REDWOOD FINANCIAL INC

2020 ANNUAL REPORT

1924 - 2020

96 YEARS

Annual Report to Stockholders
And
Financial Statements

REDWOOD FINANCIAL, INC.

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Dear Stockholder:

On behalf of the Board of Directors, management and employees of Redwood Financial, Inc., I am pleased to present to you the twenty fifth annual stockholders' report.
Due to the COVID-19 pandemic we have delayed our annual meeting to an undetermined date later this year.

2019 was another great year for our company and we reached historic levels of net income. Net income for the year ended December 31, 2019 was $4.379 million compared to $2.802 million in FY18 and comprehensive income was $5.001 million in FY19 compared to $2.611 million in FY18. Basic earnings per share in Fiscal Year 2019 were $11.05 compared to $6.88 in FY18 and $6.86 in FY17.

Total assets of the company grew to $354.1 million as of 12-31-19 compared to $319.3 million as of 12-31-18. Total liabilities grew to $321.8 million as of 12-31-19 from $291.7 million as of 12-31-18 primarily due to a $28.7 million growth in deposits in FY19. Stockholder's equity increased to $32.3 million as of 12-31-19 from $27.6 million as of 12-31-18.

Our wholly owned subsidiary, HomeTown Bank, experienced solid growth in assets, loans and deposits and generated net profit of $4.9 million. Similar to previous years, the bank had a strong net interest margin, strong fee income, and low loan losses. The bank was honored for the fifth consecutive year as a Top Work Place by the *Minneapolis StarTribune.* Also, our wholly owned insurance company, Community Insurance Brokerage, Inc., experienced solid performance and strong profitability in 2019 generating a record profit of $146,648.

In FY19, total assets of the bank grew about 10.9% to $353.3 million. Net loans grew 1.9% to $231.6 million while total deposits increased 11.2% to $260.3 million. Total capital grew 7.1% to $34.9 million (9.9% of assets). As in past years, the company's liquidity position is considered strong and its interest rate risk is low.

Redwood Financial, Inc., through HomeTown Bank, continues to provide credit to farmers, businesses and consumers. Credit quality is a very important component of bank strength and profitability and ours continues to remain strong. Non-performing loans were very low at $1.3 million (0.6% of net loans) compared to $313,122 (0.14% of net loans) as of 12-31-18.

HomeTown Bank continued to build loan loss reserves in 2019. Loan loss reserves totaled $4.02 million (1.71% of loans) as of 12-31-19 compared to $3.86 million (1.70% of loans) as of 12-31-18. The Board of Directors is committed to maintaining a strong loan loss reserve.

Also, in 2019 Redwood Financial, Inc. paid its eighth consecutive annual dividend to stockholders. The Board of Directors determined that the Company had the ability to pay a $1.50 per share dividend to stockholders, which was a $1.00 per share increase over the $0.50 per share paid in 2018 and $1.25 per share increase over the first dividend of $0.25 per share paid in 2012.

Fiscal Year 2019 was another very strong year. The company continues to experience very profitable growth while serving the communities where each branch is located. With the guidance and support of our Board of Directors and the hard work and dedication of our employees, Redwood Financial, Inc., continues to have a very bright future.

I want to thank the Board of Directors and all of our employees for the contributions made to this company. It is important to note that the Board of Directors and employees of the company live and work in the communities we serve and understand the local economies better than anyone. Our record growth, record profitability and undisputable positive trends are due to their efforts Thank you for your involvement as a stockholder and your continued confidence and loyalty in Redwood Financial, Inc.

Sincerely,

Tim J Grabow

Tim J. Grabow
President and Chief Executive Officer

Consolidated Financial Statements
December 31, 2019 and 2018

Redwood Financial, Inc. and Subsidiaries

CPAs & BUSINESS ADVISORS

Independent Auditor's Report

The Stockholders and Board of Directors
Redwood Financial, Inc. and Subsidiaries
Redwood Falls, Minnesota

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Redwood Financial, Inc. and Subsidiaries, which comprise the consolidated balance sheets, as of December 31, 2019 and 2018 , and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

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

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

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

Eide Bailly LLP

Mankato, Minnesota
April 2, 2020

111 S. 2nd St., Ste. 300 | Mankato, MN 56001-5803 | T 507.387.6031 | F 507.387.6436 | EOE

	2019	2018
Assets		
Cash and cash equivalents	$ 10,511,615	$ 8,588,599
Interest-bearing deposits in banks	6,615,000	6,370,000
Debt securities available-for-sale	70,115,187	43,098,718
Loans, net	231,790,937	227,345,470
Investments in restricted stock	10,191,000	8,893,200
Accrued interest receivable	2,111,041	2,105,006
Premises and equipment, net	15,634,117	16,115,951
Mortgage servicing rights	2,097,312	1,597,353
Goodwill	4,478,398	4,478,398
Other assets	637,041	742,918
Total Assets	$ 354,181,648	$ 319,335,613
Liabilities and Stockholders' Equity		
Deposits	$ 288,175,116	$ 259,451,875
Borrowings	21,483,461	21,068,942
Subordinated debentures	6,186,000	6,186,000
Accrued interest payable	238,899	140,581
Advance payments by borrowers for taxes and insurance	2,072,201	1,694,791
Accrued expenses and other liabilities	2,023,941	1,906,701
Deferred tax liability	1,668,662	1,251,615
Total liabilities	321,848,280	291,700,505
Common stock ($.10 par value), 1,125,000 shares authorized and issued; 399,047 and 394,050 shares outstanding, respectively	112,500	112,500
Additional paid-in capital	10,192,893	9,869,268
Retained earnings	34,387,716	30,606,883
Accumulated other comprehensive income (loss)	206,878	(414,849)
Treasury stock, at cost, 725,953 and 730,950 shares, respectively	(12,566,619)	(12,538,694)
Total stockholders' equity	32,333,368	27,635,108
Total Liabilities and Stockholders' Equity	$ 354,181,648	$ 319,335,613

	2019	2018
Interest Income		
Loans, including fees	$ 14,252,254	$ 12,345,905
Debt securities available-for-sale	1,118,851	882,859
Federal funds sold	152,255	52,613
Interest-bearing deposits in banks	204,805	150,184
Total interest income	15,728,165	13,431,561
Interest Expense		
Demand deposits	599,781	311,244
Savings deposits	238,663	284,258
Certificates of deposits	468,531	186,295
Borrowings	625,595	457,755
Subordinated debentures	269,220	274,373
Total interest expense	2,201,790	1,513,925
Net interest income	13,526,375	11,917,636
Provision for Loan Losses	142,000	399,000
Net interest income after provision for loan losses	13,384,375	11,518,636
Non-Interest Income		
Fees and service charges	1,433,707	1,311,165
Mortgage servicing income	1,111,909	747,212
Insurance commissions	652,612	542,709
Other	604,661	591,963
Total non-interest income	3,802,889	3,193,049
Non-Interest Expense		
Compensation and employee benefits	7,179,711	6,999,978
Occupancy expenses	1,467,804	1,363,070
Data processing expenses	1,129,400	867,878
Federal deposit insurance premiums	43,432	65,872
Advertising expenses	188,820	209,566
Legal and accounting expenses	194,506	298,937
Other operating expenses	986,812	1,066,073
Total non-interest expense	11,190,485	10,871,374
Net income before income taxes	5,996,779	3,840,311
Income Tax Expense	1,617,375	1,038,636
Net income	$ 4,379,404	$ 2,801,675
Earnings per Share		
Basic	$ 11.05	$ 6.88
Diluted	$ 11.05	$ 6.88

	2019	2018
Net Income	$ 4,379,404	$ 2,801,675
Other Comprehensive Income (Loss):		
Unrealized income (losses) on securities		
Unrealized holding income (losses) arising during period	981,730	(376,386)
Tax effect	(360,003)	186,021
Other comprehensive income (loss)	621,727	(190,365)
Comprehensive Income	$ 5,001,131	$ 2,611,310

