,868, data processing expense of \$34,986, and FDIC and state assessments of \$35,144, partially offset by decreases in other operating expenses of \$28,789. Noninterest expenses for the nine-month period ended September 30, 2020 were \$7,926,483, compared to \$7,774,141 for the same period in 2019, representing an increase of \$152,342 or 2.0%. Comparing the nine-month period ended September 30, 2020 to the same period in 2019, the increase in noninterest expenses was mainly attributable to increases in occupancy expense of \$123,501, furniture and equipment expense of \$88,950, data processing expense of \$98,489, and professional fees of \$32,404, partially offset by decreases in salaries and benefits expense of \$67,944, advertising expense of \$64,600 and other operating expenses of \$68,477.

Income Tax Expense

Income tax expense for the three-month period ended September 30, 2020 was \$312,003, compared to \$299,055 for the same period of 2019, an increase of \$12,948. The increase was primarily due to higher income before income taxes earned for the three-month period ended September 30, 2020 when compared to the same period of 2019. Income tax expense for the nine-month period ended September 30, 2020 was \$612,593, compared to \$871,957 for the same period of 2019, a decrease of \$259,364. The decrease was primarily due to lower income before income taxes earned for the nine-month period ended September 30, 2020 when compared to the same period of 2019. The Bank's effective income tax rate was 23.53% for the nine-month period ended September 30, 2020, compared to 25.14% for the same period in 2019.

FINANCIAL CONDITION

Assets

Total assets at September 30, 2020 increased by \$95,490,347, or 25.3%, to \$472,778,013, 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 increased by \$9,109,334, or 34.8%, to \$35,266,703 at September 30, 2020, from \$26,157,369 at December 31, 2019.

Investment securities decreased by \$1,307,472, or 3.1%, to \$40,769,803 at September 30, 2020, from \$42,077,275 at December 31, 2019.

Loans

Loans, net of the allowance for loan losses, increased by \$86,591,782, or 30.5%, to \$370,271,705 at September 30, 2020, from \$283,679,923 at December 31, 2019. This increase in loan balances was primarily due to the Bank's lending activities under the PPP loan program. The average net loan portfolio represented 83.9% of average earning assets for the nine-month period ended September 30, 2020, compared to 81.2% for the same period in 2019.

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

	September 30, 2020		December 31, 2019	
	Amount	% of Total	Amount	% of Total
Real estate				
Construction, development and other land	\$ 12,783,598	3.39%	\$ 10,417,218	3.63%
Secured by farmland	5,422,834	1.44%	5,918,714	2.06%
Commercial	180,735,955	47.87%	168,773,371	58.78%
Residential	84,942,983	22.50%	77,563,922	27.02%
Commercial and industrial				
Commercial	16,181,921	4.29%	15,516,630	5.40%
Paycheck Protection Program	68,719,576	18.20%	-	0.00%
Mobile home	4,006,778	1.06%	4,526,036	1.58%
Other consumer	4,689,885	1.24%	4,275,494	1.49%
Overdrafts	59,085	0.01%	118,583	0.04%
Gross loans	377,542,615	100.00%	287,109,968	100.00%
Net deferred (fees) costs	(2,188,030)		(175,839)	
Allowance for loan losses	(5,082,880)		(3,254,206)	
Net loans	<u>\$ 370,271,705</u>		<u>\$ 283,679,923</u>	
Allowance for loan losses to gross loans	<u>1.35%</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 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 to Gross Loans” ratio at September 30, 2020 was 1.35%, compared to 1.13% at December 31, 2019.

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 nine-month periods ended September 30, 2020 and 2019.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
Three months ended:									
September 30, 2020									
Beginning balance	\$ 81,656	\$ 265,594	\$ 3,115,757	\$ 779,227	\$ 286,017	\$ 174,969	\$ 37,930	\$ 12,900	\$ 4,754,050
Charge-offs	-	-	-	-	-	-	-	(3,984)	(3,984)
Recoveries	-	-	-	1,750	1,168	600	-	4,296	7,814
Provision or (recovery of provision)	(1,536)	3,858	325,505	(12,454)	14,205	(6,016)	(228)	1,666	325,000
Ending balance	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
September 30, 2019									
Beginning balance	\$ 190,183	\$ 180,725	\$ 1,596,259	\$ 664,067	\$ 232,146	\$ 199,204	\$ 32,809	\$ 11,138	\$ 3,106,531
Charge-offs	-	-	-	(16,119)	-	-	-	(5,130)	(21,249)
Recoveries	-	-	-	3,000	1,400	600	-	10	5,010
Provision or (recovery of provision)	(28,366)	9,565	53,718	8,428	13,952	(4,382)	(1,585)	8,670	60,000
Ending balance	<u>\$ 161,817</u>	<u>\$ 190,290</u>	<u>\$ 1,649,977</u>	<u>\$ 659,376</u>	<u>\$ 247,498</u>	<u>\$ 195,422</u>	<u>\$ 31,224</u>	<u>\$ 14,688</u>	<u>\$ 3,150,292</u>
Nine months ended:									
September 30, 2020									
Beginning balance	\$ 45,780	\$ 213,426	\$ 1,860,385	\$ 655,669	\$ 244,912	\$ 182,609	\$ 32,136	\$ 19,289	\$ 3,254,206
Charge-offs	-	-	-	-	-	-	-	(16,462)	(16,462)
Recoveries	-	-	-	5,000	3,168	1,800	-	7,168	17,136
Provision or (recovery of provision)	34,340	56,026	1,580,877	107,854	53,310	(14,856)	5,566	4,883	1,828,000
Ending balance	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
September 30, 2019									
Beginning balance	\$ 150,049	\$ 187,984	\$ 1,554,315	\$ 674,601	\$ 232,097	\$ 214,548	\$ 29,675	\$ 11,493	\$ 3,054,762
Charge-offs	-	-	-	(16,118)	-	(30,526)	(4,705)	(11,862)	(63,211)
Recoveries	-	51,458	-	9,000	4,800	1,600	-	1,883	68,741
Provision or (recovery of provision)	11,768	(49,152)	95,662	(8,107)	10,601	9,800	6,254	13,174	90,000
Ending balance	<u>\$ 161,817</u>	<u>\$ 190,290</u>	<u>\$ 1,649,977</u>	<u>\$ 659,376</u>	<u>\$ 247,498</u>	<u>\$ 195,422</u>	<u>\$ 31,224</u>	<u>\$ 14,688</u>	<u>\$ 3,150,292</u>

The allowance for loan losses was \$5,082,880 at September 30, 2020, compared to \$3,254,206 at December 31, 2019, an increase of \$1,828,674. The increase was due to the provision for loan losses of \$1,828,000 plus recoveries of amounts previously charged-off of \$17,136, partially offset by amounts charged-off of \$16,462. 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 including an assessment of the impact that the economic uncertainty created by the COVID-19 pandemic could have on the loan portfolio, and the allocation of provision to a specific large commercial real estate relationship.

The following table presents the allocation of allowance for loan losses and the balances of loans that were individually and collectively evaluated for impairment at September 30, 2020 and December 31, 2019.

