

IMPORTANT NOTICE

SHAREHOLDER MEETING: CHANGES DUE TO COVID-19

Dear Shareholders,

Your Board of Directors is closely monitoring the impact of COVID-19 (coronavirus) on public health and public gatherings. This year's Shareholder Meeting is scheduled for April 28, 2020. We truly enjoy the opportunity to visit with you and share the years' results at our annual Shareholder Meetings. However, the CDC recommends that all events with 50 or more people be cancelled for the next eight weeks to protect those most vulnerable to COVID-19. We have decided it is in the best interests of our shareholders, our employees and the community to cancel the luncheon and social gathering portion of this year's Shareholder Meeting. The business meeting will still be conducted at 10:30 AM, Eastern time.

As noted above, although the luncheon and social gathering are cancelled, the business meeting will still be conducted. We highly encourage you to VOTE BY PROXY prior to the Shareholder Meeting. The meeting and its decisions will be valid with a quorum of votes by PROXY. You will find a PROXY CARD included in this packet. When voting by PROXY, attendance in person is not necessary.

In the event our business meeting location becomes unavailable due to current events, we will communicate alternative methods of conducting the meeting on our Investor Relations webpage, as well as on our social media outlets. Below are the URLs and handles:

- Investor Relations: <https://www.mybct.com/about-us/investor-relations>
- LinkedIn: BCT-Bank of Charles Town, also known as The Community's Bank
- Facebook: @BankOfCharlesTown
- Twitter: @mybct

Additionally, Carla Nilsen, Executive Assistant, is also available to answer any questions. Her contact information is: (Email) cnilsen@mybct.com and (Phone) 304-728-2453.

We apologize for any inconvenience this may cause and hope you agree we are acting in the best interests of all. As always, feel free to call me as well.

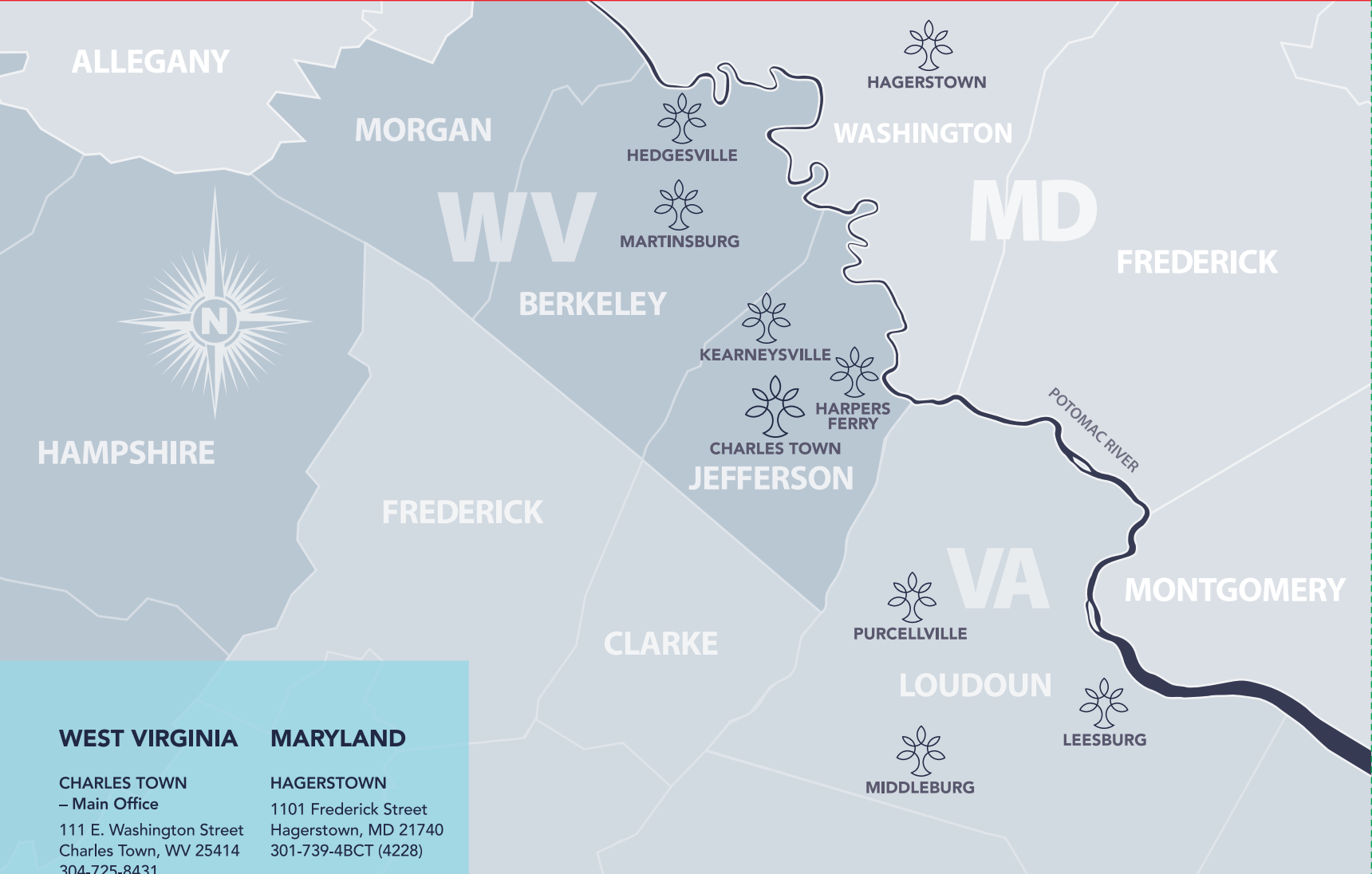
Alice P. Frazier
President & CEO
304-728-2431



**POTOMAC
BANCSHARES**

2019





WEST VIRGINIA

CHARLES TOWN – Main Office

111 E. Washington Street
Charles Town, WV 25414
304-725-8431

HARPERS FERRY

1366 W. Washington Street
Harpers Ferry, WV 25425
304-535-6336

HEDGESVILLE

119 Cowardly Lion Drive
Hedgesville, WV 25427
304-754-0000

KEARNEYSVILLE

5480 Charles Town Road
Kearneysville, WV 25430
304-876-2563

MARTINSBURG

9738 Tuscarora Pike
Martinsburg, WV 25403
304-262-0089

MARYLAND

HAGERSTOWN

1101 Frederick Street
Hagerstown, MD 21740
301-739-4BCT (4228)

VIRGINIA

LEESBURG

446 Madison Trade
Plaza SE
Leesburg, VA 20175
703-777-6319

Lending Office
602 S. King Street
Suite 300
Leesburg, VA 20175
703-443-4484

MIDDLEBURG

115 The Plains Road
Suite 150
Middleburg, VA 20117
540-687-6132

PURCELLVILLE

1201 Wolf Rock Drive
Suite 125
Purcellville, VA 20132
540-619-2913

For 149 years, BCT has focused on being a neighborhood bank that provides sensible and practical financial services to help our communities thrive. Our resiliency is no happy accident. By combining a thoughtful strategic approach to banking along with a commitment to an amazing customer experience, we have become intertwined in the lives of our neighbors.

We provide fuel for our local economies and businesses with capital to build, grow, expand, and hire. We help families buy their first homes, renovate their existing homes, save for college, pay for weddings, and plan for retirement.

We even teach children financial literacy with savings programs and local school Bank Days. As a community bank, we reflect the financial needs of our communities. Our products and services correspond to the aspirations of the people we serve.

BCT – Rooted In Tradition. Growing Our Communities.



DEAR FELLOW SHAREHOLDERS:

On behalf of the employees and Board of Directors of the Bank of Charles Town (BCT) and its holding company, Potomac Bancshares, Inc., it is our pleasure to present our 2019 Annual Report. The year was marked with several milestones, demonstrating strategies set forth in 2018 are working.

Our first milestone occurred in April 2019 with the opening of our Leesburg, Virginia, full-service branch, our ninth location. Our strategic expansion into Loudoun County has been received positively, supported by new customers finding BCT to be the local community bank they desired. In June, our second milestone occurred as total assets surpassed \$500 million to end the year at \$515.8 million, delivering a 6.4% annual growth rate.

Strategically growing our commercial banking business to diversify our loan portfolio resulted in the growth of total loans held for investment of \$48.5 million, or 13.3%, ending the year at \$412.5 million. A prudent credit culture is a priority and evident by overall credit quality metrics including a non-performing assets to total assets ratio of 0.19%.

Total deposits grew \$25.8 million to \$449.9 million at year end. Product packages were designed to promote non-interest-bearing deposits resulting in non-interest-bearing deposit growth of \$11.6 million, accounting for 45% of overall deposit growth. In addition, relationship-based pricing minimized the increase to cost of funding, allowing the net interest margin to increase slightly at year end.

We offset the negative impact of three Federal Reserve interest rate decreases and a flat yield curve with a 16.9% growth in non-interest income to \$5.5 million. Debit card usage continued to grow, driving interchange fee income to \$1.4 million. In addition, BCT Wealth Advisors onboarded 65 new relationships, increasing fees to \$1.3 million, an increase of 9.6%. Lastly, BCT's Residential Lending team achieved a lofty goal of \$1.0 million in secondary market fees, our third milestone for 2019.

A strong and empowering culture will ensure our long-term success. We continue to refine our programs to foster a positive, rewarding work environment that provides personal development towards a fulfilling career at BCT. Such efforts resulted in BCT being named an *American Banker* "Best Banks To Work For" in 2019. This recognition was an honor and another first for the company.

True to our founding principle of neighbor helping neighbor, our employees volunteered over 1,511 hours of community service in 2019. In doing so, we observed individuals and families who struggle with hunger. As a result, we made a strategic shift in our corporate giving philosophy to address hunger issues. BCTCares For The Hungry commenced, an effort combining corporate contributions with employee community service directed towards programs that fight hunger in each of the counties we serve.

As we look to 2020, we are committed to deepening relationships and expanding market share through growth of profitable customer relationships in our four business lines: commercial, retail, wealth and mortgage banking. While a branch presence is important, consumers and businesses want anytime-anywhere banking and expect information readily available to make decisions on their own. Knowing that, we are overhauling our website, transitioning to a superior digital banking platform and increasing our digital presence. Rest assured, this investment will incorporate our time-honored customer service.

Your BCT team is as dedicated as ever to creating an amazing banking experience for our customers and fostering a prosperous economic environment for the communities we serve. The Board of Directors, senior management, and employees genuinely thank you for your continued support and loyalty.

Ana P. Frazier

President & CEO,
Potomac Bancshares, Inc. &
Bank of Charles Town

Keith B. Berkeley

Chairman of the Board,
Potomac Bancshares, Inc. &
Bank of Charles Town



BOARD OF DIRECTORS

Keith B. Berkeley, D.V.M.

Chairman of the Board, Potomac Bancshares & Bank of Charles Town
Veterinarian/Owner, Valley Equine Associates

Alice P. Frazier

President & CEO, Potomac Bancshares & Bank of Charles Town

Kristina Bouweiri

President & CEO, Reston Limousine

J. Scott Boyd

Pharmacist/President, Jefferson Pharmacy
Pharmacist/President, JSB Enterprises, dba South Berkeley Pharmacy
Manager, Mountain Spring Properties

Norman M. Casagrande

Office Manager, BMC
Member, MAC Industries

Margaret M. Cogswell

CEO, Hospice of the Panhandle

Mitesh B. Kothari, M.D.