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance on December 31, 2017	$ 112,500	$ 9,593,643	$ 28,002,233	$ (224,484)	$ (11,464,574)	$ 26,019,318
Net Income	-	-	2,801,675	-	-	2,801,675
Other Comprehensive (Loss)	-	-	-	(190,365)	-	(190,365)
Vesting of Restricted Stock Grant	-	275,625	-	-	72,375	348,000
Repurchase of Common Stock	-	-	-	-	(1,146,495)	(1,146,495)
Dividends Paid	-	-	(197,025)	-	-	(197,025)
Balance on December 31, 2018	112,500	9,869,268	30,606,883	(414,849)	(12,538,694)	27,635,108
Net Income	-	-	4,379,404	-	-	4,379,404
Other Comprehensive Income	-	-	-	621,727	-	621,727
Vesting of Restricted Stock Grant	-	323,625	-	-	72,375	396,000
Repurchase of Common Stock	-	-	-	-	(100,300)	(100,300)
Dividends Paid	-	-	(598,571)	-	-	(598,571)
Balance on December 31, 2019	$ 112,500	$ 10,192,893	$ 34,387,716	$ 206,878	$ (12,566,619)	$ 32,333,368

	2019	2018
Cash Flows from Operating Activities		
Net income	$ 4,379,404	$ 2,801,675
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	142,000	399,000
Depreciation	860,662	804,981
Loss on sale of other real estate owned, net	-	101,518
Amortization of premiums/discounts on securities	232,072	235,555
Mortgage servicing rights capitalized	(791,966)	(444,671)
Amortization of mortgage servicing rights	292,007	255,658
Loss on sale of available-for-sale securities	15,202	-
Loss on disposal of premises and equipment	4,224	16,864
Decrease in other assets	105,877	420,707
(Increase) in accrued interest receivable	(6,035)	(55,021)
Increase in accrued interest payable	98,318	30,940
Increase in deferred income taxes	57,045	512,625
Vesting of restricted stock grant	396,000	348,000
Increase in accrued expenses and other liabilities	117,240	309,503
Net Cash Provided by Operating Activities	5,902,050	5,737,334
Cash Flows from Investing Activities		
Proceeds from maturities of interest-bearing deposits in banks	1,715,000	1,960,000
Purchases of interest-bearing deposits in banks	(1,960,000)	(2,940,000)
Proceeds from maturities, calls or paydowns of investment securities available-for-sale	15,240,228	8,760,251
Proceeds from sale of investment securities available-for-sale	2,194,798	-
Purchases of investment securities available-for-sale	(43,717,041)	(8,811,965)
(Increase) in loans receivable, net	(4,587,466)	(21,969,104)
Purchase of premises and equipment	(383,052)	(1,652,579)
Purchase of restricted stock	(1,297,800)	(878,600)
Net Cash (Used in) Investing Activities	(32,795,333)	(25,531,997)
Cash Flows from Financing Activities		
Increase in deposits, net	28,723,241	17,513,216
Increase in federal funds purchased, net	597,000	804,000
Increase (Decrease) in repurchase agreements, net	26,138	(56,279)
Federal Home Loan Bank advances	8,700,000	23,000,000
Payments on Federal Home Loan Bank advances	(8,537,786)	(18,073,689)
Payments on Bank stock loan	(370,833)	(356,269)
Increase in advance payments by borrowers for taxes and insurance	377,410	193,424
Repurchase of common stock	(100,300)	(1,146,495)
Dividends paid	(598,571)	(197,025)
Net Cash Provided by Financing Activities	28,816,299	21,680,883
Increase in Cash and Cash Equivalents	1,923,016	1,886,220
Cash and Cash Equivalents, Beginning of Year	8,588,599	6,702,379
Cash and Cash Equivalents, End of Year	$ 10,511,615	$ 8,588,599
Supplemental Disclosures of Cash Flow Information		
Cash paid during the period for:		
Interest	$ 2,103,472	$ 1,482,985
Income taxes	$ 1,567,486	$ 494,649

Note 1 - Summary of Significant Accounting Policies

Nature of Operations

Redwood Financial, Inc. (the Company) is the financial holding company of HomeTown Bank (the Bank), a state-chartered bank. The Bank, operating in ten facilities, provides a variety of financial services to the areas of south central and south western Minnesota, as well as the south metropolitan area, including mortgage, commercial, agricultural and consumer lending products and various deposit and savings plans. The Company also conducts business as Community Insurance, Inc. (the Agency). The Agency offers property, casualty, crop insurance, and health/life insurance in nine facilities throughout south central and south western Minnesota, and the south metropolitan area. The Company owns 100% of the common stock of Redwood Financial Statutory Trust I (the Trust). The Trust issued Preferred Trust Securities to independent entities.

The accounting and reporting policies of the Company and its subsidiaries conform to accounting principles generally accepted in the United States of America. The following summarizes the more significant accounting policies the Company follows in preparing and presenting its consolidated financial statements.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of the Company, the Bank and the Agency. All significant intercompany account balances and transactions have been eliminated in consolidation. In accordance with Financial Accounting Standards Board Codification Topic ASC 810-10, the Company has not consolidated its statutory trust (the Trust), as described in Note 9 – Subordinated Debentures.

Use of Estimates

In preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant changes in the near term relate to the determination of the allowance for loan losses and fair value of mortgage servicing rights.

Cash, Cash Equivalents and Cash Flows

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash and balances due from banks, all of which have original maturities of 90 days or less.

Balances in transaction accounts at other financial institutions may exceed amounts covered by federal deposit insurance. Management regularly evaluates the credit risk associated with other financial institutions and believes that the Company is not exposed to any significant credit risks on cash and cash equivalents.

Cash flows from loans, deposits, federal funds purchased and repurchase agreements are reported net.

Interest-Bearing Deposits in Banks

Interest-bearing deposits in banks have original maturities of ninety days or more and are carried at cost.

Debt Securities Available-for-Sale

Debt securities available-for-sale are reported at fair value with unrealized gains and losses reported as a component of accumulated other comprehensive income (loss) within stockholders' equity. Debt securities classified as available-for-sale are those debt securities the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Any decision to sell a debt security classified as available-for-sale would be based on various factors, including significant movements in interest rates, changes in the maturity mix of the Company's assets and liabilities, liquidity needs, regulatory capital considerations and other similar factors. Purchase premiums and discounts are recognized into income using the interest method over the terms of the debt securities. Gains or losses on the disposition of available-for-sale securities are recognized using the specific identification method. Fair value measurement is based on quoted prices, if available. If quoted market prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques.

Declines in the fair value of debt securities available-for-sale that are deemed to be other-than-temporary are charged to earnings as a realized loss, and a new cost basis for the securities is established. In evaluating other-than-temporary impairment, management considers the length of time and extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value in the new term. Declines in the fair value of debt securities below amortized cost are deemed to be other-than-temporary in circumstances where: (1) the Company has the intent to sell a security; (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the Company does not expect to recover the entire amortized cost basis of the security. If the Company intends to sell the security, or if it is more likely than not that the Company will be required to sell the security before recovery, an other-than-temporary impairment write-down is recognized in earnings equal to the difference between the security's amortized cost basis and its fair value. If the Company does not intend to sell the security or it is not more likely than not that it will be required to sell the security before recovery, the other-than-temporary impairment write-down is separated into an amount representing credit loss, which is recognized in earnings, and an amount related to all other factors, which is recognized in other comprehensive income (loss).

Loans and Allowance for Loan Losses

Loans are stated at their principal amount, net of unearned interest and the allowance for loan losses. Interest on loans is calculated using the simple interest method on daily balances of the principal amount outstanding. Loan origination and commitment fees, as well as certain direct origination costs, are deferred and amortized as a yield adjustment over the lives of the related loans using the interest method. Amortization of deferred loan fees is discontinued when a loan is placed on nonaccrual status.