		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
September 30, 2020	Unallocated								
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 1,124,000	\$ 5,000	\$ 4,188	\$ 2,000	\$ -	\$ -	\$ 1,135,188
Collectively evaluated									
for impairment	<u>80,120</u>	<u>269,452</u>	<u>2,317,262</u>	<u>763,523</u>	<u>297,202</u>	<u>167,553</u>	<u>37,702</u>	<u>14,878</u>	<u>3,947,692</u>
	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ 250,967</u>	<u>\$ 9,167,651</u>	<u>\$ 591,526</u>	<u>\$ 222,778</u>	<u>\$ 80,072</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,312,994</u>
Collectively evaluated									
for impairment		<u>\$ 12,532,631</u>	<u>\$ 176,991,138</u>	<u>\$84,351,457</u>	<u>\$84,678,719</u>	<u>\$ 3,926,706</u>	<u>\$4,689,885</u>	<u>\$ 59,085</u>	<u>\$ 367,229,621</u>
December 31, 2019									
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 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 September 30, 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.

Section 4013 of the U.S. Government's Coronavirus Aid, Relief, and Economic Security Act allows financial institutions to suspend application of certain current TDR accounting guidance under ASC 310-40 for loan modifications related to the COVID-19 pandemic made between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the end of the COVID-19 national emergency, provided certain criteria are met. This relief can be applied to loan modifications for borrowers that were not more than 30 days past due as of December 31, 2019 and to loan modifications that defer or delay the payment of principal or interest, or change the interest rate on the loan. In April 2020, federal and state banking regulators issued the Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus to provide further interpretation of when a borrower is experiencing financial difficulty, specifically indicating that if the modification is either short-term (e.g., six months) or mandated by a federal or state government in response to the COVID-19 pandemic, the borrower is not experiencing financial difficulty under ASC 310-40. The Bank continues to prudently work with borrowers negatively impacted by the COVID-19 pandemic while managing credit risks and recognizing appropriate allowance for loan losses on its loan portfolio. Beginning in mid-March of 2020, the Bank began offering deferral and modification of principal and/or interest payments to selected borrowers on a case-by-case basis. As of September 30, 2020, the Bank had five loans totaling \$5,924,348 subject to deferral and modification agreements, representing 1.57% of gross loans that were not classified as TDRs because they met the criteria discussed above.

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
September 30, 2020							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 12,783,598	\$ 12,783,598	\$ -
Commercial real estate and farmland	120,957	-	529,359	650,316	185,508,473	186,158,789	-
Residential real estate	-	-	279,330	279,330	84,663,653	84,942,983	-
Commercial and industrial	-	-	-	-	84,901,497	84,901,497	-
Mobile homes	179,445	37,332	30,240	247,017	3,759,761	4,006,778	-
Other consumer and overdrafts	7,018	-	-	7,018	4,741,952	4,748,970	-
Total	<u>\$ 307,420</u>	<u>\$ 37,332</u>	<u>\$ 838,929</u>	<u>\$ 1,183,681</u>	<u>\$ 376,358,934</u>	<u>\$ 377,542,615</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 and industrial	-	-	-	-	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 troubled debt restructured loans by loan classification for the dates indicated.

	September 30, 2020		December 31, 2019	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	<u>5</u>	<u>\$ 4,544,019</u>	<u>5</u>	<u>\$ 4,699,422</u>

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

Non-performing Assets	September 30, 2020	December 31, 2019
Non-accrual loans by class		
Real estate		
Commercial real estate and farmland	\$ 5,073,378	\$ 4,786,464
Residential real estate	338,355	176,146
Mobile home	74,901	51,293
Total non-accrual loans	5,486,634	5,013,903
Foreclosed real estate	-	58,500
Reposessed assets	-	-
Total non-performing assets	<u>\$ 5,486,634</u>	<u>\$ 5,072,403</u>

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 September 30, 2020 were \$412,484,256, an increase of \$99,643,320, or 31.9%, when compared to total deposit liabilities at December 31, 2019. Interest-bearing deposit liabilities at September 30, 2020 were \$292,688,179, an increase of \$59,104,667, or 25.3%, when compared to December 31, 2019. The Bank utilizes deposits primarily to fund its earning assets. During the nine-month period ended September 30, 2020, average total deposit liabilities provided funding for approximately 90.4% of average earning assets, compared to 87.5% for the comparable period of 2019.

Certificates of deposit greater than the FDIC deposit insurance limit of \$250,000 at September 30, 2020 were \$37,514,614, 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	September 30, 2020	December 31, 2019
March 20, 2020	2.8500%	Quarterly	\$ -	\$ 1,500,000
June 29, 2020	1.7100%	Monthly	-	2,500,000
September 21, 2020	2.9385%	Quarterly	-	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
			\$ 13,500,000	\$ 19,000,000

In the second quarter of 2020, the Bank established a borrowing facility under the Paycheck Protection Program Liquidity Facility ("PPPLF"), which was established by Congress and administered by the FRB. This facility uses the U.S. Small Business Administration guaranteed PPP loans as collateral, offering 100% collateral coverage with no recourse to the Bank. This facility allows the Bank to pledge PPP loans to the facility and receive nonrecourse funding equal to 100% of the principal balance of the loans pledged, with a maturity equal to the maturity date of the underlying pledged PPP loans. The PPPLF offers a fixed rate of 0.35% for all funds advanced under the program. As of September 30, 2020, the Bank had paid off all outstanding PPPLF borrowings.

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

Capital

Total stockholders' equity was \$44,200,313 at September 30, 2020, an increase of \$1,672,163, or 3.9%, when compared to total stockholders' equity at December 31, 2019. The increase was due to earnings in the amount of \$1,991,386 and stock transactions netting \$180,689, partially offset by dividends declared and paid of \$499,912.

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 maintained the minimum Tier 1 leverage capital ratio of 4.0%. Basel III also made 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 September 30, 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 September 30, 2020, the Bank's risk-based capital ratio was 15.85%.

The CET1 capital ratio 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 September 30, 2020, the Bank's CET1 ratio was 14.60%.

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 September 30, 2020, the Bank's Tier 1 capital ratio was 14.60%.

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 September 30, 2020 was 9.51%.

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 September 30, 2020, the Bank could borrow an additional \$68,700,057 from the FHLBA.

The Bank is eligible to borrow from the 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 September 30, 2020, the Bank could borrow \$5,022,370 from the FRB Discount Window.

The Bank is eligible to borrow from the FRB PPPLF. Borrowings from this facility are secured by the Bank's eligible PPP loans. Originally set to expire on September 30, 2020, the Federal Reserve Board announced on July 28, 2020 that the PPPLF was extended through December 31, 2020. As of September 30, 2020, the Bank had paid off all outstanding PPPLF borrowings. Based on the amount of PPP loans that could have been pledged as of September 30, 2020, the Bank could borrow \$64,462,276 from the FRB PPPLF.

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 September 30, 2020, or \$47,277,801.

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 September 30, 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 September 30, 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	-0.75%	-0.52%	-0.34%	0.20%	0.16%	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 September 30, 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 September 30, 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 and in Item 1 of Part II of the Bank's Quarterly Report on Form 10-Q for the quarter ended March 31, 2020. Management does not believe that any material changes in the Bank's risk factors have occurred since these risks were last discussed.

