# FIRST FEDERAL BANCORP, MHC

## Parent Company for
## First Federal Bank

## Audited Consolidated Financial Statements

## As of December 31, 2019 and 2018 and
## For the Years then Ended

## (Together with Independent Auditors' Report)

HACKER, JOHNSON & SMITH PA

Fort Lauderdale
Orlando
Tampa

Certified Public Accountants

# Independent Auditors' Report

The Board of Directors
First Federal Bancorp, MHC
Lake City, Florida:

We have audited the accompanying consolidated financial statements of First Federal Bancorp, MHC and Subsidiaries (the "Company"), which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of earnings, comprehensive income, equity and cash flows for the years then ended, and the related notes to 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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. 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 the Company as of December 31, 2019 and 2018, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Other Matters*

We also have audited, in accordance with auditing standards generally accepted in the United States of America, the Company's internal control over financial reporting as of December 31, 2019, based on criteria established in Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 27, 2020 expressed an unmodified opinion.

Hacker, Johnson & Smith PA

HACKER, JOHNSON & SMITH PA
Tampa, Florida
March 27, 2020

## FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

### Consolidated Balance Sheets
**(In thousands)**

| | At December 31, 2019 | 2018 |
|---|---|---|
| **Assets** | | |
| Cash and due from banks | $ 28,829 | 40,041 |
| Interest-bearing deposits with banks | 63,828 | 103,395 |
| Total cash and cash equivalents | 92,657 | 143,436 |
| Restricted cash | 50,000 | - |
| Time deposits. | 18,034 | 19,521 |
| Debt securities available for sale | 492,012 | 416,213 |
| Loans held for sale, net | 230,262 | 101,846 |
| Loans, net of allowance for loan losses of $5,929 and $5,457 | 1,006,406 | 949,965 |
| Accrued interest receivable | 6,925 | 6,952 |
| Premise and equipment, net | 39,804 | 34,707 |
| Right of Use lease asset | 1,442 | - |
| Federal Home Loan Bank stock, at cost | 4,717 | 2,001 |
| Foreclosed real estate | 1,486 | 2,706 |
| Income taxes receivable | 586 | 1,097 |
| Cash surrender value of bank-owned life insurance | 35,747 | 34,970 |
| Loan servicing rights, net | 44,464 | 45,817 |
| Goodwill | 28,965 | 28,235 |
| Other assets | 124,183 | 50,744 |
| Total | $ 2,177,690 | 1,838,210 |
| **Liabilities and Equity** | | |
| Liabilities: | | |
| Noninterest-bearing demand deposits | 532,545 | 355,273 |
| Interest bearing checking and money-market deposits | 855,589 | 728,955 |
| Savings deposits | 76,691 | 78,111 |
| Time deposits | 322,993 | 380,621 |
| Total deposits | 1,787,818 | 1,542,960 |
| Federal Home Loan Bank advances | 72,500 | 5,000 |
| Junior Subordinated Debt | 5,885 | 5,801 |
| Other borrowings | 30,100 | 30,100 |
| Operating lease liabilities | 1,448 | - |
| Deferred income taxes | 7,074 | 6,326 |
| Other liabilities | 37,736 | 42,826 |
| Total liabilities | 1,942,561 | 1,633,013 |
| Commitments and contingencies (Notes 8, 14, 19 and 20) | | |
| Equity: | | |
| Retained earnings | 230,647 | 205,169 |
| Accumulated other comprehensive income | 4,482 | 28 |
| Total equity | 235,129 | 205,197 |
| Total | $ 2,177,690 | 1,838,210 |

See accompanying Notes to Consolidated Financial Statements

## FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

### Consolidated Statements of Earnings
**(In thousands)**

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Interest income: | | |
| Loans | $ 60,259 | 54,347 |
| Debt securities | 14,380 | 12,295 |
| Other | 3,296 | 2,026 |
| Total interest income | 77,935 | 68,668 |
| Interest expense: | | |
| Deposits | 11,160 | 8,487 |
| Junior subordinated debt | 340 | 246 |
| Other borrowings | 3,510 | 1,255 |
| Total interest expense | 15,010 | 9,988 |
| Net interest income | 62,925 | 58,680 |
| Provision for loan losses | 691 | 617 |
| Net interest income after provision for loan losses | 62,234 | 58,063 |
| Noninterest income: | | |
| Loan servicing fees | 9,031 | 7,611 |
| Servicing rights retained from loans sold | (854) | 5,081 |
| Mortgage banking revenue | 27,036 | 19,525 |
| Service charges on deposit accounts | 4,017 | 3,784 |
| Other service charges and fees | 4,049 | 3,566 |
| Gain on sale of debt securities available for sale | 4,539 | 2,495 |
| Income from bank-owned life insurance | 777 | 585 |
| Debit card interchange income | 4,158 | 3,622 |
| Other | 966 | 51 |
| Total noninterest income | 53,719 | 46,320 |
| Noninterest expense: | | |
| Salaries and employee benefits | 58,590 | 47,681 |
| Occupancy and equipment | 10,217 | 8,633 |
| Professional fees | 2,352 | 2,838 |
| Other expenses | 11,882 | 16,688 |
| Total noninterest expense | 83,041 | 75,840 |
| Earnings before income taxes | 32,912 | 28,543 |
| Income tax expense | 7,434 | 5,253 |
| Net earnings | $ 25,478 | 23,290 |

See accompanying Notes to Consolidated Financial Statements

## FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

### Consolidated Statements of Comprehensive Income
**(In thousands)**

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Net earnings | $ 25,478 | 23,290 |
| Other comprehensive income (loss): | | |
| Change in unrealized gain on debt securities available for sale: | | |
| Unrealized gain (loss) arising during the year | 10,334 | (4,641) |
| Reclassification adjustment for realized gains | (4,539) | (2,495) |
| Reclassification adjustment for other-than-temporary impairment losses recognized | 28 | 88 |
| Net change in unrealized gain | 5,823 | (7,048) |
| Net change in fair value of cash flow hedges | (20) | - |
| Deferred income tax (expense) benefit on above change | (1,349) | 1,785 |
| Total other comprehensive income (loss) | 4,454 | (5,263) |
| Comprehensive income | $ 29,932 | 18,027 |

See accompanying Notes to Consolidated Financial Statements

## FIRST FEDERAL BANCORP, MHC AND SUBSIDIARIES

## Consolidated Statements of Equity

### Years Ended December 31, 2019 and 2018
**(In thousands)**

| | Retained Earnings | Accumulated Other Compre-hensive Income | Total |
|---|---|---|---|
| Balance at December 31, 2017 | $ 181,879 | 5,291 | 187,170 |
| Net earnings | 23,290 | - | 23,290 |
| Net change in unrealized gain on debt securities available for sale, net of income tax benefit of $1,785 | - | (5,263) | (5,263) |
| Balance at December 31, 2018 | 205,169 | 28 | 205,197 |
| Net earnings | 25,478 | - | 25,478 |
| Net change in unrealized gain on debt securities available for sale, net of income taxes of $1,354 | - | 4,469 | 4,469 |
| Net change in unrealized loss on derivative instrument, net of income tax benefit of $5 | - | (15) | (15) |
| Balance at December 31, 2019 | $ 230,647 | 4,482 | 235,129 |

See accompanying Notes to Consolidated Financial Statements

## Consolidated Statements of Cash Flows
**(In thousands)**

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net earnings | $ 25,478 | 23,290 |
| Adjustments to reconcile net earnings to net cash (used in) provided by operating activities: | | |
| Provision for loan losses | 691 | 617 |
| Depreciation and amortization | 2,214 | 2,010 |
| Deferred income tax (benefit) expense | (601) | 676 |
| Net amortization of premiums and discounts on debt securities | 3,915 | 4,419 |
| Net amortization of deferred loan fees | (732) | (1,772) |
| Loss on sale of premise and equipment | 213 | 27 |
| Gain on sale of debt securities available for sale | (4,539) | (2,495) |
| Other than temporary impairment of debt securities | 28 | 88 |
| Net loss on sale of foreclosed real estate | 31 | 2 |
| Write-down of foreclosed real estate | 51 | 250 |
| Origination of loans held for sale, net | (2,842,924) | (1,914,014) |
| Proceeds from sale of loans held for sale and loan securitizations | 2,741,544 | 1,948,727 |
| Mortgage banking revenue | (27,036) | (19,525) |
| Income from bank-owned life insurance | (777) | (585) |
| Decrease in accrued interest receivable | 27 | 1,702 |
| Net decrease (increase) in mortgage servicing rights | 1,353 | (5,137) |
| (Increase) decrease in other assets | (73,444) | 14,420 |
| Net increase in goodwill | (730) | - |
| Net amortization of operating leases | 6 | - |
| Decrease in income tax receivable | 511 | 1,238 |
| (Decrease) increase in other liabilities | (5,110) | 10,336 |
| Net cash (used in) provided by operating activities | (179,831) | 64,274 |
| Cash flows from investing activities: | | |
| Purchases of debt securities available for sale | (376,539) | (165,524) |
| Principal repayments of debt securities available for sale | 62,857 | 53,000 |
| Maturities and calls of debt securities available for sale | 82,689 | 46,085 |
| Net proceeds from sales of debt securities available for sale | 161,613 | 132,185 |
| Principal repayments of debt securities held to maturity | 5 | 83 |
| Purchase of time deposits | - | (13,051) |
| Proceeds from sale of time deposits | - | 12,450 |
| Maturities of time deposits | 1,487 | 3,037 |
| Net (increase) decrease in loans | (57,604) | 80,617 |
| Purchases of premise and equipment, net | (8,911) | (2,949) |
| Proceeds from sale of premise and equipment, net | 1,387 | 1,239 |
| Proceeds from sale of foreclosed real estate | 2,342 | 555 |
| (Purchase) redemption of Federal Home Loan Bank stock | (2,716) | 892 |
| Purchase of BOLI | - | (3,007) |
| Business acquisitions, net of cash received | - | (75,846) |
| Net cash (used in) provided by investing activities | (133,390) | 69,766 |
| Cash flows from financing activities: | | |
| Increase (decrease) in deposits | 244,858 | (8,710) |
| Increase (decrease) in Federal Home Loan Bank advances | 67,500 | (62,200) |
| Increase in other borrowings | 84 | 22,496 |
| Net cash provided by (used in) financing activities | 312,442 | (48,414) |
| Net (decrease) increase in cash, cash equivalents and restricted cash | (779) | 85,626 |
| Cash, cash equivalents and restricted cash at beginning of year | 143,436 | 57,810 |
| Cash, cash equivalents and restricted cash at end of year | $ 142,657 | 143,436 |

(continued)

## Consolidated Statements of Cash Flows, Continued

**(In thousands)**

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Cash paid during the year for: | | |
| Income taxes | $ 7,505 | 3,747 |
| Interest | $ 14,948 | 9,743 |
| Noncash transactions: | | |
| Loans transferred to foreclosed real estate | $ 1,204 | 381 |
| Capitalized servicing rights | $ 1,080 | 4,701 |
| Right of Use lease asset obtained in exchange for operating lease liabilities | $ 1,983 | - |
| Net change in unrealized gain on debt securities available for sale, net of taxes | $ 4,469 | (5,263) |
| Net change in unrealized loss on derivative instruments, net of taxes | $ (15) | - |
| Noncash assets acquired and liabilities assumed: | | |
| Debt securities available for sale | $ - | 29,966 |
| Loans held for sale | $ - | 87,887 |
| Loans, net | $ - | 375,323 |
| Accrued interest receivable | $ - | 1,389 |
| Premise and equipment | $ - | 11,020 |
| Foreclosed real estate | $ - | 2,826 |
| Cash surrender value of bank-owned life insurance | $ - | 2,464 |
| Servicing rights | $ - | 2,244 |
| Goodwill | $ - | 26,507 |
| Other assets | $ - | 17,726 |
| Deposits | $ - | 431,249 |
| Federal Home Loan Bank advances | $ - | 24,700 |
| Junior subordinated debt | $ - | 5,738 |
| Other borrowings | $ - | 7,667 |
| Other liabilities | $ - | 12,152 |

See accompanying Notes to Consolidated Financial Statements

## (1) Organization and Summary of Significant Accounting Principles

***Organization.*** First Federal Bancorp, MHC is a federally-chartered, mutual holding company. The Company through its subsidiary First Federal Bancorp, Inc. (a federal corporation) ("FFBI") owns First Federal Bank (the "Bank" or "First Federal") which serves its customers through 26 branches across Florida and South Carolina. The Bank has three loan production offices located in Florida, Georgia and Wisconsin. Lines of business include a mortgage processing company, wholesale lending, Small Business Administration ("SBA") and U.S. Department of Agriculture ("USDA") lending, warehouse lending, consumer direct lending and manufactured housing lending. The Bank's deposits are insured up to the applicable limits by the Federal Deposit Insurance Corporation ("FDIC"). On April 2, 2018 the Company acquired and merged Coastal Banking Co., Inc. ("CBC") into First Federal.