Managing Member, Capital Women's Care

Barbara H. Pichot

Certified Public Accountant
Retired Partner, CoxHollida

Barbara L. Scott

Summit Point Raceway Associates
Retired President & CEO, BSR Training

Andrew C. Skinner

Attorney/Owner, Skinner Law Firm

C. Larry Togans

Retired Deputy Branch Chief of Human Resources
U.S. Geological Survey

Anthony P. Zelenka

President & CEO, WVU Medicine
Berkeley Medical Center and Jefferson Medical Center



ADVISORY BOARD

BCT'S COMMUNITY CHAMPIONS

Many of the top business and community leaders within each market serve on Advisory Boards. These members help BCT understand each market's competitive landscapes plus provide expertise and special knowledge that helps guide our strategic planning.

Eastern Panhandle, WV, Advisory Board

John Beatty BCT, Retired	C.W. "Chip" Hensell, III (Chair) Hensell Realty
Mark Burkhardt Mountain View Farm	John Lowe Lowe Products
Alison A. Cox Bowles Rice	Jason M. Roach R.M. Roach & Sons
Darin L. Gilpin D.V.M. Shenandoah Veterinary Hospital	William A. White First Bauxite
Justin Henry Panhandle Homes of Berkeley Co.	Lisa Younis Younis Orthodontics

Loudoun County, VA, Advisory Board

Kristina Bouweiri (Chair) Reston Limousine	Deep Sran, Ph.D. Loudoun School for Advanced Studies
Paige Buscema Eyetopia	Anthony "Tony" Stafford Ford's Fish Shack
Bob Caines The Bob Caines Team Re/Max Select Properties	Sonnie Swann Climatic Heating and Cooling
Matthew Lowers Wholesale Screening Solutions	Katie Wilson The Market Group
Jeff Mitchell Mitchell & Co.	Gary Clemens Loudoun County Circuit Court
Bernard Mustafa XTIVIA Technologies	

Washington County, MD, Advisory Board

Kevin O'Leary Coldwell Banker Innovations	Mitesh B. Kothari, M.D. (Chair) Capital Women's Care
John H. Roney II Retired Banker	Richard Kramer, D.D.S. Oral and Facial Surgery
Todd A. Harrison, D.P.M. Foot & Ankle Specialist of the Mid-Atlantic	Heather Guessford United Way of Washington County
Ted Reeder III, CPA Tiger's Eye Benefits Consulting	Jeanne Singer Law Offices of Jeanne Singer

◀ **The Board of Directors welcomed Kristina Bouweiri, President and CEO of Reston Limousine, and Mitesh Kothari, M.D., Managing Member of Capital Women's Care, to the board in March. Their innovative business experience and extensive knowledge of our expansion markets will provide excellent insights and growth opportunities.**



"BCT met with us personally and closed our loan fast. A much better experience than with our previous bank. That's what a community bank should be: personal, capable, and attentive. We're a better business with BCT."

Donald DeHaven, Owner

D & L WELD

MARTINSBURG, WV



D & L Weld was founded in 1979 by Donald and Peggy DeHaven as a family-owned industrial millwright service provider. When it comes to taking equipment apart and putting it back together, no one does it quite like D & L Weld. With a focus on safety and training, they employ up to 100 qualified employees at any given time. At the core of their business is millwrighting – the installation, aggregate repair and maintenance of industrial mills such as cement factories. Additional services include Mechanical, Plant Relocation, Heavy Rigging, Steel Fabrication, Process Pipe, Crane Rental, and as the company name suggests, Welding.

D & L Weld always strives to provide superior workmanship and efficient, cost-effective solutions to their client's projects. dandlweld.com





"Concierge banking is what I get with BCT. Whatever the need, BCT employees do their best to accommodate. If you want a personal banking relationship, BCT is the place to turn."

Ted & Sandy Reeder

TIGER'S EYE BENEFITS CONSULTING

HAGERSTOWN, MD

TIGER'S EYE

Tiger's Eye Benefits Consulting is Hagerstown, Maryland's only locally owned and operated professional corporation devoted to qualified retirement plan consulting and administration.

Tiger's Eye founder and owner, Ted Reeder, III, CPA, has over 36 years of experience in the design and administration of qualified retirement plans such as Pension, Profit Sharing and 401(K) Plans and related employee benefit programs.

Ted Reeder is a respected member within the Hagerstown community, currently serving on BCT's Washington County, MD, Advisory Board, and is a Trustee of the Community Foundation of Washington County, MD. He is a past president of the

Antietam Exchange Club, and an active member in the Maryland Association of CPAs, the American Institute of CPAs, and the American Society of Pension Pros and Actuaries. tigerseyebenefits.com



"We received numerous referrals to BCT. They've been great! They are willing to lend to a business that relies on farm income, when others won't. BCT is more than a bank, they truly want to help."

Mark & Christine Vitkus
Owners

RED GATE FARM

BLUEMONT, VA



Christine and Mark Vitkus started Red Gate Farm in 2003 in Hamilton, VA, providing horse riding lessons as a "side business to help pay the bills." The business quickly outgrew their 18-acre property. In 2016, Red Gate Farm moved to its current location in Bluemont, VA. With 230 acres (including riding trails), they currently board 55 horses, employ 10-15 enthusiasts and teach 150 weekly lessons.

Red Gate Farm hosts 20 shows a year including Hunter Shows, Jumper Shows & Horse Trials. They are home to three different championship junior equitation teams and one eventing team, competing regularly in Virginia, West Virginia and Maryland. In 2019, Red Gate Farm was honored as "Best of Loudoun Equestrian Center" by the Loudoun Times-Mirror. redgatefarmva.com





"I wanted to work with a bank that was community-minded, and that's BCT. They're responsive, congenial, and provided a comprehensive bid for my business. I plan to grow with them for quite some time."

Gagan Singh, M.D.

THE MEDICAL EYE CENTER

CHARLES TOWN, WV



MEDICAL EYE CENTER

The Medical Eye Center was founded in 2004 by Gagan Singh, M.D. in Charles Town, WV. Dr. Singh expanded his practice into Germantown, MD, in 2007. A new professional building that houses The Medical Eye Center was built in Charles Town in 2010. A University of Maryland graduate, Dr. Singh is Board Certified with the American Board of Ophthalmology and is a Clinical Associate Professor at West Virginia University. Dr. Singh's practice provides compassionate medical and surgical eye care. With a full-time staff of 12, including two ophthalmologists, The Medical Eye Center features state-of-the-art medical diagnostic equipment and

helps patients manage complex medical eye diseases. Their patients include players and coaches of the Washington Redskins.

Dr. Singh has performed thousands of surgeries and medical laser procedures including cataracts, glaucoma and diabetes.

themedeyecenter.com



"My old bank became too large and we felt lost in the shuffle. I chose BCT because of their local values and community involvement. They understand that we have unique needs, and have been creative and flexible in developing our financial partnership."

Kylie Johnson, MS, SHRM-CP
Executive Director

LASTING CHANGE

HAGERSTOWN, MD



LASTING CHANGE

Lasting Change, Recovery Solutions for Women was founded in 1988 under the auspices of the W House Foundation of Hagerstown, Inc., to address the need for supportive, sober housing for alcoholic women. In 1995, the W House received the resources necessary to provide 24-hour staffing and developed a clinical program to transition women ages 18 and over from custody to community-based treatment.

Today, Lasting Change is a private, not-for-profit residential and outpatient community substance agency for women that has expanded to provide 72 clients a full range of chemical dependency services. Care is provided for physical, emotional, social, interpersonal, and spiritual well-being. Programs encourage coordination between physicians, mental health professionals, and family participation. thewhouse.org





"Financing for our type of business is specialized and unusual. From construction financing to day-to-day business banking, our experiences with BCT have been personalized and seamless."

Darin L. Gilpin, D.V.M.

**SHENANDOAH
VETERINARY HOSPITAL**

MARTINSBURG, WV



SHENANDOAH

Shenandoah Veterinary Hospital was founded in 1974 by K.W. Gilpin, D.V.M. to serve the needs of the community's pet owners. As a family-run Eastern Panhandle business, Dr. Gilpin's son, Darin, joined the practice in 1994, followed by his brother, Brian, in 1998.

In 2008, they expanded their practice from a 3,000 square foot building with 20 employees to their current state-of-the art 10,000 square foot building with a team of over 50 veterinary care professionals.

Shenandoah Veterinary Hospital is experienced in dealing with all aspects of animal care for pets of all ages – from highly technical surgical procedures to training and behavioral problems. Services include Surgery, Advanced Diagnostics including Ultrasound, Dental, Wellness Exams, Hospitalization, Laser Surgery and K-Laser Therapy. wvvethospital.com



"We're building something every day, from custom buildings to residences. Being able to pick up the phone and call my banker at BCT enables me to stay on schedule. BCT is a great partner."

Pete Kubic, President

KUBIC CONSTRUCTION

KEARNEYSVILLE, WV



Family businesses are a dying breed, which is why Kubic Construction shines so brightly. Started in 1991, Kubic Construction has become the largest home-based builder in Jefferson County, West Virginia, with 18 full-time employees. No challenge is too difficult. Kubic Construction provides personal service and outstanding quality, specializing in unique design and architectural projects. From sketch to turnkey construction, they build custom kitchens and interiors, duplex villas, townhomes and beautiful custom residential homes. Current construction projects include the Locust Hill Golf Course Community and Potomac Overlook Estates.

Kubic Construction also builds a variety of commercial structures including manufacturing plants, office buildings, storage facilities and restaurants. Recently completed projects include Mountain View Professional Offices and five regional Dairy Queen restaurants.

kubicconstruction.com



#BCTCares

In 1871, BCT was formed by neighbors helping neighbors to provide vital financial support for a community in need. We still practice neighbor helping neighbor, not only through our financial products and services, but by volunteering our talent and time to support those who are less fortunate and promote our thriving communities. Being an involved community citizen is a significant part of who we are. We call it "BCT Cares."

In 2019, we volunteered at over 58 local community organizations which equated to 1,511 hours. We supported Meals On Wheels, toy drives, clothing drives, and shelters for people in need, to name a few. We also had over 45 volunteers support the largest public event in Berkeley County, WV, the Mountain State Apple Harvest Festival. Additionally, through our Wealth Advisors group, we administer scholarship funds that granted 28 local students with over \$556,000 towards post high school education. BCT Cares is a family of bankers who hold a trust and conviction that we must lend a helping hand to our neighbors. It's who we are.