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 ESPP"), the 2008 Key Employee Stock Option Plan (the "2008 Key Employee Plan"), the 2015 Director Stock Option Plan (the "2015 Director Plan") and the 2020 Employee Stock Purchase Plan (the "2020 ESPP"). The DRIP, the Director Stock Purchase Plan, and the Incentive Stock Option 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 2015 Director Plan so that the Bank may continue to incent non-employee directors through the grant of non-qualified stock options. The 2008 Key Employee Plan expired in April 2018 and no further grants may be made under the plan, but options granted under the 2008 Key Employee Plan remain outstanding and subject to exercise until April 2028. The 2008 ESPP expired in April 2018 and all options granted under the 2008 ESPP have expired. On May 20, 2020, the Bank's stockholders approved the 2020 ESPP that allows eligible employees to acquire up to 100,000 shares of the Bank's common stock at a discount through accumulated payroll deductions.

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 were issued pursuant to the exercise of options at an average exercise price of \$12.92 per share.

During the second quarter of 2020, a net total of 754 shares of common stock were sold pursuant to the DRIP at \$23.25 per share. During the second quarter of 2020, a total of 980 shares of common stock were issued pursuant to the exercise of options at an average exercise price of \$17.49 per share.

During the third quarter of 2020, a net total of two shares of common stock were sold pursuant to the DRIP at \$22.00 per share. During the third quarter of 2020, a total of 1,008 shares of common stock were issued pursuant to the exercise of options at an average exercise price of \$14.68 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 10.1	Harford Bank 2020 Employee Stock Purchase Plan (incorporated by reference to Appendix A to the Bank's definitive proxy statement for the 2020 annual meeting of stockholders filed with the FDIC on April 11, 2020).
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: November 4, 2020

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

Date: November 4, 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:	September 30, 2020	December 31, 2019
ASSETS	(Unaudited)	
Cash and due from banks	\$ 6,871,254	\$ 6,064,958
Federal Reserve Bank deposit	32,972,476	24,784,162
Federal funds sold and Federal Home Loan Bank deposit	<u>44,227</u>	<u>123,207</u>
Cash and cash equivalents	39,887,957	30,972,327
Time deposits in other banks	2,250,000	1,250,000
Investment securities held to maturity (fair value of \$41,548,683 in 2020 and \$42,306,343 in 2019)	40,769,803	42,077,275
Federal Home Loan Bank stock, at cost	977,100	1,178,300
Total loans, including deferred fees net of costs	375,354,585	286,934,129
Less: Allowance for loan losses	<u>(5,082,880)</u>	<u>(3,254,206)</u>
Net loans	370,271,705	283,679,923
Bank premises and equipment, net	8,717,685	8,709,600
Income taxes refundable	5,069	153,264
Accrued interest receivable	1,449,946	870,208
Deferred income taxes	587,400	587,400
Bank owned life insurance	6,103,655	6,493,400
Foreclosed real estate	-	58,500
Other assets	<u>1,757,693</u>	<u>1,257,469</u>
Total assets	<u><u>\$ 472,778,013</u></u>	<u><u>\$ 377,287,666</u></u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Deposits		
Noninterest-bearing	\$ 119,796,077	\$ 79,257,424
Interest-bearing	<u>292,688,179</u>	<u>233,583,512</u>
Total deposits	412,484,256	312,840,936
Federal Home Loan Bank advances	13,500,000	19,000,000
Accrued interest payable	223,533	213,909
Other liabilities	<u>2,369,911</u>	<u>2,704,671</u>
	<u>428,577,700</u>	<u>334,759,516</u>
Stockholders' equity		
Common stock, par value \$10 per share; authorized 5,000,000 shares; issued and outstanding 1,432,362 shares in 2020, and 1,423,882 shares in 2019	14,323,620	14,238,820
Surplus	17,042,556	16,946,667
Undivided profits	<u>12,834,137</u>	<u>11,342,663</u>
Total stockholders' equity	<u>44,200,313</u>	<u>42,528,150</u>
Total liabilities and stockholders' equity	<u><u>\$ 472,778,013</u></u>	<u><u>\$ 377,287,666</u></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 September 30,		For the nine months ended September 30,	
	2020	2019	2020	2019
Interest revenue				
Loans, including fees	\$ 4,399,146	\$ 3,576,908	\$ 12,146,022	\$ 10,673,669
Investment securities held to maturity	151,718	230,197	535,117	645,551
Federal funds sold and Federal Home Loan Bank deposit	2	2,889	1,633	6,813
Federal Reserve Bank deposit	7,472	172,779	84,212	452,715
Time deposits in other banks	10,547	5,765	29,167	7,779
Other	10,306	21,141	38,895	69,637
Total interest revenue	<u>4,579,191</u>	<u>4,009,679</u>	<u>12,835,046</u>	<u>11,856,164</u>
Interest expense				
Deposits	512,509	435,492	1,477,597	1,146,750
Borrowed funds	101,321	139,943	329,479	444,287
Total interest expense	<u>613,830</u>	<u>575,435</u>	<u>1,807,076</u>	<u>1,591,037</u>
Net interest income	<u>3,965,361</u>	<u>3,434,244</u>	<u>11,027,970</u>	<u>10,265,127</u>
Provision for loan losses	<u>325,000</u>	<u>60,000</u>	<u>1,828,000</u>	<u>90,000</u>
Net interest income after provision for loan losses	<u>3,640,361</u>	<u>3,374,244</u>	<u>9,199,970</u>	<u>10,175,127</u>
Noninterest revenue				
Service charges on deposit accounts	119,399	199,507	400,499	498,333
Earnings on bank owned life insurance	34,580	37,676	103,629	111,917
Other fees and commissions	264,783	162,999	826,364	452,039
Total noninterest revenue	<u>418,762</u>	<u>400,182</u>	<u>1,330,492</u>	<u>1,062,289</u>
Noninterest expense				
Salaries and benefits	1,613,790	1,518,635	4,470,501	4,538,445
Occupancy	249,765	195,897	718,149	594,648
Furniture and equipment	157,723	129,332	463,235	374,285
Data processing expense	256,037	221,051	717,803	619,314
Professional fees	60,874	57,780	260,052	227,648
Director and committee fees	59,800	74,183	193,962	190,385
Stationery and supplies	29,168	39,821	119,088	134,517
FDIC and state assessments	46,008	10,864	84,274	68,717
Advertising	22,148	46,136	72,540	137,140
Net expenses, (gains), losses and write-downs on repossessed assets and foreclosed real estate	(832)	(26,017)	1,668	(4,646)
Other operating	278,851	307,640	825,211	893,688
Total noninterest expense	<u>2,773,332</u>	<u>2,575,322</u>	<u>7,926,483</u>	<u>7,774,141</u>
Income before income taxes	<u>1,285,791</u>	<u>1,199,104</u>	<u>2,603,979</u>	<u>3,463,275</u>
Income taxes	<u>312,003</u>	<u>299,055</u>	<u>612,593</u>	<u>871,957</u>
Net income	<u>\$ 973,788</u>	<u>\$ 900,049</u>	<u>\$ 1,991,386</u>	<u>\$ 2,591,318</u>
Basic net income per share	\$ 0.68	\$ 0.63	\$ 1.39	\$ 1.83
Diluted net income per share	\$ 0.68	\$ 0.63	\$ 1.39	\$ 1.81