The accounting and reporting policies of the Company conform to accounting principles generally accepted in the United States of America ("GAAP"). The following summarizes the more significant of these policies and practices:

***Subsequent Events.*** Management has evaluated all significant events occurring subsequent to the balance sheet date through March 27, 2020, which is the date the consolidated financial statements were available to be issued, determining no events require additional disclosure in the consolidated financial statements.

***Principles of Consolidation.*** The consolidated financial statements include the accounts of First Federal Bancorp, MHC and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

***Estimates.*** The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in its near term relate to the determination of whether a security is other-than-temporarily impaired, the allowance for loan losses, and the estimated fair value of the tangible assets and identifiable assets acquired, and liabilities assumed.

***Acquisition Method of Accounting.*** The Company accounts for acquisitions using the acquisition method of accounting. The acquisition method of accounting requires the Company to estimate the fair value of the tangible assets and identifiable assets acquired, and liabilities assumed. These estimated fair values are based on available information and current economic conditions at the date of acquisition. Fair value may be obtained from independent appraisers, discounted cash flow present value techniques, management valuation models, quoted prices on national markets or quoted market prices from brokers. These fair value estimates will affect future earnings through the disposition or amortization of the underlying assets and liabilities.

(continued)

**(1) Organization and Summary of Significant Accounting Policies, Continued**

***Acquisition Method of Accounting, Continued.*** Accounting for business combination under GAAP prohibits "carrying over" valuation allowances, such as the allowance for loan losses. Uncertainties relating to the expected future cash flows are reflected in the fair value measurement of the acquired loans and reflected in the purchase price. The Company will establish loan loss allowances for the acquired loans in periods after the acquisition, but only for losses incurred on these loans due to credit deterioration after acquisition.

***Purchase Credit-Impaired Loans.*** As part of the business acquisition, the Company acquired loans, some of which have shown evidence of credit deterioration since origination. These purchase credit-impaired ("PCI") loans were determined to be credit impaired based on borrower payment history, past due status, loan credit grading, value of underlying collateral and other factors that affect the collectability of contractual cash flows. Under GAAP, loans acquired in the same fiscal quarter may be assembled into one or more pools with common characteristics. Once pooled, a single composite interest rate is used to determine aggregate expected cash flows for the pool.

As a result of the Company's 2018 acquisition, the Company engaged a third party to evaluate 50 PCI loans. The company estimated the amount and timing of expected cash flows for each individually analyzed loan. Estimated cash flows in excess of the amount paid was recorded as interest income over the remaining life of the loan. On a quarterly basis, the Company has updated the amount of loan principal and interest cash flows expected to be collected, incorporating assumptions regarding default rates, loss severities, the amounts and timing of prepayments and other factors that are reflective of current market conditions. Probable decreases in expected loan principal cash flows trigger recognition of impairment, which is then measured as the present value of the expected principal loss plus any related foregone interest cash flows discounted at the loan's effective interest rate. Impairments that have occurred after the acquisition date have been recognized through the allowance for loan losses; any remaining increases have been recognized prospectively as adjustments to interest income. Disposals of loans, which may include sale of loans, receipt of payments in full by the borrower, or foreclosures, result in the removal of the loan from the PCI portfolio.

***Cash and Cash Equivalents.*** For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash, due from banks and interest-earning deposits with banks, all of which have original maturities of less than ninety days.

The Company may be required under Federal Reserve Board regulations to maintain reserves, generally consisting of cash, interest-bearing deposits with the Federal Reserve Bank or noninterest-earning accounts with qualifying banks, against its transaction accounts. Required reserves were $11.6 million and $8.4 million at December 31, 2019 and 2018, respectively.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Debt Securities.*** The Company may classify its debt securities as either trading, held to maturity or available for sale. Trading debt securities are held principally for resale and recorded at their fair values. Unrealized gains and losses on trading debt securities are included immediately in earnings. Held-to-maturity debt securities are those which the Company has the positive intent and ability to hold to maturity and are reported at amortized cost. Available-for-sale debt securities consist of debt securities not classified as trading debt securities nor as held-to-maturity debt securities. Unrealized holding gains and unrealized losses, net of tax, on available-for-sale debt securities are excluded from earnings and reported in accumulated other comprehensive income. Gains and losses on the sale of debt securities are determined using the specific-identification method. Premiums and discounts on debt securities available for sale and held to maturity are recognized in interest income using the interest method over the period to maturity.

The Company assess individual debt securities in its investment portfolio for impairment at least on a quarterly basis, and more frequently when economic or market conditions warrant such an evaluation. An investment is impaired if the fair value of the debt security is less than its carrying value at the consolidated financial statement date. When a debt security is impaired, the Company then determines whether this impairment is temporary or other-than-temporary. In estimating other-than-temporary impairment (“OTTI”) losses, management assesses whether it intends to sell, or it is more likely than not it will be required to sell, a debt security in an unrealized loss position before recovery of its amortized cost basis. If either of these criteria is met, the entire difference between amortized cost and fair value is recognized in earnings. For debt securities that do not meet the aforementioned criteria, the amount of impairment recognized in earnings is limited to the amount related to credit losses, while impairment related to other factors is recognized in accumulated other comprehensive income. Management utilizes cash flow models to segregate impairments to distinguish between impairment related to credit losses and impairment related to other factors.

To assess for OTTI, management considers, among other things, (i) the severity and duration of the impairment; (ii) the ratings of the debt security; (iii) the overall transaction structure (the Company’s position within the structure, the aggregate, near-term financial performance of the underlying collateral, delinquencies, defaults, loss severities, recoveries, prepayments, cumulative loss projections, and discounted cash flows); and (iv) the timing and magnitude of a break in modeled cash flows.

***Loans Held for Sale, Net.*** Mortgage loans originated and intended for sale in the secondary market are carried at fair value in the aggregate. Net unrealized gains and (losses), if any, are recognized through a valuation allowance and are included in earnings.

***Loans.*** Loans are reported at their outstanding principal adjusted for any charge-offs, the allowance for loan losses, and any deferred fees or costs.

Loan origination fees are deferred, and certain direct origination costs are capitalized. Both are recognized as an adjustment of the yield of the related loan.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Loans, Continued.*** The accrual of interest on all portfolio classes is discontinued at the time the loan is ninety days delinquent unless the loan is well collateralized and in process of collection. Guaranteed loans that are 90+ days past due and accruing are well secured by guarantees from the U.S. Government and are in the process of collection or being rehabilitated to be held for sale. Guarantees cover the principal basis in these loans and interest will be paid by the guarantor through the claim payment date. Loans which are guaranteed through U.S. Government programs that are in the process of foreclosure are placed on nonaccrual as recovery of the contract interest is no longer covered by the guarantee. Generally, claims on guaranteed student loans cannot be filed until the loan has been delinquent more than 270 days. In all cases, loans are placed on nonaccrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on nonaccrual or charged-off is reversed against interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

***Allowances for Loan Losses.*** The allowance for loan losses is established as losses are estimated to have occurred through a credit 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. There were no changes in the Company's accounting policies or methodology during the years ended December 31, 2019 and 2018.

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 specific and general components. The specific component relates to loans that are classified as impaired. For such loans, an allowance is established when the discounted cash flows or the collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers nonimpaired and is based on historical loss experience, adjusted for qualitative factors.

The historical loss component of the allowance is determined by losses recognized by portfolio segment over the preceding two years. This is supplemented by the risks for each portfolio segment. Risk factors impacting loans in each of the portfolio segments include any deterioration of property values, reduced consumer and business spending as a result of unemployment and reduced credit availability and lack of confidence in the economy. The historical experience is adjusted for qualitative factors including, economic conditions, industry specific factors, portfolio and other trends or uncertainties that could affect management's estimate of probable losses.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Allowances for Loan Losses, Continued.*** 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. 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 for all loans 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.

***Servicing.*** Servicing assets are recognized as separate assets when rights are acquired through purchase or through sale of financial assets. Capitalized servicing rights are amortized in proportion to, and over the period of, the estimated future net servicing income of the underlying financial assets. Prior to 2014, the Company recorded servicing assets based on the lower of cost or market. Beginning in 2014, the Company began recording servicing assets at fair value. With the acquisition of CBC, the Company assumed SBA servicing assets. The Company has chosen to account for these servicing rights under the lower of cost or market method. Servicing assets are evaluated for impairment based upon the fair value of the rights compared to amortized cost. Impairment is determined by stratifying rights by predominant characteristics, such as interest rates and terms. Fair value is determined using prices for similar assets with similar characteristics, when available, or based upon discounted cash flows using market-based assumptions. Impairment is recognized through a valuation allowance for an individual stratum, to the extent that fair value is less than the capitalized amount for the stratum. At December 31, 2019 and 2018, all impairment of servicing assets has been recognized.

***Premises and Equipment.*** Land is carried at cost. Building and improvements and furniture and equipment are carried at cost less accumulated depreciation and amortization computed using the straight-line and accelerated methods over the estimated life of the assets. Interest costs are capitalized in connection with the construction of new banking offices.

***Foreclosed Real Estate.*** Real estate acquired through, or in lieu of, foreclosure, is initially recorded at fair value less selling costs establishing a new cost basis. After foreclosure, valuations are periodically performed by management and the foreclosed real estate is carried at the lower of the new cost basis or fair value less selling costs. Revenue and expenses from operations and changes in the valuation allowance are included in earnings.

(continued)

## (1) Organization and Summary of Significant Accounting Principles, Continued

***Goodwill and Core Deposit Intangibles.*** Goodwill represents the excess of the acquisition cost over the fair value of the net assets acquired in acquisition. GAAP requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances and written down when impaired. Management has internally evaluated goodwill in accordance with GAAP and determined, based on a qualitative assessment, that it is not more-likely-than-not that the fair value of the reporting unit is less than its carrying value as of December 31, 2019 and 2018 and therefore has determined that there was no impairment of goodwill during the years ended December 31, 2019 and 2018. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings. As of December 31, 2019 and 2018, the Company had goodwill in the amount of $29.0 million and $28.2 million, respectively.

Upon completion of an acquisition the Company is permitted one year to assess the various aspects of the recording of the acquisition and adjust goodwill accordingly. As of April 2, 2019, the Company has completed its review and adjusted goodwill by $730,000.

The core deposit intangibles ("CDI") are intangible assets arising from either branch acquisitions or whole bank acquisitions. CDI are initially measured at fair value and then amortized up to ten years on a straight-line basis using projected decay rates of the underlying core deposits. The principal factors considered when valuing the CDI consist of the following: (1) the rate and maturity structure of the interest bearing liabilities, (2) estimated retention rates for each deposit liability category, (3) the current interest rate environment and (4) estimated noninterest income potential of the acquired relationship. The CDI is evaluated periodically for impairment. As of December 31, 2019, the Company determined the CDI was not impaired.

The Company's CDI is as follows (dollars in thousands):

| Acquisition | Core Deposit Intangible Acquired | Period of Amortization | Amortization Recognized in 2019 | Amortization Recognized in 2018 | Remaining Core Deposit Intangible at December 31, 2019 | Remaining Core Deposit Intangible at December 31, 2018 |
|---|---|---|---|---|---|---|
| CBC Bank | $ 6,453 | 69 months | $ 1,207 | 732 | $ 4,514 | 5,721 |

The CDI was included in Other Assets in the accompanying consolidated balance sheets.