1511 VOLUNTEER HOURS



28 SCHOLARSHIPS TOTALING \$556,020



WITH MANY THANKS TO OUR EMPLOYEES

Andrea Anderson
Mary Armstrong
Diane Armstrong
Crystal Baker
Destiny Baker
Tiffany Bartgis
Andrew Beckwith
Page Benjamin
Deborah Black
Maryann Blehr
Jessica Bohrer
Mary Bowers
Ray Bromley
Scott Bronson
Colleen Busey
Sarah Butler
Taylor Butts
Diana Cangialosi
Lou Ann Cannon
Larissa Carson

Beth Cash
Missy Castle
Sherry Clem
Desiree Cline
Dee Clingan
Dean Cognetti
Alec Collis
Steve Cowen
Leslie Crabill
Christal Crowl
Tiffany Dailey
David Dalton
Leah Day
Bryan Decker
Brittney Delauter
Tammy Demick
Kim DeSarno
Stacy Duranko
Carolyn Fisher
Kim Flagle

Shawn Fletcher
Alice Frazier
AJ Gibson
Raymond Goodrich
Michelle Griffith
Kristie Hadley
Misty Harder
Trish Hardy
Madeline Harrison
Bonnie Hayden
Kevin Haymaker
Lori Heskett
Gabrielle Hill
Wanda Hill
Kim Himes
Shelly Holmes
Aaron Howell
Zari Hylock
Sally Ishak
Linda Jenkins

Mandy Johnson
Jana Jones
Ryan Kerns
Brittany Keyes
Tim Lewis
Jennifer Lincoln
Michael Martin
Donna McCullough
Kim McGarrah
Kristal Mc Kenrick
Vicky Melby
Brent Milbourne
Gwen Miller
Tammy Miller
Christina Mills-Morrison
Ashley Minogue
Bev Mitchell
Bethany Myers
Hannah Nguyen
Ariana Nieves

Carla Nilsen
Sheila Nix
Lance Nobles
Hannah Noel
Amber Owens
Josh Parham
Urvi Patel
Julia Perry-Thorne
Jesselle Pike
Jennifer Poling
Joy Quezada
Anthony Rangelhelli
Peggy Rankin
Mikayla Reiff
Susan Riston
Nikki Robbins
Vilma Roberts
Sindy Rodrick
Jasmine Rollins
Dominique Rorie

Tyler Russell
Will Scarborough
Karen Schleuss
Lauren Silveous
Scott Slick
Betsy Smith
Angie Staubs
Selene Stevens
Barbara Stevenson
Alyssa Stewart
Matt Stickel
Shawn Stotler
Liz Turnure
Tobey Twigg
Diandra Valderrama
Jenny Villar-Revello
Julie Weister
Grant Wetmore
Steven Winters
Charles (Peanut) Wyndham

AMERICAN BANKER
BEST BANKS
TO WORK FOR
2019

SPECIAL RECOGNITION

Kristie Hadley

2019 marked a year of success for many in our BCT family. One achievement deserves special notice. Kristie Hadley, Vice President, Market Leader, was awarded the 2019 West Virginia Outstanding Community Banker Award by the Community Bankers of West Virginia (CBWV). The award recognizes a community banker in West Virginia who best exemplifies the spirit of community banking and who is acknowledged by his or her peers as an exceptional banker, community banking advocate, and community leader. We are extraordinarily proud of Kristie for this prestigious honor.



Clara Carroll

After serving BCT for nearly 48 years, Clara Carroll retired in 2019. She left a legacy of loyalty, competence, kindness, and customer allegiance. While Clara's length of service is certainly noteworthy, it is remarkable historically. She served for nearly one third of BCT's history. During that time, she performed many roles throughout the bank, including Executive Assistant to two CEOs. In addition, she provided invaluable institutional knowledge that helped BCT retain foundational values while evolving with the many changes to the financial services industry. We are thankful for Clara's distinguished career with BCT and wish her a meaningful and prosperous retirement.



QUARTERLY FINANCIAL REPORTS are available online. To access a copy of these reports, visit: mybct.com

For further information contact:
Dean J. Cagnetti
Executive Vice President,
Chief Financial Officer &
Secretary/Treasurer,
Potomac Bancshares, Inc.

111 East Washington Street
P.O. Box 906
Charles Town, WV 25414-0906



Stock Trading Symbol – OTC: PTBS

Dividend Reinvestment & Direct Stock Purchase and Sale Plan

American Stock Transfer & Trust Company, LLC (the "Plan Administrator") has established a Dividend Reinvestment & Direct Stock Purchase and Sale Plan (the "Plan") for convenience of investors and shareholders in Potomac Bancshares, Inc. common stock. Contact American Stock Transfer directly with any questions.

STOCK TRANSFER AGENT

American Stock Transfer & Trust
Company, LLC
Operations Center – 6201 15th Avenue,
Brooklyn, NY 11219
718-921-8124 / 800-937-5449
www.astfinancial.com

ANNUAL MEETING

The annual meeting of stockholders will be held at the
Bavarian Inn
164 Shepherd Grade Road
Shepherdstown, WV 25443
Tuesday, April 28th, 2020
Beginning at 10:30 a.m.

POTOMAC BANCSHARES, INC.

Charles Town, West Virginia

NOTICE OF REGULAR ANNUAL MEETING OF SHAREHOLDERS

TO BE HELD APRIL 28, 2020

To the Shareholders:

The Regular Annual Meeting of Shareholders of Potomac Bancshares, Inc. ("Potomac") will be held at the Bavarian Inn, Shepherdstown, West Virginia, at 10:30 a.m., on April 28, 2020, for the purposes of considering and voting upon proposals:

1. To elect a class of directors for a term of three years;
2. To ratify the appointment by the Board of Directors of Yount, Hyde & Barbour, P.C., as independent registered public accountants for the year 2020; and

To approve any other business that may properly be brought before the meeting or any adjournment thereof.

Only those shareholders of record at the close of business on February 26, 2020, shall be entitled to notice of the meeting and to vote at the meeting.

By Order of the Board of Directors

Alice P. Frazier
President and Chief Executive Officer

PLEASE SIGN AND RETURN THE ENCLOSED PROXY AS PROMPTLY AS POSSIBLE, WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING IN PERSON. IF YOU DO ATTEND THE MEETING, YOU HAVE THE OPTION TO REVOKE YOUR PROXY BEFORE IT IS VOTED.

IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY MATERIALS FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON APRIL 28, 2020 - THE PROXY STATEMENT AND 2019 ANNUAL REPORT ARE AVAILABLE AT WWW.PROXYVOTE.COM.

March 16, 2020

**POTOMAC BANCSHARES, INC.
111 EAST WASHINGTON STREET
P.O. BOX 906
CHARLES TOWN, WEST VIRGINIA 25414-0906
(304) 725-8431**

**PROXY STATEMENT
ANNUAL MEETING OF SHAREHOLDERS – APRIL 28, 2020**

Potomac Bancshares, Inc. is furnishing this statement in connection with its solicitation of proxies for use at the annual meeting of shareholders of Potomac Bancshares, Inc. to be held on April 28, 2020, at the time and for the purposes set forth in the accompanying notice of regular annual meeting of shareholders.

Solicitation of Proxies

Potomac's management, at the direction of Potomac's Board of Directors, is making this proxy solicitation. These proxies enable shareholders to vote on all matters scheduled to come before the meeting. If the enclosed proxy is signed and returned, it will be voted as directed; or if not directed, the proxy will be voted "FOR" all of the various proposals to be submitted to the vote of shareholders described in the enclosed notice of regular annual meeting and this proxy statement. A shareholder executing the proxy may revoke it at any time before it is voted by:

- notifying Potomac in person,
- giving written notice to Potomac of the revocation of the proxy,
- submitting to Potomac a subsequently dated proxy, or
- attending the meeting and withdrawing the proxy before it is voted at the meeting.

Potomac will pay the expenses of this proxy solicitation. In addition to this solicitation by mail, officers and regular employees of Potomac and Bank of Charles Town may, to a limited extent, solicit proxies personally or by telephone or telegraph, although no person will be engaged specifically for that purpose.

Eligibility of Stock for Voting Purposes

Under Potomac's bylaws, the Board of Directors has fixed February 26, 2020, as the record date for determining the shareholders entitled to notice of, and to vote at, the meeting or any adjournment thereof. Only shareholders of record at the close of business on that date are entitled to notice of and to vote at the annual meeting or any adjournment thereof. The presence, in person, or by properly executed proxy, of the holders of a majority of the outstanding shares of the company's common stock entitled to vote at the annual meeting is necessary to constitute a quorum at the annual meeting. Abstentions will be counted as shares present for purposes of determining the presence of a quorum. Any shares held in street name that are not voted ("broker non-votes") in the election of directors will not be included in determining the number of votes.

As of the record date for the annual meeting, 4,133,811 shares of the capital stock of Potomac were outstanding and entitled to vote. As of the record date, Potomac had a total of approximately 1,200 shareholders.

PURPOSES OF MEETING

1. ELECTION OF DIRECTORS

General

Potomac's articles of incorporation currently provide for a classified Board of Directors. There are three classes with each being elected for a three-year term. There are presently 12 directors on the Board, four of whom are nominees for election at the 2020 annual meeting. Four directors (Bouweiri, Casagrande, Cogswell, and Skinner) are being elected for a term of three years.

Directors are elected by a plurality of the shares voted. As required by West Virginia law, each share is entitled to one vote per nominee, unless a shareholder requests cumulative voting for directors at least 48 hours before the meeting. If a shareholder properly requests cumulative voting for directors, then each shareholder will have the right to vote the number of shares owned by that shareholder for as many persons as there are directors to be elected, or to cumulate such shares and give one candidate as many votes as the number of directors multiplied by the number of shares owned shall equal, or to distribute them on the same principle among as many candidates as the shareholder sees fit. If any shares are voted cumulatively for the election of directors, the proxies, unless otherwise directed, shall have full discretion and authority to cumulate their votes and vote for less than all such nominees. For all other purposes, each share is entitled to one vote. Because director nominees must receive a plurality of the votes cast at the meeting, a vote withheld will not affect the outcome of the election.

The Board of Directors has a nominating committee tasked with identifying potential Board of Director members. The nominating committee makes nominations based upon its belief that candidates for director should have certain minimum qualifications, including:

- Directors should be of the highest ethical character.
- Directors should have excellent personal and professional reputations in the company's market area.
- Directors should be accomplished in their professions or careers.
- Directors should be able to read and understand financial statements and either have knowledge of, or the ability and willingness to learn, financial institution law.
- Directors should have relevant experience and expertise to evaluate financial data and provide direction and advice to the Chief Executive Officer and the ability to exercise sound business judgment.
- Directors must be willing and able to expend the time to attend meetings of the Board of Directors of the company and the bank and to serve on Board committees.
- The Board of Directors will consider whether a nominee is independent. In addition, directors should avoid the appearance of any conflict and should be independent of any particular constituency and be able to serve all shareholders of the company.

- Directors must be acceptable to the company's and the bank's regulatory agencies, including the Federal Reserve Board, the Federal Deposit Insurance Corporation and the West Virginia Division of Financial Institutions and must not be under any legal disability which prevents them from serving on the Board of Directors or participating in the affairs of a financial institution.
- Directors must own or acquire sufficient capital stock to satisfy the requirements of federal law, state law and the bylaws of Potomac.

The nominating committee reserves the right to modify these minimum qualifications from time to time, except where the qualifications are required by the laws relating to financial institutions.

The process of identifying and evaluating nominees is as follows: In the case of incumbent directors whose terms are set to expire, the committee considers the directors' overall service to the company during their term, including such factors as the number of meetings attended, the level of participation, quality of performance and any transactions between such directors of the company and the bank. The Board also reviews the payment history of loans, if any, made to such directors of the bank to ensure that the directors are not chronically delinquent and in default. The committee considers whether any transactions between the directors and the bank have been criticized by any banking regulatory agency or the bank's external auditors and whether corrective action, if required, has been taken and was sufficient. The nominating committee also confirms that such directors remain eligible to serve on the Board of Directors of a financial institution under federal and state law. For new director candidates, the committee uses its network of contacts in the company's market area to compile a list of potential candidates. The committee then meets to discuss each candidate and whether he or she meets the criteria set forth above. The committee then discusses each candidate's qualifications and chooses a candidate by majority vote.

The committee will consider director candidates recommended by shareholders, provided that the recommendations are received at least 120 days before the next annual meeting of shareholders. In addition, the procedures set forth below are to be followed by shareholders submitting nominations. The committee does not intend to alter the manner in which it evaluates candidates, regardless of whether or not the candidate was recommended or nominated by a shareholder.

Potomac's bylaws provide that nominations for election to the Board of Directors, other than those made by or on behalf of Potomac's existing management, must be made by a shareholder in writing delivered or mailed to the President not less than 14 days nor more than 50 days prior to the meeting called for the election of directors; provided, however, that if less than 21 days' notice of the meeting is given to shareholders, the nominations must be mailed or delivered to the President not later than the close of business on the 7th day following the day on which the notice of meeting was mailed. The notice of nomination must contain the following information, to the extent known:

- name and address of nominee(s);
- principal occupation of nominee(s);
- total shares to be voted for each nominee;
- name and address of notifying shareholder;
- number of shares owned by notifying shareholder; and
- consent of such nominee(s) to being named in the proxy statement as a nominee and to serving as such a director, if elected.

