

Bank of Ocean City

Financial Statements

December 31, 2019

Bank of Ocean City

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The Board of Directors and Stockholders
Bank of Ocean City
Ocean City, Maryland

Report of Independent Auditors

Report on the Financial Statements

We have audited the accompanying financial statements of Bank of Ocean City, which comprise the balance sheets as of December 31, 2019, 2018, and 2017, and the related statements of income, comprehensive income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Bank of Ocean City as of December 31, 2019, 2018, and 2017, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Rowles & Company, LLP

Baltimore, Maryland
February 28, 2020

Bank of Ocean City

Balance Sheets

December 31,	2019	2018	2017
Assets			
Cash and due from banks	\$ 7,187,711	\$ 6,852,781	\$ 6,806,326
Interest-bearing deposits in other financial institutions	33,371,324	21,009,331	4,336,252
Federal funds sold	<u>5,497,677</u>	<u>9,430,786</u>	<u>6,232,908</u>
Cash and cash equivalents	46,056,712	37,292,898	17,375,486
Certificates of deposit in other financial institutions	4,190,000	5,437,253	4,570,505
Restricted stock at cost	362,800	345,700	352,650
Investment securities available for sale	22,834,939	22,815,446	1,473,172
Investment securities held to maturity (approximate fair value of \$24,584,088, \$30,942,781, and \$75,425,532)	23,865,754	31,169,553	76,739,489
Loans, less allowance for loan losses of \$2,071,813, \$1,855,108, and \$1,707,309	255,161,295	229,815,868	207,156,137
Premises and equipment	7,711,780	7,889,252	8,056,022
Accrued interest receivable	905,347	864,408	837,150
Deferred income taxes	244,225	409,585	-
Prepaid income taxes	18,399	-	-
Other assets	<u>949,870</u>	<u>343,501</u>	<u>790,542</u>
	<u>\$362,301,121</u>	<u>\$336,383,464</u>	<u>\$317,351,153</u>
Liabilities and Stockholders' Equity			
Deposits			
Noninterest-bearing	\$ 109,529,494	\$ 101,649,101	\$ 94,285,012
Interest-bearing	<u>211,378,542</u>	<u>198,117,852</u>	<u>189,162,660</u>
Total deposits	320,908,036	299,766,953	283,447,672
Accrued interest payable	66,479	84,661	32,335
Dividend payable	500,360	446,364	409,186
Deferred compensation payable	629,559	674,423	729,063
Deferred income taxes	-	-	69,309
Income taxes payable	-	57,054	35,871
Other liabilities	<u>463,029</u>	<u>630,817</u>	<u>396,205</u>
	<u>322,567,463</u>	<u>301,660,272</u>	<u>285,119,641</u>
Stockholders' equity			
Common stock, par value \$1 per share; authorized 800,000 shares; issued and outstanding 555,955 shares at December 31, 2019, 557,955 shares at December 31, 2018, and 560,529 shares at December 31, 2017	555,955	557,955	560,529
Surplus	9,702,755	9,840,755	10,018,361
Undivided profits	29,119,480	24,395,229	20,585,668
Accumulated other comprehensive income (loss)	<u>355,468</u>	<u>(70,747)</u>	<u>1,066,954</u>
	<u>39,733,658</u>	<u>34,723,192</u>	<u>32,231,512</u>
	<u>\$362,301,121</u>	<u>\$336,383,464</u>	<u>\$317,351,153</u>

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

Bank of Ocean City

Statements of Income

Years Ended December 31,	2019	2018	2017
Interest and dividend revenue			
Loans, including fees	\$12,632,819	\$10,842,575	\$9,598,633
U.S. government agency securities	596,011	971,937	977,197
U.S. Treasury securities	52,653	54,609	38,857
State and municipal securities	56,899	60,681	14,875
Federal funds sold and interest-bearing deposits	831,152	564,635	347,845
Mortgage-backed securities	597,274	188,105	65,993
Equity securities	19,756	38,681	37,166
Total interest and dividend revenue	14,786,564	12,721,223	11,080,566
Interest expense			
Deposits	1,641,766	1,237,439	955,173
Borrowed funds	3,449	2	-
Total interest expense	1,645,215	1,237,441	955,173
Net interest income	13,141,349	11,483,782	10,125,393
Provision for loan losses			
Net interest income after provision for loan losses	18,750	168,627	203,591
	13,122,599	11,315,155	9,921,802
Noninterest revenue			
Service charges on deposit accounts	487,349	469,581	443,626
Card services	334,353	310,467	263,364
Gain (loss) on disposition of premises and equipment	(71,778)	-	2,000
Loss on sale of investment securities available for sale	-	(84,824)	-
Other-than-temporary impairment of restricted stock	-	(21,850)	(8,150)
Other revenue	240,057	192,250	198,166
Total noninterest revenue	989,981	865,624	899,006
Noninterest expenses			
Salaries	3,236,008	2,885,513	2,721,223
Employee benefits	741,040	685,661	680,342
Occupancy	434,532	432,706	485,052
Furniture and equipment	248,432	213,322	216,354
Data processing	799,998	753,522	657,936
Other operating	1,293,793	1,296,389	1,224,736
Total noninterest expenses	6,753,803	6,267,113	5,985,643
Income before income taxes	7,358,777	5,913,666	4,835,165
Income taxes	1,910,984	1,483,977	1,723,970
Net income	\$ 5,447,793	\$ 4,429,689	\$3,111,195
Earnings per common share	\$ 9.77	\$ 7.91	\$ 5.48

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

Bank of Ocean City

Statements of Comprehensive Income

Years Ended December 31,	2019	2018	2017
Net income	<u>\$5,447,793</u>	<u>\$4,429,689</u>	<u>\$3,111,195</u>
Other comprehensive income (loss)			
Unrealized gain (loss) on investment securities available for sale	590,025	(1,654,445)	180,478
Reclassification of loss on sale of investment securities available for sale	-	84,824	-
Income tax relating to unrealized (gain) loss on investment securities available for sale	<u>(163,810)</u>	<u>431,920</u>	<u>(71,190)</u>
Other comprehensive income (loss)	<u>426,215</u>	<u>(1,137,701)</u>	<u>109,288</u>
Total comprehensive income	<u>\$5,874,008</u>	<u>\$3,291,988</u>	<u>\$3,220,483</u>

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

Bank of Ocean City

Statements of Changes in Stockholders' Equity

	Common stock			Undivided	Accumulated other comprehensive	Total stockholders'
	Shares	Par value	Surplus	profits	income (loss)	equity
Balance, December 31, 2016	570,300	\$570,300	\$10,667,450	\$18,201,461	\$ 782,091	\$30,221,302
Net income	-	-	-	3,111,195	-	3,111,195
Unrealized gain on investment securities available for sale, net of income taxes of \$71,190	-	-	-	-	109,288	109,288
Reclassification due to the adoption of ASU No. 2018-02	-	-	-	(175,575)	175,575	-
Stock repurchase	(9,771)	(9,771)	(649,089)	-	-	(658,860)
Cash dividend, \$0.98 per share	-	-	-	(551,413)	-	(551,413)
Balance, December 31, 2017	560,529	560,529	10,018,361	20,585,668	1,066,954	32,231,512
Net income	-	-	-	4,429,689	-	4,429,689
Unrealized loss on investment securities available for sale, net of income taxes of \$431,920	-	-	-	-	(1,137,701)	(1,137,701)
Stock repurchase	(2,574)	(2,574)	(177,606)	-	-	(180,180)
Cash dividends, \$1.11 per share	-	-	-	(620,128)	-	(620,128)
Balance, December 31, 2018	557,955	557,955	9,840,755	24,395,229	(70,747)	34,723,192
Net income	-	-	-	5,447,793	-	5,447,793
Unrealized gain on investment securities available for sale, net of income taxes of \$163,810	-	-	-	-	426,215	426,215
Stock repurchase	(2,000)	(2,000)	(138,000)	-	-	(140,000)
Cash dividends, \$1.30 per share	-	-	-	(723,542)	-	(723,542)
Balance, December 31, 2019	<u>555,955</u>	<u>\$555,955</u>	<u>\$ 9,702,755</u>	<u>\$29,119,480</u>	<u>\$ 355,468</u>	<u>\$39,733,658</u>