The future expected amortization of CDI with determinable useful lives as of December 31, 2019 is as follows (in thousands):

| Year Ending December 31, | Amount |
|---|---|
| 2020 | $ 1,138 |
| 2021 | 1,138 |
| 2022 | 1,138 |
| 2023 | 1,100 |
| | $ 4,514 |

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Junior Subordinated Debt.*** With the acquisition of CBC, the Company assumed two Trust Preferred Securities. Coastal Banking Company Statutory Trust I ("Trust I") is a non-consolidated subsidiary issued in May 2004 with a maturity date of July 23, 2034. The Trust used the proceeds from the sale of its Trust Preferred Securities and from the issuance of the common interests in the Trust to acquire Junior Subordinated Debt (the "Debenture") issued by the CBC. The debenture balance of $3,093,000 was valued at $2,584,835 at acquisition date. The debenture carries a floating rate equal to the 3-month LIBOR plus 2.75%, adjusted quarterly. Coastal Banking Company Statutory Trust II ("Trust II") is a non-consolidated subsidiary issued in June 2006 with a maturity date of September 30, 2036. The debenture balance of $4,124,000 was valued at $2,935,914 at acquisition date. The debenture carries a floating rate equal to the 3-month LIBOR plus 1.60%, adjusted quarterly.

All of the common securities of Trust I and Trust II are owned by the Company.

***Transfer of Financial Assets.*** Transfers of financial assets or a participating interest in an entire financial asset 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. A participating interest is a portion of an entire financial asset that (1) conveys proportionate ownership rights with equal priority to each participating interest holder (2) involves no recourse (other than standard representations and warranties) to, or subordination by, any participating interest holder, and (3) does not entitle any participating interest holder to receive cash before any other participating interest holder.

***Mortgage Banking Revenue.*** Mortgage banking revenue includes gains on the sale of loans originated for sale, gains on the sale of loans originated for securitization by third parties and the fair market value adjustment on loans held for sale. The Company recognized mortgage banking revenue from mortgage loans originated and securitized in the consolidated statements of earnings upon sale of the loans.

***Income Taxes.*** There are two components of income taxes: current and deferred. Current income taxes reflect taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred income taxes result from changes in deferred tax assets and liabilities between periods.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Income Taxes, Continued.*** Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax that has a greater than 50 percent likelihood of being realized upon settlement with a taxing authority that has full knowledge of all relevant information. The determination of whether or not a tax position has met the more-likely-than-not recognition threshold considers the taxes, circumstances, and information available at the reporting date and is subject to management's judgment. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized. As of December 31, 2019, management is not aware of any uncertain tax positions that would have a material effect on the Company's consolidated financial statements.

The Company recognizes interest and penalties on income taxes if any as a component of income tax expense.

The Holding Company and the Bank file consolidated income tax returns. Income taxes are allocated proportionately to the Holding Company and the Bank as though separate income tax returns were filed.

***Off-Balance-Sheet Financial Instruments.*** In the ordinary course of business, the Company has entered into off-balance-sheet financial instruments consisting of unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they are funded.

***Derivative Financial Instruments.*** Derivative financial instruments are recognized as assets or liabilities in the accompanying consolidated balance sheets and measured at fair value.

***Interest-Rate Swap Agreements.*** For asset/liability management purposes, the Company uses interest-rate swap agreements to hedge various exposures or to modify interest-rate characteristics of various balance sheet accounts. Such derivatives are used as part of the asset/liability management process and are linked to specific assets or liabilities and have high correlation between the contract and the underlying item being hedged, both at inception and throughout the hedge period.

The Company used an interest-rate swap agreement to convert a portion of its variable-rate debt to a fixed rate (cash flow hedge). Interest-rate swaps are contracts in which a series of interest rate flows are exchanged over a prescribed period. The notional amount on which the interest payments are based is not exchanged.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Interest-Rate Swap Agreements, Continued.*** Interest-rate derivative financial instruments receive hedge accounting treatment only if they are designated as a hedge and are expected to be, and are, effective in substantially reducing interest- rate risk arising from the assets and liabilities identified as exposing the Company to risk. Those derivative financial instruments that do not meet the hedging criteria discussed below would be classified as trading activities and would be recorded at fair value with changes in fair value recorded in earnings. Derivative hedge contracts must meet specific effectiveness tests (i.e., over time the change in their fair values due to the designated hedge risk must be within 80 to 125 percent of the opposite change in the fair values of the hedged assets or liabilities). Changes in fair value of the derivative financial instruments must be effective at offsetting changes in the fair value of the hedged items due to the designated hedge risk during the term of the hedge. Further, if the underlying financial instrument differs from the hedged asset or liability, there must be a clear economic relationship between the prices of the two financial instruments. If periodic assessment indicates derivatives no longer provide an effective hedge, the derivatives contracts would be closed out and settled or classified as a trading activity.

Hedges of variable-rate debt are accounted for as cash flow hedges, with changes in fair value recorded in derivative assets or liabilities and other comprehensive income (loss). The net settlement (upon close out or termination) that offsets changes in the value of the hedged debt is deferred and amortized into net interest income over the life of the hedged debt. Hedges of fixed-rate liabilities are accounted for as fair value hedges, with changes in fair value recorded in derivative liabilities and interest income. The net settlement (upon close out or termination) that offsets changes in the value of the liabilities adjusts the basis of the liabilities and is deferred and amortized to interest income over the life of the liability. The portion, if any, of the net settlement amount that did not offset changes in the value of the hedged asset or liability is recognized immediately in noninterest income.

***Rate-Lock Commitments and Forward Loan Sale Contracts.*** The Company enters into commitments to originate loans whereby the interest-rate on the loan is determined prior to funding (rate-lock commitments). Rate-lock commitments on mortgage loans that are intended to be sold are considered to be derivatives. Accordingly, such commitments, along with any related fees received from potential borrowers, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in the net gain or loss on sale of mortgage loans. Fair value is based on fees currently charged to enter into similar agreements, and for fixed-rate commitments, the difference between current levels of interest rates and the committed rates is also considered.

The Company utilizes forward loan sale contracts to mitigate the interest-rate risk inherent in the Company’s mortgage loan pipeline or rate-lock commitments and held-for-sale portfolio. Forward loan sale contracts are contracts for future delivery of mortgage loans. The Company agrees to deliver on a specified future date, a specified amount of loans, at a specified price or yield. However, the contract may allow for cash settlement.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Rate-Lock Commitments and Forward Loan Sale Contracts, Continued.*** The credit risk inherent to the Company arises from the potential inability of counterparties to meet the terms of their contracts. In the event of nonacceptance by the counterparty, the Company would be subject to the credit risk of the loans retained. Such contracts are accounted for as derivatives and, along with related fees paid to investors, are recorded at fair value in derivative assets or liabilities, with changes in fair value recorded in mortgage banking revenue. Fair value is based on the estimated amounts that the Company would receive or pay to terminate the commitment at the reporting date.

***Fair Value Measurements.*** Fair value is the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The fair value hierarchy requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The hierarchy describes three levels of inputs that may be used to measure fair value:

Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities that are not active; and model-driven valuations whose inputs are observable or whose significant value drivers are observable. Valuations may be obtained from, or corroborated by, third-party pricing services.

Level 3: Unobservable inputs to measure fair value of assets and liabilities for which there is little, if any market activity at the measurement date, using reasonable inputs and assumptions based upon the best information at the time, to the extent that inputs are available without undue cost and effort.

The following describes valuation methodologies used for assets and liabilities measured at fair value.

***Debt Securities Available for Sale.*** Where quoted prices are available in an active market, debt securities are classified within Level 1 of the valuation hierarchy. Level 1 debt securities include highly liquid government bonds, certain mortgage products and exchange-traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include certain collateralized mortgage and debt obligations, U.S. Government agency bonds, corporate bonds, municipal bonds, and certain high-yield debt securities. In certain cases where there is limited activity or loss transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy. Debt securities classified within Level 3 include certain residual interests in securitizations and other less liquid securities.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Fair Value Measurements, Continued.***

***Derivatives.*** Exchange-traded derivatives that are valued using quoted prices are classified within Level 1 of the valuation hierarchy. However, few classes of derivative contracts are listed on an exchange; thus, the majority of the derivative positions are valued by the investment banker using their models and are classified within Level 2 of the valuation hierarchy. Derivatives that are valued based upon models with significant unobservable market parameters and that are normally traded less actively or have trade activity that is one way are classified within Level 3 of the valuation hierarchy and are also valued by the Company's investment banker. Such derivatives are rate-lock commitments or forward sales contracts.

***Impaired Loans.*** The Company's impaired loans are normally collateral dependent and, as such, are carried at the lower of the Company's net recorded investment in the loan or the estimated fair value of the collateral less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

***Loans Held for Sale, Net.*** Loans held for sale, net primarily consist of loans that are valued based on traded market prices of similar assets, a Level 2 measurement.

***Foreclosed Real Estate.*** The Company's foreclosed real estate is recorded at the lower of cost or fair value less estimated selling costs. Estimates of fair value are determined based on a variety of information, including the use of available appraisals, estimates of market value by licensed appraisers or local real estate brokers and the knowledge and experience of the Company's management related to values of properties in the Company's market areas. Management takes into consideration the type, location and occupancy of the property as well as current conditions in the area the property is located in assessing estimates of fair value. Accordingly, fair value estimates for impaired loans are classified as Level 3.

***Assets Acquired and Liabilities Assumed.*** The estimated fair values of the investment securities classified as available for sale were calculated utilizing Level 2 inputs. The Company reviewed the data and assumptions used in pricing the securities by its third-party provider to ensure the highest level of significant inputs are derived from market observable data.

***Servicing Rights.*** The fair value of servicing rights is based on a valuation model that calculated the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness. Servicing rights were valued using Level 3 inputs.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Fair Values of Financial Instruments.*** The following methods and assumptions were used by the Company in estimating fair values of financial instruments:

***Cash, Cash Equivalents and Restricted Cash.*** The carrying amounts of cash, cash equivalents and restricted cash approximate fair value.

***Time Deposits.*** The carrying amounts of time deposits approximate fair value.

***Debt Securities.*** Fair values for debt securities held to maturity and available for sale are based on the framework for measuring fair value.

***Loans Held for Sale, Net.*** The fair value of loans held for sale, net is based on the framework for measuring fair value.

***Loans.*** For variable-rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair values for fixed-rate mortgage loans (for example, fixed-rate one-to-four family residential) and consumer loans are estimated by discounting the estimated future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities. Fair values for impaired loans are based on the framework for measuring fair value.

***Accrued Interest Receivable.*** The carrying amount of accrued interest receivable approximates its fair value.

***Federal Home Loan Bank Stock.*** The stock is not publicly traded, and the estimated fair value is based on its redemption value.

***Servicing Rights.*** The fair value of servicing rights is based on the framework for measuring fair value.

***Deposits.*** The fair value estimated for demand deposits (e.g., interest and noninterest-bearing NOW accounts, passbook savings, and money-market accounts) is, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate time deposits are estimated using a discounted cash flow calculation that applies interest rates currently being offered on time deposits to a schedule of aggregate expected monthly time deposit maturities.

***Accrued Interest Payable.*** The carrying amount of accrued interest payable approximates its fair value.

***Federal Home Loan Bank ("FHLB") Advances.*** The fair value of FHLB Advances is estimated using discounted cash flow analysis based on the Company's current incremental borrowing rates for similar types of borrowings.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Fair Values of Financial Instruments, Continued.***

***Junior Subordinated Debt and Other Borrowings.*** The fair value of the Junior Subordinated Debt and other borrowings is estimated using discounted cash flow analysis based on current rates of similar debt.

***Derivative Financial Instruments.*** The fair value of derivative financial instruments is based on the framework for measuring fair value.

***Off-Balance Sheet Instruments.*** Fair values of off-balance sheet lending commitments are based on fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the counterparties' credit standings.

***Comprehensive Income.*** GAAP requires that recognized revenue, expenses, gains and losses be included in earnings. Although certain changes in consolidated assets and liabilities, such as unrealized gains and losses on available-for-sale debt securities and fair value adjustments on cash flow hedges, are reported as a separate component of the equity section of the consolidated balance sheet, such items along with net earnings, are components of comprehensive income.