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

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

	Common stock			Undivided	Total
	<u>Shares</u>	<u>Par value</u>	<u>Surplus</u>	<u>profits</u>	<u>Stockholders' Equity</u>
Three months ended:					
September 30, 2020					
Balance at beginning of period	1,431,352	\$ 14,313,520	\$ 17,034,067	\$ 12,003,585	\$ 43,351,172
Net income				973,788	973,788
Cash dividends, \$0.10 per share				(143,236)	(143,236)
Common stock issued:					
Shares issued under stock-based compensation plans and related tax effects	1,008	10,080	4,722	-	14,802
Stock sold and dividend reinvestment plan (DRIP)	2,046	20,460	24,544	-	45,004
Stock-based compensation expense			3,751	-	3,751
Stock acquired for DRIP administration	(2,044)	(20,440)	(24,528)	-	(44,968)
Balance at end of period	<u>1,432,362</u>	<u>\$ 14,323,620</u>	<u>\$ 17,042,556</u>	<u>\$ 12,834,137</u>	<u>\$ 44,200,313</u>
September 30, 2019					
Balance at beginning of period	1,417,912	\$ 14,179,120	\$ 16,858,501	\$ 10,224,852	\$ 41,262,473
Net income				900,049	900,049
Cash dividends, \$0.17 per share				(241,380)	(241,380)
Common stock issued:					
Shares issued under stock-based compensation plans and related tax effects	2,005	20,050	13,353	-	33,403
Stock sold and dividend reinvestment plan (DRIP)	2,647	26,470	47,836	-	74,306
Stock-based compensation expense			31,653	-	31,653
Stock acquired for DRIP administration	-	-	-	-	-
Balance at end of period	<u>1,422,564</u>	<u>\$ 14,225,640</u>	<u>\$ 16,951,343</u>	<u>\$ 10,883,521</u>	<u>\$ 42,060,504</u>
Nine months ended:					
September 30, 2020					
Balance at beginning of period	1,423,882	\$ 14,238,820	\$ 16,946,667	\$ 11,342,663	\$ 42,528,150
Net income				1,991,386	1,991,386
Cash dividends, \$0.35 per share				(499,912)	(499,912)
Common stock issued:					
Shares issued under stock-based compensation plans and related tax effects	4,500	45,000	4,329	-	49,329
Stock sold and dividend reinvestment plan (DRIP)	6,775	67,750	86,410	-	154,160
Stock-based compensation expense			39,628	-	39,628
Stock acquired for DRIP administration	(2,795)	(27,950)	(34,478)	-	(62,428)
Balance at end of period	<u>1,432,362</u>	<u>\$ 14,323,620</u>	<u>\$ 17,042,556</u>	<u>\$ 12,834,137</u>	<u>\$ 44,200,313</u>
September 30, 2019					
Balance at beginning of period	1,410,371	\$ 14,103,710	\$ 16,719,667	\$ 8,774,102	\$ 39,597,479
Net income				2,591,318	2,591,318
Cash dividends, \$0.34 per share				(481,899)	(481,899)
Common stock issued:					
Shares issued under stock-based compensation plans and related tax effects	3,352	33,520	24,348	-	57,868
Stock sold and dividend reinvestment plan (DRIP)	8,841	88,410	157,770	-	246,180
Stock-based compensation expense			49,558	-	49,558
Stock acquired for DRIP administration	-	-	-	-	-
Balance at end of period	<u>1,422,564</u>	<u>\$ 14,225,640</u>	<u>\$ 16,951,343</u>	<u>\$ 10,883,521</u>	<u>\$ 42,060,504</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 nine months ended September 30,	2020	2019
Cash flows provided by (used in) operating activities		
Interest received	\$ 11,265,769	\$ 11,740,279
Fees and commissions received	1,537,624	1,177,142
Interest paid	(1,797,452)	(1,516,001)
Cash paid to suppliers and employees	(8,432,792)	(7,657,329)
Income taxes paid	<u>(464,398)</u>	<u>(800,500)</u>
Net cash provided by (used in) operating activities	<u>2,108,751</u>	<u>2,943,591</u>
Cash flows provided by (used in) investing activities		
Purchases of time deposits in other banks	(1,000,000)	(1,250,000)
Proceeds from calls and maturities of investment securities	18,992,791	18,082,163
Purchases of investment securities	(17,846,917)	(24,878,404)
Redemption (purchase) of FHLB stock	201,200	116,500
Loans originated, net of principal repayments	(90,431,972)	(5,114,290)
Net increase (decrease) in deferred loan fees and costs	2,956,195	(8,800)
Proceeds from bank owned life insurance	493,374	-
Proceeds from sale of foreclosed real estate	56,486	-
Purchases of bank premises and equipment	<u>(398,747)</u>	<u>(691,897)</u>
Net cash provided by (used in) investing activities	<u>(86,977,590)</u>	<u>(13,744,728)</u>
Cash flows provided by (used in) financing activities		
Net (decrease) increase in time deposits	18,184,260	12,497,247
Net (decrease) increase in other deposits	81,459,060	12,952,887
Proceeds from borrowed funds	4,257,300	1,000,000
Repayments of borrowed funds	(9,757,300)	(4,000,000)
Dividends paid	(499,912)	(721,662)
Dividends reinvested	154,160	246,179
Shares issued under stock-based compensation plans and related tax effects	49,329	57,869
Stock acquired for DRIP administration	<u>(62,428)</u>	<u>-</u>
Net cash provided by (used in) financing activities	<u>93,784,469</u>	<u>22,032,520</u>
Net increase (decrease) in cash and cash equivalents	8,915,630	11,231,383
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>39,887,957</u>	\$ <u>40,523,198</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 nine months ended September 30,	2020	2019
Reconciliation of net income to net cash provided by (used in) operating activities		
Net income	\$ 1,991,386	\$ 2,591,318
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Net amortization and accretion on loan fees and costs	(944,005)	16,814
Net amortization and accretion on investment securities	161,598	51,808
Depreciation and amortization on fixed assets and software	386,142	326,036
BOLI income	(103,629)	(111,917)
Provision for loan losses	1,828,000	90,000
Loss (gain) on disposition of bank premises and equipment	-	423
Loss (gain) on foreclosed real estate	2,014	-
Stock-based compensation expense	39,628	49,558
Decrease (increase) in		
Accrued interest receivable	(579,738)	(69,654)
Income taxes refundable	148,195	59,558
Other assets	(495,704)	(544,986)
Increase (decrease) in		
Accrued interest payable	9,624	75,036
Income taxes payable	-	11,899
Other liabilities	(334,760)	397,698
Net cash provided by (used in) operating activities	<u>\$ 2,108,751</u>	<u>\$ 2,943,591</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 ("FHLBA"), the Bank is required to hold FHLBA stock as a condition of membership as well as in relation to the Bank's use of products and services. FHLBA stock is not publicly-traded and is sold and redeemed by the FHLBA at par. The Bank views its investment in FHLBA 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 FHLBA 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 did not consider this investment to be other-than-temporarily impaired at September 30, 2020 or December 31, 2019, and no impairment has been recognized.

Loans and allowance for loan losses

Loans are stated at unpaid principal balance as adjusted for any amounts partially charged-off, the associated allowance for loan losses, and any 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. Non-accrual loans may be considered for return to accrual status after a minimum six-month period of on-time payment performance provided no amount of the loan has been charged-off. 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 ("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.