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

Bank of Ocean City

Statements of Cash Flows

Years Ended December 31,	2019	2018	2017
Cash flows from operating activities			
Interest received	\$14,706,760	\$12,681,872	\$10,969,026
Fees and commissions received	1,061,759	1,078,972	907,156
Interest paid	(1,663,397)	(1,185,115)	(951,913)
Cash paid to suppliers and employees	(7,254,578)	(5,443,272)	(6,223,463)
Income taxes paid	(1,964,488)	(1,509,767)	(1,656,972)
Cash provided by operating activities	<u>4,886,056</u>	<u>5,622,690</u>	<u>3,043,834</u>
Cash flows from investing activities			
(Purchases) redemptions of certificates of deposit, net	1,247,253	(866,748)	3,499,857
Proceeds from sale of investment securities available for sale	-	41,901,278	-
Purchase of investment securities held to maturity	-	(24,547,626)	(4,002,550)
Purchase of investment securities available for sale	(5,000,000)	(10,069,860)	-
Proceeds from matured investment securities held to maturity	7,341,985	15,301,517	6,351,583
Proceeds from matured investment securities available for sale	5,569,209	-	-
Purchase of restricted stock, net	(17,100)	(14,900)	(13,000)
Loans made, net of principal repayments	(25,364,176)	(22,828,358)	(31,523,425)
Purchases of premises, equipment, and software	(230,950)	(136,732)	(489,998)
Cash used by investing activities	<u>(16,453,779)</u>	<u>(1,261,429)</u>	<u>(26,177,533)</u>
Cash flows from financing activities			
Net increase (decrease) in			
Time deposits	4,211,532	1,898,946	(4,872,515)
Other deposits	16,929,551	14,420,335	19,410,733
Repurchase of common stock	(140,000)	(180,180)	(658,860)
Dividends paid	(669,546)	(582,950)	(541,437)
Cash provided by financing activities	<u>20,331,537</u>	<u>15,556,151</u>	<u>13,337,921</u>
Net increase (decrease) in cash and cash equivalents	8,763,814	19,917,412	(9,795,778)
Cash and cash equivalents at beginning of year	<u>37,292,898</u>	<u>17,375,486</u>	<u>27,171,264</u>
Cash and cash equivalents at end of year	<u>\$46,056,712</u>	<u>\$37,292,898</u>	<u>\$17,375,486</u>

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

Bank of Ocean City

Statements of Cash Flows (Continued)

Years Ended December 31,	2019	2018	2017
Reconciliation of net income to net cash provided by operating activities			
Net income	\$5,447,793	\$4,429,689	\$3,111,195
Adjustments to reconcile net income to net cash provided by operating activities			
Amortization of investment premiums and accretion of discounts	(38,865)	(12,093)	(4,472)
Provision for loan losses	18,750	168,627	203,591
Depreciation and amortization	336,644	303,502	299,185
(Gain) loss on disposal of premises and equipment	71,778	-	(2,000)
(Gain) loss on sale of investment securities	-	84,824	-
Other-than-temporary impairment of restricted stock	-	21,850	8,150
Deferred income taxes	3,550	(46,973)	(73,731)
Deferred tax liability adjustment for change in corporate income tax rate	-	-	(42,660)
Decrease (increase) in			
Accrued interest receivable	(40,939)	(27,258)	(107,068)
Other assets and prepaid income taxes	(624,767)	447,041	(329,156)
Increase (decrease) in			
Accrued interest payable	(18,182)	52,326	3,260
Income taxes payable	(57,054)	21,183	-
Other liabilities and deferred compensation payable	(212,652)	179,972	(22,460)
 Cash provided by operating activities	 <u>\$4,886,056</u>	 <u>\$5,622,690</u>	 <u>\$3,043,834</u>

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

Bank of Ocean City

Notes to Financial Statements

1. Summary of Significant Accounting Policies

The accounting and reporting policies reflected in the financial statements conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. Management makes 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.

Business

Bank of Ocean City provides a full range of banking services to customers located primarily in Worcester County, Maryland, Sussex County, Delaware, and the surrounding areas.

Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, money market funds, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

Certificates of deposit in other financial institutions

Certificates of deposit in other financial institutions are carried at cost. As of December 31, 2019, they mature as follows:

<u>Year</u>	<u>Amount</u>
2020	\$ 500,000
2021	988,000
2022	735,000
2023	1,967,000
2024	-
	<u>\$4,190,000</u>

Restricted stock

Restricted stock includes the Bank's investment in Federal Home Loan Bank of Atlanta stock, in the amount of **\$302,800**, \$285,700, and \$270,800, as of December 31, 2019, 2018, and 2017, respectively. As a member of the Federal Home Loan Bank, the Bank is required to purchase stock based on its total assets. The stock is recorded at cost on the balance sheet. The remaining balance of restricted stock represents investments in the common stock of two bankers' banks. During the years ended December 31, 2018 and 2017, the Bank recognized an other-than-temporary impairment of \$21,850 and \$8,150, respectively, related to one of the restricted bankers' bank stocks.

Investment securities

As securities are purchased, management determines if the securities should be classified as held to maturity or available for sale. Securities which management has the intent and ability to hold to maturity are recorded at amortized cost, which is cost adjusted for amortization of premiums and accretion of discounts to maturity. Available for sale securities are recorded at fair value with unrealized gains and losses included in stockholders' equity on an after-tax basis. Premiums are amortized and discounts are accreted using the interest method. Premiums are amortized through the earliest call date. Discounts are accreted through maturity.

Gains and losses on disposal are determined using the specific-identification method.

Bank of Ocean City

Notes to Financial Statements (Continued)

1. Summary of Significant Accounting Policies (Continued)

Loans and allowance for loan losses

Loans are stated at face value less the allowance for loan losses. Interest on loans is accrued based on the principal amounts outstanding. 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. If collection of principal is evaluated as doubtful, all payments are applied to principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with contractual terms for a reasonable period of time, and the ultimate collectability of the total contractual principal and interest is no longer in doubt.