Nominations not made in accordance with these requirements may be disregarded by the chairman of the meeting and in such case the votes cast for each such nominee will likewise be disregarded.

Management Nominees to the Board of Potomac

Nominees	Age	Served As Director of Potomac Since	Family Relationship With Other Nominees	Year in Which Term Expires	Principal Occupation or Employment Last Five Years
<u>For a term of three years:</u>					
Kristina Bouweiri	57	2019	None	2020	President & CEO, Reston Limousine, Loudoun County, Virginia.
Norman M. Casagrande	60	2013	None	2020	Retired Location Manager, BMC East, LLC; Member, MAC Industries, LLC Berkeley County, West Virginia
Margaret M. Cogswell	61	2003	None	2020	Chief Executive Officer, Hospice of the Panhandle, Berkeley, Hampshire, Jefferson and Morgan Counties, West Virginia since 1987.
Andrew C. Skinner	49	2017	None	2020	Attorney/Owner, Skinner Law Firm. Jefferson County, West Virginia.

The Board of Directors recommends that shareholders vote “For” all the nominees listed above.

Directors Continuing to Serve Unexpired Terms

Nominees	Age	Served As Director of Potomac Since	Family Relationship With Other Nominees	Year in Which Term Expires	Principal Occupation or Employment Last Five Years
Dr. Keith B. Berkeley	61	2008	None	2021	Veterinarian, President of Valley Equine Associates, Jefferson County, West Virginia. Chairman of The Board, Potomac Bancshares, Inc. and Bank of Charles Town.
J. Scott Boyd	63	1999	None	2022	Pharmacist, owner Jefferson Pharmacy, Inc., Jefferson County, West Virginia since 1982; Pharmacist, owner JSB Enterprises, Inc. dba South Berkeley Pharmacy, Berkeley County, West Virginia since 2006; Manager, Mountain Spring Properties, LLC.
Alice P. Frazier	55	2017	None	2021	Employed by Potomac Bancshares, Inc. and Bank of Charles Town as of July 5, 2017 as President and Chief Executive Officer.
Dr. Mitesh B. Kothari, M.D.	50	2019	None	2022	Partner, Capital Women's Care, Washington County, Maryland; Chairman, Bank of Charles Town Washington County, Maryland Advisory Board.
Barbara H. Pichot	72	2004	None	2022	Certified Public Accountant (retired), retired partner CoxHollida LLP, a public accounting firm in Berkeley County, West Virginia, 1981 to 2006; past President, Hospice of the Panhandle; past Chair, Board of Governors, Shepherd University.
Barbara L. Scott	71	2012	None	2021	Summit Point Raceway Associates, Inc. and BSR, Inc.; CEO of Summit Point Raceway Associates, Inc. and BSR, Inc., 2009 to 2018; former Managing Member of Summit Point Automotive Research Center, LLC.
C. Larry Togans	73	2004	None	2022	Retired Deputy Branch Chief of Human Resources, U. S. Geological Survey, employed 1973 to 2001.
Anthony P. Zelenka	66	2015	None	2021	President and Chief Executive Officer of WVU Medicine – Berkeley Medical Center and Jefferson Medical Center.

Alice P. Frazier has 29 years of banking experience. She was the Executive Vice President and Chief Operating Officer of Cardinal Financial Corporation prior to being hired as President and CEO of Potomac Bancshares and Bank of Charles Town. Before joining Cardinal, she was Senior Vice President and Area Executive for BB&T in the Loudoun County, VA market. Ms. Frazier began her banking career at Middleburg Financial Corporation in 1991 serving as Chief Financial Officer and later Chief Operating Officer. Prior to her banking career, she worked in public accounting with a national and a regional firm. Ms. Frazier is a graduate of Radford University and Stonier Graduate School of Banking. She is a past Chair of the Virginia Association of Community Banks. Ms. Frazier has served as chair of various committees and as at large director with the Independent Community Bankers America (ICBA). In March 2019, Ms. Frazier was elected Secretary of the ICBA. She is a current board member of two non-profit organizations; the Loudoun County Economic Development Authority and WVU Hospital.

Dr. Keith B. Berkeley is the Chairman of the Board of Directors of Potomac and the Bank and has served on the Board of Directors since July 2008. He has been a veterinarian and business owner in the Eastern Panhandle of West Virginia for 20 plus years. Dr. Berkeley earned his Doctor of Veterinary Medicine from the Tuskegee Institute. Dr. Berkeley was elected to the Board for his business experience and his knowledge of Potomac's and Bank of Charles Town's market areas by virtue of his relationship with the community through his veterinary practice and as a successful businessman. In addition, Dr. Berkeley has attended the FDIC/West Virginia Community Bankers Directors College to further his own knowledge of the banking industry and his responsibilities as a Director.

Kristina Bouweiri serves as CEO and President of Reston Limousine, the premier chauffeured transportation provider in the Washington, DC Metro area and eighth largest in the nation. The company is headquartered in Sterling, Virginia and she is a long-time resident of Leesburg, Virginia. Ms. Bouweiri is a former board member of the DC Chamber of Commerce and Washington DC Economic Partnership. She is a current board member of Northern Virginia Community College, Inova Loudoun Hospital Foundation, Loudoun CEO Cabinet, Childrens Science Center and Enterprising Woman magazine. Ms. Bouweiri also serves as trustee of the Loudoun Education Foundation. Bouweiri founded the networking luncheon Sterling Women and co-founded the annual Virginia Women's Business Conference, two programs that have helped hundreds of women entrepreneurs and executives achieve their professional goals. She also is a member of the Dean's Council of the George Mason School of Business. In addition, Bouweiri has numerous awards and recognitions including Washington Business Journal's Power 100 and Top Women-Owned Businesses in Washington, DC, George Mason University School of Business Outstanding Leadership Award, DC Chamber of Commerce Business Leader of the Year and International Women's Entrepreneurial Challenge Award. Ms. Bouweiri holds a Bachelor of Arts degree in International Affairs from George Washington University.

J. Scott Boyd is a pharmacist and owner of one pharmacy in both Berkeley and Jefferson Counties. Mr. Boyd is a graduate of the West Virginia University School of Pharmacy. Mr. Boyd was chosen for his experience as a business owner and his knowledge of the market areas of Potomac and Bank of Charles Town in both Berkeley and Jefferson Counties. He has 30 plus years of business experience as well as his contacts with an array of persons from the communities the bank serves. Mr. Boyd has attended the FDIC/West Virginia Community Bankers Directors College.

Norman M. Casagrande is retired from his position as location manager for BMC East, LLC. He is also a member in MAC Industries, LLC in Spring Mills, West Virginia. BMC East is a building materials supplier and manufacturer. Mr. Casagrande is originally from the Pittsburgh, PA area and earned a Business/Economics degree from Washington and Jefferson College in Washington, PA. He previously owned a building materials company and was employed with 84 Lumber for eight years. Mr. Casagrande's manufacturing background and experience in the housing industry is an important asset for the board as much of the bank's portfolio is invested in residential real estate. Mr. Casagrande has attended the FDIC/West Virginia Community Bankers Directors College.

Margaret M. Cogswell is Chief Executive Officer of Hospice of the Panhandle. She has an Associate of Science degree in Nursing from Shepherd College. Ms. Cogswell brings a unique perspective of someone that has been involved in non-profit organizations most of her adult life and as a result, has a number of contacts within the company's and the bank's market area in Jefferson and Berkeley Counties, West Virginia. Her duties as CEO include management of a multi-million-dollar budget. Ms. Cogswell is and has been involved with the non-profit community and her management experience is a valuable asset to the Board of Directors. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director. In addition, she serves as Chairwoman of the Personnel Committee.

Dr. Mitesh B. Kothari, M.D. is a partner of Capital Women's Care, one of the largest medical practices for female health services in Hagerstown and Washington County, Maryland. This premier group is located at the Trilogy Professional Center in Hagerstown, Maryland. Dr. Kothari also serves as Chairman of BCT's Washington County, Maryland, Advisory Board, where he was a member since 2014. Additionally, Dr. Kothari serves and has served on many community and non-profit Boards, including Meritus Medical Center Foundation, Community Foundation of Washington County, Leadership Washington County, YMCA, and the Greater Hagerstown Committee. After completing his residency training in Obstetrics and Gynecology at the University of Maryland Hospital, Dr. Kothari returned to Hagerstown to open his practice. Dr. Kothari completed his graduate and undergraduate studies at the University of Maryland.

Barbara H. Pichot is a Certified Public Accountant (retired), and retired partner with CoxHollida LLP. Ms. Pichot has over 25 years of experience in public accounting and as the controller of a concrete manufacturing facility. She is a graduate of Shepherd College with a degree in accounting and was elected to the Board for her financial and accounting expertise. She currently serves as the company's Audit Committee financial expert. Ms. Pichot adds her knowledge of accounting and audit procedures and her business acumen to the board. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director.

Barbara L. Scott retired from Summit Point Raceway Associates Inc. (SPRA) and BSR Inc. where she served as CEO from 2009 to 2018. These are the operating entities for the 785-acre Summit Point Motorsports Park located in Summit Point, West Virginia. SPRA hosts motorsport events to include amateur road racing for sports cars, motorcycles and karts. BSR Inc. provides specialty and anti-terrorist driver training programs for government agencies and the U.S. military. Ms. Scott is a graduate of Southern Methodist University with a degree in Biology and English. Ms. Scott began her employment at Summit Point in 1987 and has extensive experience in all facets of the business. She contributes her business acumen gained in managing and operating a multi-faceted and highly successful company. Additionally, Ms. Scott has gained experience working and negotiating with governmental entities which are becoming more and more prevalent in the bank's local market area. Ms. Scott currently resides near Middleburg, Virginia and provides good perspective on the Northern Virginia banking market. She has attended the FDIC/West Virginia Community Bankers Directors College to further her knowledge of the banking industry and her responsibilities as a Director.

Andrew C. Skinner is an attorney/owner at Skinner Law Firm in Charles Town, WV. Mr. Skinner has a bachelor's degree in economics from the College of William and Mary. Mr. Skinner served in the Army for four years. After coming off active duty, he obtained his law degree from the University of Texas School of Law. Mr. Skinner continues his military career by serving in the Army Reserves. He serves on the Board of the Jefferson County Chamber of Commerce. He also founded Leadership Jefferson, a program of the Jefferson County Chamber of Commerce. Mr. Skinner brings broad legal expertise to the board and has strong ties in the community.

C. Larry Togans is retired from the U. S. Geological Survey in Reston, VA where he served as the Deputy Branch Chief of Human Resources and Management Support. In his position, Mr. Togans served as special advisor to the Senior Executive Staff (SES) who manages more than 5000 geoscientists and technical support staff members. Mr. Togans received his Bachelor's degree from Shepherd College. Mr. Togans provides expertise in the human resources field and he has served as Board member in several positions including serving on the Shepherd University Foundation and Jefferson County Board of Education. Mr. Togans has taken the time to advance his knowledge of banking and directorship by attending the FDIC/West Virginia Community Bankers Directors College.

Anthony P. Zelenka was named President and Chief Executive Officer of WVU Medicine – Berkeley Medical Center and Jefferson Medical Center during 2015. Mr. Zelenka previously held the title of President and Chief Operating Officer from 2008 until 2015. A graduate of Marietta College in Ohio, he holds a certificate from the Executive Program in Healthcare Financial Management and a Master of Health Administration from The Ohio State University. Mr. Zelenka's business acumen and knowledge of an evolving healthcare industry is a real asset to the company.