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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies - continued

Other real estate owned and other repossessed assets

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. 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 real estate property or other collateral are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the real estate property or other 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
September 30, 2020				
U.S. Treasury securities	\$ 3,607,505	\$ 63,575	\$ -	\$ 3,671,080
U.S. government agency securities	13,753,033	161,074	1,121	13,912,986
Mortgage-backed securities	16,841,182	386,695	12,049	17,215,828
Asset-backed securities	6,253,888	208,434	43,506	6,418,816
State and municipal securities	314,195	15,778	-	329,973
	<u>\$ 40,769,803</u>	<u>\$ 835,556</u>	<u>\$ 56,676</u>	<u>\$ 41,548,683</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 penalty. Investment securities are pledged to secure deposits of federal and local governments.

	September 30, 2020		December 31, 2019	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Maturing				
In one year or less	\$ 3,008,586	\$ 3,032,100	\$ 4,609,750	\$ 4,625,893
Over one to five years	14,351,952	14,551,966	16,732,215	16,779,012
Greater than five years	314,195	329,973	315,744	322,922
Mortgage-backed and asset-backed securities	<u>23,095,070</u>	<u>23,634,644</u>	<u>20,419,566</u>	<u>20,578,516</u>
	<u>\$ 40,769,803</u>	<u>\$ 41,548,683</u>	<u>\$ 42,077,275</u>	<u>\$ 42,306,343</u>
 Pledged securities	 <u>\$ 21,372,447</u>	 <u>\$ 21,770,752</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	
	Gross		Gross		Gross	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Losses	Value	Losses	Value	Losses
September 30, 2020						
U.S. Treasury securities	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
U.S. government agency securities	998,650	1,121	-	-	998,650	1,121
Mortgage-backed securities	2,913,879	12,049	-	-	2,913,879	12,049
Asset-backed securities	1,781,143	43,506	-	-	1,781,143	43,506
State and municipal securities	-	-	-	-	-	-
	<u>\$ 5,693,672</u>	<u>\$ 56,676</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,693,672</u>	<u>\$ 56,676</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 September 30, 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 Federal Home Loan Bank ("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:

	September 30, 2020	December 31, 2019
Real estate		
Construction, development and other land	\$ 12,783,598	\$ 10,417,218
Secured by farmland	5,422,834	5,918,714
Commercial	180,735,955	168,773,371
Residential	84,942,983	77,563,922
Commercial and industrial		
Commercial	16,181,921	15,516,630
Paycheck Protection Program	68,719,576	-
Mobile home	4,006,778	4,526,036
Other consumer	4,689,885	4,275,494
Overdrafts	59,085	118,583
Gross loans	377,542,615	287,109,968
Net deferred (fees) costs	(2,188,030)	(175,839)
Allowance for loan losses	(5,082,880)	(3,254,206)
Net loans	<u>\$ 370,271,705</u>	<u>\$ 283,679,923</u>
Principal balance of pledged loans	<u>\$ 123,376,377</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. In the second quarter of 2020, the Bank began making loans to small businesses under the Paycheck Protection Program ("PPP") for, among other things, payroll, group health care benefit costs and qualifying mortgage, rent and utility payments. These loans carry an SBA guarantee, and the borrower may receive forgiveness of the loan if the loans proceeds are used in a manner that qualifies the borrower for forgiveness.

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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

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.

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

	September 30, 2020	December 31, 2019
<i>Maturing</i>		
In one year or less	\$ 16,953,978	\$ 14,758,993
Over one to three years	77,051,459	13,281,289
Over three to five years	25,468,176	17,976,003
Over five to fifteen years	101,952,429	98,732,816
Over fifteen years	156,116,573	142,360,867
Gross loans	<u>\$ 377,542,615</u>	<u>\$ 287,109,968</u>
Variable rate loans included above	<u>\$ 227,791,091</u>	<u>\$ 215,203,234</u>

The following table analyzes the status of loans for the periods 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
September 30, 2020							
Construction, development and other land	\$ -	\$ -	\$ -	\$ -	\$ 12,783,598	\$ 12,783,598	\$ -
Commercial real estate and farmland	120,957	-	529,359	650,316	185,508,473	186,158,789	-
Residential real estate	-	-	279,330	279,330	84,663,653	84,942,983	-
Commercial and industrial	-	-	-	-	84,901,497	84,901,497	-
Mobile homes	179,445	37,332	30,240	247,017	3,759,761	4,006,778	-
Other consumer and overdrafts	7,018	-	-	7,018	4,741,952	4,748,970	-
Total	<u>\$ 307,420</u>	<u>\$ 37,332</u>	<u>\$ 838,929</u>	<u>\$ 1,183,681</u>	<u>\$ 376,358,934</u>	<u>\$ 377,542,615</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 and industrial	-	-	-	-	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
September 30, 2020				
Construction, development and other land	\$ 2,150,793	\$ 156,219	\$ 250,967	\$ 2,557,979
Commercial real estate and farmland	36,434,174	2,856,107	10,935,574	50,225,855
Residential real estate	5,133,856	272,486	690,368	6,096,710
Commercial and industrial	1,452,796	22,597	222,778	1,698,171
Mobile home	-	-	80,072	80,072
Other consumer	54,457	-	-	54,457
	<u>\$ 45,226,076</u>	<u>\$ 3,307,409</u>	<u>\$ 12,179,759</u>	<u>\$ 60,713,244</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 and industrial	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 the three- and nine-month periods ended September 30, 2020 and 2019. Allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories. No allowance for loan losses has been recognized for PPP loans as such loans are fully guaranteed by the SBA.

	Unallocated	Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
Three months ended:									
September 30, 2020									
Beginning balance	\$ 81,656	\$ 265,594	\$ 3,115,757	\$ 779,227	\$ 286,017	\$ 174,969	\$ 37,930	\$ 12,900	\$ 4,754,050
Charge-offs	-	-	-	-	-	-	-	(3,984)	(3,984)
Recoveries	-	-	-	1,750	1,168	600	-	4,296	7,814
Provision or (recovery of provision)	(1,536)	3,858	325,505	(12,454)	14,205	(6,016)	(228)	1,666	325,000
Ending balance	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
September 30, 2019									
Beginning balance	\$ 190,183	\$ 180,725	\$ 1,596,259	\$ 664,067	\$ 232,146	\$ 199,204	\$ 32,809	\$ 11,138	\$ 3,106,531
Charge-offs	-	-	-	(16,119)	-	-	-	(5,130)	(21,249)
Recoveries	-	-	-	3,000	1,400	600	-	10	5,010
Provision or (recovery of provision)	(28,366)	9,565	53,718	8,428	13,952	(4,382)	(1,585)	8,670	60,000
Ending balance	<u>\$ 161,817</u>	<u>\$ 190,290</u>	<u>\$ 1,649,977</u>	<u>\$ 659,376</u>	<u>\$ 247,498</u>	<u>\$ 195,422</u>	<u>\$ 31,224</u>	<u>\$ 14,688</u>	<u>\$ 3,150,292</u>
Nine months ended:									
September 30, 2020									
Beginning balance	\$ 45,780	\$ 213,426	\$ 1,860,385	\$ 655,669	\$ 244,912	\$ 182,609	\$ 32,136	\$ 19,289	\$ 3,254,206
Charge-offs	-	-	-	-	-	-	-	(16,462)	(16,462)
Recoveries	-	-	-	5,000	3,168	1,800	-	7,168	17,136
Provision or (recovery of provision)	34,340	56,026	1,580,877	107,854	53,310	(14,856)	5,566	4,883	1,828,000
Ending balance	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
September 30, 2019									
Beginning balance	\$ 150,049	\$ 187,984	\$ 1,554,315	\$ 674,601	\$ 232,097	\$ 214,548	\$ 29,675	\$ 11,493	\$ 3,054,762
Charge-offs	-	-	-	(16,118)	-	(30,526)	(4,705)	(11,862)	(63,211)
Recoveries	-	51,458	-	9,000	4,800	1,600	-	1,883	68,741
Provision or (recovery of provision)	11,768	(49,152)	95,662	(8,107)	10,601	9,800	6,254	13,174	90,000
Ending balance	<u>\$ 161,817</u>	<u>\$ 190,290</u>	<u>\$ 1,649,977</u>	<u>\$ 659,376</u>	<u>\$ 247,498</u>	<u>\$ 195,422</u>	<u>\$ 31,224</u>	<u>\$ 14,688</u>	<u>\$ 3,150,292</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table presents the allocation of allowance for loan losses for loans that were individually and collectively evaluated for impairment at September 30, 2020 and December 31, 2019, and the loan balances by loan class for loans that were individually and collectively evaluated for impairment at September 30, 2020 and December 31, 2019.