The Bank maintains an allowance that is adequate to provide for probable loan losses based on management's review and analysis of the loan portfolio as well as prevailing and anticipated economic conditions. The allowance consists of specific and general components. For loans that are classified as impaired, an allowance is established when the collateral value or the discounted cash flows of the impaired loan is lower than the carrying value of that loan. The general component covers pools of nonclassified loans and is based on historical loss experience adjusted for qualitative factors. There may be an unallocated component of the allowance, which reflects the margin of imprecision inherent in the underlying assumptions used in the methods for estimating specific and general losses in the portfolio. If the current economy or real estate market were to suffer a severe downturn, the estimate for uncollectible loans would need to be increased. Loan losses are charged to the allowance when management believes that collectability is unlikely. Collections of loans previously charged off are added to the allowance at the time of recovery.

Loans are considered impaired when, based on current information, management considers it unlikely that collection of principal and interest payments will be made according to contractual terms. Generally, loans are not reviewed for impairment until the accrual of interest has been discontinued, or they have been classified as substandard. Loans that have been modified in a troubled debt restructuring are considered impaired, even if they are on accrual status.

Premises and equipment

Land is recorded at cost. Premises and equipment are recorded at cost less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Expenditures for maintenance, repairs, and minor replacements are charged to operating expenses as incurred.

Foreclosed real estate

Real estate acquired through foreclosure is recorded at the lower of cost or fair value on the date acquired. In general, cost equals the Bank's investment in the property at the time of foreclosure. Losses incurred at the time of acquisition of the property are charged to the allowance for loan losses. Subsequent reductions in the estimated value of the property are included in noninterest expense.

Bank of Ocean City

Notes to Financial Statements (Continued)

1. **Summary of Significant Accounting Policies** (Continued)

Income taxes

The provision for income taxes includes taxes payable for the current year and deferred income taxes. Deferred income taxes are provided to account for temporary differences between financial and taxable income. 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.

In December 2017, the President of the United States signed the Tax Cuts and Jobs Act of 2017. The federal corporate income tax rate was reduced from 34% to 21% in 2018. Enactment of the law required the Bank to revalue its deferred tax assets and liabilities as of December 31, 2017. The Bank recorded a net income tax benefit of \$42,660 related to this revaluation as a reduction of income tax expense. Of this amount, \$175,575 of benefit was attributable to the Bank's deferred tax liability for unrealized gains on available for sale securities. In addition to adjusting the deferred tax liability for this benefit, the Bank recorded an adjustment to accumulated other comprehensive income with a transfer from undivided profits.

Reclassification

Certain amounts in the financial statements of prior years have been reclassified to conform with the current classifications.

Subsequent events

The Bank has evaluated events and transactions subsequent to December 31, 2019 through February 28, 2020, the date these financial statements were available to be issued.

In February 2020, the Bank transferred title of its branch location on Dorchester Street in Ocean City, Maryland to the Town of Ocean City and the Ocean City Lifesaving Station Museum. The book value of the property of \$71,778 was recorded as a loss on disposal during the year ended December 31, 2019. The branch location was closed December 31, 2019.

No other significant subsequent events were identified that would affect the presentation of the financial statements.

2. **Cash and Due From Banks**

The Bank normally carries balances with other banks that exceed the federally insured limit. The average balance carried in excess of the limit, including unsecured federal funds sold to the same banks, was approximately **\$9,772,828** for 2019, \$11,013,794 for 2018, and \$12,835,213 for 2017.

Deposits held in noninterest-bearing transaction accounts are aggregated with any interest-bearing deposits the owner may hold in the same ownership category. The combined total is insured up to \$250,000.

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. **Earnings Per Common Share**

Earnings per common share are determined by dividing net income by the average number of shares outstanding. There were **557,593**, 560,253, and 567,757 average shares outstanding during the years ended December 31, 2019, 2018, and 2017, respectively. There are no dilutive shares.

Bank of Ocean City

Notes to Financial Statements (Continued)

4. Investment Securities

Investment securities are summarized as follows:

December 31, 2019	Amortized cost	Unrealized gains	Unrealized losses	Fair value
<i>Available for sale</i>				
U.S. government agency	\$ 9,999,487	\$ 1,250	\$ 15,947	\$ 9,984,790
Mortgage-backed securities	<u>12,345,034</u>	<u>505,115</u>	<u>-</u>	<u>12,850,149</u>
	<u>\$22,344,521</u>	<u>\$ 506,365</u>	<u>\$ 15,947</u>	<u>\$22,834,939</u>
<i>Held to maturity</i>				
U.S. Treasury	\$ 1,983,215	\$ 61,945	\$ -	\$ 2,045,160
U.S. government agency	14,916,814	518,479	14,123	15,421,170
State and municipal	<u>1,654,721</u>	<u>89,017</u>	<u>-</u>	<u>1,743,738</u>
	18,554,750	669,441	14,123	19,210,068
Mortgage-backed securities	<u>5,311,004</u>	<u>63,016</u>	<u>-</u>	<u>5,374,020</u>
	<u>\$23,865,754</u>	<u>\$ 732,457</u>	<u>\$ 14,123</u>	<u>\$24,584,088</u>
<hr/> December 31, 2018 <hr/>				
<i>Available for sale</i>				
U.S. government agency	\$ 7,999,244	\$ -	\$ 215,764	\$ 7,783,480
Mortgage-backed securities	<u>14,913,808</u>	<u>118,158</u>	<u>-</u>	<u>15,031,966</u>
	<u>\$ 22,913,052</u>	<u>\$ 118,158</u>	<u>\$ 215,764</u>	<u>\$ 22,815,446</u>
<i>Held to maturity</i>				
U.S. Treasury	\$ 1,978,062	\$ 6,938	\$ -	\$ 1,985,000
U.S. government agency	20,879,592	91,089	135,621	20,835,060
State and municipal	<u>1,854,690</u>	<u>1,255</u>	<u>71,504</u>	<u>1,784,441</u>
	24,712,344	99,282	207,125	24,604,501
Mortgage-backed securities	<u>6,457,209</u>	<u>1,166</u>	<u>120,095</u>	<u>6,338,280</u>
	<u>\$ 31,169,553</u>	<u>\$ 100,448</u>	<u>\$ 327,220</u>	<u>\$ 30,942,781</u>
<hr/> December 31, 2017 <hr/>				
<i>Available for sale</i>				
Equity securities	<u>\$ 1,156</u>	<u>\$1,472,016</u>	<u>\$ -</u>	<u>\$ 1,473,172</u>
<i>Held to maturity</i>				
U.S. Treasury	\$ 2,999,112	\$ -	\$ 6,732	\$ 2,992,380
U.S. government agency	67,972,786	-	1,270,514	66,702,272
State and municipal	<u>401,266</u>	<u>7,448</u>	<u>-</u>	<u>408,714</u>
	71,373,164	7,448	1,277,246	70,103,366
Mortgage-backed securities	<u>5,366,325</u>	<u>-</u>	<u>44,159</u>	<u>5,322,166</u>
	<u>\$ 76,739,489</u>	<u>\$ 7,448</u>	<u>\$1,321,405</u>	<u>\$ 75,425,532</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

4. Investment Securities (Continued)

Investment securities with unrealized losses for continuous periods of less than 12 months and 12 months or longer are as follows:

	Less than 12 months		12 months or longer		Total	
	Fair value	Unrealized losses	Fair value	Unrealized losses	Fair value	Unrealized losses
December 31, 2019						
<i>Available for sale</i>						
U.S. government agency	\$ -	\$ -	\$1,983,540	\$ 15,947	\$1,983,540	\$ 15,947
<i>Held to maturity</i>						
U.S. government agency	\$ -	\$ -	\$3,983,240	\$ 14,123	\$3,983,240	\$ 14,123
<hr/> December 31, 2018 <hr/>						
<i>Available for sale</i>						
U.S. government agency	\$ -	\$ -	\$ 7,783,480	\$ 215,764	\$ 7,783,480	\$ 215,764
<i>Held to maturity</i>						
U.S. Treasury	\$ -	\$ -	\$ 6,859,040	\$ 135,621	\$ 6,859,040	\$ 135,621
U.S. government agency	1,582,789	71,504	-	-	1,582,789	71,504
Mortgage-backed securities	1,610,338	54,959	2,919,381	65,136	4,529,719	120,095
	<u>\$3,193,127</u>	<u>\$126,463</u>	<u>\$ 9,778,421</u>	<u>\$ 200,757</u>	<u>\$ 12,971,548</u>	<u>\$ 327,220</u>
<hr/> December 31, 2017 <hr/>						
<i>Held to maturity</i>						
U.S. Treasury	\$1,997,340	\$ 2,250	\$ 995,040	\$ 4,482	\$ 2,992,380	\$ 6,732
U.S. government agency	1,999,300	700	64,702,972	1,269,814	66,702,272	1,270,514
Mortgage-backed securities	5,322,166	44,159	-	-	5,322,166	44,159
	<u>\$9,318,806</u>	<u>\$ 47,109</u>	<u>\$ 65,698,012</u>	<u>\$1,274,296</u>	<u>\$ 75,016,818</u>	<u>\$1,321,405</u>

Management has the ability and intent to hold these investments until maturity. The decline in fair value is the result of changes in interest rates, not a deterioration of the credit standing of the issuers.

Bank of Ocean City

Notes to Financial Statements (Continued)

4. Investment Securities (Continued)

Contractual maturities and the amount of pledged securities are shown below. Actual maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities are due in monthly installments.

December 31, 2019	Available for sale		Held to maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
Maturing				
Within one year	\$ -	\$ -	\$ 1,999,648	\$ 1,999,080
Over one to five years	9,999,487	9,984,790	14,900,381	15,467,250
Over five to ten years	-	-	-	-
Over ten years	-	-	1,654,721	1,743,738
Mortgage-backed securities	<u>12,345,034</u>	<u>12,850,149</u>	<u>5,311,004</u>	<u>5,374,020</u>
	<u>\$22,344,521</u>	<u>\$22,834,939</u>	<u>\$23,865,754</u>	<u>\$24,584,088</u>
Pledged securities	<u>\$ -</u>	<u>\$ -</u>	<u>\$16,900,029</u>	<u>\$17,466,330</u>

December 31, 2018	Available for sale		Held to maturity	
	Amortized cost	Fair value	Amortized cost	Fair value
Maturing				
Within one year	\$ 2,999,910	\$ 2,965,480	\$ 2,200,397	\$ 2,199,752
Over one to five years	4,999,334	4,818,000	12,951,880	12,836,200
Over five to ten years	-	-	9,560,067	9,568,549
Mortgage-backed securities	<u>14,913,808</u>	<u>15,031,966</u>	<u>6,457,209</u>	<u>6,338,280</u>
	<u>\$ 22,913,052</u>	<u>\$ 22,815,446</u>	<u>\$ 31,169,553</u>	<u>\$ 30,942,781</u>
Pledged securities	<u>\$ 1,999,334</u>	<u>\$ 1,917,540</u>	<u>\$ 16,876,666</u>	<u>\$ 16,837,260</u>

December 31, 2017	Held to maturity	
	Amortized cost	Fair value
Maturing		
Within one year	\$ 14,198,637	\$ 14,147,542
Over one to five years	52,175,343	51,123,624
Over five to ten years	4,999,184	4,832,200
Mortgage-backed securities	<u>5,366,325</u>	<u>5,322,166</u>
	<u>\$ 76,739,489</u>	<u>\$ 75,425,532</u>
Pledged securities	<u>\$ 15,992,075</u>	<u>\$ 15,814,940</u>

Investments are pledged as of December 31, 2019, 2018, and 2017, as collateral for government deposits and Federal Reserve Bank borrowings.

Bank of Ocean City

Notes to Financial Statements (Continued)

4. Investment Securities (Continued)

During the year ended December 31, 2018, in an effort to restructure the investment portfolio, management elected to reclassify securities with a fair value of \$50,217,784 and amortized cost of \$51,984,157 from the held to maturity category to the available for sale category. This reclassification was elected under provisions of Financial Accounting Standards Board Accounting Standard Update 2017-12, which allows a one-time reclassification of securities without calling into question management's intent and ability to hold the remainder of the held to maturity securities portfolio to maturity. At the time of the transfer, the securities had unrealized losses of \$1,766,373. Securities with a fair value of \$40,573,284 were sold immediately upon transfer, resulting in gross losses of \$1,411,662. Available for sale equity securities previously owned were also sold during the year ended December 31, 2018, resulting in proceeds of \$1,327,994 and a gross gain of \$1,326,838.

There were no sales of investment securities in 2019 and 2017.

5. Loans and Allowance for Loan Losses

Major classifications of loans are as follows:

	2019	2018	2017
Real estate			
Residential	\$ 78,143,596	\$ 63,900,530	\$ 58,050,389
Commercial	142,247,700	127,533,311	113,712,987
Construction, land development, and land	17,588,795	20,440,627	18,039,490
Commercial	17,459,417	17,962,470	17,196,879
Consumer	1,793,600	1,834,038	1,863,701
	<u>257,233,108</u>	<u>231,670,976</u>	<u>208,863,446</u>
Allowance for loan losses	2,071,813	1,855,108	1,707,309
Loans, net	<u>\$255,161,295</u>	<u>\$229,815,868</u>	<u>\$207,156,137</u>

The loan portfolio, as of December 31, 2019, 2018, and 2017, will mature or reprice as follows:

	2019	2018	2017
Within three months	\$ 31,591,031	\$ 28,989,675	\$ 15,415,934
After three months, within one year	47,573,340	50,731,688	52,165,450
After one year, within five years	144,646,147	110,568,827	105,765,373
After five years	33,422,590	41,380,786	35,516,689
	<u>\$257,233,108</u>	<u>\$231,670,976</u>	<u>\$208,863,446</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

Transactions in the allowance for loan losses for the year ended December 31, 2019, 2018, and 2017, were as follows:

	Beginning balance	Provision for loan losses	Charge offs	Recoveries	Ending balance	Allowance for loan losses ending balance evaluated for impairment:		Outstanding loan balances evaluated for impairment:	
						Individually	Collectively	Individually	Collectively
December 31, 2019									
Real estate									
Residential	\$ 473,751	\$140,536	\$ -	\$ -	\$ 614,287	\$29,261	\$ 585,026	\$137,107	\$ 78,006,489
Commercial	1,008,380	8,471	-	77,546	1,094,397	-	1,094,397	-	142,247,700
Construction, land development, and land	163,985	(123,424)	(17,956)	153,720	176,325	-	176,325	-	17,588,795
Commercial	152,811	2,961	-	-	155,772	-	155,772	-	17,459,417
Consumer	49,123	(15,040)	(16,490)	1,135	18,728	3,177	15,551	3,177	1,790,423
Unallocated	7,058	5,246	-	-	12,304	-	12,304	-	-
	<u>\$1,855,108</u>	<u>\$ 18,750</u>	<u>\$(34,446)</u>	<u>\$232,401</u>	<u>\$2,071,813</u>	<u>\$32,438</u>	<u>\$2,039,375</u>	<u>\$140,284</u>	<u>\$257,092,824</u>
December 31, 2018									
Real estate									
Residential	\$ 459,339	\$ 14,412	\$ -	\$ -	\$ 473,751	\$35,101	\$ 438,650	\$142,947	\$ 63,757,583
Commercial	920,105	76,108	-	12,167	1,008,380	-	1,008,380	-	127,533,311
Construction, land development, and land	153,367	10,618	-	-	163,985	-	163,985	-	20,440,627
Commercial	120,032	59,738	(29,409)	2,450	152,811	-	152,811	-	17,962,470
Consumer	52,440	2,719	(7,682)	1,646	49,123	8,293	40,830	8,293	1,825,745
Unallocated	2,026	5,032	-	-	7,058	-	7,058	-	-
	<u>\$1,707,309</u>	<u>\$168,627</u>	<u>\$(37,091)</u>	<u>\$ 16,263</u>	<u>\$1,855,108</u>	<u>\$43,394</u>	<u>\$1,811,714</u>	<u>\$151,240</u>	<u>\$231,519,736</u>
December 31, 2017									
Real estate									
Residential	\$ 389,876	\$ 68,263	\$ -	\$ 1,200	\$ 459,339	\$45,005	\$ 414,334	\$346,001	\$ 57,704,388
Commercial	766,132	106,673	-	47,300	920,105	-	920,105	-	113,712,987
Construction, land development, and land	148,826	4,541	-	-	153,367	-	153,367	-	18,039,490
Commercial	94,058	25,974	-	-	120,032	-	120,032	-	17,196,879
Consumer	57,422	(3,886)	(8,618)	7,522	52,440	13,015	39,425	13,015	1,850,686
Unallocated	-	2,026	-	-	2,026	-	2,026	-	-
	<u>\$1,456,314</u>	<u>\$203,591</u>	<u>\$ (8,618)</u>	<u>\$ 56,022</u>	<u>\$1,707,309</u>	<u>\$58,020</u>	<u>\$1,649,289</u>	<u>\$359,016</u>	<u>\$208,504,430</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

Past due loans, segregated by age and class of loans, as of December 31, 2019, 2018, and 2017, were as follows:

	Loans			Total past due loans	Current loans	Total loans	Accruing	Nonaccrual	
	Loans 30-59 days past due	Loans 60-89 days past due	Loans 90 or more days past due				loans 90 or more days past due	Nonaccrual loans	interest not accrued
December 31, 2019									
Real estate									
Residential	\$2,328,914	\$100,037	\$ 92,169	\$2,521,120	\$ 75,622,476	\$ 78,143,596	\$92,169	\$ -	\$ -
Commercial	1,054,465	-	-	1,054,465	141,193,235	142,247,700	-	-	-
Construction, land development, and land	-	-	-	-	17,588,795	17,588,795	-	-	-
Commercial	-	-	-	-	17,459,417	17,459,417	-	-	-
Consumer	184,373	-	-	184,373	1,609,227	1,793,600	-	-	-
	<u>\$3,567,752</u>	<u>\$100,037</u>	<u>\$ 92,169</u>	<u>\$3,759,958</u>	<u>\$253,473,150</u>	<u>\$257,233,108</u>	<u>\$92,169</u>	<u>\$ -</u>	<u>\$ -</u>
December 31, 2018									
Real estate									
Residential	\$ 150,616	\$102,630	\$ -	\$ 253,246	\$ 63,647,284	\$ 63,900,530	\$ -	\$ -	\$ -
Commercial	8,109	-	-	8,109	127,525,202	127,533,311	-	-	-
Construction, land development, and land	19,140	-	43,728	62,868	20,377,759	20,440,627	43,728	-	-
Commercial	7,832	-	-	7,832	17,954,638	17,962,470	-	2,990	240
Consumer	4,168	-	-	4,168	1,829,870	1,834,038	-	-	-
	<u>\$ 189,865</u>	<u>\$102,630</u>	<u>\$ 43,728</u>	<u>\$ 336,223</u>	<u>\$231,334,753</u>	<u>\$231,670,976</u>	<u>\$43,728</u>	<u>\$ 2,990</u>	<u>\$ 240</u>
December 31, 2017									
Real estate									
Residential	\$ 489,779	\$337,703	\$ -	\$ 827,482	\$ 57,222,907	\$ 58,050,389	\$ -	\$ -	\$ -
Commercial	165,372	-	-	165,372	113,547,615	113,712,987	-	-	-
Construction, land development, and land	45,496	-	43,728	89,224	17,950,266	18,039,490	43,728	-	-
Commercial	199,945	26,093	-	226,038	16,970,841	17,196,879	-	-	-
Consumer	5,091	-	-	5,091	1,858,610	1,863,701	-	-	-
	<u>\$ 905,683</u>	<u>\$363,796</u>	<u>\$ 43,728</u>	<u>\$1,313,207</u>	<u>\$207,550,239</u>	<u>\$208,863,446</u>	<u>\$43,728</u>	<u>\$ -</u>	<u>\$ -</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

Impaired loans as of December 31, 2019, 2018, and 2017, were as follows:

December 31, 2019	Unpaid contractual principal balance	Recorded investment with no allowance	Recorded investment with allowance	Total recorded investment	Related allowance	Average recorded investment	Interest recognized
December 31, 2019							
Real estate							
Residential	\$137,107	\$ 64,506	\$72,601	\$137,107	\$29,261	\$139,925	\$ 4,570
Commercial	-	-	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-	-	-
Commercial	-	-	-	-	-	-	-
Consumer	<u>3,177</u>	<u>-</u>	<u>3,177</u>	<u>3,177</u>	<u>3,177</u>	<u>5,553</u>	<u>470</u>
	<u>\$140,284</u>	<u>\$ 64,506</u>	<u>\$75,778</u>	<u>\$140,284</u>	<u>\$32,438</u>	<u>\$145,478</u>	<u>\$ 5,040</u>
December 31, 2018							
Real estate							
Residential	\$ 142,947	\$ 67,086	\$ 75,861	\$ 142,947	\$ 35,101	\$ 178,498	\$ 7,912
Commercial	-	-	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-	-	-
Commercial	-	-	-	-	-	-	-
Consumer	<u>8,293</u>	<u>-</u>	<u>8,293</u>	<u>8,293</u>	<u>8,293</u>	<u>10,487</u>	<u>863</u>
	<u>\$ 151,240</u>	<u>\$ 67,086</u>	<u>\$ 84,154</u>	<u>\$ 151,240</u>	<u>\$ 43,394</u>	<u>\$ 188,985</u>	<u>\$ 8,775</u>
December 31, 2017							
Real estate							
Residential	\$ 346,001	\$ -	\$346,001	\$ 346,001	\$ 45,005	\$ 352,898	\$ 37,024
Commercial	-	-	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-	-	-
Commercial	-	-	-	-	-	-	-
Consumer	<u>13,015</u>	<u>-</u>	<u>13,015</u>	<u>13,015</u>	<u>13,015</u>	<u>15,047</u>	<u>1,218</u>
	<u>\$ 359,016</u>	<u>\$ -</u>	<u>\$359,016</u>	<u>\$ 359,016</u>	<u>\$ 58,020</u>	<u>\$ 367,945</u>	<u>\$ 38,242</u>

The Bank was not committed to advance any funds in connection with impaired loans at December 31, 2019, 2018, or 2017.