Ownership of Securities by Nominees, Directors and Officers

All nominees, directors and principal officers have beneficial ownership of 154,261 shares as a group. These shares represent, in aggregate, 3.73% of the common stock of Potomac Bancshares, Inc. The information is furnished as of January 31, 2020, on which date 4,133,811 shares were outstanding.

Compensation of Directors

Directors of Potomac were not compensated for their services as directors during 2019, other than for committee meetings attended. Directors of the bank were compensated at the rate of \$900 for each regular Board meeting attended in 2019. The Chairman of the Board was paid \$500 per month in addition to director and committee fees. Directors were compensated \$220 for each committee meeting attended in 2019. The Audit Committee member who is deemed the financial expert was compensated \$330 for each Audit Committee meeting attended in 2019. The Chairperson of the Salary and Personnel Committee receives \$330 per meeting attended. All directors receive 50 shares of Potomac Stock for each quarter of service as additional compensation. Directors who are operating officers of the bank are not compensated for committee meetings attended. Potomac has an incentive plan for directors. In the event that certain profitability goals are achieved, each director is eligible to receive 200 shares of common stock. Those goals were achieved in 2018, and each director received 200 shares in 2019. These shares were purchased on the open market and transferred to the directors.

Certain Transactions with Directors, Officers and Their Associates

Potomac and the bank have had, and expect to have in the future, transactions in the ordinary course of business with directors, officers, principal shareholders and their associates. All these transactions remain on substantially the same terms, including interest rates, collateral and repayment terms on the extension of credit, as those prevailing at the same time for comparable transactions with unaffiliated persons, and in the opinion of management of Potomac and the bank, did not involve more than the normal risk of collectability or present other unfavorable features.

Potomac does not have a formal policy on related party transactions, although these transactions are subject to compliance with federal and state corporate and banking laws. As stated in the previous paragraph, transactions with directors are on the same terms and require the same documentation as those transactions with unaffiliated persons. These transactions are voted on by the Board of Directors with the particular director absent for the discussion and voting. The transactions and voting are recorded in the minutes. These transactions are designated so the information is accessible as needed for reporting purposes.

2. RATIFICATION OF SELECTION OF AUDITORS

The Audit Committee of the Board of Directors has selected the firm of Yount, Hyde & Barbour, P.C. to serve as independent auditors for Potomac for the calendar year 2020. If the shareholders do not ratify the appointment of Yount, Hyde & Barbour, P.C., the committee will consider the appointment of other auditors. Potomac is advised that no member of this accounting firm has any direct or indirect material interest in Potomac, or any of its subsidiaries.

A representative of Yount, Hyde & Barbour, P.C., will be present at the annual meeting to respond to appropriate questions and to make a statement if he or she so desires. The enclosed proxy will be voted “FOR” the ratification of the selection of Yount, Hyde & Barbour, P.C., unless otherwise directed. The affirmative vote of a majority of the shares of Potomac’s common stock represented at the annual meeting of shareholders is required to ratify the appointment of Yount, Hyde & Barbour, P.C. Because a majority of the votes cast will be sufficient for the ratification of the appointment of Yount, Hyde & Barbour, P. C., neither broker non-votes nor abstentions will affect the outcome of the proposal. Any shares held in street name that are not voted (“broker non-votes”) will not be included in determining the number of votes cast.

The Audit Committee and the Board of Directors unanimously recommend that shareholders vote “For” such ratification.

OTHER MATTERS

If any of the nominees for election as directors should be unable to serve as a director by reason of death or other unexpected occurrence, a proxy will be voted for a substitute nominee or nominees designated by the Board of Potomac unless the Board of Directors adopts a resolution pursuant to the bylaws reducing the number of directors.

The Board of Directors is unaware of any other matters to be considered at the meeting but; if any other matters properly come before the meeting, persons named in the proxy will vote such proxy in accordance with their judgment on such matters.

SHAREHOLDER COMMUNICATIONS WITH THE BOARD

Any shareholder desiring to contact the Board of Directors or any individual director serving on the Board may do so by written communication mailed to: Board of Directors, Attention: (name of director(s), as applicable), c/o Corporate Secretary Dean Cognetti, Potomac Bancshares, Inc., P.O. Box 906, Charles Town, West Virginia 25414. Any proper communication so received will be processed by the Corporate Secretary as agent for the Board. Unless, in the judgment of the Corporate Secretary, the matter is not intended or appropriate for the Board (and subject to any applicable regulatory requirements), the Corporate Secretary will prepare a summary of the communication for prompt delivery to each member of the Board or, as appropriate, to the member(s) of the Board named in the communication. Any director may request the Corporate Secretary to produce for his or her review the original of the shareholder communication.

MEETING LOCATION, TIME AND DATE

The Regular Annual Meeting of Shareholders will be held at the Bavarian Inn, Shepherdstown, WV at 10:30 a.m. on April 28, 2020.

Alice P. Frazier
President and Chief Executive Officer

Charles Town, West Virginia
March 16, 2020

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders
Potomac Bancshares, Inc. and Subsidiary
Charles Town, West Virginia

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Potomac Bancshares, Inc. and Subsidiary, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, changes in stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements).

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

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

Yount, Hyde & Barbours, P.C.

Winchester, Virginia
March 16, 2020

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS
December 31, 2019 and 2018
(\$ in thousands, except per share data)

	<u>2019</u>	<u>2018</u>
ASSETS		
Cash and due from banks	\$ 2 994	\$ 2 449
Interest-bearing deposits in other financial institutions	29 512	53 972
Investment Securities:		
Available-for-sale, at fair value	50 471	48 463
Equity securities, at fair value	133	132
Loans held for sale	2 034	323
Loans, net of allowance for loan losses of \$3,716 in 2019 and \$3,269 in 2018	408 744	360 688
Premises and equipment, net	7 897	7 770
Other real estate owned, net of valuation allowance of \$51 in 2019 and \$192 in 2018	53	170
Accrued interest receivable	1 178	1 053
Bank owned life insurance	7 641	7 457
Federal Home Loan Bank of Pittsburgh stock	727	645
Other assets	<u>4 402</u>	<u>1 428</u>
 Total Assets	 <u><u>\$515 786</u></u>	 <u><u>\$484 550</u></u>
 LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Deposits		
Noninterest-bearing	\$ 70 023	\$ 58 449
Interest-bearing	<u>379 857</u>	<u>365 678</u>
Total Deposits	449 880	424 127
Short term borrowings	3 910	3 287
Long term borrowings	5 000	5 516
Accrued interest payable	337	355
Other liabilities	<u>4 737</u>	<u>1 741</u>
Total Liabilities	<u><u>\$463 864</u></u>	<u><u>\$435 026</u></u>
 STOCKHOLDERS' EQUITY		
Common stock, \$1 per share par value; 10,000,000 shares authorized; 4,482,501 issued and outstanding at December 31, 2019 and at December 31, 2018	\$ 4 483	\$ 4 483
Surplus	14 358	14 358
Undivided profits	38 869	36 814
Accumulated other comprehensive loss, net	<u>(2 294)</u>	<u>(2 637)</u>
	\$ 55 416	\$ 53 018
Less cost of shares acquired for the treasury, 348,690 shares in 2019 and 2018	<u>(3 494)</u>	<u>(3 494)</u>
Total Stockholders' Equity	<u><u>\$ 51 922</u></u>	<u><u>\$ 49 524</u></u>
 Total Liabilities and Stockholders' Equity	 <u><u>\$515 786</u></u>	 <u><u>\$484 550</u></u>

See Notes to Consolidated Financial Statements.

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2019 and 2018
(\$ in thousands, except per share data)

	2019	2018
Interest and Dividend Income:		
Interest and fees on loans	\$17 830	\$15 869
Interest on securities available for sale – taxable	1 153	702
Interest on securities available for sale – nontaxable	44	64
Other interest and dividends	1 048	930
Total Interest and Dividend Income	<u>20 075</u>	<u>17 565</u>
Interest expense:		
Interest on deposits	3 655	2 522
Interest on short term borrowings	13	20
Interest on long term borrowings	115	157
Total Interest Expense	<u>3 783</u>	<u>2 699</u>
Net Interest Income	16 292	14 866
Provision for Loan Losses	474	312
Net Interest Income after Provision for Loan Losses	<u>15 818</u>	<u>14 554</u>
Noninterest Income:		
Trust and financial services	1 334	1 217
Service charges on deposit accounts	1 173	1 129
Secondary market income	1 050	453
Interchange fees	1 384	1 319
Earnings on bank owned life insurance	184	178
Loss on sales of securities available for sale	(7)	(6)
Other operating income	347	385
Total Noninterest Income	<u>5 465</u>	<u>4 675</u>
Noninterest Expense:		
Salaries and employee benefits	9 070	7 735
Net occupancy expense of premises	1 136	864
Furniture and equipment expenses	1 628	1 403
Loss (gain) on sales of other real estate	7	(2)
Accounting, audit and compliance	302	213
Advertising and public relations	367	369
Computer services and online banking	733	691
FDIC assessment	67	153
Other professional fees	271	300
Trust investing outsource	208	209
Director & committee fees	251	217
Legal fees	205	206
Printing, stationery and supplies	235	202
Communications	325	194
Foreclosed property expense	36	35
Write down of other real estate owned	10	50
ATM and check card expenses	825	772
Other operating expenses	1 493	1 272
Total Noninterest Expenses	<u>17 169</u>	<u>14 883</u>
Income before Income Tax Expense	4 114	4 346
Income Tax Expense	901	954
Net Income	<u>\$ 3 213</u>	<u>\$ 3 392</u>
Earnings Per Common Share, Basic and Diluted	<u>\$ 0.78</u>	<u>\$.94</u>

See Notes to Consolidated Financial Statements.

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2019 and 2018
(\$ in thousands)

	<u>2019</u>	<u>2018</u>
Net Income	<u>\$3 213</u>	<u>\$3 392</u>
Other comprehensive income:		
Unrealized holding gain (loss) on securities, net of tax of \$202 and \$8, respectively	605	(23)
Reclassification adjustment for losses included in net income, net of tax of \$2 and \$1, respectively	5	5
Net pension and other postretirement loss arising during the period net of tax of \$151 and \$24, respectively	(455)	(71)
Amortization of net actuarial loss included in net periodic benefit cost net of tax of \$63 and \$61, respectively	<u>188</u>	<u>182</u>
Other comprehensive income, net of tax	<u>343</u>	<u>93</u>
Comprehensive income	<u><u>\$3 556</u></u>	<u><u>\$3 485</u></u>

See Notes to Consolidated Financial Statements.

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years Ended December 31, 2019 and 2018
(\$ in thousands, except per share data)

	Common Stock	Surplus	Undivided Profits	Treasury Stock	Accumulated Other Comprehensive Loss, net	Total
Balances, December 31, 2017	\$3 672	\$ 3 944	\$34 425	\$ (3 494)	\$ (2 728)	\$ 35 819
Net Income	--	--	3 392	--	--	3 392
Issuance of common shares, net of issuance costs	811	10 414	--	--	--	11 225
Cumulative effect adjustment (ASU 2016-01)	--	--	2	--	(2)	--
Other comprehensive income	--	--	--	--	93	93
Cash dividends (\$.28 per share)	--	--	(1 005)	--	--	(1 005)
Balances, December 31, 2018	<u>\$4 483</u>	<u>\$14 358</u>	<u>\$36 814</u>	<u>\$ (3 494)</u>	<u>\$ (2 637)</u>	<u>\$49 524</u>
Net Income	--	--	3 213	--	--	3 213
Other comprehensive income	--	--	--	--	343	343
Cash dividends (\$.28 per share)	--	--	(1 158)	--	--	(1 158)
Balances, December 31, 2019	<u>\$4 483</u>	<u>\$14 358</u>	<u>\$38 869</u>	<u>\$ (3 494)</u>	<u>\$ (2 294)</u>	<u>\$51 922</u>

See Notes to Consolidated Financial Statements.