		Construction, Development & Other Land	Commercial Real Estate & Farmland	Residential Real Estate	Commercial & Industrial	Mobile Home	Other Consumer	Overdrafts	Total
September 30, 2020	Unallocated								
Allowance balance allocated to loans:									
Individually evaluated									
for impairment	\$ -	\$ -	\$ 1,124,000	\$ 5,000	\$ 4,188	\$ 2,000	\$ -	\$ -	\$ 1,135,188
Collectively evaluated									
for impairment	<u>80,120</u>	<u>269,452</u>	<u>2,317,262</u>	<u>763,523</u>	<u>297,202</u>	<u>167,553</u>	<u>37,702</u>	<u>14,878</u>	<u>3,947,692</u>
	<u>\$ 80,120</u>	<u>\$ 269,452</u>	<u>\$ 3,441,262</u>	<u>\$ 768,523</u>	<u>\$ 301,390</u>	<u>\$ 169,553</u>	<u>\$ 37,702</u>	<u>\$ 14,878</u>	<u>\$ 5,082,880</u>
Loan balances:									
Individually evaluated									
for impairment		<u>\$ 250,967</u>	<u>\$ 9,167,651</u>	<u>\$ 591,526</u>	<u>\$ 222,778</u>	<u>\$ 80,072</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 10,312,994</u>
Collectively evaluated									
for impairment		<u>\$ 12,532,631</u>	<u>\$ 176,991,138</u>	<u>\$84,351,457</u>	<u>\$ 84,678,719</u>	<u>\$ 3,926,706</u>	<u>\$4,689,885</u>	<u>\$ 59,085</u>	<u>\$ 367,229,621</u>
December 31, 2019									
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 September 30, 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 nine- and 12-month periods then ended.

	Unpaid Principal Balance	Recorded Investment	Related Allowance	Average Recorded Investment	Interest Income Recognized
September 30, 2020					
With no related allowance recorded:					
Construction, development and other land	\$ 250,967	\$ 250,967	\$ -	\$ 251,614	\$ 10,685
Commercial real estate and farmland	5,395,722	4,870,330	-	4,920,195	155,260
Residential real estate	551,608	387,340	-	402,271	2,420
Commercial and industrial	-	-	-	-	-
Mobile home	92,877	72,742	-	77,584	511
Other consumer	-	-	-	-	-
With an allowance recorded:					
Construction, development and other land	-	-	-	-	-
Commercial real estate and farmland	4,517,281	4,297,321	1,124,000	4,344,293	-
Residential real estate	204,186	204,186	5,000	211,959	8,133
Commercial and industrial	223,586	222,778	4,188	226,942	9,726
Mobile home	12,702	7,330	2,000	7,981	-
Other consumer	-	-	-	-	-
Total:					
Construction, development and other land	250,967	250,967	-	251,614	10,685
Commercial real estate and farmland	9,913,003	9,167,651	1,124,000	9,264,488	155,260
Residential real estate	755,794	591,526	5,000	614,230	10,553
Commercial and industrial	223,586	222,778	4,188	226,942	9,726
Mobile home	105,579	80,072	2,000	85,565	511
Other consumer	-	-	-	-	-
	<u>\$ 11,248,929</u>	<u>\$ 10,312,994</u>	<u>\$ 1,135,188</u>	<u>\$ 10,442,839</u>	<u>\$ 186,735</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 and industrial	-	-	-	-	-
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 and industrial	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 and industrial	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 TDRs 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.

	September 30, 2020		December 31, 2019	
	Number of Contracts	Outstanding Loan Balance	Number of Contracts	Outstanding Loan Balance
Commercial real estate	<u>5</u>	<u>\$ 4,544,019</u>	<u>5</u>	<u>\$ 4,699,422</u>

The Bank did not modify or remodify any loans during the nine-month period ended September 30, 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 September 30, 2020 for which there was a payment default during the nine-month period ended September 30, 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.

Section 4013 of the U.S. Government's Coronavirus Aid, Relief, and Economic Security Act allows financial institutions to suspend application of certain current TDR accounting guidance under ASC 310-40 for loan modifications related to the COVID-19 pandemic made between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the end of the COVID-19 national emergency, provided certain criteria are met. This relief can be applied to loan modifications for borrowers that were not more than 30 days past due as of December 31, 2019 and to loan modifications that defer or delay the payment of principal or interest, or change the interest rate on the loan. In April 2020, federal and state banking regulators issued the Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus to provide further interpretation of when a borrower is experiencing financial difficulty, specifically indicating that if the modification is either short-term (e.g., six months) or mandated by a federal or state government in response to the COVID-19 pandemic, the borrower is not experiencing financial difficulty under ASC 310-40. The Bank continues to prudently work with borrowers negatively impacted by the COVID-19 pandemic while managing credit risks and recognizing appropriate allowance for loan losses on its loan portfolio. Beginning in mid-March of 2020, the Bank began offering deferral and modification of principal and/or interest payments to selected borrowers on a case-by-case basis. As of September 30, 2020, the Bank had five loans totaling \$5,924,348 subject to deferral and modification agreements, representing 1.57% of gross loans that were not classified as TDRs because they met the criteria discussed above.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

4. Loans - continued

The following table summarizes nonaccrual loans at September 30, 2020 and December 31, 2019.

Non-accrual loans by class	September 30, 2020	December 31, 2019
Real estate		
Commercial real estate and farmland	\$ 5,073,378	\$ 4,786,464
Residential real estate	338,355	176,146
Mobile home	<u>74,901</u>	<u>51,293</u>
Total non-accrual loans	<u>\$ 5,486,634</u>	<u>\$ 5,013,903</u>

The following table presents the amount of gross interest income that would have been recorded during the three- and nine-month periods ended September 30, 2020 and 2019 had the nonaccrual loans been current and performing according to terms.

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2020	2019	2020	2019
Interest not accrued on non-accrual loans	<u>\$ 56,964</u>	<u>\$ 52,418</u>	<u>\$ 161,467</u>	<u>\$ 153,151</u>

There were no consumer mortgage loans secured by residential real estate that were in the process of foreclosure as of September 30, 2020.