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

Credit quality indicators

As part of the ongoing monitoring of the credit quality of the Bank's loan portfolio, management tracks certain credit quality indicators including trends related to the risk grade of loans, the level of classified loans, net charge-offs, nonperforming loans, and the general economic conditions in the Bank's market.

The Bank utilizes a risk grading matrix to assign a risk grade to each of its loans. A description of the general characteristics of loans characterized as watch list or classified is as follows:

Pass/Watch

Loans graded as Pass/Watch are secured by generally acceptable assets which reflect above-average risk. The loans warrant closer scrutiny by management than is routine, due to circumstances affecting the borrower, the borrower's industry, or the overall economic environment. Borrowers may reflect weaknesses such as inconsistent or weak earnings, break even or moderately deficit cash flow, thin liquidity, minimal capacity to increase leverage, or volatile market fundamentals or other industry risks. Such loans are typically secured by acceptable collateral, at or near appropriate margins, with realizable liquidation values.

Special mention

A special mention loan has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the Bank's credit position at some future date. Special mention loans are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification.

Borrowers may exhibit poor liquidity and leverage positions resulting from generally negative cash flow or negative trends in earnings. Access to alternative financing may be limited to finance companies for business borrowers and may be unavailable for commercial real estate borrowers.

Substandard

A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Substandard loans have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Bank will sustain some loss if the deficiencies are not corrected.

Borrowers may exhibit recent or unexpected unprofitable operations, an inadequate debt service coverage ratio, or marginal liquidity and capitalization. These loans require more intense supervision by Bank management.

Doubtful

A doubtful loan has all the weaknesses inherent as a substandard loan with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

The following tables present the December 31, 2019, 2018, and 2017, balances of loans by risk grade.

December 31, 2019	Pass/ Watch	Special Mention	Substandard	Doubtful	Total
Real estate					
Residential	\$512,327	\$ -	\$425,061	\$ -	\$ 937,388
Commercial	-	-	147,576	-	147,576
Construction, land development, and land	-	-	-	-	-
Commercial	-	-	-	-	-
Consumer	-	184,373	809	-	185,182
	<u>\$512,327</u>	<u>\$184,373</u>	<u>\$573,446</u>	<u>\$ -</u>	<u>\$1,270,146</u>
<hr/>					
December 31, 2018					
Real estate					
Residential	\$ -	\$ -	\$ 392,898	\$ -	\$ 392,898
Commercial	-	-	155,877	-	155,877
Construction, land development, and land	-	-	43,728	-	43,728
Commercial	-	-	3,562	-	3,562
Consumer	-	189,352	2,554	-	191,906
	<u>\$ -</u>	<u>\$ 189,352</u>	<u>\$ 598,619</u>	<u>\$ -</u>	<u>\$ 787,971</u>
<hr/>					
December 31, 2017					
Real estate					
Residential	\$ 6,981	\$ -	\$ 772,834	\$ -	\$ 779,815
Commercial	-	-	168,710	-	168,710
Construction, land development, and land	-	-	89,224	-	89,224
Commercial	-	-	3,647	-	3,647
Consumer	-	195,145	-	-	195,145
	<u>\$ 6,981</u>	<u>\$ 195,145</u>	<u>\$1,034,415</u>	<u>\$ -</u>	<u>\$ 1,236,541</u>

Impaired loans also include certain loans that have been modified in troubled debt restructurings (TDRs) where economic concessions have been granted to borrowers who have experienced or are expected to experience financial difficulties. These concessions typically result from the Bank's loss mitigation activities and could include reductions in the interest rate, payment extensions, forgiveness of principal, forbearance, or other actions. Certain TDRs are classified as nonperforming at the time of restructure and may only be returned to performing status after considering the borrower's sustained repayment performance for a reasonable period, generally six months.

Bank of Ocean City

Notes to Financial Statements (Continued)

5. Loans and Allowance for Loan Losses (Continued)

The status of TDRs as of December 31, 2019, 2018, and 2017, follows:

December 31, 2019	Number of contracts	Pre-modification recorded investment	December 31, 2019 recorded investment		
			Performing	Nonperforming	Total
Real estate					
Residential	2	\$ 149,023	\$ 137,107	\$ -	\$ 137,107
Commercial	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-
Commercial	-	-	-	-	-
Consumer	<u>1</u>	<u>3,177</u>	<u>3,177</u>	<u>-</u>	<u>3,177</u>
	<u>3</u>	<u>\$ 152,200</u>	<u>\$ 140,284</u>	<u>\$ -</u>	<u>\$ 140,284</u>
December 31, 2018	Number of contracts	Pre-modification recorded investment	December 31, 2018 recorded investment		
			Performing	Nonperforming	Total
Real estate					
Residential	2	\$ 161,432	\$ 142,947	\$ -	\$ 142,947
Commercial	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-
Commercial	-	-	-	-	-
Consumer	<u>1</u>	<u>19,100</u>	<u>8,293</u>	<u>-</u>	<u>8,293</u>
	<u>3</u>	<u>\$ 180,532</u>	<u>\$ 151,240</u>	<u>\$ -</u>	<u>\$ 151,240</u>
December 31, 2017	Number of contracts	Pre-modification recorded investment	December 31, 2017 recorded investment		
			Performing	Nonperforming	Total
Real estate					
Residential	3	\$ 379,095	\$ 148,578	\$ 197,423	\$ 346,001
Commercial	-	-	-	-	-
Construction, land development, and land	-	-	-	-	-
Commercial	-	-	-	-	-
Consumer	<u>1</u>	<u>19,100</u>	<u>13,015</u>	<u>-</u>	<u>13,015</u>
	<u>4</u>	<u>\$ 398,195</u>	<u>\$ 161,593</u>	<u>\$ 197,423</u>	<u>\$ 359,016</u>

The Bank did not modify any loans considered TDRs during 2019, 2018, or 2017. There were no loans secured by 1-4 family residential properties in the process of foreclosure at December 31, 2019, 2018, or 2017.

The Bank lends to customers located primarily in the Delmarva region. Although the loan portfolio is diversified, its performance will be influenced by the economy of the region.

Bank of Ocean City

Notes to Financial Statements (Continued)

6. Credit Commitments

The following credit commitments are outstanding as of December 31:

	2019	2018	2017
Mortgage and other loans	\$13,320,000	\$ 6,581,738	\$ 3,715,000
Construction loans	5,416,930	4,454,100	5,657,909
Lines of credit	<u>18,695,226</u>	<u>18,053,514</u>	<u>13,822,083</u>
	<u>\$37,432,156</u>	<u>\$29,089,352</u>	<u>\$23,194,992</u>
 Standby letters of credit	 <u>\$ 613,950</u>	 <u>\$ 598,159</u>	 <u>\$ 564,695</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 fixed interest at current market 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.