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2019 and 2018
(\$ in thousands)

	2019	2018
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3 213	\$ 3 392
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	474	312
Depreciation and amortization	999	545
Loss on disposals of premises and equipment	--	14
Deferred tax (benefit) expense	(39)	107
(Discourt accretion) premium amortization on securities, net	(24)	11
Write down of other real estate owned	10	50
Loss (gain) on sales of other real estate owned	7	(2)
Loss on sale of securities available for sale, net	7	6
Fair value adjustment on equity securities	(1)	(14)
Increase in loans held for sale	(1 711)	(323)
Earnings on bank owned life insurance	(184)	(178)
Changes in assets and liabilities:		
Increase in accrued interest receivable	(125)	(90)
Increase in other assets	(646)	(106)
(Decrease) increase in accrued interest payable	(18)	136
Decrease in other liabilities	(78)	(45)
Net cash provided by operating activities	<u>\$ 1 884</u>	<u>\$ 3 815</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from maturity of certificates of deposits in other financial institutions	\$ 2 747	\$ 1 000
Proceeds from call of certificates of deposits in other financial institutions	250	--
Purchase of certificates of deposits from other financial institutions	(245)	(2 747)
Proceeds from sale of securities available for sale	2 986	703
Proceeds from maturities and principal repayments of securities available for sale	8 870	7 353
Proceeds from call of securities available for sale	15 045	--
Purchases of securities available for sale	(28 078)	(25 363)
Net increase in loans	(48 530)	(17 971)
Purchases of premises and equipment	(812)	(1 174)
(Purchase) redemption of FHLB stock, net	(82)	209
Proceeds from sale of other real estate owned	100	151
Net cash used in investing activities	<u>\$(47 749)</u>	<u>\$(37 839)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Net increase in noninterest-bearing deposits	\$ 11 574	\$ 3 765
Net increase in interest-bearing deposits	14 179	48 203
Net proceeds (repayment) of short term borrowings	623	(538)
Net repayment of long term borrowings	(516)	(6 022)
Proceeds from issuance of common stock, net of issuance costs	--	11 225
Cash dividends	(1 158)	(1 005)
Net cash provided by financing activities	<u>\$ 24 702</u>	<u>\$ 55 628</u>
(Decrease) increase in cash and cash equivalents	\$(21 163)	\$ 21 604
CASH AND CASH EQUIVALENTS		
Beginning	49 424	27 820
Ending	<u>\$ 28 261</u>	<u>\$ 49 424</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash payments for:		
Interest	\$ 3 801	\$ 2 563
Income taxes	<u>\$ 672</u>	<u>\$ 579</u>
SUPPLEMENTAL DISCLOSURES OF NON-CASH		
INVESTING AND FINANCING ACTIVITIES		
Unrealized gain (loss) on securities available for sale	\$ 814	\$ (25)
Change in benefit obligations and plan assets for pension and other postretirement benefits	\$ (355)	\$ 148
Loans transferred to other real estate owned	\$ --	\$ 149
Lease liabilities arising from right-of-use assets	<u>\$ 2 718</u>	<u>\$ --</u>

See Notes to Consolidated Financial Statements.

POTOMAC BANCSHARES, INC. AND SUBSIDIARY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Nature of Banking Activities and Significant Accounting Policies

Potomac Bancshares, Inc., and Subsidiary (collectively the company), through Bank of Charles Town, (the bank) a wholly owned subsidiary of Potomac Bancshares, Inc., grants commercial, financial, agricultural, residential and consumer loans to customers, primarily in Jefferson, Berkeley and Morgan Counties of West Virginia; Clarke, Frederick and Loudoun Counties of Virginia; and Washington and Frederick Counties of Maryland. The loan portfolio, while having a higher concentration of real estate loans, is diversified among a large number of borrowers and loans generally are collateralized by assets of the customers. The loans are expected to be repaid from cash flows from business operations, customers' recurring income, or proceeds from the sale of selected assets of the borrowers.

Bank of Charles Town is a West Virginia state-chartered bank that formed and opened for business in 1871. The Federal Deposit Insurance Corporation insures the customer's deposits up to \$250,000. The main office is in Charles Town, West Virginia at 111 East Washington Street, with additional branch and loan production offices in:

- Harpers Ferry, West Virginia,
- Kearneysville, West Virginia,
- Martinsburg, West Virginia,
- Hedgesville, West Virginia,
- Hagerstown, Maryland,
- Middleburg, Virginia,
- Purcellville, Virginia,
- Leesburg, Virginia and
- Leesburg, Virginia, Loan Production office

The company also offers deposit products to the same primary market area as loans. These products include noninterest-bearing and interest-bearing checking accounts, savings accounts and certificates of deposit in various terms. The company also offers through BCT Wealth Management; financial planning, trust and investment management products.

The accounting and reporting policies of the company conform to accounting principles generally accepted in the United States of America and to general practices within the banking industry. The following is a summary of the more significant policies.

Principles of Consolidation

The consolidated financial statements of Potomac Bancshares, Inc. and its wholly-owned subsidiary, Bank of Charles Town, include the accounts of both companies. All material intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

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

Interest-Bearing Deposits in Financial Institutions

Interest-bearing deposits in financial institutions are primarily overnight deposits held at the Federal Reserve and certificates of deposits with other financial institutions. These funds are carried at cost.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Securities

Investments in debt securities with readily determinable fair values are classified as either held to maturity, available for sale, or trading, based on management's intent. Currently all debt securities of the company are classified as available for sale. Available for sale securities are carried at estimated fair value with the corresponding unrealized gains and losses excluded from earnings and reported in other comprehensive income. Gains or losses are recognized in earnings on the trade date using the amortized cost of the specific security sold. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities.

Impairment of securities occurs when the fair value of a security is less than its amortized cost. For debt securities, impairment is considered other-than-temporary and recognized in its entirety in net income if either (1) the company intends to sell the security or (2) it is more-likely-than-not that the company will be required to sell the security before recovery of its amortized cost basis. If, however, the company does not intend to sell the security and it is not more-likely-than-not that it will be required to sell the security before recovery, the company must determine what portion of the impairment is attributable to a credit loss, which occurs when the amortized cost basis of the security exceeds the present value of the cash flows expected to be collected from the security. If there is credit loss, the loss must be recognized in net income and the remaining portion of impairment must be recognized in other comprehensive income.

Management regularly reviews each investment security for other-than-temporary impairment based on criteria that includes the extent to which cost exceeds market price, the duration of that market decline, the financial health of and specific prospects for the issuer, the best estimate of the present value of cash flows expected to be collected from debt securities, its intention with regard to holding the security to maturity and the likelihood that the company would be required to sell the security before recovery.

Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. FHLB stock is classified as restricted and carried at cost and is periodically evaluated for impairment based on the ultimate recovery of par value. The entirety of any impairment on the equity securities is recognized in earnings.

On January 1, 2018, the company adopted the new accounting standard for Financial Instruments, which requires equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income. The adoption of this guidance resulted in a \$2 thousand increase to beginning retained earnings and a \$2 thousand decrease to accumulated other comprehensive loss.

Loans

The company grants mortgage, commercial and consumer loans to customers. A substantial portion of the loan portfolio is comprised of loans secured by real estate. The ability of the company's debtors to honor their contracts is dependent upon customers' recurring income or income derived from collateral securing the loan, real estate and general economic conditions of the company's market area.

Loans that management has the intent and ability to hold for the foreseeable future or until maturity or pay-off, generally, are reported at their recorded investment, which is the outstanding unpaid principal balance adjusted for the allowance for loan losses and any deferred fees or costs on the originated loan. Interest income is accrued on the unpaid principal balance. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method.

Loans are placed on nonaccrual status when bank management determines that it is no longer prudent for a loan to continue to accrue interest. Generally, it is the policy of this bank to stop accruing interest when principal or interest is greater than 90 days past due based upon the loan's contractual terms, unless the loan is well secured and in the process of collection. Furthermore, should the bank become aware of events which have occurred or are expected to occur which causes doubt as to the full collectability of principal or interest in the future, even though the loan is currently less than 90 days past due, the loan should be considered for nonaccrual status.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Loans (Continued)

In order to justify the continuation of the accrual of interest on a loan which is greater than 90 days past due, the loan must be well secured and in the process of collection. In order to determine whether the loan is well secured, an appraisal of the collateral may be obtained establishing a value at least equal to principal and accrued interest for all loans greater than \$250,000. For all loans greater than 90 days past due which fall below this threshold, the bank may complete its own appraisal or valuation of the collateral as long as its methodology is documented and consistently applied. For a loan to be considered in the process of collection, there must be corrective action contemplated by the borrower, such as payment of all past due amounts, or the bank must be ready to pursue the liquidation of the underlying collateral, generally within a reasonable period.

All interest accrued but not collected for all classes of loans that are placed on nonaccrual or charged-off is reversed against interest income. If the ultimate repayment of principal, in whole or in part, is not expected, any payment received on a loan on which the accrual of interest has been suspended is applied to reduce principal to the extent necessary to restore the expectation of ultimate collectability. At such time as full collection of the remaining recorded balance is expected, interest payments are recorded as interest income on a cash basis until such time the loan can be restored to accrual status in accordance with regulatory guidelines. Loans of all classes are returned to accrual status when all payments contractually due are brought current and future payments are reasonably assured.

For all classes of loans, approval of the President or Chief Lending Officer is required for all loans greater than 90 days past due which are not placed on nonaccrual status and for restoration of nonaccrual loans to accrual status.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the probable losses inherent in our loan portfolio. The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the collectability of a loan balance is no longer present. Subsequent recoveries, if any, are credited to the allowance.

The allowance is based on two basic principles of accounting: (1) losses are accrued when they are probable of occurring and are capable of estimation and (2) losses are accrued based on the differences between the value of collateral, present value of future cash flows or values that are observable in the secondary market and the loan balance.

The allowance for loan losses is evaluated on a regular basis, monthly by management, and is based upon management's ongoing review of the collectability of the loans in light of historical experience, the economic environment, concentration and growth trends, 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. Management monitors the loan portfolio on a continual basis with procedures that allow for problem loans and potential problem loans to be highlighted and watched. Written reports are prepared on a monthly basis for all commercial loans graded below a certain level for management review and are reviewed with certain Board members on a periodic basis.

Based on experience, these loan policies and the bank's grading and review system, management believes the loan loss allowance is adequate. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

During these evaluations, particular risk characteristics associated with a segment of the loan portfolio are also considered. These characteristics are detailed below:

- Loans secured by farmland, commercial real estate, and commercial loans not secured by real estate carry risks associated with the successful operation of a business or farm and the repayment of these loans may depend on the profitability and cash flows of the business or farm. Additional risk relates to the value of collateral other than real estate where depreciation occurs, and the appraisal is less precise.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

- Real estate secured construction loans carry risks that a project will not be completed as scheduled and budgeted and that the value of the collateral may, at any point, be less than the principal amount of the loan. Additional risks may occur if the general contractor, who may not be the loan customer, is unable to finish the project as planned due to financial pressures unrelated to the project.
- Consumer and all other loans carry risks associated with the continued credit-worthiness of the borrower and the value of the collateral, such as automobiles, which may depreciate more rapidly than other assets. In addition, these loans may be unsecured. These loans are more likely than real estate loans to be immediately affected in an adverse manner by job loss, divorce, illness or personal bankruptcy.
- Residential real estate loans carry risks associated with the continued credit-worthiness of the borrower and changes in the value of the collateral.