5. Credit Commitments

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

At:	September 30, 2020	December 31, 2019
Commitments to extend credit		
Loan origination commitments	\$ 11,428,556	\$ 8,070,043
Unused consumer real estate construction	582,000	477,660
Unused home equity lines of credit	13,546,298	11,321,186
Unused overdraft lines of credit	5,716,216	5,099,625
Unused commercial lines of credit	<u>42,644,642</u>	<u>45,843,242</u>
	<u>\$ 73,917,712</u>	<u>\$ 70,811,756</u>
Letters of credit	<u>\$ 3,725,809</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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

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:	September 30, 2020	December 31, 2019
Beginning balance	\$ 15,774,321	\$ 16,425,113
Advances	3,379,311	4,998,284
Change in related party	-	(12,353)
Payments	(2,169,739)	(5,758,052)
Other addition	-	121,329
Ending balance	<u>\$ 16,983,893</u>	<u>\$ 15,774,321</u>

The change in related party was due to the retirement of a related party that occurred in May 2019. The other addition was due to the discovery of a previously unidentified related party loan.

In addition to the outstanding balances listed above, the Bank's related parties had \$2,877,375 in unused loans committed but not funded as of September 30, 2020. As of December 31, 2019, the Bank's related parties had \$2,922,819 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 \$9,312 to these related parties during the nine months ended September 30, 2020. The Bank paid \$6,622 to these related parties during the nine months ended September 30, 2019.

Deposits of executive officers and directors of the Bank totaled \$6,558,736 at September 30, 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 expense are as follows:

	Useful Lives	September 30, 2020	December 31, 2019
Land		\$ 3,174,756	\$ 3,174,756
Building and improvements	15 - 39 years	7,579,979	7,430,474
Leasehold improvements	5 - 19 years	584,131	518,660
Furniture, fixtures, and equipment	3 - 10 years	<u>2,596,022</u>	<u>2,479,288</u>
		13,934,888	13,603,178
Accumulated depreciation		<u>5,217,203</u>	<u>4,893,578</u>
Net bank premises and equipment		<u>\$ 8,717,685</u>	<u>\$ 8,709,600</u>

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2020	2019	2020	2019
Depreciation expense	<u>\$ 131,424</u>	<u>\$ 112,666</u>	<u>\$ 380,205</u>	<u>\$ 320,581</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

7. Bank Premises and Equipment – continued

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

	Useful Life	September 30, 2020	December 31, 2019
Computer software	3 years	\$ 272,145	\$ 261,649
Accumulated amortization		<u>255,281</u>	<u>249,305</u>
Net computer software		<u>\$ 16,864</u>	<u>\$ 12,344</u>

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2020	2019	2020	2019
Amortization expense	<u>\$ 2,218</u>	<u>\$ 1,818</u>	<u>\$ 5,937</u>	<u>\$ 5,455</u>

8. Leases

The Bank leases certain banking facilities under operating leases expiring on various dates through 2026. At September 30, 2020, the Bank had lease liabilities totaling \$562,758 included in other liabilities and right-of-use lease assets totaling \$562,758 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 weighted-average discount rate on operating lease balances outstanding at September 30, 2020 was 2.46%. The weighted-average remaining lease term of operating leases outstanding at September 30, 2020 was 4.6 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 September 30, 2020 was \$60,892. 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 September 30, 2019 was \$35,616. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the nine months ended September 30, 2020 was \$170,697. Rent expense, consisting of lease payments plus common area maintenance and all other charges assessed by the lessor, paid in cash for the nine months ended September 30, 2019 was \$102,357.

As of September 30, 2020, future minimum payments, by year and in the aggregate, of operating leases are as follows:

Year	Amount
Remainder of 2020	\$ 43,240
2021	158,710
2022	116,534
2023	117,339
2024	112,097
2025 and thereafter	<u>77,202</u>
Total undiscounted lease payments	625,122
Discount on cash flows	<u>(62,364)</u>
Total lease liability	<u>\$ 562,758</u>

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

9. Borrowings and Available Lines of Credit

FHLBA fixed rate term advances are summarized as follows:

Maturity Date	Interest Rate	Interest Frequency	September 30, 2020	December 31, 2019
March 20, 2020	2.8500%	Quarterly	\$ -	\$ 1,500,000
June 29, 2020	1.7100%	Monthly	-	2,500,000
September 21, 2020	2.9385%	Quarterly	-	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>\$ 13,500,000</u>	<u>\$ 19,000,000</u>

FHLBA term advances as of September 30, 2020 will require principal repayments as follows:

Year	Principal Reduction
Remainder of 2020	\$ 1,000,000
2021	7,000,000
2022	<u>5,500,000</u>
	<u>\$ 13,500,000</u>

In the second quarter of 2020, the Bank established a Paycheck Protection Program Liquidity Facility with the Federal Reserve Bank of Richmond. This facility allows the Bank to pledge PPP loans to the facility and receive nonrecourse funding equal to 100% of the principal balance of the loans pledged, with a maturity equal to the maturity date of the underlying pledged PPP loans. The FRB PPPLF offers a fixed rate of 0.35% for all funds advanced under the program. Originally set to expire on September 30, 2020, the Federal Reserve Board announced on July 28, 2020 that the PPPLF was extended through December 31, 2020. As of September 30, 2020, the Bank had paid off all outstanding PPPLF borrowings. Based on the amount of PPP loans that could have been pledged as of September 30, 2020, the Bank could borrow \$64,462,276 from the FRB PPPLF.

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 September 30, 2020, the Bank could borrow an additional \$68,700,057 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 September 30, 2020, the Bank could borrow \$5,022,370 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 September 30, 2020, or \$47,277,801.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

9. Borrowings and Available Lines of Credit – continued

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.

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 \$1,146,533 related to these benefits at September 30, 2020. SERP expense for the three months ended September 30, 2020 was \$23,373. SERP expense for the three months ended September 30, 2019 was \$38,691. SERP expense for the nine months ended September 30, 2020 was \$70,990. SERP expense for the nine months ended September 30, 2019 was \$120,358.

11. Interest-Bearing Deposits

Major classifications of interest-bearing deposits at:	September 30, 2020	December 31, 2019
Interest-bearing checking and Money Market	\$ 132,725,056	\$ 103,856,879
Savings	52,100,845	40,048,615
Certificates of deposit	107,862,278	89,678,018
	<u>\$ 292,688,179</u>	<u>\$ 233,583,512</u>

Maturities of certificates of deposit at:	September 30, 2020	December 31, 2019
Maturing within twelve months	\$ 64,736,216	\$ 48,257,310
Maturing over one to three years	32,582,289	29,429,742
Maturing over three to five years	10,543,773	11,990,966
	<u>\$ 107,862,278</u>	<u>\$ 89,678,018</u>

Certificates of deposit over \$250,000 included above:	<u>\$ 37,514,614</u>	<u>\$ 26,087,312</u>
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	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
Interest expense:	2020	2019	2020	2019
Interest-bearing checking and Money Market	\$ 47,536	\$ 42,404	\$ 135,403	\$ 125,970
Savings	17,178	13,753	46,991	40,771
Certificates of deposit	447,795	379,335	1,295,203	980,009
	<u>\$ 512,509</u>	<u>\$ 435,492</u>	<u>\$ 1,477,597</u>	<u>\$ 1,146,750</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:	September 30, 2020	September 30, 2019
Federal	\$ 454,536	\$ 669,023
State	158,057	202,934
	<u>\$ 612,593</u>	<u>\$ 871,957</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:	September 30, 2020	September 30, 2019
Statutory federal income tax rate	21.00 %	21.00 %
Increase (decrease) resulting from		
State income taxes, net of federal income tax benefit	4.80	4.63
Tax-exempt income	(2.52)	(0.93)
Nondeductible expenses	0.25	0.44
	<u>23.53 %</u>	<u>25.14 %</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.