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

7. Premises and Equipment

A summary of premises and equipment and the related depreciation is as follows:

	Estimated useful lives	2019	2018	2017
Land		\$ 3,745,773	\$ 3,789,459	\$ 3,789,458
Buildings and improvements	5 - 40 years	5,415,380	5,576,563	5,516,354
Furniture and equipment	3 - 20 years	<u>1,913,517</u>	<u>2,159,859</u>	<u>2,083,336</u>
		11,074,670	11,525,881	11,389,148
Accumulated depreciation		<u>3,362,890</u>	<u>3,636,629</u>	<u>3,333,126</u>
Net premises and equipment		<u>\$ 7,711,780</u>	<u>\$ 7,889,252</u>	<u>\$ 8,056,022</u>
 Depreciation expense		 <u>\$ 336,644</u>	 <u>\$ 303,502</u>	 <u>\$ 299,185</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

8. Lease Commitments

The Bank leased a branch office building. The lease had a five-year term beginning January 1, 2009. The Bank exercised a five-year renewal option beginning January 1, 2014. The Bank abandoned the leased space in October 2016 when the Fenwick branch was opened and has no remaining obligation to the landlord as of December 31, 2019.

Rent expense for 2017 was \$76,895.

9. Interest-Bearing Deposits

Major classifications of interest-bearing deposits are as follows:

	2019	2018	2017
Money market	\$ 86,634,315	\$ 79,007,020	\$ 86,630,594
Savings and NOW	68,803,905	67,382,042	65,223,611
Certificates of deposit, \$250,000 or more	12,535,521	10,975,150	5,145,873
Other time deposits	43,404,801	40,753,640	32,162,582
	\$211,378,542	\$198,117,852	\$189,162,660

Maturities of time deposits are as follows:

	2019	2018	2017
Within one year	\$37,838,182	\$31,282,940	\$13,846,334
One year to within two years	6,882,223	6,984,008	6,531,066
Two years to within three years	5,810,018	5,640,765	5,344,316
Three years to within four years	1,850,429	5,768,851	5,516,063
Four years to within five years	3,559,470	2,052,226	5,914,489
Five years and longer	-	-	156,187
Total	\$55,940,322	\$51,728,790	\$37,308,455

10. Available Lines of Credit

The Bank has available lines of credit of \$11,500,000 in overnight federal funds and \$8,000,000 in secured federal funds facilities from other banks. The Bank also has access to certificate of deposit funding through a financial network. The funding is limited to 15% of the Bank's assets, or approximately **\$57,436,050** as of December 31, 2019.

As of December 31, 2019, the Bank has pledged investment securities to the Federal Reserve Bank of Richmond to provide a borrowing capacity totaling approximately **\$5,055,040** under its discount window program.

There were no outstanding advances under any of these facilities at December 31, 2019.

Bank of Ocean City

Notes to Financial Statements (Continued)

11. Related-Party Transactions

In the normal course of banking business, loans are made to senior management and directors of the Bank. The terms of these transactions are substantially the same as the terms provided to other borrowers entering into similar loan transactions. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than normal credit risk.

A summary of these loans is as follows:

	2019	2018	2017
Balance at beginning of year	\$3,860,359	\$3,623,365	\$4,112,017
New loans	655,199	949,711	307,500
Principal payments	(656,791)	(712,717)	(796,152)
Balance at end of year	<u>\$3,858,767</u>	<u>\$3,860,359</u>	<u>\$3,623,365</u>

Deposits from senior management and directors and their related interests were **\$9,497,934** as of December 31, 2019, \$7,069,730 as of December 31, 2018, and \$8,251,089 as of December 31, 2017.

During the year ended December 31, 2019, a director's law firm provided professional services to the Bank. The Bank paid \$360 for these services. The Bank did not make any payments to the director's law firm during the years ended December 31, 2018 and 2017.

12. Other Operating Expenses

Other operating expenses consist of the following:

	2019	2018	2017
Communications	\$ 185,573	\$ 182,986	\$ 161,511
Director and secretary fees	151,580	164,400	150,400
Professional fees	105,369	97,558	123,445
Supplies	102,761	70,882	99,032
Charitable contributions	98,519	110,058	79,474
Education	68,255	51,416	41,347
Advertising	66,695	61,692	44,844
Insurance	64,370	33,340	32,356
FDIC insurance	63,651	138,946	137,810
Software amortization and licenses	62,382	49,281	43,338
Postage and freight	60,461	60,153	59,190
Dues and subscriptions	54,498	52,572	49,667
Correspondent bank fees	46,561	43,774	43,325
Armored car and courier	39,469	37,032	36,372
Loan processing fees	21,169	17,132	6,365
Other	<u>102,480</u>	<u>125,167</u>	<u>116,260</u>
	<u>\$1,293,793</u>	<u>\$1,296,389</u>	<u>\$1,224,736</u>

Bank of Ocean City

Notes to Financial Statements (Continued)

13. Retirement Plans

The Bank has a nonqualified retirement plan for a retired executive. The plan specified an annual salary deferral of \$70,099 through retirement, plus interest of 6% annually on the balance deferred. The Bank had a separate nonqualified retirement plan for another retired executive. The expense related to the two plans was **\$38,138**, \$41,638, and \$44,480 for the years ended December 31, 2019, 2018, and 2017, respectively.

The Bank has a 401(k) plan, which covers essentially all employees. The Bank matches participant contributions up to 6%, plus contributes an additional 1% of compensation for contributing participants. The contributions to the Plan were **\$148,720**, \$153,403, and \$136,819 for the years ended December 31, 2019, 2018, and 2017, respectively.

14. Income Taxes

The components of income tax expense are as follows:

	2019	2018	2017
Current			
Federal	\$1,392,714	\$1,160,720	\$1,545,232
State	<u>514,720</u>	<u>370,230</u>	<u>295,129</u>
	1,907,434	1,530,950	1,840,361
Change in corporate income tax rate	-	-	(42,660)
Deferred	<u>3,550</u>	<u>(46,973)</u>	<u>(73,731)</u>
	\$1,910,984	\$1,483,977	\$1,723,970

The components of the deferred tax expense (benefits) are as follows:

Provision for loan losses	\$ (5,160)	\$ (46,401)	\$ (80,306)
Other-than-temporary impairment of restricted stock	8,741	(8,255)	-
Depreciation	(12,399)	(7,330)	(14,078)
Nonaccrual interest	23	(23)	-
Nonqualified retirement plans	<u>12,345</u>	<u>15,036</u>	<u>20,653</u>
	\$ 3,550	\$ (46,973)	\$ (73,731)

Bank of Ocean City

Notes to Financial Statements (Continued)

14. Income Taxes (Continued)

The components of the net deferred tax asset (liability) are as follows:

	2019	2018	2017
Deferred tax assets			
Allowance for loan losses	\$ 285,049	\$ 279,889	\$ 233,488
Other-than-temporary impairment of restricted stock	-	8,255	-
Nonaccrual interest	-	23	-
Dorchester Street donation	19,752	-	-
Unrealized loss on investment securities available for sale	-	26,859	-
Nonqualified retirement plans	<u>173,239</u>	<u>185,584</u>	<u>200,620</u>
	<u>478,040</u>	<u>500,610</u>	<u>434,108</u>
Deferred tax liabilities			
Deferred casualty gain	10,268	10,268	10,268
Depreciation	88,110	80,757	88,087
Maryland carry back	486	-	-
Unrealized gain on investment securities available for sale	<u>134,951</u>	<u>-</u>	<u>405,062</u>
	<u>233,815</u>	<u>91,025</u>	<u>503,417</u>
Net deferred tax asset (liability)	<u>\$ 244,225</u>	<u>\$ 409,585</u>	<u>\$ (69,309)</u>

A reconciliation of the provision for income taxes from the statutory federal income tax rate to the effective income tax rates follows:

	2019	2018	2017
Tax at statutory federal income tax rate	21.0 %	21.0 %	34.0 %
Tax effect of			
Tax-exempt income	(0.5)	(0.7)	(1.2)
State income tax, net of federal benefit	5.5	4.8	3.8
Change in corporate income tax rate	<u>-</u>	<u>-</u>	<u>(0.9)</u>
Income tax expense	<u>26.0 %</u>	<u>25.1 %</u>	<u>35.7 %</u>

The Bank does not have material uncertain tax positions and did not recognize any adjustments for unrecognized tax benefits. The Bank remains subject to examination for income tax returns for the years ending after December 31, 2015.