The components of accumulated other comprehensive income are as follows (in thousands):

| | At December 31, | |
|---|---|---|
| | **2019** | **2018** |
| Net unrealized gain on debt securities available for sale | $ 5,859 | 36 |
| Net unrealized loss on fair value of cash flow hedges | (20) | - |
| Gross unrealized amount | 5,839 | 36 |
| Income tax expense | (1,357) | (8) |
| Net unrealized amount | $ 4,482 | 28 |

***Reclassifications.*** Certain amounts in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation.

(continued)

**(1) Organization and Summary of Significant Accounting Principles, Continued**

***Recent Pronouncements.*** In February 2016, the Financial Accounting Standards Board issued Accounting Standards Update ("ASU") No. 2016-02, *Leases (Topic 842)*. ASU 2016-02 is intended to improve financial reporting of leasing transactions by requiring organizations that lease assets to recognize assets and liabilities for the rights and obligations created by leases on the consolidated balance sheet. The Company adopted ASU 2016-02 on January 1, 2019. All of our leases at the adoption date were operating leases. The effect of this ASU increased total assets and total liabilities by $1,435,000, at the adoption date. During the year 2019, the Company entered into various other operating leases while existing leases expired or renewed. This resulted in an additional increase to total asset and liabilities of $548,000.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments-Credit Losses (Topic 326)*. The ASU requires the Company to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. The Company will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. The ASU requires enhanced disclosures to help investors and other consolidated financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an organization's portfolio.

These disclosures include qualitative and quantitative requirements that provide additional information about the amounts recorded in the consolidated financial statements. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. The ASU will take effect for fiscal years, and for interim periods within fiscal years, beginning after December 15, 2022 (as amended). Early adoption is permitted. The Company is in the process of determining the effect of the ASU on its consolidated financial statements.

***Recent Regulatory Developments***

***Community Bank Leverage Ratio***. During 2019, the federal banking agencies jointly issued a rule that provides for an optional, simplified measure of capital adequacy. The Agency established the community bank leverage ratio framework (CBLR framework) for qualifying community banking organizations. A qualifying community banking organization is defined as having less than $10 billion in total consolidated assets, a leverage ratio greater than 9%, off-balance sheet exposures of 25% or less of total consolidated assets, and trading assets and liabilities of 5% or less of total consolidated assets. Banks opting into the CBLR framework will not be required to calculate or report risk-based capital. The final rule became effective on January 1, 2020. The Company elected not to adopt CBLR framework.

(continued)

## (2) Business Combinations

***Acquisition of Coastal Banking Company, Inc. and Subsidiaries***. On April 2, 2018, pursuant to an Agreement and Plan of Merger entered into November 7, 2017, the Company completed its acquisition of Coast Banking Company, Inc. (CBC) and its wholly-owned subsidiary CBC National Bank. At the effective time of the Merger, the Company paid $21.50 per share in cash for each CBC common share and stock option outstanding in a transaction valued at $86.8 million. The Company acquired these assets and liabilities to expand its market presence in the Florida, Georgia, and South Carolina areas. The Company also gained residential, SBA, and USDA lending offices across Florida and multiple states. The Company incurred approximately $1 million in merger and acquisition related expenses recognized in the 2018 statement of earnings.

The following table summarizes the fair value of assets acquired and liabilities assumed on the date of acquisition, April 2, 2018.

| | | | |
|---|---|---|---|
| Cash and cash equivalents | $ 10,046 | Deposits | $ 431,249 |
| Debt securities available for sale | 29,966 | Federal Home Loan Bank Advances | 24,700 |
| Loans held for sale | 87,887 | Junior Subordinated Debt | 5,738 |
| Loans | 375,323 | Other borrowings | 7,667 |
| Accrued interest receivable | 1,389 | Other liabilities | 12,152 |
| Premise and equipment | 11,020 | | |
| Foreclosed real estate | 2,826 | Total liabilities assumed | 481,506 |
| Cash surrender value of bank-owned life insurance | 2,464 | | |
| Servicing rights | 2,244 | | |
| Goodwill | 26,507 | | |
| Other assets | 17,726 | | |
| Total assets acquired | 567,398 | Net assets acquired | $ 85,892 |

Results of operations for CBC prior to the acquisition date are not included in the consolidated statement of earnings for the year ended December 31, 2018. The following table presents unaudited financial information regarding the former CBC operations excluded from the consolidated statement of earnings prior to the date of acquisition:

| | Actual from January 31, 2018 through April 1, 2018 |
|---|---|
| Net interest income | $ 5,518 |
| Noninterest income | 5,512 |
| Net earnings | 1,357 |

The following table presents unaudited pro forma information as if the acquisition of CBC had occurred on January 1, 2018. The table does not consider the effect of expense savings created by the merger other than to exclude merger related expenses.

| | Unaudited pro forma information Year Ended December 31, 2018 |
|---|---|
| Net interest income | $ 64,198 |
| Noninterest income | 51,034 |
| Net earnings | 24,647 |

(continued)

## (2) Business Combinations, Continued

The tables above have been prepared for comparative purposes only and are not necessarily indicative of the actual results that would have been attained had the acquisition occurred as of the beginning of the periods presented, nor is it indicative of future results. Furthermore, the unaudited pro forma information does not reflect the Company's estimate of any revenue enhancing opportunities nor anticipated cost savings as a result of the integration and consolidation of the acquisition.

## (3) Debt Securities

Debt securities have been classified according to management's intention. The carrying amounts of debt securities and their fair value are summarized as follows (in thousands):

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| **Debt Securities Available for Sale:** | | | | |
| ***At December 31, 2019:*** | | | | |
| Corporate bonds | $ 1,000 | 12 | - | 1,012 |
| Municipal securities | 52,428 | 3,698 | (15) | 56,111 |
| Collateralized mortgage obligations | 159,186 | 2,695 | (389) | 161,492 |
| SBA pool securities | 51,263 | - | (577) | 50,686 |
| Asset-based securities | 64,335 | 167 | (562) | 63,940 |
| Mortgage-backed securities | 157,941 | 1,294 | (464) | 158,771 |
| | $ 486,153 | 7,866 | (2,007) | 492,012 |
| ***At December 31, 2018:*** | | | | |
| U.S Treasury | 46,465 | - | (15) | 46,450 |
| U.S. Government agency bonds | 729 | - | (18) | 711 |
| Municipal securities | 140,466 | 1,791 | (560) | 141,697 |
| Collateralized mortgage obligations | 76,022 | 594 | (736) | 75,880 |
| SBA pool securities | 78,741 | 80 | (539) | 78,282 |
| Asset-based securities | 19,105 | 20 | - | 19,125 |
| Mortgage-backed securities | 54,649 | 86 | (667) | 54,068 |
| | $ 416,177 | 2,571 | (2,535) | 416,213 |

The following summarizes sales of debt securities (in thousands):

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Proceeds | $ 161,613 | 132,185 |
| Gross gains | 4,815 | 2,921 |
| Gross losses | (276) | (426) |
| Net gain | $ 4,539 | 2,495 |

(continued)

**(3) Debt Securities, Continued**

The scheduled maturities of debt securities at December 31, 2019 are as follows (in thousands):

| | Amortized Cost | Fair Value |
|---|---|---|
| Due after one year through five years | $ 1,721 | 1,754 |
| Due after five years through ten years | 51,707 | 55,369 |
| Collateralized mortgage obligations | 159,186 | 161,492 |
| SBA pool securities | 51,263 | 50,686 |
| Asset-backed securities | 64,335 | 63,940 |
| Mortgage-backed securities | 157,941 | 158,771 |
| | $ 486,153 | 492,012 |

At December 31, 2019 and 2018, the Company pledged, as collateral for state and municipal deposits, debt securities with a carrying value of $43,337,000 and $147,096,000, respectively.

The Company's debt securities available for sale with gross unrealized losses aggregated by investment category and length of time that individual debt securities have been in a continuous loss position, is as follows (in thousands):

| | Less Than Twelve Months | | Over Twelve Months | |
|---|---|---|---|---|
| | Gross Unrealized Losses | Fair Value | Gross Unrealized Losses | Fair Value |
| *December 31, 2019:* | | | | |
| Municipal securities | $ (15) | 3,469 | - | - |
| Collateralized mortgage obligations | (306) | 58,480 | (83) | 6,420 |
| SBA pool securities | (59) | 11,366 | (518) | 39,320 |
| Asset-backed securities | (562) | 41,873 | - | - |
| Mortgage-backed securities | (429) | 89,990 | (35) | 10,423 |
| Total | $(1,371) | 205,178 | (636) | 56,163 |
| *December 31, 2018:* | | | | |
| U.S. Treasury bonds | (15) | 46,450 | - | - |
| U.S. Government agency bonds | - | - | (18) | 711 |
| Municipal securities | (289) | 45,255 | (271) | 16,295 |
| Collateralized mortgage obligations | (168) | 18,261 | (568) | 30,101 |
| SBA pool securities | (357) | 62,406 | (182) | 6,770 |
| Mortgage-backed securities | (92) | 23,561 | (575) | 13,391 |
| Total | $ (921) | 195,933 | (1,614) | 67,268 |

(continued)

## (3) Debt Securities, Continued

At December 31, 2019 and 2018, the unrealized losses on 56 and 84 investment debt securities available for sale, respectively, were caused by market conditions. It is expected that the securities would not be settled at a price less than the par value of the investments. Because the decline in fair value is attributable to changes in market conditions and not credit quality, and because the Company has the ability and intent to hold these investments until a market price recovery or maturity, these investments are not considered other-than-temporarily impaired.

The Company invests in residential Collateralized Mortgage Obligations ("CMO's") included in debt securities available for sale and corporate bonds held to maturity. Quarterly, management stress tests all CMO's and corporate bonds via a third-party resource that takes into account housing price appreciation (depreciation), interest rates, expected loss trends, both nationally and in geographic areas represented by the CMO and future cash flows of the corporate bonds. These stress tests are done, where data is available, at the individual loan level, opposed to using averages from services such as Bloomberg. If these stress tests indicate, on a present value basis, the Company will not receive the contracted cash flows; the Company makes an other-than-temporary impairment charge through the consolidated statements of earnings. Based on the lack of an active market and the results of the Company's continuing valuation of the underlying collateral and cash flows of these securities, these securities have been deemed as other-than-temporarily impaired. Based on current accounting policies, the portion of losses seemed as credit losses is charged against earnings and the portion deemed as noncredit losses is included in other comprehensive (loss) income. As of December 31, 2019, the Company's management does not intend to sell these securities, nor is it more likely that not that the Company will be required to sell the securities for liquidity or other reasons.

The following tables provide various information regarding the Company's debt securities deemed other-than-temporarily impaired (in thousands):

| | Year Ended December 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Impairment Losses | Fair Value | Impairment Losses | Fair Value |
| ***Debt Securities Available for Sale-*** | | | | |
| Collateralized mortgage obligations | $ 28 | 222 | 88 | 630 |

The Company will continue to evaluate the investment ratings in the securities portfolio, severity in pricing declines, market price quotes along with timing and receipt of amounts contractually due. Based upon these and other factors, the securities portfolio may experience further impairment.