Loans are generally placed on a nonaccrual status when principal or interest is 90 days past due, or when payment in full is not anticipated. When a loan is placed on nonaccrual status, interest accrued, but not received, is generally reversed against interest income. If collectability is in doubt, cash receipts on nonaccrual loans are used to reduce principal rather than recorded as interest income.

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. 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 for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectability of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows (or collateral value or observable market price) of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for qualitative factors.

A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's obtainable market price, or the fair value of the collateral if the loan is collateral dependent.

General reserves cover non-impaired loans and are based on historical loss rates for each portfolio segment, adjusted for the effects of qualitative or environmental factors that are likely to cause estimated credit losses as of the evaluation date to differ from the portfolio segment's historical loss experience. Qualitative factors include consideration of the following: changes in lending policies and procedures; changes in economic conditions; changes in the nature and volume of the portfolio; changes in the experience, ability and depth of lending management and other relevant staff; changes in the volume and severity of past due, nonaccrual and other adversely graded loans; changes in the loan review system; changes in the value of the underlying collateral for collateral-dependent loans; concentrations of credit and the effect of other external factors such as competition and legal and regulatory requirements.

Portfolio segments identified by the Company include commercial, commercial real estate, agricultural, residential real estate and consumer loans. Relevant risk characteristics for these portfolio segments generally include debt service coverage, loan-to-value ratios and financial performance on non-consumer loans and credit scores, debt-to-income, collateral type and loan-to-value ratios for consumer loans.

Investments in Restricted Stock

Investments in restricted stock consist of Federal Home Loan Bank (FHLB) stock. The Company, as a member of the FHLB system, is required to maintain a minimum investment in FHLB stock. Membership stock is based on a percentage of total assets and activity stock is based on participation in various mortgage loan programs. No ready market exists for FHLB stock, and has no quoted fair value, thus the FHLB stock is carried at cost and evaluated periodically for impairment.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Buildings and related components are depreciated using the straight-line method with useful lives ranging from 40 to 50 years. Building improvements are depreciated using the straight-line method with useful lives ranging from 10 to 35 years. Furniture, fixtures and equipment are depreciated using the straight-line method with useful lives ranging from 1 to 10 years.

Mortgage Servicing Rights

Servicing assets are recognized as separate assets when rights are acquired through sale of financial assets. For sales of mortgage loans, a portion of the cost of originating the loan is allocated to the servicing right based on its fair value. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. Servicing assets are evaluated for impairment based upon the fair value of the rights as compared to amortized cost. Impairment is recognized through valuation allowance for individual tranches, to the extent that fair value is less than the capitalized amount for the tranches. If the Company later determines that all or a portion of the impairment no longer exists, a reduction of the allowance may be recorded as an increase to income. Capitalized servicing rights are reported as a separate line item on the consolidated balance sheets and are amortized into non-interest income in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets.

Servicing fee income is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal; or a fixed amount per loan and are recorded as income when earned. The amortization of mortgage servicing rights is netted against loan servicing fee income.

Goodwill

Goodwill is a result of HomeTown Bank entering into branch purchase and assumption agreements. Goodwill is not amortized, rather potential impairment is considered on an annual basis, or more frequently upon the occurrence of an event or when circumstances indicate that the amount of goodwill is greater than its fair value. As of December 31, 2019, the carrying value of the Company's goodwill was not considered impaired.

Other Real Estate Owned

Other real estate owned (ORE) represents properties acquired through foreclosure or other proceedings. ORE is recorded at the lower of the carrying amounts of the related loans or fair value of the properties at the date of foreclosure, less estimated costs of disposal. Any write-down to fair value less estimated costs of disposal at the time of transfer to ORE is charged to the allowance for loan losses. Property is evaluated periodically to ensure that the recorded amount is supported by its current fair value less estimated costs of disposal. Subsequent write-downs are charged to other expense. Gains or losses on the sale of ORE are charged to operations.

Income Taxes

The Company files its tax return as a C corporation and consolidates the results of operations of its subsidiaries for tax reporting purposes.

The Company evaluates its tax positions that have been taken or are expected to be taken on income tax returns to determine if an accrual is necessary for uncertain tax positions. As of December 31, 2019 and 2018, the unrecognized tax benefit accrual was zero. The Company will recognize future accrued interest and penalties related to unrecognized tax benefits in income tax expense if incurred. The Company is no longer subject to Federal tax examinations by tax authorities for years before 2016.

Deferred taxes are provided on an asset and liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Comprehensive Income

Comprehensive income is defined as the change in equity during a period from transactions and other events from non-owner sources. Comprehensive income is the total of net income and other comprehensive income (loss) which, for the Company, is comprised entirely of unrealized gains and losses on securities available-for-sale, net of the related deferred tax effect.

Reclassifications

Certain reclassifications of amounts previously reported have been made to the accompanying consolidated financial statements to maintain consistency between periods presented. The reclassifications had no impact on the net income or stockholders' equity.

Advertising Costs

The Company expenses advertising costs as incurred.

Earnings per Common Share

Basic earnings per common share is net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share includes the dilutive effect of additional potential common shares issuable under stock plans. A reconciliation of earning per share for the years ended December 31, 2019 and 2018 is below:

	2019	2018
Net income	$ 4,379,404	$ 2,801,675
Basic EPS:		
Weighted average number of shares	396,334	407,022
Earnings per shrae	$ 11.05	$ 6.88
Diluted EPS:		
Weighted average number of shares	396,334	407,022
Earnings per share	$ 11.05	$ 6.88

Adoption of Accounting Standards Codification Topic 606

As of January 1, 2018, the Company adopted the provisions of FASB Accounting Standards Codification Topic 606, *Revenue from Contracts with* Customers (Topic 606), which (i) creates a single framework for recognizing revenue from contracts with customers that fall within its scope and (ii) revises when it is appropriate to recognize a gain (loss) from the transfer of nonfinancial assets, such as foreclosed assets. The majority of the Company’s revenues come from interest income and other sources, including loans and securities that are outside the scope of Topic 606. The Company’s services that fall within the scope of Topic 606 are presented within non-interest income and are recognized as revenue as the Company satisfies its obligation to the customer. Services within the scope of Topic 606 include service charges and fees, insurance commissions and the sale of foreclosed assets. The Company has determined the adoption of Topic 606 had no impact on prior year or previously disclosed amounts.

A description of the Company’s revenue streams accounted for under Topic 606 follows:

Service Charges and fees: The Company earns fees from its deposit customers for transaction-based, account-maintenance, and overdraft services. Transaction-based fees, which include services such as ATM use fees, stop payment charges, statement rendering, and ACH fees, are recognized at the time the transaction is executed as that is the point in time the Company fulfills the customer’s request. Account maintenance fees, which related primarily to monthly maintenance, are earned over the course of a month, representing the period over which the Company satisfies the performance obligation. Overdraft fees are recognized at the point in time that the overdraft occurs. Service charges on deposits are withdrawn from the customer’s account balance.

Insurance Commissions: The Company receives commissions from the third-party service provider on a monthly basis based upon customer activity for the month. The fees are recognized monthly and a receivable is recorded until commissions are paid. Because the Company (i) acts as an agent in arranging the relationship between the customer and the third-party service provider and (ii) does not control the services rendered to the customers, insurance commissions are presented net of related costs.

Gains (Losses) on Sales of Foreclosed Assets: The Company records a gain or loss from the sale of foreclosed assets when control of the property transfers to the buyer, which generally occurs at the time of an executed deed. When the Company finances the sale of foreclosed asset to the buyer, the Company assesses whether the buyer is committed to perform their obligations under the contract and whether collectability of the transaction price is probable. Once these criteria are met, the foreclosed asset is derecognized and the gain or loss on sale is recorded upon the transfer of control of the property to the buyer. In determining the gain or loss on the sale, the Company adjusts the transaction price and related gain (loss) on sale if a significant financing component is present.