The primary tool used in managing and controlling problem loans is a watch list report. The report is a listing of all commercial loans that are considered problem loans. The report is controlled by Credit Administration. Consumer and residential mortgage loans deemed significant may be included at management's discretion. It is a primary responsibility of the loan officer to manage the credit risk within their loan portfolio. As such, they should be proactive rather than reactive when considering adding a loan to the watch list report. Occurrence of any of the following criteria is a basis for adding a loan to the watch list report.

- Loans classified as special mention, substandard, doubtful or loss by bank examiners, external loan review, loan officer or the bank's credit administration department personnel based upon financial trends of the business.
- Loans on nonaccrual status.
- Loans more than 60 days delinquent.
- Loans renewed or extended more than three times with little or no principal curtailment.
- Loans judgmentally selected by executive management due to unexpected changes or events which could have a potentially adverse effect on the borrower's ability to repay.

The allowance consists of specific and general components. The specific component may relate to loans that are classified as doubtful or substandard. For such loans that are also classified as impaired, an allowance is established when the discounted cash flows or collateral value of the impaired loan is lower than the carrying value of that loan. The general component covers non-classified loans and is based on historical loss experience adjusted for environmental factors such as economic, concentration and growth trends. The bank uses a thirty-six-month rolling average to determine the historical loss allocations in the allowance for loan losses.

Characteristics of the bank's risk classification grades are as follows:

- Pass – Pass rated loans are to persons or business entities with an acceptable financial condition, appropriate collateral margins, appropriate cash flow to service the existing loan, and an appropriate leverage ratio. Borrower has paid all obligations as agreed and it is expected that this type of payment history will continue. Acceptable personal guarantors support the loan as needed.
- Special Mention – Are assets that have 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 in the institution's credit position at some future date.
- Substandard – The bank 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 bank will sustain some loss if the deficiencies are not corrected.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Allowance for Loan Losses (Continued)

- Doubtful – Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable.
- Loss – Loans classified in this category are considered uncollectable and of such little value that their continuation as bankable assets is not warranted. This classification does not mean that the loan 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. Any time a credit is placed in this category, it will be in non-accrual status.

A loan is generally considered impaired when, in the judgment of management, based on current information and events, it is probable that the company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment record, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan by loan basis for commercial and construction loans 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. If an impaired loan is on nonaccrual status, any payments received will generally be applied first to principal. If an impaired loan is not on nonaccrual status, generally any payments received will be applied to principal and interest using our standard procedures.

Large groups of smaller balance homogeneous loans (consumer and residential mortgage loans) are collectively evaluated for impairment. Accordingly, the company does not necessarily separately identify individual consumer and residential loans for impairment disclosures unless these loans are related to a borrower with commercial or other real estate loans that are classified or are the subject of a troubled debt restructuring.

In connection with the evaluation of the collectability of all classes of loans which are greater than 90 days past due as to principal or interest for nonaccrual status, any amounts not deemed well secured or otherwise collectible shall be recommended for charge-off at that time. Additionally, charge-off consideration shall be given to loans evaluated in connection with the bank's loan review policy and procedures and loans identified for repossession or foreclosure or meet the criteria for classification as an in-substance foreclosure. In any event, it shall be the policy of the bank to charge-off amounts deemed uncollectable in the periods when identified. All charge-off amounts are approved by the President, subject to Board ratification.

Troubled Debt Restructurings

In situations where, for economic or legal reasons related to a borrower's financial condition, management may grant a concession to the borrower that it would not otherwise consider, the related loan is classified as a troubled debt restructuring (TDR). Management strives to identify borrowers in financial difficulty early and work with them to modify their loan to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal forgiveness, payment forbearance and other actions intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal, management measures any impairment on the restructuring as noted above for impaired loans. All home equity, lot, real estate, and commercial loans that are processed for a renewal, modification or refinance are reviewed to determine if it qualifies as a TDR. All loans that are not dependent on the sale of

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Troubled Debt Restructurings (Continued)

collateral or operation of collateral for repayment, the impairment will be based on a discounted future cash flow method. All loans with similar characteristics, such as mortgage and retail, will be measured as one homogenous group. If the repayment of the loan is solely based on the sale of collateral, the impairment will be based on the discounted value of the collateral. If repayment is based on operation of the collateral, the impairment will be based on fair value without discount. At times when a loan has previously been modified in a troubled debt restructuring, the company and the borrower may subsequently enter into another restructuring agreement. The facts and circumstances of each subsequent restructuring of a TDR are then evaluated to determine the appropriate accounting. Under certain circumstances we may no longer account for the subsequently restructured loan as a TDR if at the time of the subsequent restructuring the borrower is not experiencing financial difficulties, and under the terms of the subsequent restructuring agreement, no concession has been granted by us to the borrower. To meet these conditions for removing the TDR designation, the subsequent restructuring agreement must specify market terms, including a contractual interest rate not less than a market interest rate for new debt with similar credit risk characteristics and other terms no less favorable to the company than those it would offer for such new debt. If at the time of the subsequent restructuring the loan meets the conditions discussed above and no prior principal was forgiven or partial charge-off taken, the loan is no longer disclosed as a TDR or individually evaluated for impairment.

Loans Held for Sale

Loans originated and intended for sale in the secondary market are carried at the lower of cost or market value determined in the aggregate. As of December 31, 2019, there were \$2.03 million of loans held for sale. As of December 31, 2018, there were \$323 thousand of loans held for sale.

Premises and Equipment

Land is carried at cost. Premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method. Estimated useful lives range from five to forty years for premises and improvements and three to seven years for furniture and equipment.

Maintenance and repairs of property and equipment are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

Other Real Estate Owned

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are recorded at the fair value net of estimated selling costs at the date of foreclosure, establishing a new cost basis. The value of real estate collateral is determined based on an internal evaluation, appraisal outside of the company, or a comparative market analysis. Revenue and expenses from operations and changes in the valuation allowance are included in foreclosed property expense and write down of other real estate owned, respectively.

There was no residential real estate included in the balance of other real estate owned as of December 31, 2019 and \$54 thousand as of December 31, 2018 as a result of obtaining physical possession of the property. As of December 31, 2019, and December 31, 2018, there were no consumer mortgage loans secured by residential real estate properties for which formal foreclosure proceedings were in process.

Bank-Owned Life Insurance

The company owns insurance on the lives of a certain group of key employees. The cash surrender value of these policies is included as an asset on the consolidated balance sheets, and any increase in cash surrender value is recorded as noninterest income on the consolidated statements of income. In the event of the death of an insured individual under these policies, the company would receive a death benefit, with the excess of the proceeds over the recorded cash surrender value recorded as other noninterest income.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Employee Benefit Plans

Summaries of company employee benefit plans are given below:

- The noncontributory, defined benefit pension plan covering employees meeting certain age and service requirements was frozen at October 31, 2009, the end of the plan year. No additional participants may enter the plan, and there will be no further increase in benefits due to increases in salaries and years of service.
- A postretirement life insurance plan covers certain current retirees who met certain requirements. This plan is not available for future retirees.
- A health care plan covers certain retirees who met certain eligibility requirements. This plan is not available for future retirees.
- A contributory health care plan is available to current full time employees.
- A 401(k)-retirement savings plan is available to all employees meeting certain age requirements. The employer match for this plan was increased with the freezing of the defined benefit plan as described above. Under this plan, the employer may make a discretionary matching contribution each plan year and may also make other discretionary contributions to the plan.

Earnings Per Common Share

Basic earnings per common share represents income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per common share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance.

Income Taxes

Deferred income tax assets and liabilities are determined using the balance sheet method. Under this method, the net deferred tax asset or liability is determined based on the tax effects of the temporary difference between the book and tax basis of the various balance sheet assets and liabilities and gives current recognition to changes in tax rates and laws.

When tax returns are filed, it is highly certain that some positions taken would be sustained upon examination by the taxing authorities, while others are subject to uncertainty about the merits of the position taken or the amount of the position that would be ultimately sustained. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying consolidated balance sheets along with any associated interest and penalties that would be payable to the taxing authorities upon examination. There were no unrecognized tax benefits recorded as of December 31, 2019 and 2018. Interest and penalties, if any, associated with unrecognized tax benefits are classified as additional income taxes in the consolidated statements of income.

Cash and Cash Equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, interest-bearing deposits in financial institutions, securities purchased under agreements to resell and federal funds sold. Generally, securities purchased under agreements to resell and federal funds sold are purchased and sold for one-day periods. Certificates of deposits in other financial institutions of \$4.2 million and \$7.0 million as of December 31, 2019 and December 31, 2018, respectively, are not included in cash and cash equivalents. These balances typically have maturities greater than 90 days.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

BCT Wealth Management

Securities and other property held by BCT Wealth Management in a fiduciary or agency capacity are not assets of the company and are not included in the accompanying consolidated financial statements.

Advertising and Public Relations

The company follows the policy of charging the costs of advertising and public relations to expense as incurred. These amounts were \$367 thousand and \$369 thousand in 2019 and 2018, respectively.

Treasury Stock

Common shares repurchased are recorded as treasury stock at cost.

Comprehensive Income

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities and changes in pension and postretirement benefit obligations, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income, and are presented in the consolidated statements of comprehensive income.

Fair Value of Financial Instruments

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 16. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect the estimates.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the company—presumptively beyond reach of the transferor and its creditors, even in bankruptcy or other receivership, (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 or the ability to unilaterally cause the holder to return specific assets.

Revenue Recognition

On January 1, 2018, the company adopted ASU No. 2014-09, “Revenue from Contracts with Customers: Topic 606.” This ASU revised guidance for the recognition, measurement, and disclosure of revenue from contracts with customers. The original guidance was amended through subsequent accounting standard updates that resulted in technical corrections, improvements, and a one-year deferral of the effective date to January 1, 2018. The guidance, as amended, is applicable to all entities and replaces significant portions of existing industry and transaction-specific revenue recognition rules with a more principles-based recognition model. Most revenue associated with financial instruments, including interest income, loan origination fees, and credit card fees, is outside the scope of the guidance. Gains and losses on investment securities, derivatives, financial guarantees, and sales of financial instruments are similarly excluded from the scope. The guidance is applicable to noninterest revenue streams such as trust and financial services income, deposit related fees, interchange fees, and certain other sources of the company’s noninterest income.

As the guidance does not apply to revenue associated with financial instruments, including loans and securities that are accounted for under other GAAP, the new guidance did not have a material impact on revenue most closely associated with financial instruments, interest income. The company completed its

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Revenue Recognition (Continued)

overall assessment of revenue streams and review of related contracts potentially affected by the ASU, including trust and financial services income, deposit related fees, interchange fees, and certain other sources of the company's noninterest income. The company also completed an evaluation of certain revenue streams to determine whether they should be presented gross versus net. Based on these assessments, the company concluded that ASU 2014-09 did not materially change the method in which the company currently recognizes revenue for its in-scope revenue streams. The company adopted ASC 606 using the modified retrospective method applied to all contracts not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 are presented under ASC 606 while prior period amounts continue to be reported in accordance with legacy GAAP. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue and as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary.

Leases

On January 1, 2019 the company adopted ASU 2016-02 "Leases (Topic 842)" and all subsequent amendments thereto. Adoption of the leasing standard resulted in the recognition of right-of-use assets and lease liabilities of \$2.1 million. Refer to "Note 6. Leases" for further discussion of the standard's adoption and the company's accounting for its lease agreements.

Reclassifications

Certain reclassifications have been made to the prior period amounts to conform to the current year presentation. None were of a material nature and had no impact on prior year net income or stockholders' equity.