(continued)

**(4) Loans**

The segments and classes of loans are summarized as follows (in thousands):

| | At December 31, 2019 | At December 31, 2018 |
|---|---|---|
| Real estate mortgage loans: | | |
| Commercial real estate | $ 326,478 | 322,642 |
| Residential real estate | 226,726 | 221,886 |
| Construction and land | 87,883 | 76,237 |
| Total real estate mortgage loans | 641,087 | 620,765 |
| Commercial loans: | | |
| Warehouse lines of credit | 180,294 | 132,906 |
| Other commercial | 60,366 | 66,961 |
| Total commercial loans | 240,660 | 199,867 |
| Consumer loans | 139,098 | 144,616 |
| Subtotal | 1,020,845 | 965,248 |
| Deduct (add): | | |
| Allowance for loan losses | 5,929 | 5,457 |
| Loan discount | 9,818 | 11,460 |
| Net deferred loan origination costs | (1,308) | (1,634) |
| Loans, net | $ 1,006,406 | 949,965 |

(continued)

## (4) Loans, Continued

An analysis of the change in the allowance for loan losses follows (in thousands):

| | Real Estate Mortgage Loans | Commercial Loans | Consumer Loans | Total |
|---|---|---|---|---|
| ***Year Ended December 31, 2019:*** | | | | |
| Beginning balance | $ 3,189 | 917 | 1,351 | 5,457 |
| Provision for loan losses | 395 | 113 | 183 | 691 |
| Charge-offs | (75) | - | (666) | (741) |
| Recoveries | 164 | 3 | 355 | 522 |
| Ending balance | $ 3,673 | 1,033 | 1,223 | 5,929 |
| ***Year Ended December 31, 2018:*** | | | | |
| Beginning balance | 2,984 | 893 | 1,558 | 5,435 |
| Provision for loan losses | 349 | 24 | 244 | 617 |
| Charge-offs | (337) | (2) | (601) | (940) |
| Recoveries | 193 | 2 | 150 | 345 |
| Ending balance | $ 3,189 | 917 | 1,351 | 5,457 |
| ***Year Ended December 31, 2019:*** | | | | |
| Balance in allowance for loan losses: | | | | |
| Individually evaluated for impairment | 148 | - | - | 148 |
| Loans acquired | - | - | - | - |
| Loans acquired with deteriorated credit quality | 23 | - | - | 23 |
| Collectively evaluated for impairment | 3,502 | 1,033 | 1,223 | 5,758 |
| Ending balance | $ 3,673 | 1,033 | 1,223 | 5,929 |
| Recorded investment: | | | | |
| Individually evaluated for impairment | 6,164 | 37 | 106 | 6,307 |
| Loans acquired | 213,359 | 3,919 | 11,549 | 228,827 |
| Loans acquired with deteriorated credit quality | 16,470 | 444 | - | 16,914 |
| Collectively evaluated for impairment | 405,094 | 236,260 | 127,443 | 768,797 |
| Ending balance | $ 641,087 | 240,660 | 139,098 | 1,020,845 |
| ***Year Ended December 31, 2018:*** | | | | |
| Balance in allowance for loan losses: | | | | |
| Individually evaluated for impairment | 218 | - | - | 218 |
| Loans acquired | - | - | - | - |
| Loans acquired with deteriorated credit quality | 14 | 3 | - | 17 |
| Collectively evaluated for impairment | 2,957 | 914 | 1,351 | 5,222 |
| Ending balance | $ 3,189 | 917 | 1,351 | 5,457 |
| Recorded investment: | | | | |
| Individually evaluated for impairment | 5,217 | 6 | 60 | 5,283 |
| Loans acquired | 268,298 | 7,983 | 16,121 | 292,402 |
| Loans acquired with deteriorated credit quality | 17,634 | 2,035 | - | 19,669 |
| Collectively evaluated for impairment | 329,616 | 189,843 | 128,435 | 647,894 |
| Ending balance | $ 620,765 | 199,867 | 144,616 | 965,248 |

(continued)

## (4) Loans, Continued

The Company has divided the loan portfolio into three portfolio segments, each with different risk characteristics and methodologies for assessing risk. All loans are underwritten based upon standards set forth in the policies approved by the Company's Board of Directors. The portfolio segments identified by the Company are as follows:

***Real Estate Mortgage Loans.*** Real estate mortgage loans are typically segmented into three classes: Commercial real estate, Residential real estate and Construction and Land. Commercial real estate loans are secured by the subject property and are approved based on standards that include, among other factors, loan to value limits, cash flow coverage and general creditworthiness of the obligors. Residential real estate loans are underwritten based on repayment capacity and source, value of the underlying property, credit history and stability. Construction loans to borrowers are to finance the construction of owner occupied and lease properties. These loans are categorized as construction loans during the construction period, later converting to commercial or residential real estate loans after the construction is complete and amortization of the loan begins. Construction loans are approved based on an analysis of the borrower and guarantor, the viability of the project and on an acceptable percentage of the appraised value of the property securing the loan. Construction loan funds are disbursed periodically based on the percentage of construction completed. The Company carefully monitors these loans with on-site inspections and requires the receipt of lien waivers on funds advanced. Construction loans are typically secured by the properties under development or construction, and personal guarantees are typically obtained. Further, to assure that reliance is not placed solely on the value of the underlying property, the financial condition and reputation of the borrower and guarantors, the amount of the borrower's equity in the project, independent appraisals, cost estimates and pre-construction sale information. The Company also makes loans on occasion for the purchase of land for future development by the borrower. Land loans are extended for the future development for either commercial or residential use by the borrower. The Company carefully analyzes the intended use of the property and the viability thereof.

***Commercial Loans.*** Commercial loans are segmented into two classes: warehouse lines of credit and other commercial loans. Warehouse lending provides a line of credit to mortgage bankers throughout the United States who use the lines to fund 1-4 family residential lending for sale within 90 days into the secondary market. Other commercial loans are primarily underwritten on the basis of the borrowers' ability to service such debt from income. The cash flows of borrowers, however, may not be as expected and the collateral securing these loans may fluctuate in value. As a general practice, the Company takes as collateral a security interest in mortgage loans, any available equipment, or other chattel, although loans may also be made on an unsecured basis. Collateralized working capital loans typically are secured by short-term assets whereas long-term loans are primarily secured by long-term assets.

(continued)

## (4) Loans, Continued

***Consumer Loans.*** Consumer loans are executed for various purposes, including purchases of automobiles, recreational vehicles, and boats. The Company also offers lines of credit, personal loans, and deposit account collateralized loans. Consumer loans include guaranteed student loans purchased at approximately 99% of principal balance outstanding and the principal balance of such loans is approximately 98% guaranteed by the U.S. Department of Education. Repayment of these loans is primarily dependent on the personal income of the borrowers, which can be impacted by economic conditions in their market areas such as unemployment levels. Loans to consumers are extended after a credit evaluation, including the creditworthiness of the borrower(s), the purpose of the credit, and the secondary source of repayment. Consumer loans are made at fixed and variable interest rates and may be made on terms of up to ten years. Risk is mitigated by the fact that the loans are of smaller individual amounts and spread over a large number of borrowers.

The following summarizes the loan credit quality (in thousands):

| | Real Estate Mortgage Loans | | | | | |
|---|---|---|---|---|---|---|
| | Commercial Real Estate | Residential Real Estate | Construction and Land | Commercial Loans | Consumer Loans | Total |
| ***Credit Risk Profile by Internally Assigned Grade:*** | | | | | | |
| ***At December 31, 2019:*** | | | | | | |
| Grade: | | | | | | |
| Pass | $ 304,910 | 222,639 | 87,341 | 239,513 | 138,586 | 992,989 |
| Special mention | 4,582 | 64 | - | 109 | - | 4,755 |
| Substandard | 16,986 | 4,023 | 542 | 1,038 | 512 | 23,101 |
| Total | $ 326,478 | 226,726 | 87,883 | 240,660 | 139,098 | 1,020,845 |
| ***At December 31, 2018:*** | | | | | | |
| Grade: | | | | | | |
| Pass | 295,584 | 218,501 | 76,163 | 197,513 | 144,061 | 931,822 |
| Special mention | 15,829 | 404 | - | 1,979 | 280 | 18,492 |
| Substandard | 11,229 | 2,981 | 74 | 375 | 275 | 14,934 |
| Total | $ 322,642 | 221,886 | 76,237 | 199,867 | 144,616 | 965,248 |

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, 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 includes nonhomogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on at least an annual basis.

(continued)

**(4) Loans, Continued**

Loans excluded from the review process above are generally classified as pass credits until: (a) they become past due; (b) management becomes aware of a deterioration in the credit worthiness of the borrower; or (c) the customer contacts the Company for a modification. In these circumstances, the loan is specifically evaluated for potential classification as to special mention, substandard or even charged-off. The Company uses the following definitions for risk ratings:

**Pass –** A Pass loan's primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary.

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

**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. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected.

**Doubtful –** A loan classified Doubtful has all the weaknesses inherent in one classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

**Loss –** A loan classified Loss is considered uncollectible and of such little value that continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be affected in the future.

(continued)

## (4) Loans, Continued

An analysis of past-due loans is as follows (in thousands):

| | Accruing Loans | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 Days Past Due | 60-89 Days Past Due | Than 90 Days Past Due | Total Past Due | Current | Nonaccrual Loans | Total Loans |
| ***At December 31, 2019:*** | | | | | | | |
| Real estate mortgage loans: | | | | | | | |
| Commercial real estate | $ 2,210 | 97 | - | 2,307 | 314,564 | 9,607 | 326,478 |
| Residential real estate[2] | 1,717 | 3,416 | 27,338 | 32,471 | 193,121 | 1,134 | 226,726 |
| Construction and land | 158 | 148 | - | 306 | 87,035 | 542 | 87,883 |
| Commercial loans | 17 | - | - | 17 | 240,119 | 524 | 240,660 |
| Consumer loans[1] | 1,734 | 895 | 1,289 | 3,918 | 135,060 | 120 | 139,098 |
| Total | $ 5,836 | 4,556 | 28,627 | 39,019 | 969,899 | 11,927 | 1,020,845 |
| ***At December 31, 2018:*** | | | | | | | |
| Real estate mortgage loans: | | | | | | | |
| Commercial real estate | 2,702 | 682 | - | 3,384 | 317,346 | 1,912 | 322,642 |
| Residential real estate[2] | 3,986 | 1,430 | 28,513 | 33,929 | 186,944 | 1,013 | 221,886 |
| Construction and land | 671 | - | - | 671 | 75,473 | 93 | 76,237 |
| Commercial loans | 98 | 95 | - | 193 | 199,457 | 217 | 199,867 |
| Consumer loans[1] | 1,472 | 364 | 1,952 | 3,788 | 140,768 | 60 | 144,616 |
| Total | $ 8,929 | 2,571 | 30,465 | 41,965 | 919,988 | 3,295 | 965,248 |

(1) At December 31, 2019 and 2018, guaranteed student loans were $9.7 million and $11.4 million, respectively. Guaranteed student loans of $790,000 and $1.5 million at December 31, 2019 and 2018 that are 90+ days past due and accruing are well secured by guarantees from the U.S. Government and are in the process of collection. Guarantees cover the principal basis in these loans and interest will be paid by the guarantor through the claim payment date. Generally, claims on guaranteed student loans cannot be filed until the loan has been delinquent more than 270 days. As of December 31, 2019 and 2018, there were $123,000 and $193,000, respectively, of student loans 270+ days past due and accruing. At December 31, 2019 and 2018, FHA Title I loans were $51.4 million and $55.5 million, respectively. FHA Title I loans of $499,000 and $488,000 at December 31, 2019 and 2018, respectively, that are 90+ days past due and accruing are well secured by guarantees from the U.S Government and are in the process of collection.

(2) Guaranteed loans in the process of collection or being rehabilitated to be held for sale were $31.9 million and $31.3 million at December 31, 2019 and 2018, respectively.

(continued)

## (4) Loans, Continued

The following summarizes the amount of impaired loans (in thousands):

| | With No Related Allowance Recorded | | With an Allowance Recorded | | | Total | | |
|---|---|---|---|---|---|---|---|---|
| | Recorded Investment | Unpaid Contractual Principal Balance | Recorded Investment | Unpaid Contractual Principal Balance | Related Allowance | Recorded Investment[1] | Unpaid Contractual Principal Balance | Related Allowance |
| ***December 31, 2019:*** | | | | | | | | |
| Real estate mortgage loans: | | | | | | | | |
| Commercial real estate | $ 2,739 | 3,014 | 375 | 620 | 148 | 3,114 | 3,634 | 148 |
| Residential real estate | 2,508 | 3,002 | - | - | - | 2,508 | 3,002 | - |
| Construction and land | 542 | 542 | - | - | - | 542 | 542 | - |
| Commercial loans | 37 | 37 | - | - | - | 37 | 37 | - |
| Consumer loans | 106 | 106 | - | - | - | 106 | 106 | - |
| | $ 5,932 | 6,701 | 375 | 620 | 148 | 6,307 | 7,321 | 148 |
| ***December 31, 2018:*** | | | | | | | | |
| Real estate mortgage loans: | | | | | | | | |
| Commercial real estate | 1,959 | 2,234 | 520 | 763 | 218 | 2,479 | 2,997 | 218 |
| Residential real estate | 2,664 | 3,297 | - | - | - | 2,664 | 3,297 | - |
| Construction and land | 74 | 168 | - | - | - | 74 | 168 | - |
| Commercial loans | 6 | 6 | - | - | - | 6 | 6 | - |
| Consumer loans | 60 | 61 | - | - | - | 60 | 61 | - |
| | $ 4,763 | 5,766 | 520 | 763 | 218 | 5,283 | 6,529 | 218 |

[1] The recorded investment of impaired loans does not include $8.9 million of loans acquired which are in nonaccrual status and covered by a discount.