In 2008, the Bank adopted a qualified employee stock purchase plan (the "2008 ESPP") that allowed 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 2008 ESPP fully vest at the time of grant. On April 23, 2018, the 2008 ESPP expired, and all options outstanding subject to exercise expired in July 2020.

The total number of shares originally authorized for active director stock option plans and inactive director and officer plans with outstanding options was 249,890. At September 30, 2020, a total of 47,522 shares remain available for grant under the active director plan.

A summary of activity for stock option activity for the nine months ended September 30, 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	8,580	\$ 24.25		
Options exercised	(12,122)	\$ 22.05		
Options forfeited or expired	(4,986)	\$ 18.70		
Outstanding at September 30, 2020	<u>74,751</u>	<u>\$ 23.47</u>	<u>5.94</u>	<u>\$ 100,114</u>
Exercisable at September 30, 2020	<u>67,001</u>	<u>\$ 23.11</u>	<u>5.75</u>	<u>\$ 100,114</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 nine months ended September 30, 2020 is as follows:

Nonvested Options	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2020	17,372	\$5.07
Options granted	-	\$0.00
Options vested	(9,621)	\$5.09
Options forfeited or expired	(1)	\$5.11
Outstanding at September 30, 2020	<u>7,750</u>	\$5.03

Stock-based compensation expense is recognized ratably over the requisite service period for all awards. The service period generally matches the vesting period. At September 30, 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	\$ 3,751
2021	<u>5,001</u>
	<u>\$ 8,752</u>

For the three months ended September 30, 2020, the Bank recorded stock-based compensation expense of \$3,751. For the three months ended September 30, 2019, the Bank recorded stock-based compensation expense of \$31,653. For the nine months ended September 30, 2020, the Bank recorded stock-based compensation expense of \$39,628. For the nine months ended September 30, 2019, the Bank recorded stock-based compensation expense of \$49,558.

The intrinsic value of options exercised during the nine months ended September 30, 2020 was \$62,307. The intrinsic value of options exercised during the nine months ended September 30, 2019 was \$36,730.

At the annual meeting of stockholders held on May 20, 2020, the Bank's stockholders approved a new qualified employee stock purchase plan (the "2020 ESPP") that allows eligible employees to acquire up to 100,000 shares of the Bank's common stock at a discount through accumulated payroll deductions. A summary of these terms is set forth in the Bank's definitive proxy statement for the 2020 annual meeting of stockholders, which was filed with the FDIC on April 11, 2020.

The first quarterly offering period of the 2020 ESPP commenced July 1, 2020 and concluded September 30, 2020. Based on employee withholdings during the offering period and the quarter-end stock price of \$21.90, a total of 534 shares will be granted under the terms of the 2020 ESPP. At September 30, 2020, a total of 99,466 shares remain available for grant under the 2020 ESPP.

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.

Harford Bank and Subsidiary

Notes to Consolidated Financial Statements (Unaudited)

14. Capital Standards - continued

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).

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	Amount	Ratio
September 30, 2020								
Total capital	\$ 48,001	15.85%	\$ 30,281	10.00%	\$ 24,225	8.00%	\$ 31,795	10.50%
Tier 1 capital	44,200	14.60%	24,225	8.00%	18,169	6.00%	25,739	8.50%
Common equity Tier 1 capital	44,200	14.60%	19,683	6.50%	13,627	4.50%	21,197	7.00%
Tier 1 leverage capital	44,200	9.51%	23,101	5.00%	18,481	4.00%	18,481	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	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 September 30, 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 September 30,		For the Nine Months Ended September 30,	
	2020	2019	2020	2019
Basic:				
Net income	\$ 973,788	\$ 900,049	\$1,991,386	\$2,591,318
Weighted-average common shares outstanding	<u>1,431,817</u>	<u>1,418,822</u>	<u>1,429,217</u>	<u>1,415,516</u>
Basic net income per common share	<u>\$ 0.68</u>	<u>\$ 0.63</u>	<u>\$ 1.39</u>	<u>\$ 1.83</u>
Diluted:				
Net income	\$ 973,788	\$ 900,049	\$1,991,386	\$2,591,318
Weighted-average common shares outstanding	<u>1,431,817</u>	<u>1,418,822</u>	<u>1,429,217</u>	<u>1,415,516</u>
Dilutive common stock equivalents	<u>4,496</u>	<u>17,690</u>	<u>6,022</u>	<u>17,464</u>
Dilutive EPS shares	<u>1,436,313</u>	<u>1,436,512</u>	<u>1,435,239</u>	<u>1,432,980</u>
Diluted net income per common share	<u>\$ 0.68</u>	<u>\$ 0.63</u>	<u>\$ 1.39</u>	<u>\$ 1.81</u>
Anti-dilutive shares	<u>59,055</u>	<u>7,260</u>	<u>39,979</u>	<u>7,260</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 nine- and 12-month periods ended September 30, 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
September 30, 2020				
Impaired loans (net of impairment)	\$ -	\$ 8,959,216	\$ 218,590	\$ 9,177,806
Other real estate owned	-	-	-	-
Reposessed assets	-	-	-	-
Total	<u>\$ -</u>	<u>\$ 8,959,216</u>	<u>\$ 218,590</u>	<u>\$ 9,177,806</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 September 30, 2020, impaired loans totaling \$10,312,994 had specific loan loss allowances of \$1,135,188 carried in the allowance for loan losses, resulting in a fair value of impaired loans (net of impairment) measured on a nonrecurring basis of \$9,177,805. 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)
September 30, 2020					
Financial assets:					
Time deposits in other banks	\$ 2,250,000	\$ 2,286,056	\$ -	\$ -	\$ 2,286,056
Investment securities held to maturity					
U.S. Treasury securities	3,607,505	3,671,080	-	3,671,080	-
U.S. government agencies	13,753,033	13,912,986	-	13,912,986	-
Mortgage-backed securities	16,841,182	17,215,828	-	17,215,828	-
Asset-backed securities	6,253,888	6,418,816	-	6,418,816	-
State and municipal securities	314,195	329,973	-	329,973	-
Loans, net	370,271,706	375,491,648	-	8,959,216	366,532,432
Financial liabilities:					
Interest-bearing deposits	292,688,179	294,769,159	-	-	294,769,159
FHLBA advances	13,500,000	13,841,268	-	-	13,841,268
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
Financial liabilities:					
Interest-bearing deposits	233,583,512	234,307,530	-	-	234,307,530
FHLBA 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. The fair value of negotiable time deposits 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.

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.

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.

FHLBA advances

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

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. 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. 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.

ASU 2020-8, *“Codification Improvements to Subtopic 310-20, Receivables - Nonrefundable Fees and Other Costs.”* ASU 2020-8 clarifies the accounting for the amortization of purchase premiums for callable debt securities with multiple call dates. ASU 2020-8 will be effective for the Bank on January 1, 2021 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: November 4, 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: November 4, 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 September 30, 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: November 4, 2020

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

Date: November 4, 2020

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