15. Capital Standards

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

Bank of Ocean City

Notes to Financial Statements (Continued)

15. Capital Standards (Continued)

The Basel III Capital Rules became effective for the Bank on January 1, 2015 (subject to a phase-in period for certain provisions). Quantitative measures established by the Basel III Capital Rules to ensure capital adequacy require the maintenance of minimum amounts and ratios (set forth in the table below) of Common Equity Tier 1 capital, Tier 1 capital, and Total capital (as defined in the regulations) to risk-weighted assets (as defined), and of Tier 1 capital to adjusted quarterly average assets (as defined).

In connection with the adoption of the Basel III Capital Rules, the Bank elected to opt-out of the requirement to include accumulated other comprehensive income in Common Equity Tier 1 capital. Common Equity Tier 1 capital for the Bank is reduced by goodwill and other intangible assets, if any, net of associated deferred tax liabilities and subject to transition provisions.

Under the revised prompt corrective action requirements, as of January 1, 2015, insured depository institutions are required to meet the following in order to qualify as "well capitalized:" (1) a Common Equity Tier 1 risk-based capital ratio of 6.5%; (2) a Tier 1 risk-based capital ratio of 8%; (3) a total risk-based capital ratio of 10%; and (4) a Tier 1 leverage ratio of 5%.

The implementation of the capital conservation buffer began on January 1, 2016, at the 0.625% level and was phased in over a four-year period (increasing by that amount on each subsequent January 1, until it reached 2.5% on January 1, 2019). The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Bank.

The aforementioned capital conservation buffer is designed to absorb losses during periods of economic stress. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets above the minimum but below the conservation buffer (or below the combined capital conservation buffer and countercyclical capital buffer, when the latter is applied) will face constraints on dividends, equity repurchases, and compensation based on the amount of the shortfall.

The following table presents actual and required capital ratios as of December 31, 2019, 2018, and 2017, for the Bank under the Basel III Capital Rules. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2019, 2018, and 2017, based on the phase-in provisions of the Basel III Capital Rules. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

As of December 31, 2019, the most recent notification from the FDIC has categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain ratios as set forth in the table. There have been no conditions or events since that notification that management believes have changed the Bank's category.

The FDIC, through formal or informal agreement, has the authority to require an institution to maintain higher capital ratios than those provided by statute, to be categorized as well capitalized under the regulatory framework for prompt corrective action.

Bank of Ocean City

Notes to Financial Statements (Continued)

15. Capital Standards (Continued)

(in thousands)	Actual		Minimum capital adequacy		To be well capitalized	
December 31, 2019	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage ratio	\$39,378	10.62%	\$18,535	5.00%	\$14,828	4.00%
Tier 1 capital (to risk-weighted assets)	\$39,378	14.44%	\$23,180	8.50%	\$21,816	8.00%
Common equity tier 1 capital ratio (to risk-weighted assets)	\$39,378	14.44%	\$19,089	7.00%	\$17,726	6.50%
Total capital ratio (to risk-weighted assets)	\$41,450	15.20%	\$28,634	10.50%	\$27,270	10.00%
<hr/>						
December 31, 2018						
Tier 1 leverage ratio	\$ 34,794	9.98%	\$ 17,428	5.00%	\$ 13,943	4.00%
Tier 1 capital (to risk-weighted assets)	\$ 34,794	13.71%	\$ 20,298	8.00%	\$ 19,981	7.88%
Common equity tier 1 capital ratio (to risk-weighted assets)	\$ 34,794	13.71%	\$ 16,492	6.50%	\$ 16,175	6.38%
Total capital ratio (to risk-weighted assets)	\$ 36,649	14.44%	\$ 25,373	10.00%	\$ 25,056	9.88%
<hr/>						
December 31, 2017						
Tier 1 leverage ratio	\$ 31,164	9.49%	\$ 16,415	5.00%	\$ 13,132	4.00%
Tier 1 capital (to risk-weighted assets)	\$ 31,164	14.32%	\$ 17,412	8.00%	\$ 15,780	7.25%
Common equity tier 1 capital ratio (to risk-weighted assets)	\$ 31,164	14.32%	\$ 14,147	6.50%	\$ 12,515	5.75%
Total capital ratio (to risk-weighted assets)	\$ 33,533	15.41%	\$ 21,765	10.00%	\$ 20,133	9.25%

16. Fair Value Measurements

Generally accepted accounting principles define fair value, establish a framework for measuring fair value, expand disclosures about fair value, and establish 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 three levels are as follows:

Level 1 – Inputs to the valuation method are quoted prices (unadjusted) for identical assets or liabilities in active markets;

Level 2 – Inputs to the valuation method include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and

Level 3 – Inputs to the valuation method are unobservable and significant to the fair value measurement.

Bank of Ocean City

Notes to Financial Statements (Continued)

16. Fair Value Measurements (Continued)

Fair value measurements on a recurring basis

Securities available for sale are the only instruments that are measured at fair value on a recurring basis. The Bank has categorized its securities available for sale as follows as of December 31, 2019, 2018, and 2017:

December 31, 2019	Total	Level 1 inputs	Level 2 inputs	Level 3 inputs
U.S. government agency	\$ 9,984,790	\$ -	\$ 9,984,790	\$ -
Mortgage-backed securities	<u>12,850,149</u>	<u>-</u>	<u>12,850,149</u>	<u>-</u>
	<u><u>\$22,834,939</u></u>	<u><u>\$ -</u></u>	<u><u>\$22,834,939</u></u>	<u><u>\$ -</u></u>
<hr/>				
December 31, 2018				
U.S. government agency	\$ 7,783,480	\$ -	\$ 7,783,480	\$ -
Mortgage-backed securities	<u>15,031,966</u>	<u>-</u>	<u>15,031,966</u>	<u>-</u>
	<u><u>\$ 22,815,446</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 22,815,446</u></u>	<u><u>\$ -</u></u>
<hr/>				
December 31, 2017				
Equity securities	<u><u>\$ 1,473,172</u></u>	<u><u>\$1,473,172</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>

Fair value measurements on a nonrecurring basis

Impaired loans are generally measured based on the fair value of the loan's collateral. Fair value is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included as Level 3 fair values since the market for impaired loans is not active. As of December 31, 2019, 2018, and 2017, the fair values of **\$107,846**, \$107,846, and \$300,996 consist of recorded loan balances net of any specific valuation allowances.