The average net investment in impaired loans and interest income recognized and received on impaired loans are as follows (in thousands):

| | Average Recorded Investment | Interest Income Recognized | Interest Income Received |
|---|---|---|---|
| ***Year Ended December 31, 2019:*** | | | |
| Real estate mortgage loans: | | | |
| Commercial real estate | $ 2,721 | 94 | 167 |
| Residential real estate | 2,422 | 95 | 163 |
| Construction and land | 142 | - | 8 |
| Commercial loans | 15 | - | 2 |
| Consumer loans | 57 | 3 | 6 |
| | $ 5,357 | 192 | 346 |
| ***Year Ended December 31, 2018:*** | | | |
| Real estate mortgage loans: | | | |
| Commercial real estate | 2,742 | 115 | 168 |
| Residential real estate | 3,278 | 87 | 214 |
| Construction and land | 388 | - | 3 |
| Commercial loans | 3 | - | 1 |
| Consumer loans | 80 | 3 | 10 |
| | $ 6,491 | 205 | 396 |

(continued)

## (4) Loans, Continued

Troubled debt restructurings ("TDR") during the years ended December 31, 2019 and 2018 are as follows (dollars in thousands):

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment | Number of Contracts | Pre-Modification Outstanding Recorded Investment | Post-Modification Outstanding Recorded Investment |
| ***Troubled Debt Restructurings:*** | | | | | | |
| Real estate mortgage loans: | | | | | | |
| Modified interest rate, principal and amortization | 1 | $ 265 | $ 161 | - | $ - | $ - |
| Residential real estate: | | | | | | |
| Modified amortization | - | - | - | 6 | 395 | 408 |
| Consumer loans: | | | | | | |
| Modified amortization | - | - | - | 2 | 105 | 105 |
| | 1 | $ 265 | $ 161 | 8 | $ 500 | $ 513 |

The allowance for loan losses on all classes of loans that have been restructured and are considered TDRs is included in the Company's specific reserve. The specific reserve is determined on a loan by loan basis by either the present value of expected future cash flows discounted at the loan's effective interest rate, or the fair value of the collateral if the loan is collateral-dependent. TDRs that have subsequently defaulted are considered collateral-dependent. There were no TDRs modified during the years ended December 31, 2019 and 2018 that subsequently defaulted during the same year.

***Net Deferred Loan Origination Fees (Costs).*** The following is an analysis of the change in the net deferred loan origination fees (costs) (in thousands):

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Beginning balance | $(1,634) | (65) |
| Deferred loan origination fees | 5,238 | 2,200 |
| Capitalized direct underwriting costs | (4,342) | (3,031) |
| Net amortization | (570) | (738) |
| Ending balance | $(1,308) | (1,634) |

***Concentrations of Credit Risk.*** The Company grants the majority of its loans to borrowers throughout the Florida counties of Baker, Bay, Columbia, Duval, Holmes, Jackson, Marion, Nassau, and Suwanee. With the acquisition of CBC, the Company has added concentrations in the Atlanta, Georgia and Beaufort, South Carolina areas. Although the Company has a diversified loan portfolio, a significant portion of its borrowers' ability to honor their contracts is dependent upon the economy in these areas. The Company does not have significant concentrations to any one industry or customer other than warehouse lines of credit.

(continued)

**(5) Purchase Credit Impaired Loans ("PCI")**

The carrying amounts as of acquisition date of PCI loans acquired are detailed in the following (in thousands):

| | During Year Ending December 31, 2018 |
|---|---|
| Contractually required principal and interest at acquisition | $ 25,772 |
| Nonaccretable difference | (4,271) |
| Cash flows expected to be collected at acquisition | 21,501 |
| Accretable yield | (961) |
| Carrying value of PCI loans | $ 20,540 |

The carrying amounts of PCI loans acquired are detailed in the following (in thousands):

| | As of December 31, 2019 | 2018 |
|---|---|---|
| Beginning outstanding balance | $ 19,669 | - |
| Acquired | - | 25,772 |
| Paydowns | (2,755) | (6,103) |
| Ending outstanding balance | 16,914 | 19,669 |
| Accretable yield | (305) | (840) |
| Nonaccretable yield | (3,029) | (3,483) |
| Carrying value of PCI loans | $ 13,580 | 15,346 |

In the following is the reconciliation of the accretable yield adjustment (in thousands):

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Beginning accretable yield | $(840) | - |
| Accretable yield from acquisition | - | (961) |
| Accretion | 535 | 121 |
| Ending accretable yield | $(305) | (840) |

(continued)

## (6) Loan Servicing

Loans serviced for others are not included in the accompanying consolidated balance sheets. The unpaid principal balances of these loans are summarized as follows (in thousands):

| | At December 31, 2019 | 2018 |
|---|---|---|
| Mortgage loan portfolios serviced for: | | |
| Government agencies: | | |
| FHLB | $ 5,486 | 6,366 |
| FHLMC | 2,764,346 | 2,771,739 |
| GNMA | 1,342,626 | 1,213,782 |
| FNMA | 103,649 | 92,011 |
| All other | 246,410 | 224,533 |
| | $ 4,462,517 | 4,308,431 |

Custodial escrow balances maintained in connection with loans serviced for others were $28.5 million and $28.2 million at December 31, 2019 and 2018, respectively. The escrow balances are included in noninterest-bearing demand deposits in the accompanying consolidated balance sheets.

The following summarizes servicing rights activity, along with the aggregate activity in related valuation allowances (in thousands):

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Beginning balance | $ 46,170 | 38,845 |
| Additions from loans originated and sold | 1,080 | 6,702 |
| Acquired from CBC | - | 2,244 |
| Amortization | (1,934) | (1,621) |
| Ending balance | 45,316 | 46,170 |
| Allowance | (835) | (334) |
| Discount | (17) | (19) |
| Servicing rights, net | $ 44,464 | 45,817 |
| Allowance for impairment beginning balance | 334 | 248 |
| Additions | 501 | 155 |
| Reductions | - | (69) |
| Allowance for impairment ending balance | $ 835 | 334 |

(continued)

**(6) Loan Servicing, Continued**

During the year ended December 31, 2019, the fair value of mortgage servicing rights was determined using discount rates ranging from 9.00% to 11.50% for all loans serviced and constant prepayment rates (CPR) ranging from 8.62% to 24.98%, depending on the stratification of the specific rights. For the year ended December 31, 2018, the discount rates ranged from 7.26% to 20.85% with CPRs ranging from 7.26% to 20.85%.

As a result of the acquisition of CBC, the Company acquired a portfolio of Small Business Administration loans. During the year ended December 31, 2019, the fair value of servicing rights was determined using discount rates ranging from 6.56% to 29.74% for all loans serviced and constant prepayment rates (CPR) ranging from 9.03% to 24.85%, depending on the stratification of the specific rights. For the year ended December 31, 2018, the discount rates ranged from 9.29% to 23.10% with CPRs ranging from 6.34% to 15.65%.

The following is a summary of Service Rights by accounting method (in thousands):

| | At Ended December 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Carrying Value | Fair Value | Carrying Value | Fair Value |
| Service Rights, at fair market value | $ 36,661 | 36,661 | 35,581 | 35,581 |
| Service Rights, at lower of cost or market value | 7,803 | 9,889 | 10,236 | 14,903 |
| Total | $ 44,464 | 46,550 | 45,817 | 50,484 |

Loan servicing and servicing rights income has been recognized as follows (in thousands):

| | Year Ended December 31, | |
|---|---|---|
| | 2019 | 2018 |
| Servicing fees received from investors net of servicing expense | $ 9,031 | 7,611 |
| Servicing rights additions from loans originated and sold | 1,080 | 6,702 |
| Less amortization of servicing rights | (1,934) | (1,621) |
| | (854) | 5,081 |
| Income from servicing rights | $ 8,177 | 12,692 |

(continued)

## (7) Premises and Equipment

The components of premises and equipment are summarized as follows (in thousands):

| | At December 31, 2019 | 2018 |
|---|---|---|
| Land | $ 11,525 | 10,114 |
| Buildings and improvements | 30,999 | 29,621 |
| Furniture and equipment | 23,066 | 19,780 |
| Total, at cost | 65,590 | 59,515 |
| Less accumulated depreciation and amortization | 25,786 | 24,808 |
| Premise and equipment, net | $ 39,804 | 34,707 |

## (8) Leases

The Company adopted ASU 2016-02, *Leases*, on January 1, 2019, which initially resulted in the recognition of twenty-seven operating leases on the consolidated balance sheets in 2019 and forward. (See Note 1 – *Recent Pronouncements* for more information on the adoption of the ASU.) We determine if a contract contains a lease at inception and recognize operating lease right-of-use assets and operating lease liabilities based on the present value of the future minimum lease payments at the adoption date. As our leases do not provide implicit rates, we use our incremental borrowing rate based on the information available at the lease inception date in determining the present value of future payments. Rent expense was $988,000 for the year ended December 31, 2018. Lease agreements that have lease and non-lease components are accounted for as a single lease component. Lease expense is recognized on a straight-line basis over the lease term ($ in thousands).

| | Year Ended December 31, 2019 |
|---|---|
| Operating lease cost | $ 867 |
| Operating lease expense recognized | $ 883 |

| | At December 31, 2019 |
|---|---|
| Operating lease right-of-use assets | $ 1,442 |
| Operating lease liabilities | $ 1,448 |
| Weighted-average remaining lease term | 2.0 years |
| Weighted-average discount rate | 2.34% |

(continued)

**(8) Leases, Continued**

Future minimum lease payments under noncancellable leases, reconciled to our discounted operating lease liabilities at December 31, 2019 are as follows, (in thousands):

| | |
|---|---|
| 2020 | $ 640 |
| 2021 | 479 |
| 2022 | 301 |
| 2023 | 61 |
| 2024 | 13 |
| Total future minimum lease payments | 1,494 |
| Less: imputed interest | (46) |
| Total operating lease liability | $ 1,448 |

**(9) Deposits and Economic Dependence**

The aggregate amount of time deposits with a denomination of over $250,000 was approximately $82.2 million and $68.0 million at December 31, 2019 and 2018, respectively.

A schedule of maturities of time deposits at December 31, 2019 is as follows (in thousands):

| Year Ending December 31, | |
|---|---|
| 2020 | $ 208,805 |
| 2021 | 52,453 |
| 2022 | 19,796 |
| 2023 | 4,367 |
| 2024 and thereafter | 37,572 |
| | $ 322,993 |

In the ordinary course of business, the Company accepts deposits from various governmental agencies and public institutions. The aggregate amount of these deposits was approximately $369.8 million and $272.9 million at December 31, 2019 and 2018, respectively.

**(10) Related Parties**

The Company enters into transactions in the ordinary course of business with officers and directors of the Company and their affiliates (related parties). The following summarizes these transactions (in thousands):

| | At December 31, | |
|---|---|---|
| | 2019 | 2018 |
| Deposits | $ 4,036 | 4,757 |
| Loans | $ 2,832 | 5,675 |

(continued)

## (11) Federal Home Loan Bank ("FHLB") Advances

The maturities and interest rates on FHLB advances were as follows ($ in thousands):

| Description | Maturity Date | Interest Rate | At December 31, 2019 | 2018 |
|---|---|---|---|---|
| Fixed Rate Credit | 01/30/2020 | 1.77% | $ 22,000 | 5,000 |
| Fixed Rate Credit | 07/24/2020 | 1.98% | 2,500 | - |
| Fixed Rate Hybrid | 05/21/2021 | 2.329% | 28,000 | - |
| Fixed Rate Hybrid | 06/17/2021 | 1.936% | 20,000 | - |
| | | | $ 72,500 | 5,000 |

The collateral agreement with the FHLB includes a blanket lien covering qualifying loans such as first mortgage, one-to-four family residential loans, and home equity lines of credit owned by the Company with a carrying value of $318.1 million at December 31, 2019. In addition, the Company may pledge marketable debt securities as collateral where the qualifying loans are insufficient. At December 31, 2019, debt securities with a fair value of $215.8 million were pledged as collateral for FHLB advances. At December 31, 2019, the Company had available credit if additional collateral were pledged of $589 million.