Adoption of Accounting Standards Codification Topic 842

Effective January 1, 2019, the Company adopted the new lease accounting guidance in Accounting Standards Update No. 2016-02, Leases (Topic 842). The Company elected to apply the guidance as of January 1, 2019, the beginning of the adoption period. The comparative financial information and disclosures presented are in accordance with the legacy standard, ASC 840. The standard requires the recognition of right-of-use assets and lease liabilities for lease contracts with terms greater than 12 months. Operating lease costs are recognized in the income statement as a single lease cost and finance lease costs are recognized in two components, interest expense and amortization expense. The Company has elected the package of practical expedients permitted in ASC Topic 842. Accordingly, the Company accounted for its existing leases as either finance or operating lease under the new guidance, without reassessing (a) whether the contract contains a lease under ASC Topic 842, (b) whether classification of the operating lease would be different in accordance with ASC Topic 842, or (c) whether the unamortized initial direct costs before transition adjustments would have met the definition of initial direct costs in ASC Topic 842 at lease commencement. The Company has determined the adoption of Topic 842 had no impact on the current year financial statements.

Subsequent Events

The Company has evaluated subsequent events through April 2, 2020, the date which the consolidated financial statements were available to be issued.

Note 2 - Restrictions on Cash and Cash Equivalents

Based on the type and amount of deposits received, the Bank must maintain an appropriate cash reserve in accordance with Federal Reserve Bank reserve requirements. The total of those reserve requirements was $2,705,000 as of December 31, 2019. The total of the reserve requirements was approximately $748,000 as of December 31, 2018.

Note 3 - Debt Securities Available-for-Sale

Debt securities available-for-sale at December 31, 2019 and 2018, are summarized as follows:

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$ 14,355,725	$ 40,476	$ (29,913)	$ 14,366,288
State and municipal securities	10,967,295	65,191	(4,292)	11,028,194
Mortgage-backed securities	31,631,336	348,382	(92,148)	31,887,570
Collateralized mortgage obligations	12,870,517	40,433	(77,815)	12,833,135
Total securities available-for-sale	$ 69,824,873	$ 494,482	$ (204,168)	$ 70,115,187

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$ 5,394,275	$ 5,846	$ (69,926)	$ 5,330,195
State and municipal securities	16,655,611	8,131	(170,215)	16,493,527
Mortgage-backed securities	16,905,227	23,416	(405,032)	16,523,611
Collateralized mortgage obligations	4,835,020	6,052	(89,687)	4,751,385
Total securities available-for-sale	$ 43,790,133	$ 43,445	$ (734,860)	$ 43,098,718

The amortized cost and estimated fair value of investment securities available-for-sale at December 31, 2019, by contractual maturity, are shown below:

	Amortized Cost	Fair Value
Due within one year	$ 2,560,965	$ 2,564,371
Due after one year through five years	14,256,294	14,332,762
Due after five years through ten years	8,505,761	8,497,349
	25,323,020	25,394,482
Mortgage-backed securities	31,631,336	31,887,570
Collateralized mortgage obligations	12,870,517	12,833,135
Total	$ 69,824,873	$ 70,115,187

Anticipated maturities on mortgage-backed securities and collateralized mortgage obligations are not readily determinable since they may be prepaid without penalty.

At December 31, 2019 and 2018, debt securities and interest-bearing deposits in banks with an amortized cost of approximately $15,259,000 and $14,664,000, respectively, were pledged to secure public and private deposits. The fair value of pledged securities was approximately $15,368,000 and $14,471,000 as of December 31, 2019 and 2018, respectively.

Proceeds from the sale of available-for-sale securities during the year ended December 31, 2019, were $2,194,798, resulting in gross realized losses of $15,202. For the year ended December 31, 2018, there were no sales of securities and no unrealized gains or losses.

The following table shows the gross unrealized losses and fair value of the Company's debt securities with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual debt securities have been in a continuous unrealized loss position at December 31, 2019 and 2018.

	December 31, 2019			
	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$ (28,981)	$ 7,901,019	$ (932)	$ 684,440
State and municipal securities	(3,830)	922,827	(462)	184,538
Mortgage-backed securities	(72,369)	11,178,050	(19,779)	2,123,099
Collateralized mortgage obligations	(73,971)	7,130,462	(3,844)	588,756
Total	$ (179,151)	$ 27,132,358	$ (25,017)	$ 3,580,833

	December 31, 2018			
	Less Than Twelve Months		Over Twelve Months	
	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value
U.S. government agency securities	$ (2,627)	$ 492,734	$ (67,299)	$ 1,765,464
State and municipal securities	(14,126)	2,979,077	(156,089)	10,440,341
Mortgage-backed securities	(20,787)	4,336,647	(384,245)	11,177,211
Collateralized mortgage obligations	-	-	(89,687)	3,655,324
Total	$ (37,540)	$ 7,808,458	$ (697,320)	$ 27,038,340

At December 31, 2019, a total of 27 debt securities had unrealized losses, none of which management considers to be other-than-temporarily impaired. Management evaluates securities for other-than-temporary impairment at least on a quarterly basis and more frequently when economic or market concerns warrant such evaluation. Consideration is given to (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the insurer and (3) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. During the years ending December 31, 2019 and 2018, the Company recognized no other-than-temporary impairments on investments.

Note 4 - Loans

Loans at December 31 are summarized as follows:

	2019	2018
Commercial	$ 23,146,818	$ 20,926,503
Commercial real estate	90,951,852	94,407,281
Agricultural	25,436,418	20,237,234
Residential real estate	70,506,178	69,504,658
Consumer	25,775,432	26,134,525
	235,816,698	231,210,201
Less: allowance for loan losses	(4,025,761)	(3,864,731)
Loans, net	$ 231,790,937	$ 227,345,470

Credit Quality Indicators

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt such as: current financial information, historical payment experience, collateral adequacy, credit documentation, public information and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans as to credit risk. This analysis is performed on an ongoing basis as new information is obtained. The Company uses the following definitions for risk ratings:

Pass – Loans classified as Pass represent loans that are evaluated and are performing under the stated terms. Pass rated assets are analyzed by the paying capacity, the current net worth, and the value of the loan collateral of the obligor.

Watch – Loans classified as Watch possess potential weaknesses that require management attention, but do not yet warrant adverse classification. While the status of a loan put on this list may not technically trigger their classification as Substandard or Doubtful, it is considered a proactive way to identify potential issues and address them before the situation deteriorates further and does result in a loss for the Company.

Substandard – Loans classified as Substandard are inadequately protected by the current net worth, paying capacity of the obligor, or by the collateral pledged. Substandard loans must have a well-defined weakness or weaknesses that jeopardize the repayment of the debt as originally contracted. They are characterized by the distinct possibility that the Company will sustain a loss if the deficiencies are not corrected.

Doubtful – Loans classified as Doubtful have the weaknesses of those classified as Substandard, 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. Loans in this category are allocated a specific reserve based on the estimated discounted cash flows from the loan (or collateral value less cost to sell for collateral dependent loans) or are charged off if deemed uncollectible.

Based on the most recent analysis performed, the risk category of loans by class of loans was as follows as of December 31, 2019 and 2018:

December 31, 2019	Pass	Watch	Substandard	Doubtful	Total
Commercial	$ 22,470,280	$ 532,890	$ 143,648	$ -	$ 23,146,818
Commercial real estate	88,411,308	975,419	1,565,125	-	90,951,852
Agricultural	19,637,437	463,429	5,335,552	-	25,436,418
Residential real estate	68,921,606	130,809	1,453,763	-	70,506,178
Consumer	25,720,708	-	54,724	-	25,775,432
	$ 225,161,339	$ 2,102,547	$ 8,552,812	$ -	$ 235,816,698

December 31, 2018	Pass	Watch	Substandard	Doubtful	Total
Commercial	$ 20,107,061	$ 490,010	$ 329,432	$ -	$ 20,926,503
Commercial real estate	92,081,821	367,769	1,957,691	-	94,407,281
Agricultural	18,729,298	231,589	1,276,347	-	20,237,234
Residential real estate	68,033,340	312,978	1,158,340	-	69,504,658
Consumer	25,959,345	109,137	66,043	-	26,134,525
	$ 224,910,865	$ 1,511,483	$ 4,787,853	$ -	$ 231,210,201

The following table summarizes the aging of the past due loans by portfolio segments at December 31, 2019 and 2018:

December 31, 2019	Still Accruing		
	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual Balance
Commercial	$ 22,227	$ -	$ -
Commercial real estate	163,441	-	251,824
Agricultural	-	-	-
Residential real estate	418,978	-	1,080,737
Consumer	9,918	-	30,140
Total	$ 614,564	$ -	$ 1,362,701

December 31, 2018	Still Accruing		
	30-89 Days Past Due	Over 90 Days Past Due	Nonaccrual Balance
Commercial	$ 610,352	$ -	$ -
Commercial real estate	157,489	-	230,794
Agricultural	-	-	-
Residential real estate	945,774	-	82,328
Consumer	82,737	-	-
Total	$ 1,796,352	$ -	$ 313,122

The following table summarizes individually impaired loans by class of loans as of December 31, 2019 and 2018:

December 31, 2019	Recorded Investment	Unpaid Principal Balance (1)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial	$ -	$ -	$ -	$ -
Commercial real estate	156,974	272,893	301,782	-
Agricultural	-	-	-	-
Residential real estate	725,029	725,029	809,515	6,865
Consumer	8,679	8,679	9,487	77
	$ 890,682	$ 1,006,601	$ 1,120,784	$ 6,942

	Recorded Investment	Unpaid Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial real estate	94,850	94,850	32,379	102,056	-
Agricultural	-	-	-	-	-
Residential real estate	355,708	355,708	3,317	382,700	2,294
Consumer	21,460	21,460	2,992	24,013	234
	$ 472,018	$ 472,018	$ 38,688	$ 508,769	$ 2,528

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

December 31, 2018	Recorded Investment	Unpaid Principal Balance (1)	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded				
Commercial	$ -	$ -	$ -	$ -
Commercial real estate	230,795	346,714	363,096	14,773
Agricultural	-	-	-	-
Residential real estate	425,576	425,576	428,423	17,612
Consumer	3,440	3,440	4,837	285
	$ 659,811	$ 775,730	$ 796,356	$ 32,670

	Recorded Investment	Unpaid Principal Balance (1)	Related Allowance	Average Recorded Investment	Interest Income Recognized
With an allowance recorded					
Commercial	$ -	$ -	$ -	$ -	$ -
Commercial real estate	-	-	-	-	-
Agricultural	-	-	-	-	-
Residential real estate	-	-	-	-	-
Consumer	6,512	6,512	5,645	7,213	362
	$ 6,512	$ 6,512	$ 5,645	$ 7,213	$ 362

(1) Represents the borrower's loan obligation, gross of any previously charged-off amounts.

The following table presents the activity in the allowance for loan losses for the year 2019 and the recorded investment in loans and impairment method as of December 31, 2019, by portfolio segment:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Total
Allowance for Loan Losses						
Balance at beginning of period	$ 287,020	$ 1,619,751	$ 628,483	$ 928,868	$ 400,609	$ 3,864,731
Charge-offs	-	-	-	-	(13,312)	(13,312)
Recoveries	6,874	-	-	13,698	11,770	32,342
Provisions	(6,955)	(153,749)	336,911	(30,958)	(3,249)	142,000
Balance at end of period	$ 286,939	$ 1,466,002	$ 965,394	$ 911,608	$ 395,818	$ 4,025,761
Individually evaluated for impairment	$ -	$ 32,379	$ -	$ 3,317	$ 2,992	$ 38,688
Collectively evaluated for impairment	286,939	1,433,623	965,394	908,291	392,826	3,987,073
Balance at end of period	$ 286,939	$ 1,466,002	$ 965,394	$ 911,608	$ 395,818	$ 4,025,761
Loans						
Individually evaluated for impairment	$ -	$ 251,824	$ -	$ 1,080,737	$ 30,139	$ 1,362,700
Collectively evaluated for impairment	23,146,818	90,700,028	25,436,418	69,425,441	25,745,293	234,453,998
Balance at end of period	$ 23,146,818	$ 90,951,852	$ 25,436,418	$ 70,506,178	$ 25,775,432	$ 235,816,698

The following table presents the activity in the allowance for loan losses for the year 2018 and the recorded investment in loans and impairment method as of December 31, 2018, by portfolio segment:

	Commercial	Commercial Real Estate	Agricultural	Residential Real Estate	Consumer	Total
Allowance for Loan Losses						
Balance at beginning of period	$ 265,166	$ 1,374,494	$ 659,872	$ 729,059	$ 382,226	$ 3,410,817
Charge-offs	(58,296)	-	-	-	(18,919)	(77,215)
Recoveries	2,381	-	-	84,713	45,035	132,129
Provisions	77,769	245,257	(31,389)	115,096	(7,733)	399,000
Balance at end of period	$ 287,020	$ 1,619,751	$ 628,483	$ 928,868	$ 400,609	$ 3,864,731
Individually evaluated for impairment	$ -	$ -	$ -	$ -	$ 5,645	$ 5,645
Collectively evaluated for impairment	287,020	1,619,751	628,483	928,868	394,964	3,859,086
Balance at end of period	$ 287,020	$ 1,619,751	$ 628,483	$ 928,868	$ 400,609	$ 3,864,731
Loans						
Individually evaluated for impairment	$ -	$ 230,795	$ -	$ 425,576	$ 9,952	$ 666,323
Collectively evaluated for impairment	20,926,503	94,176,486	20,237,234	69,079,082	26,124,573	230,543,878
Balance at end of period	$ 20,926,503	$ 94,407,281	$ 20,237,234	$ 69,504,658	$ 26,134,525	$ 231,210,201

Impaired loans also include loans modified in a troubled debt restructuring (TDR) where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collections.

There were no troubled debt restructurings that occurred during the years ended December 31, 2019 and 2018.

There were no troubled debt restructurings that defaulted for the years ended December 31, 2019 and 2018.

There were no material commitments to lend additional funds to customers whose loans were classified as impaired or restructured at December 31, 2019 and 2018.

Note 5 - Premises and Equipment

A summary of premises and equipment at December 31 are as follows:

	2019	2018
Land and office buildings	$ 17,415,250	$ 17,340,296
Furniture and equipment	3,670,378	3,399,536
	21,085,628	20,739,832
Less: accumulated depreciation	(5,451,511)	(4,623,881)
Total premises and equipment, net	$ 15,634,117	$ 16,115,951

Depreciation expense totaled $860,662 and $804,981 for the years ended December 31, 2019 and 2018, respectively.

The Company leases one of their facilities through June 30, 2020. Total rent and lease expense for the years ended December 31, 2019 and 2018 amounted to $43,163 and $40,624, respectively. Annual payments on the long-term lease commitment are as follows:

2020	$ 21,582

Note 6 - Mortgage Servicing Rights

Loans serviced for others are not included in the accompanying consolidated balance sheet. The risks inherent in mortgage servicing rights relate primarily to changes in prepayments that result from shifts in mortgage interest rates. The unpaid principal balances of loans serviced for others was approximately $268,197,000 and $234,355,000 as of December 31, 2019 and 2018, respectively. The carrying amount of the mortgage servicing rights were $2,097,312 and $1,597,353 as of December 31, 2019 and 2018, respectively. There was no valuation allowance for the years ended December 31, 2019 and 2018.