## (12) Other Borrowings

The Company has issued $30 million face value of subordinated debt (the "Subordinated Debt") due December 27, 2028. The Subordinated Debt bears a fixed annual interest rate of 6.125% until December 27, 2023, at which time the rate will become an annual floating rate equal to three-month LIBOR, determined quarterly, plus 326.7 basis points. If at any time while the Subordinated Debt is outstanding LIBOR ceases to exist or be reported, the Company shall select an alternative rate. Interest is payable in arrears on March 31, June 30, September 30, and December 31, of each year through the maturity date, unless redeemed. The Company may, at its option, beginning December 27, 2023, and on any scheduled interest payment date, thereafter, redeem the Subordinated Debt, in whole or in part, at 100% of the principal amount of the Subordinated Debt plus any accrued and unpaid interest. The Subordinated Debt was structured to comply with certain regulatory requirements which provide for qualification as Tier 2 Capital. The Subordinated Debt is subject to certain affirmative and negative covenants and at December 31, 2019, the Company was in compliance with the covenants.

The Company also has a line of credit at a financial institution that would allow the Company to borrow up to $12 million. The agreement requires that the Company maintain a $100,000 balance which is the amount outstanding at December 31, 2019 and 2018. This line of credit is unsecured and carries an interest rate of three-month LIBOR, determined quarterly, plus 350 basis points.

(continued)

**(13) Income Taxes**

Allocation of Federal and state income taxes between current and deferred portions is as follows (in thousands):

| | Year Ended December 31, 2019 | 2018 |
|---|---|---|
| Current: | | |
| Federal | $ 6,158 | 3,341 |
| State | 1,877 | 1,236 |
| Total current | 8,035 | 4,577 |
| Deferred: | | |
| Federal | (526) | 529 |
| State | (75) | 147 |
| Total deferred | (601) | 676 |
| Income tax expense | $ 7,434 | 5,253 |

The effective income tax rate differs from the statutory Federal income tax rate for the following reasons (dollars in thousands):

| | Year Ended December 31, 2019 Amount | 2019 % | 2018 Amount | 2018 % |
|---|---|---|---|---|
| Income taxes at statutory Federal rate | $ 6,912 | 21.0% | $ 5,975 | 21.0% |
| Increase (decrease) in taxes resulting from: | | | | |
| State taxes, net of Federal tax benefit | 1,424 | 4.3 | 1,093 | 3.8 |
| Income from bank-owned life insurance | (163) | (0.5) | (123) | (0.4) |
| Tax-exempt interest income | (630) | (1.9) | (1,186) | (4.2) |
| Other | (109) | (0.3) | (506) | (1.8) |
| Total | $ 7,434 | 22.6% | $ 5,253 | 18.4% |

(continued)

## (13) Income Taxes, Continued

The components of the net deferred tax liability is as follows (in thousands):

| | At December 31, | |
|---|---|---|
| | 2019 | 2018 |
| Deferred tax assets: | | |
| Allowance for loan losses | $ 1,495 | 1,383 |
| Deferred compensation | 2,352 | 1,980 |
| Nonaccrual interest income | 203 | 342 |
| Impaired debt securities | 107 | 78 |
| Unrealized loss on derivative instrument | 5 | - |
| Accrued expenses | 676 | 761 |
| Fair market value adjustment | 1,629 | 1,661 |
| Other | 950 | 367 |
| Total deferred tax assets | 7,417 | 6,572 |
| Deferred tax liabilities: | | |
| Deferred loan costs | (1,014) | (889) |
| Mortgage servicing rights | (10,864) | (11,258) |
| Unrealized gain in debt securities available for sale | (1,362) | (8) |
| Depreciation | (776) | (238) |
| Prepaid expenses | (475) | (505) |
| Total deferred tax liabilities | (14,491) | (12,898) |
| Net deferred tax liability | $ (7,074) | (6,326) |

The Company files consolidated income tax returns in the U.S. federal jurisdiction and the States of Florida, Wisconsin, Georgia, Illinois, Indiana, Maryland, North Carolina, South Carolina, Tennessee, Michigan, Ohio and Delaware. The Company is no longer subject to U.S. federal or state and local income tax examinations by taxing authorities for years before 2016.

## (14) Off-Balance-Sheet Financial Instruments

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 are unused lines of credit, undisbursed loans in process, commitments to extend credit and standby letters of credit and involve, to varying degrees, elements of credit and interest-rate risk in excess of the amount recognized in the consolidated balance sheet. The contract amounts of these instruments reflect the extent of involvement the Company has in these financial instruments.

(continued)

## (14) Off-Balance-Sheet Financial Instruments, Continued

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, unused lines of credit, undisbursed loans in process and standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments as it does for on-balance-sheet loan instruments.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed-expiration dates or other termination clauses and may require payment of a fee. Since some of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each customer's credit worthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Company upon extension of credit is based on management's credit evaluation of the counterparty.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to customers. All outstanding letters of credit expire in the next twelve months. The Company has in some cases obtained guarantees securing these agreements.

A summary of the amounts of the Company's off-balance-sheet financial instruments at December 31, 2019 follows (in thousands):

| | Contract Amount |
|---|---|
| Unused lines of credit | $ 38,535 |
| Undisbursed loans in process | $ 67,108 |
| Commitments to extend credit | $ 61,115 |
| Standby letters of credit | $ 3,355 |

## (15) Derivative Financial Instruments

***Interest-Rate Risk Management-Cash Flow Hedging Instruments.*** The information pertaining to outstanding interest-rate swap agreements at December 31, 2019 used to hedge variable rate debt is as follows ($ in thousands):

| | |
|---|---|
| Notional amount | $ 22,000 |
| Pay rate fixed | 1.68% |
| Weighted-average receive rate variable | 1.91% |
| Maturity in years | 2.83 |
| Unrealized loss relating to interest-rate swap | $ 20 |

(continued)

## (15) Derivative Financial Instruments, Continued

This agreement provides for the Company to receive payments at a variable rate determined by a specified index (USD LIBOR) in exchange for making payments at a fixed-rate.

***Rate-Lock Commitments.*** The total outstanding rate-lock commitments at December 31, 2019 and 2018 were approximately $255.7 million and $158.3 million, respectively. The fair value of rate-lock commitments at December 31, 2019 and 2018 were $2.0 million and $1.8 million, respectively, and are included in other assets in the accompanying consolidated balance sheets.

***Forward Loan Sale Contracts.*** The notional amounts of forward loan sale contracts outstanding at December 31, 2019 and 2018 were $303 million and $67.5 million, respectively. The fair value of forward loan sale commitments were $393,000 and $584,000 at December 31, 2019 and 2018, respectively, are included in other liabilities in the accompanying consolidated balance sheets.

## (16) Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| | At December 31, | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial assets: | | | | |
| Cash and cash equivalents | $ 92,657 | 92,657 | 143,436 | 143,436 |
| Restricted cash | 50,000 | 50,000 | - | - |
| Time deposits | 18,034 | 18,034 | 19,521 | 19,521 |
| Debt securities available for sale | 492,012 | 492,012 | 416,213 | 416,213 |
| Loans held for sale, net | 230,262 | 230,262 | 101,846 | 101,846 |
| Loans | 1,006,406 | 1,028,411 | 949,965 | 957,052 |
| Accrued interest receivable | 6,925 | 6,925 | 6,952 | 6,952 |
| Federal Home Loan Bank stock | 4,717 | 4,717 | 2,001 | 2,001 |
| Servicing rights | 44,464 | 46,550 | 45,817 | 50,484 |
| Rate-lock commitments | 1,986 | 1,986 | 1,834 | 1,834 |
| Financial liabilities: | | | | |
| Deposits | 1,787,818 | 1,732,250 | 1,542,960 | 1,540,875 |
| Accrued interest payable | 261 | 261 | 293 | 293 |
| Federal Home Loan Bank advances | 72,500 | 72,740 | 5,000 | 4,959 |
| Other borrowings | 35,985 | 35,325 | 35,901 | 35,605 |
| Forward loan sale contracts | 393 | 393 | 584 | 584 |
| Off-balance-sheet financial instruments | - | - | - | - |

(continued)

**(17) Regulatory Matters**

During the year ended December 31, 2018, the Federal Reserve Bank raised the threshold from $1 billion to $3 billion in total consolidated assets to be considered a small bank holding company. As a result of this change the Company is excluded from consolidated capital requirements. The Bank is subject to various regulatory capital requirements including the Basel III framework ("Basel III") administered by the 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 the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts, and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Under Basel III, the Bank became subject to the capital conservation buffer rules which place limitations on distributions, including dividend payments, and certain discretionary bonus payments to executive officers. In order to avoid these limitations, a bank must hold a capital conservation buffer above its minimum risk-based capital requirements. As of December 31, 2019 and 2018, the Bank's capital conservation buffer exceeds the minimum requirement of 2.50% and 1.875%, respectively.

As of December 31, 2019 and 2018, the Bank was well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, the Bank must maintain minimum total risk-based, Tier 1 risk-based, and Tier 1 leverage percentages as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

| | Actual | | For Capital Adequacy Purposes | | Minimum To Be Well Capitalized Under Prompt Corrective Action Provisions | |
|---|---|---|---|---|---|---|
| | **Amount** | **%** | **Amount** | **%** | **Amount** | **%** |
| ***As of December 31, 2019:*** | | | | | | |
| Common equity tier 1 Capital ratio | $ 218,807 | 16.85% | $ 58,434 | 4.50% | $ 84,405 | 6.50% |
| Tier 1 capital ratio | 218,807 | 16.85 | 77,912 | 6.00 | 103,883 | 8.00 |
| Total capital ratio | 226,988 | 17.48 | 103,883 | 8.00 | 129,854 | 10.00 |
| Tier 1 leverage ratio | 218,807 | 10.24 | 85,503 | 4.00 | 106,879 | 5.00 |
| ***As of December 31, 2018:*** | | | | | | |
| Common equity tier 1 Capital ratio | 190,847 | 18.34 | 46,830 | 4.50 | 67,643 | 6.50 |
| Tier 1 capital ratio | 190,847 | 18.34 | 62,439 | 6.00 | 83,253 | 8.00 |
| Total capital ratio | 198,924 | 19.12 | 83,253 | 8.00 | 104,066 | 10.00 |
| Tier 1 leverage ratio | 190,847 | 10.77 | 70,865 | 4.00 | 88,581 | 5.00 |

(continued)

## (18) Profit Sharing Plan

The Company sponsors a Section 401(k) profit sharing plan (the "Plan") which is available to all employees electing to participate after meeting certain length-of-service requirements. The Company's contributions to the Plan are discretionary and are determined annually. Expenses relating to the Company's contributions to the Plan, included in the accompanying consolidated financial statements, were $4.2 million and $3.1 million for the years ended December 31, 2019 and 2018, respectively.

## (19) Deferred Compensation Plans

***General.*** The Company has established several deferred compensation and other non-qualified benefit programs for selected key managers. The individual programs have different program features and are based on reaching certain performance goals. All of these plans are unfunded programs recorded only on the books of the Company as liabilities are subject to the claims of creditors in the event of bankruptcy or receivership. The plans include two Discretionary Non-Contributory Money Purchase Plans, as well as a Longevity Reward and Retention Plan, and a Death Benefit program. All of the plans require vesting periods, and if not met, the unvested balances forfeit back to the Company. All programs provide immediate vesting in the event of in-service death or disability.

***Discretionary Non-Contributory Money Purchase Plans.*** One plan (Plan A) is a program where the Company makes a contribution to the plan for selected key managers. A portion of the balance is paid out annually based on a formula after the first six years. These funds are not credited with any interest or earnings. The contributions and manager participation are determined solely at the discretion of the Company. The other plan (Plan B) is similar except that the money is converted to units and earns a return each year. The units are a means to compound the returns. In the event the Company was to have publicly traded stock, the units would be priced at the public stock price. The plan is funded via mandatory reductions for the employees earned incentive compensation, in an amount determined by the Company. The second plan also has limited immediate vesting in change of control situations. A portion of the balance is paid out every five years based on a formula. Both plans have a 20-year vesting.

***Death Benefit Plan.*** The Company provides a program where selected key managers who meet vesting and other requirements share in a death benefit provided by a life insurance policy owned by the Company on the life of the employee. The amount of the benefit varies and is subject to reduction based upon the Company recovering the reported cash surrender values of the policies as described in the contract with the employee.

***Longevity and Retention Plan.*** The Company has established an employment contract to reward longevity and promote manager retention. This benefit is payable due to death or disability of a participant, or for separation of service and change of control. Participation is determined by the Board of Directors.