Mortgage servicing rights for the years ended December 31, 2019 and 2018 were:

	2019	2018
Mortgage servicing rights at beginning of year	$ 1,597,353	$ 1,408,340
Additions	791,966	444,671
Disposals	-	-
Amortization	(292,007)	(255,658)
Mortgage servicing rights at end of year	$ 2,097,312	$ 1,597,353
Estimated fair value of servicing rights, beginning of period	$ 2,304,173	$ 1,916,368
Estimated fair value of servicing rights, end of period	2,292,559	2,304,173

The fair value of servicing rights was determined using discount rates ranging from 9.5% to 12.5%, prepayment speeds ranging from 120 PSA to 258 PSA, depending on the stratification of the specific right.

Future amortization of mortgage servicing rights for the years ending December 31 follows:

2020	$ 419,261
2021	367,140
2022	393,200
2023	393,200
Thereafter	524,511
	$ 2,097,312

Projections of amortization are based on existing asset balances and the existing interest rate environment as of December 31, 2019 and 2018. The Company's actual experiences may be significantly different depending upon changes in mortgage rates and other market conditions.

Contractually specified servicing and ancillary fees are included in mortgage servicing income, and late fees are included in fees and service charges.

	2019	2018
Contractually specified servicing fees	$ 611,950	$ 558,200
Late fees	14,035	11,107
	$ 625,985	$ 569,307

Note 7 - Deposits

A summary of deposits at December 31 follows:

	2019	2018
Non-interest bearing demand deposit accounts	$ 72,978,690	$ 68,750,295
Interest-bearing demand deposit accounts	80,174,668	62,889,017
Savings and money market accounts	99,986,898	96,762,151
Time deposits, meet or exceed the FDIC insurance limit	4,795,871	4,218,250
Other time deposits	30,238,989	26,832,162
Total deposits	$ 288,175,116	$ 259,451,875

At December 31, 2019, the scheduled maturities of time deposits are as follows:

2020	$ 24,570,926
2021	7,061,492
2022	2,492,930
2023	504,469
2024 and thereafter	405,043
Total time deposits	$ 35,034,860

Note 8 - Borrowings

Borrowings at December 31 are summarized as follows:

	2019	2018
Federal Home Loan Bank advances	$ 15,883,684	$ 15,721,470
Federal funds purchased	1,401,000	804,000
Repurchase agreements	501,138	475,000
Bank stock loan	3,697,639	4,068,472
Total borrowings	$ 21,483,461	$ 21,068,942

Federal Home Loan Bank Advances

At December 31, 2019 and 2018, the interest rates on the Company's Federal Home Loan Bank (FHLB) advances ranged from 1.89% to 3.41%. At December 31, 2019, the scheduled maturities of the FHLB advances are as follows:

Due in 2020	$	4,452,673
Due in 2021		2,500,000
Due in 2022		1,750,000
Due in 2023		2,500,000
Due in 2024 and thereafter		4,681,011
Total FHLB advances	$	15,883,684

The Company's level of FHLB stock at December 31, 2019 and 2018, is required by FHLB to maintain the current level of FHLB advances.

The Company maintains a collateral pledge agreement with the Federal Home Loan Bank of Des Moines covering secured advances whereby the Company has agreed to retain, free of all other pledges, liens and encumbrances, residential, and commercial and agricultural real estate loans. The pledged loans are discounted at 122% to 149% as of December 31, 2019, when aggregating the amount of loans required by the pledge agreement. The amount of eligible loans was approximately $65,307,000 and $62,190,000 as of December 31, 2019 and 2018, respectively.

With sufficient collateral, the total borrowing limit from the FHLB was approximately $40,601,000 at December 31, 2019. With the total FHLB advances of $15,883,684 and the net credit enhancement commitments on the loans sold to FHLB of $1,194,131 as of December 31, 2019, the Company can borrow approximately an additional $23,523,000 from FHLB.

Federal Funds Purchased

The Company has overnight advances available for daily operating needs up to their maximum borrowing limit. The company had $1,401,000 borrowed on this line at December 31, 2019. The Company had $804,000 borrowed on this line at December 31, 2018.

Repurchase Agreements

Repurchase agreements, which are classified as secured borrowings, generally mature within one year from the transaction date. Repurchase agreements are reflected at the amount of cash received in connection with a transaction. The Company may be required to provide additional collateral based on the fair value of the underlying securities.

Bank Stock Loan

The Company borrowed $5,000,000 on February 3, 2016, collateralized by HomeTown Bank stock.

Amount	$ 3,697,639
Issuance date	February 3, 2016
Maturity date	February 3, 2023
Fixed interest rate	3.97%

The scheduled maturities of the Bank stock loan are as follows:

Due in 2020	$ 385,576
Due in 2021	401,737
Due in 2022	418,153
Due in 2023	2,492,173
	$ 3,697,639

The Company has a $3,000,000 line of credit with Bell Bank. At December 31, 2019, this line is subject to a variable interest rate of .50 % under the current "Prime Rate". The rate at December 31, 2019 was 4.25%. This line matures on March 1, 2021. As of December 31, 2019, there were no advances on the line of credit.

Note 9 - Subordinated Debentures

The Company has a statutory business trust for the purpose of issuing trust preferred securities. The proceeds from such issuances, together with the proceeds of the related issuances of common securities of the trust, were invested in junior subordinated debentures (debentures). Concurrent with the issuance of the preferred securities by the trust, the trust issued guarantees for the benefit of the security holders.

The sole assets of the trust are the debentures. The common securities of the trust are owned by the Company and are reported as an investment in unconsolidated subsidiaries within other assets of the consolidated balance sheet. The preferred securities issued by the trust rank senior to the common securities. The obligations of Redwood Financial Statutory Trust I under the debentures, the indentures, the relevant trust agreements and the guarantees, in the aggregate, constitute a full and unconditional guarantee by the trust of the obligations of the trust under the trust preferred securities and rank subordinate and junior in right of payment to all their other liabilities. The Company guarantees the obligations of Redwood Financial Statutory Trust I.

Amount	$ 6,186,000
Issuance date	September 21, 2006
Maturity date	December 15, 2036
Interest rate	LIBOR + 1.75%
Interest rate on December 31, 2019	3.64%

The trust preferred securities are subject to mandatory redemption at the stated maturity date of the debentures, upon repayment of the debentures, or earlier, pursuant to the terms of the Trust Agreement. On any interest payment date, the trust preferred securities may be redeemed, and the corresponding debentures may be prepaid at the option of the Company subject to Federal Reserve Bank approval, at declining redemption prices. Prior to the maturity date indicated above, the trust preferred securities may be redeemed at the option of the Company, on the occurrence of certain events that result in a negative tax impact, negative regulatory impact on the trust preferred securities or negative legal or regulatory impact on the appropriate special purpose trust which would define it as an investment company. In addition, the Company has the right to defer payment of interest on the debentures and, therefore, distributions on the trust preferred securities for up to five years.

Note 10 - Income Taxes

Deferred tax assets and liabilities consists of the following components as of December 31, 2019 and 2018:

	2019	2018
Deferred tax assets:		
Allowance for losses on loans receivable	$ 1,157,004	$ 1,110,724
Unrealized loss on securities available-for-sale	-	276,566
Other	719,887	685,929
Total deferred tax assets	1,876,891	2,073,219
Deferred tax liabilities:		
Goodwill	(1,098,197)	(1,026,305)
Mortgage servicing asset	(602,767)	(459,079)
Premises and equipment	(1,166,933)	(1,227,586)
Unrealized gain on securities available-for-sale	(83,436)	-
Other	(594,220)	(611,864)
Total deferred tax liabilities	(3,545,553)	(3,324,834)
Net deferred tax (liability)	$ (1,668,662)	$ (1,251,615)

The provision for income taxes charged to operations consists of the following:

	2019	2018
Current tax expense	$ 1,560,330	$ 526,011
Deferred tax	57,045	512,625
	$ 1,617,375	$ 1,038,636

The income tax provision differs from the amount of income tax determined by applying the U.S. Federal income tax rate to pretax income as follows:

	2019	2018
Computed "expected" federal income tax expense	$ 1,259,324	$ 806,465
Increase (decrease) resulting from:		
State income taxes, net of federal tax benefit	464,271	297,318
Tax-exempt interest income (net of disallowed expenses)	(89,242)	(81,366)
Other	(16,978)	16,219
Income tax expense	$ 1,617,375	$ 1,038,636

Note 11 - Related Party Transactions

There were no loans to directors and executive officers of the Company as of December 31, 2019 and 2018.

Liabilities at December 31, 2019 and 2018, included amounts on deposit from Company directors and executive officers of $571,455 and $654,661, respectively. Such deposits were accepted in the ordinary course of business with normal interest rates, interest payment terms, and maturities.

Note 12 - Employee Benefits

401(k) Plan

All employees are eligible to participate in the Company's 401(k) plan on the first day of the following quarter from the date of hire, after they attain age 21, and are employed at least 1,000 hours during the plan year. Participating employees may contribute the maximum amount allowed by law and the Company will match up to five percent. The match vests at 20% after the second year of service, until fully vested after six years of service. Contributions to the plan for the years ended December 31, 2019 and 2018 were $233,408 and $225,126, respectively.

Phantom Stock Plan

The Company has a phantom stock plan. The phantom stock plan grants phantom shares up to a total of 35,000 shares to certain key management employees, which vest over a five-year period at 20% per year. At December 31, 2019 and 2018, there were 28,580 and 30,825 shares of phantom stock granted to 12 employees, respectively. 24,526 and 25,645 shares were vested at December 31, 2019 and 2018, respectively. Expense related to the vesting of the shares at December 31, 2019 and 2018 totaled $185,856 and $163,270, respectively.

Restricted Stock Grant Plan

The Company has a restricted stock grant agreement. Under the agreement, future grants of certain shares of Company stock were granted to six directors of the Company. A total grant of 30,000 shares of common stock of the Company will be awarded equally over the agreement's first five one-year anniversary dates. No vesting restrictions apply. Shares are fully vested upon the grant date. Expenses related to the vesting of shares for 2019 and 2018 were $396,000 and $348,000, respectively.

Note 13 - Minimum Regulatory Capital Requirements

The federal banking agencies published final rules (the "Basel III Capital Rules") that revised their risk-based and leverage capital requirements and their method for calculating risk-weighted assets to implement, in part, agreements reached by the Basel Committee and certain provisions of the Dodd-Frank Act. The Basel III Capital Rules apply to banking organizations, including the Bank.

In connection with the effective date of Basel III, most banks were required to decide whether to elect to opt-out of the inclusion of Accumulated Other Comprehensive Income ("AOCI") in their Common Equity Tier 1 Capital. This was a one-time election and generally irrevocable. If electing to opt-out, most AOCI items will be treated, for regulatory capital purposes, in the same manner in which they were prior to Basel III. The Bank has elected to opt-out of the inclusion.

Among other things, the Basel III Capital Rules: (i) introduce a new capital measure entitled "Common Equity Tier 1" ("CET1"); (ii) specify that tier 1 capital consist of CET1 and additional financial instruments satisfying specified requirements that permit inclusion in tier 1 capital; (iii) define CET1 narrowly by requiring that most deductions or adjustments to regulatory capital measures be made to CET1 and not to the other components of capital; and (iv) expand the scope of the deductions or adjustments from capital as compared to the existing regulations.

A minimum leverage ratio (tier 1 capital as a percentage of total assets) of 4.0% is also required under the Basel III Capital Rules (even for highly rated institutions). The Basel III Capital Rules additionally require institutions to retain a capital conservation buffer of 2.5% above these required minimum capital ratio levels. Banking organizations that fail to maintain the minimum 2.5% capital conservation buffer could face restrictions on capital distributions or discretionary bonus payment to executive officers.

The Bank is subject to various regulatory capital requirements administered by the federal and state banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the 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 their assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors. Prompt corrective action provisions are not applicable to bank holding companies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios of Common Equity Tier 1 Capital ("CET1"), Tier 1 Capital, Total Capital and leverage ratio of Tier 1 Capital. As of January 1, 2015, the requirements are:

- 4.5% based upon CET1
- 6.0% based upon tier 1 capital
- 8.0% based on total regulatory capital
- Leverage ratio of Tier 1 Capital assets equal to 4%

As of December 31, 2019 and 2018, management believes the Bank met all capital adequacy requirements to which they are subject. As of December 31, 2019, the most recent notification from the Federal Deposit Insurance Company (FDIC) categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since the notification that management believes have changed the Bank's category.

The Banks' actual capital amounts and ratios are presented in the following table:

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2019:						
Common equity Tier 1 capital						
(to risk weighted assets)	$ 35,475,000	14.1%	≥ $11,283,000	≥4.5%	≥ $16,298,000	≥6.5%
Tier I capital						
(to risk weighted assets)	$ 35,475,000	14.1%	≥ $15,044,000	≥6.0%	≥ $20,059,000	≥8.0%
Total capital						
(to risk weighted assets)	$ 38,620,000	15.4%	≥ $20,059,000	≥8.0%	≥ $25,074,000	≥10.0%
Tier I capital						
(to average assets)	$ 35,475,000	10.2%	≥ $13,858,000	≥4.0%	≥ $17,323,000	≥5.0%

	Actual		For Capital Adequacy Purposes		To Be Well-Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of December 31, 2018:						
Common equity Tier 1 capital						
(to risk weighted assets)	$ 32,204,000	13.9%	≥ $10,459,000	≥4.5%	≥ $15,107,000	≥6.5%
Tier I capital						
(to risk weighted assets)	$ 32,204,000	13.9%	≥ $13,945,000	≥6.0%	≥ $18,593,000	≥8.0%
Total capital						
(to risk weighted assets)	$ 35,121,000	15.1%	≥ $18,593,000	≥8.0%	≥ $23,241,000	≥10.0%
Tier I capital						
(to average assets)	$ 32,204,000	10.3%	≥ $12,466,000	≥4.0%	≥ $15,583,000	≥5.0%

Note 14 - Restrictions

The Company's ability to pay dividends to stockholders is subject to the requirements of their state charter. No dividend may be paid by the Company unless the Board of Directors determines that the Company will be able to pay its debts in the ordinary course of business after payment of the dividend. In addition, the Company's ability to pay dividends is dependent, in part, upon the dividends from the subsidiary bank. The Bank may not declare or pay a cash dividend on any of its stock if the effect thereof would cause the Bank's regulatory capital to be reduced below (1) the amount required for the liquidation account established in connection with the Bank's conversion from mutual stock form, or (2) the regulatory capital requirements imposed by the State Banking Department.

Note 15 - Stock Repurchases

During the year ended December 31, 2019, the Company repurchased 1,003 of its shares of outstanding common stock at an average price per share of $100. During the year ended December 31, 2018 the Company repurchased 21,059 of its shares of outstanding common stock at an average price per share of $47.45. During 2019 and 2018, the Company released 6,000 shares of treasury shares into shares of outstanding common stock at an average price per share of $12.06 as part of the Restricted Stock Grant Plan during each year. Repurchased shares are considered treasury shares and will be utilized for general corporate and other purposes.

Note 16 - Commitments and Contingencies

The Company is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the accompanying balance sheets. The contract amounts of these instruments reflect the extent of involvement by the Company.

The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contract amount of these commitments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet instruments.