At December 31, 2019 and 2018, $4.9 million and $4.0 million, respectively, was accrued under all of these plans. During the years ended December 31, 2019 and 2018, $489,000 and $412,000, respectively, was expensed under all of these plans.

(continued)

## (20) Contingencies

Various legal claims also arise from time to time in the normal course of business which, in the opinion of management of the Company, will not have a material effect on the Company's consolidated financial statements.

## (21) Fair Value Measurements

Assets and (liabilities) measured at fair value on a recurring basis are summarized below (in thousands):

| | Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| ***At December 31, 2019:*** | | | | |
| ***Available-for-Sale Debt Securities:*** | | | | |
| Corporate bonds | $ 1,012 | - | 1,012 | - |
| Municipal securities | 56,111 | - | 56,111 | - |
| Collateralized mortgage obligations | 161,492 | - | 161,492 | - |
| SBA pool securities | 50,686 | - | 50,686 | - |
| Asset-backed securities | 63,940 | - | 63,940 | - |
| Mortgage-backed securities | 158,771 | - | 158,771 | - |
| Total | $ 492,012 | - | 492,012 | - |
| Loans held for sale, net | $ 230,262 | - | 230,262 | - |
| Rate-lock commitments, net | $ 1,986 | - | - | 1,986 |
| Forward loan sale contracts, net | $ (393) | - | - | (393) |
| Servicing rights at fair value | $ 36,661 | - | - | 36,661 |

(continued)

## (21) Fair Value Measurements, Continued

| | Fair Value | Quoted Prices In Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| *At December 31, 2018:* | | | | |
| *Available-for-Sale Debt Securities:* | | | | |
| U.S. Treasury bonds | $ 46,450 | - | 46,450 | - |
| U.S. Government agency bonds | 711 | - | 711 | - |
| Municipal securities | 141,697 | - | 141,697 | - |
| Collateralized mortgage obligations | 75,880 | - | 75,880 | - |
| SBA pool securities | 78,282 | - | 78,282 | - |
| Asset-backed securities | 19,125 | - | 19,125 | - |
| Mortgage-backed securities | 54,068 | - | 54,068 | - |
| Total | $ 416,213 | - | 416,213 | - |
| Loans held for sale, net | $ 101,846 | - | 101,846 | - |
| Rate-lock commitments, net | $ 1,834 | - | - | 1,834 |
| Forward loan sale contracts, net | $ (584) | - | - | (584) |
| Servicing rights at fair value | $ 35,581 | - | - | 35,581 |

The table below presents a reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) (in thousands):

| | Year Ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | 2018 | | |
| | Rate-Lock Commitments Net | Forward Loan Sale Contracts Net | MSR at FMV | Rate-Lock Commitments Net | Forward Loan Sale Contracts Net | MSR at FMV |
| Balance at beginning of year | $ 1,834 | (584) | 35,581 | 1,083 | (93) | 28,879 |
| Total gains or losses (realized/unrealized) purchases, issuances and net settlements | 152 | 191 | 1,080 | 751 | (491) | 6,702 |
| Balance at end of year | $ 1,986 | (393) | 36,661 | 1,834 | (584) | 35,581 |

(continued)

## (21) Fair Value Measurements, Continued

Gains and losses due to changes in fair value, including both realized and unrealized gains and losses, recorded in earnings for Level 3 assets are as follows (in thousands):

| | Classification of Gains and Losses (Realized/Unrealized) Included in Earnings Year Ended December 31, 2019 Net Derivatives | 2018 Net Derivatives |
|---|---|---|
| Mortgage-banking revenue | $ 343 | 260 |
| Servicing rights retained from loans sold | $ 1,080 | 6,702 |

Assets and liabilities measured at fair value on a nonrecurring basis are summarized below (in thousands):

| | Fair Value | At Year End Level 1 | Level 2 | Level 3 | Total Losses | (Recoveries) Losses Recorded in Earnings for the Year Ended |
|---|---|---|---|---|---|---|
| ***At December 31, 2019:*** | | | | | | |
| Impaired loans: | | | | | | |
| Commercial real estate | $ 663 | - | - | 663 | 652 | (28) |
| Residential real estate | 258 | - | - | 258 | 189 | - |
| Construction | - | - | - | - | - | - |
| Consumer loans | 220 | - | - | 220 | 215 | 14 |
| Total | $ 1,141 | - | - | 1,141 | 1,056 | (14) |
| Foreclosed real estate | $ 1,486 | - | - | 1,486 | - | - |
| Mortgage servicing rights at lower of cost of market | $ 9,889 | - | - | 9,889 | 501 | 501 |
| ***At December 31, 2018:*** | | | | | | |
| Impaired loans: | | | | | | |
| Commercial real estate | 781 | - | - | 781 | 724 | 338 |
| Residential real estate | 635 | - | - | 635 | 265 | 15 |
| Construction | 74 | - | - | 74 | 94 | 16 |
| Consumer loans | 365 | - | - | 365 | 262 | 74 |
| Total | $ 1,855 | - | - | 1,855 | 1,345 | 443 |
| Foreclosed real estate | $ 2,706 | - | - | 2,706 | - | - |
| Mortgage servicing rights at lower of cost of market | $ 14,903 | - | - | 14,903 | 87 | 87 |

(continued)

## (22) Consolidating Financial Statements

### Consolidating Balance Sheet
### At December 31, 2019
**(In thousands)**

| | First Federal Bancorp, MHC | First Federal Bancorp, Inc. Consolidation: First Federal Bancorp, Inc. | First Federal Bank Consolidated | Consolidating Entries Debit (Credit) | Consolidated | Consolidating Entries Debit (Credit) | Consolidated |
|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | |
| Cash and due from banks | $ 10 | 5,767 | 28,354 | (5,292) | 28,829 | (10)[a] | 28,829 |
| Interest-bearing deposits | - | - | 63,828 | - | 63,828 | - | 63,828 |
| Restricted stock | - | - | 50,000 | - | 50,000 | - | 50,000 |
| Time deposits | - | - | 18,034 | - | 18,034 | - | 18,034 |
| Debt securities | - | - | 492,012 | - | 492,012 | - | 492,012 |
| Investment in subsidiaries | 235,119 | 264,903 | - | (264,903) | - | (235,119)[b] | - |
| Loans, net | - | - | 1,236,668 | - | 1,236,668 | - | 1,236,668 |
| Accrued interest receivable | - | 7 | 6,918 | - | 6,925 | - | 6,925 |
| Premises and equipment, net | - | - | 39,804 | - | 39,804 | - | 39,804 |
| Right of Use asset | - | - | 1,442 | - | 1,442 | - | 1,442 |
| Federal Home Loan Bank stock, at cost | - | - | 4,717 | - | 4,717 | - | 4,717 |
| Foreclosed real estate | - | - | 1,486 | - | 1,486 | - | 1,486 |
| Income taxes receivable | - | 44 | 586 | (44) | 586 | - | 586 |
| Cash surrender value of bank-owned life insurance | - | - | 35,747 | - | 35,747 | - | 35,747 |
| Servicing rights, net | - | - | 44,464 | - | 44,464 | - | 44,464 |
| Goodwill | - | - | 28,965 | - | 28,965 | - | 28,965 |
| Other assets | - | 620 | 123,563 | - | 124,183 | - | 124,183 |
| Total assets | $ 235,129 | 271,341 | 2,176,588 | (270,239) | 2,177,690 | (235,129) | 2,177,690 |
| **Liabilities, Capital Stock and Retained Earnings and Accumulated Other Comprehensive Income** | | | | | | | |
| Liabilities: | | | | | | | |
| Deposits | - | - | 1,793,120 | (5,292) | 1,787,828 | (10)[a] | 1,787,818 |
| Federal Home Loan Bank Advances | - | - | 72,500 | - | 72,500 | - | 72,500 |
| Junior Subordinated Debt | - | 5,885 | - | - | 5,885 | - | 5,885 |
| Other borrowings | - | 30,100 | - | - | 30,100 | - | 30,100 |
| Operating leases | - | - | 1,448 | - | 1,448 | - | 1,448 |
| Deferred income taxes | - | 151 | 6,923 | - | 7,074 | - | 7,074 |
| Other liabilities | - | 86 | 37,694 | (44) | 37,736 | - | 37,736 |
| Total liabilities | - | 36,222 | 1,911,685 | (5,336) | 1,942,571 | (10) | 1,942,561 |
| Capital stock | - | - | 1 | (1) | - | - | - |
| Retained earnings and accumulated other comprehensive income | 235,129 | 235,119 | 264,902 | (264,902) | 235,119 | (235,119)[b] | 235,129 |
| Total liabilities, capital stock and retained earnings and accumulated other comprehensive income | $ 235,129 | 271,341 | 2,176,588 | (270,239) | 2,177,690 | (235,129) | 2,177,690 |

[a] Elimination of intercompany accounts
[b] Elimination of investment in subsidiaries

(continued)

## (22) Consolidating Financial Statements, Continued

### Consolidating Statement of Earnings
### At December 31, 2019
**(In thousands)**

| | | First Federal Bancorp, Inc. Consolidation | | | | | |
|---|---|---|---|---|---|---|---|
| | First Federal Bancorp, MHC | First Federal Bancorp, Inc. | First Federal Bank Consolidated | Consolidating Entries Debit (Credit) | Consolidated | Consolidating Entries Debit (Credit) | Consolidated |
| Interest income: | | | | | | | |
| Loans | $ - | - | 60,259 | - | 60,259 | - | 60,259 |
| Debt securities | - | 6 | 14,374 | - | 14,380 | - | 14,380 |
| Other | - | 57 | 3,239 | - | 3,296 | - | 3,296 |
| Total interest income | - | 63 | 77,872 | - | 77,935 | - | 77,935 |
| Interest expense | | | | | | | |
| Deposits | - | - | 11,160 | - | 11,160 | - | 11,160 |
| Borrowings | - | 2,184 | 1,666 | - | 3,850 | - | 3,850 |
| Total interest expense | - | 2,184 | 12,826 | - | 15,010 | - | 15,010 |
| Net interest income | - | (2,121) | 65,046 | - | 62,925 | - | 62,925 |
| Provision for loan losses | - | - | 691 | - | 691 | - | 691 |
| Net interest income after provision for loan losses | - | (2,121) | 64,355 | - | 62,234 | - | 62,234 |
| Noninterest income: | | | | | | | |
| Loan servicing fees | - | - | 9,031 | - | 9,031 | - | 9,031 |
| Servicing rights retained from loans sold | - | - | (854) | - | (854) | - | (854) |
| Mortgage banking revenue | - | - | 27,036 | - | 27,036 | - | 27,036 |
| Service charges on deposit accounts | - | - | 4,017 | - | 4,017 | - | 4,017 |
| Other service charges and fees | - | - | 4,049 | - | 4,049 | - | 4,049 |
| Gain on sale of debt securities available for sale | - | (7) | 4,546 | - | 4,539 | - | 4,539 |
| Income from bank-owned life insurance | - | - | 777 | - | 777 | - | 777 |
| Debit card interchange income | - | - | 4,158 | - | 4,158 | - | 4,158 |
| Other | 25,478 | 27,358 | 803 | (27,195)[a] | 966 | (25,478)[a] | 966 |
| Total noninterest income | 25,478 | 27,351 | 53,563 | (27,195) | 53,719 | (25,478) | 53,719 |
| Noninterest expenses: | | | | | | | |
| Salaries and employee benefits | - | 9 | 58,590 | (9) | 58,590 | - | 58,590 |
| Occupancy and equipment | - | 2 | 10,217 | (2) | 10,217 | - | 10,217 |
| Professional fees | - | 49 | 2,328 | (25) | 2,352 | - | 2,352 |
| Other expenses | - | 171 | 11,711 | - | 11,882 | - | 11,882 |
| Total noninterest expenses | - | 231 | 82,846 | (36) | 83,041 | - | 83,041 |
| Earnings before income taxes | 25,478 | 24,999 | 35,072 | (27,159) | 32,912 | (25,478) | 32,912 |
| Income tax | - | (479) | 7,913 | - | 7,434 | - | 7,434 |
| Net earnings | $ 25,478 | 25,478 | 27,159 | (27,159) | 25,478 | (25,478) | 25,478 |

[a] Elimination of income of subsidiaries