The contract amounts of these financial instruments at December 31 are as follows:

	2019	2018
Financial instruments whose contract amount represents risk:		
Commitments to extend credit	$ 46,727,875	$ 44,033,005
Standby letters of credit	531,906	1,570,035
MPF credit enhancement	1,194,131	923,847
Total	$ 48,453,912	$ 46,526,887

Commitments to extend credit are agreements to lend to a customer provided there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since a portion of the commitments may expire without being drawn upon, the total commitment amount does not necessarily represent future cash requirements. The Company evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by the Company upon extension of credit, is based on the loan type and on management's evaluation of the borrower. Collateral held varies, but may include real estate, accounts receivable, crops, livestock, inventory, property and equipment, and income-producing commercial properties. The Company would incur no losses if any or all of these commitments expire unused.

Standby letters of credit are conditional lending commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally have fixed expiration dates or other termination clauses and may require payment of a fee. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company's policy for obtaining collateral, and the nature of such collateral, is essentially the same as that involved in making commitments to extend credit.

The Banks' exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual notional amount of those instruments. The Bank uses the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

Mortgage Partnership Finance (MPF) credit enhancements allow the Corporation to share the credit risk associated with home mortgage finance with the Federal Home Loan Bank (FHLB). MPF provides the Corporation the ability to originate, sell, and service fixed rate residential mortgage loans, and receive a credit enhancement fee based on the performance of the loans. FHLB manages the liquidity, interest rate, and prepayment risks of the loans only after a foreclosure loss exceeds the borrower's equity, private mortgage insurance, and the funded first loss account. Based on the delinquency results for states where properties are located and the Corporation's historical loss experience, the estimated foreclosure losses are immaterial.

Financial Instruments with Concentrations of Credit Risk

Concentration by Loan Type: A large portion of the Company's loan portfolio finances properties secured by real estate, including retail buildings, multi-family homes, farmland, land development, and other non-residential real estate.

Litigation

In the ordinary course of business, the Company and the Bank may be subject to litigation. Based upon the available information and advice from the Company's legal counsel, management does not believe that any potential, threatened, or pending litigation to which it is a party will have a material adverse effect on the Company's liquidity, financial condition, or results of operations.

Note 17 - Fair Values of Assets and Liabilities

Determination of Fair Value

Accounting guidance on fair value measurements and disclosures defines fair value, and establishes a framework for measuring the fair value of assets and liabilities using a hierarchy system and expands disclosures about fair value measurement. It clarifies that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the market in which the reporting entity transacts business.

The three-level valuation hierarchy for disclosure of fair value 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; or other inputs that are observable or can be corroborated by observable market data.
>
> Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Debt Securities Available-for-Sale

Fair values for debt securities available-for-sale are based on quoted market prices, if available, and are classified within Level 1 of the valuation hierarchy. For those debt securities available-for-sale where quoted prices are unavailable, fair values are calculated based on market prices of similar securities and, therefore, are classified as Level 2 within the valuation hierarchy.

Impaired Loans

The Company does not record loans at fair value on a recurring basis. However, from time to time, a loan is considered impaired and a specific reserve is established. The specific reserves for collateral dependent impaired loans are based on the fair value of the collateral less estimated costs to sell. The fair value of the collateral was determined based on appraisals. When significant adjustments were based on unobservable inputs, the resulting fair value measurement has been categorized as a Level 3 measurement.

Fair values of assets measured on a recurring basis at December 31, 2019 and 2018, are as follows:

		Fair Value Measurements at Reporting Date Using:		
	Fair Value	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
December 31, 2019				
Debt securities available-for-sale	$ 70,115,187	$ -	$ 70,115,187	$ -
December 31, 2018				
Debt securities available-for-sale	$ 43,098,718	$ -	$ 43,098,718	$ -

Fair values of assets measured on a non-recurring basis at December 31, 2019 and 2018, are as follows:

		Fair Value Measurements at Reporting Date Using:					
	Fair Value	Quoted Prices in Active Markets for Identical Items (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Valuation Technique	Unobservable input	Range (Weighted Avg.)
December 31, 2019							
Impaired loans	$ 1,324,012	$ -	$ -	$ 1,324,012	Collateral valuation	Discount from market value	5%-10%
December 31, 2018							
Impaired loans	$ 660,678	$ -	$ -	$ 660,678	Collateral valuation	Discount from market value	5%-10%

The following table presents quantitative information about recurring Level 3 fair value measurements at December 31, 2019 and 2018:

	2019	2018	Valuation Technique	Unobservable input	Range (Weighted Avg.)
Mortgage servicing rights	$ 2,097,312	$ 1,597,353	Discounted Cash Flows	Prepayment speeds Discount Rates	9.5% - 12.5%

The following is a reconciliation for Level 3 assets and liabilities measured on a recurring basis:

	Mortgage Servicing Rights	
	2019	2018
Beginning balance	$ 1,597,353	$ 1,408,340
Additions	791,966	444,671
Amortization	(292,007)	(255,658)
Ending balance	$ 2,097,312	$ 1,597,353

The estimated fair values, and related carrying amounts, of the Company's financial instruments are as follows:

	2019		2018	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and cash equivalents	$ 10,511,615	$ 10,511,615	$ 8,588,599	$ 8,588,599
Interest-bearing deposits in banks	6,615,000	6,615,000	6,370,000	6,484,513
Debt securities available-for-sale	70,115,187	70,115,187	43,098,718	43,098,718
Loans, net	231,790,937	230,821,120	227,345,470	226,525,418
Investments in restricted stock	10,191,000	10,191,000	8,893,200	8,893,200
Accrued interest receivable	2,111,041	2,111,041	2,105,006	2,105,006
Mortgage Servicing Rights	2,097,312	2,097,312	1,597,353	1,597,353
Financial liabilities:				
Deposits	288,175,116	288,558,894	259,451,875	259,616,553
Borrowings	21,483,461	21,367,424	21,068,942	20,408,601
Accrued interest payable	238,899	238,899	140,581	140,581
Subordinated debentures	6,186,000	6,186,000	6,186,000	6,186,000
Off-balance sheet financial instruments:				
Commitments to extend credit and standby letters of credit	47,259,781	47,259,781	45,603,040	45,603,040

The following methods and assumptions were used by the Company in estimating fair value disclosures for financial instruments:

Cash and cash equivalents and interest-bearing deposits in banks – The carrying value approximates their fair values.

Debt securities available-for-sale and restricted stock – Fair values for debt securities are based on quoted market prices or whose value is determined using discounted cash flow methodologies, except for restricted stock for which fair value is assumed to equal cost.

Loans – The fair values for loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms and credit quality.

Accrued interest receivable – The carrying value approximates its fair value.

Mortgage Servicing Rights – Fair values are estimated using discounted cash flows based on current market rates of interest.

Deposit – The fair values disclosed for demand deposits (for example, interest and noninterest checking, passbook savings, and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The carrying amounts of variable-rate, fixed-term money market accounts and certificates of deposit approximate their fair values at the reporting date. Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings – The carrying amounts of federal funds purchased and repurchase agreements approximate their fair values. Federal Home Loan Bank Advances use current market rates for debt with similar terms and remaining maturities are used to estimate fair value of existing debt. Fair value of the Bank stock loan is based on quoted market prices or dealer quotes for the identical liability when traded as an asset in an active market. If a quoted market price is not available, an expected present value technique is used to estimate fair value.

Junior Subordinated Debentures – Fair values for subordinated debentures is equal to the carrying value due to the interest rate being adjust quarterly.

Accrued interest payable – The carrying value approximates the fair value.

Off-balance sheet instruments – Fair values for the Company's off-statement-of-financial-condition instruments (unused lines of credit and letters of credit), which are based upon fees currently charged to enter into similar agreements taking into account the remaining terms of the agreements and counterparties' credit standing, are not significant. Many of the Company's off-balance sheet instruments, primarily loan commitments and standby letters of credit, are expected to expire without being drawn upon; therefore, the commitment amounts do not necessarily represent future cash requirements.