Recent Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The amendments in this ASU, among other things, require the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. 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. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. For public business entities that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer, excluding smaller reporting companies, the standard is effective for fiscal years beginning after December 15, 2019, including interim periods in those fiscal years. All other entities will be required to apply the guidance for fiscal years, and interim periods within those years, beginning after December 15, 2022. The company is currently assessing the impact that ASU 2016-13 will have on its consolidated financial statements. The company has investigated data available, consulted industry experts, and assessed informational needs.

In August 2018, the FASB issued ASU 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement." The amendments modify the disclosure requirements in Topic 820 to add disclosures regarding changes in unrealized gains and losses, the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements and the narrative description of measurement uncertainty. Certain disclosure requirements in Topic 820 are also removed or modified. The amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Certain of the amendments are to be applied prospectively while others are to be applied retrospectively. Early adoption is permitted. The company does not expect the adoption of ASU 2018-13 to have a material impact on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In August 2018, the FASB issued ASU 2018-14, “Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans.” These amendments modify the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. Certain disclosure requirements have been deleted while the following disclosure requirements have been added: the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The amendments also clarify the disclosure requirements in paragraph 715-20-50-3, which state that the following information for defined benefit pension plans should be disclosed: The projected benefit obligation (PBO) and fair value of plan assets for plans with PBOs in excess of plan assets and the accumulated benefit obligation (ABO) and fair value of plan assets for plans with ABOs in excess of plan assets. The amendments are effective for fiscal years ending after December 15, 2020. Early adoption is permitted. The company does not expect the adoption of ASU 2018-14 to have a material impact on its consolidated financial statements.

In April 2019, the FASB issued ASU 2019-04, “Codification Improvements to Topic 326, Financial Instruments—Credit Losses, Topic 815, Derivatives and Hedging, and Topic 825, Financial Instruments.” This ASU clarifies and improves areas of guidance related to the recently issued standards on credit losses, hedging, and recognition and measurement including improvements resulting from various Transition Resource Group (TRG) Meetings. The effective date of each of the amendments depends on the adoption date of ASU 2016-01, ASU 2016-13, and ASU 2017-12. The company is currently assessing the impact that ASU 2019-04 will have on its consolidated financial statements.

In May 2019, the FASB issued ASU 2019-05, “Financial Instruments—Credit Losses (Topic 326): Targeted Transition Relief.” The amendments in this ASU provide entities that have certain instruments within the scope of Subtopic 326-20 with an option to irrevocably elect the fair value option in Subtopic 825-10, applied on an instrument-by-instrument basis for eligible instruments, upon the adoption of Topic 326. The fair value option election does not apply to held-to-maturity debt securities. An entity that elects the fair value option should subsequently measure those instruments at fair value with changes in fair value flowing through earnings. The effective date and transition methodology for the amendments in ASU 2019-05 are the same as in ASU 2016-13. The company is currently assessing the impact that ASU 2019-05 will have on its consolidated financial statements.

In November 2019, the FASB issued ASU 2019-11, “Codification Improvements to Topic 326, Financial Instruments – Credit Losses.” This ASU addresses issues raised by stakeholders during the implementation of ASU No. 2016-13, “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” Among other narrow-scope improvements, the new ASU clarifies guidance around how to report expected recoveries. “Expected recoveries” describes a situation in which an organization recognizes a full or partial write-off of the amortized cost basis of a financial asset, but then later determines that the amount written off, or a portion of that amount, will in fact be recovered. While applying the credit losses standard, stakeholders questioned whether expected recoveries were permitted on assets that had already shown credit deterioration at the time of purchase (also known as PCD assets). In response to this question, the ASU permits organizations to record expected recoveries on PCD assets. In addition to other narrow technical improvements, the ASU also reinforces existing guidance that prohibits organizations from recording negative allowances for available-for-sale debt securities. The ASU includes effective dates and transition requirements that vary depending on whether or not an entity has already adopted ASU 2016-13. The company is currently assessing the impact that ASU 2019-11 will have on its consolidated financial statements.

Note 1. Nature of Banking Activities and Significant Accounting Policies (Continued)

Recent Accounting Pronouncements (Continued)

In December 2019, the FASB issued ASU 2019-12, “Income Taxes (Topic 740) – Simplifying the Accounting for Income Taxes.” The ASU is expected to reduce cost and complexity related to the accounting for income taxes by removing specific exceptions to general principles in Topic 740 (eliminating the need for an organization to analyze whether certain exceptions apply in a given period) and improving financial statement preparers’ application of certain income tax-related guidance. This ASU is part of the FASB’s simplification initiative to make narrow-scope simplifications and improvements to accounting standards through a series of short-term projects. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The company is currently assessing the impact that ASU 2019-12 will have on its consolidated financial statements.

In January 2020, the FASB issued ASU 2020-01, “Investments – Equity Securities (Topic 321), Investments – Equity Method and Joint Ventures (Topic 323), and Derivatives and Hedging (Topic 815) – Clarifying the Interactions between Topic 321, Topic 323, and Topic 815.” The ASU is based on a consensus of the Emerging Issues Task Force and is expected to increase comparability in accounting for these transactions. ASU 2016-01 made targeted improvements to accounting for financial instruments, including providing an entity the ability to measure certain equity securities without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. Among other topics, the amendments clarify that an entity should consider observable transactions that require it to either apply or discontinue the equity method of accounting. For public business entities, the amendments in the ASU are effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted. The company does not expect the adoption of ASU 2020-01 to have a material impact on its consolidated financial statements.

Note 2. Securities

There were no securities held to maturity as of December 31, 2019 and 2018.

The amortized cost and fair value of securities available for sale (in thousands) as of December 31, 2019 and 2018 are as follows:

	2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Obligations of U.S. Government sponsored agencies	\$13 438	\$ 97	\$ (13)	\$13 522
Mortgage-backed	35 042	520	(63)	35 499
State and municipal obligations	1 429	21	- -	1 450
	<u>\$49 909</u>	<u>\$638</u>	<u>\$ (76)</u>	<u>\$50 471</u>
	2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Fair Value
Obligations of U.S. Government sponsored agencies	\$36 647	\$ 4	\$ (378)	\$36 273
Mortgage-backed	10 292	154	- -	10 446
State and municipal obligations	1 776	2	(34)	1 744
	<u>\$48 715</u>	<u>\$160</u>	<u>\$ (412)</u>	<u>\$48 463</u>

Note 2. Securities (Continued)

The company adopted ASU 2016-01 effective January 1, 2018 and held equity securities with an aggregate fair value of \$133 thousand at December 31, 2019 and \$132 thousand at December 31, 2018 are presented separately on the balance sheet. The fair value adjustment recorded through earnings in other operating income totaled \$1 thousand and \$14 thousand for the twelve months ended December 31, 2019 and December 31, 2018, respectively.

The amortized cost and fair value of the securities available for sale as of December 31, 2019 (in thousands), by contractual maturity, are shown below.

	Amortized Cost	Fair Value
Due in one year or less	\$ 2 353	\$ 2 354
Due after one year through five years	11 660	11 764
Due after five years through ten years	452	441
Due after ten years	35 444	35 912
	<u>\$49 909</u>	<u>\$50 471</u>

Proceeds of sales of securities during 2019 were \$2.986 million. Gross losses of \$7 thousand were realized on those sales. The tax benefit applicable to these losses amounted to \$2 thousand. Proceeds of the sales of securities during 2018 were \$703 thousand. Gross losses of \$6 thousand were realized on those sales. The tax benefit applicable to these realized losses amounted to \$1 thousand.

The primary purpose of the investment portfolio is to generate income and meet liquidity needs of the company through readily saleable financial instruments. The portfolio is made up primarily of fixed rate bonds and mortgage-backed securities, whose prices move inversely with rates. At the end of any accounting period, the investment portfolio has unrealized gains and losses. The company monitors the portfolio, which is subject to liquidity needs, market rate changes and credit risk changes, to see if adjustments are needed. The primary concern in a loss situation is the credit quality of the issuer behind the instrument. The primary cause of impairments is the decline in the prices of the debt and mortgage-backed securities when rates rise. There are ten securities in the consolidated portfolio that had a loss at December 31, 2019. There were twenty-three security accounts in the consolidated portfolio that had a loss at December 31, 2018. The primary cause of the temporary impairments in the company's investments in debt and mortgage-backed securities was fluctuations in interest rates. Because the company intends to hold these investments in debt and mortgage-backed securities to maturity and it is more likely than not that the company will not be required to sell these investments before a recovery of the unrealized loss, the company does not consider these investments to be other-than-temporarily impaired at December 31, 2019 and 2018 and no impairment has been recognized.

US Government sponsored agencies include the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation debt and mortgage-backed securities with a fair value of \$40.5 million and \$25.3 million as of December 31, 2019 and December 31, 2018, respectively.

Note 2. Securities (Continued)

The following table summarizes the fair value and gross unrealized losses for securities aggregated by investment category and length of time that individual securities have been in a continuous gross unrealized loss position as of December 31, 2019 and 2018 (in thousands).

		December 31, 2019					
		Less than 12 months		More than 12 months		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Obligations of U.S. Government sponsored agencies		\$ --	\$ --	\$ 2 448	\$ (13)	\$ 2 448	\$ (13)
Mortgage-backed		10 751	(63)	--	--	10 751	(63)
		<u>\$ 10 751</u>	<u>\$ (63)</u>	<u>\$ 2 448</u>	<u>\$ (13)</u>	<u>\$ 13 199</u>	<u>\$ (76)</u>
		December 31, 2018					
		Less than 12 months		More than 12 months		Total	
		Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Obligations of U.S. Government sponsored agencies		\$ 4 991	\$ (11)	\$21 297	\$ (367)	\$ 26 288	\$ (378)
State and municipal obligations		344	(1)	514	(33)	858	(34)
		<u>\$ 5 335</u>	<u>\$ (12)</u>	<u>\$21 811</u>	<u>\$ (400)</u>	<u>\$ 27 146</u>	<u>\$ (412)</u>

The company's investment in Federal Home Loan Bank (FHLB) stock totaled \$727 thousand at December 31, 2019. FHLB stock is generally viewed as a long-term investment and as a restricted investment security, which is carried at cost, because there is no market for the stock, other than the FHLB or member institutions. Therefore, when evaluating FHLB stock for impairment, its value is based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The company does not consider this investment to be other-than-temporarily impaired at December 31, 2019 and no impairment has been recognized. FHLB stock is shown as a separate line item on the consolidated balance sheet and is not a part of the available for sale securities portfolio.

Securities with a carrying value of \$23.7 million and \$16.2 million at December 31, 2019 and 2018, respectively were pledged to secure public funds, securities sold under agreement to repurchase, other borrowings, and for other purposes as required or permitted by law.

Note 3. Loans and Related Party Transactions

The loan portfolio, stated at face amount is composed of the following:

	December 31	
	2019	2018
	(in thousands)	
Commercial – non real estate		
Commercial and industrial	\$ 20 371	\$ 17 275
Commercial real estate		
Owner occupied	57 305	44 070
Non-owner occupied	80 664	60 784
Construction		
Residential	4 982	4 851
Commercial	19 166	15 608
Real Estate		
Farmland	4 872	5 259
Residential		
Revolving open end	13 280	11 832
1 to 4 family – first liens	170 123	164 171
1 to 4 family – junior liens	3 223	3 733
5 or more family	21 110	17 428
Consumer loans	7 732	9 344
All other loans	9 632	9 602
Total loans (1)	\$412 460	\$363 957
Less: allowance for loan losses	3 716	3 269
	<u>\$408 744</u>	<u>\$360 688</u>

(1) Includes net deferred loan fees of \$145 thousand and \$73 thousand, respectively.

Loans to directors and executive officers of the company or to their associates at December 31, 2019 and 2018 totaled \$4.5 million and \$4.2 million, respectively. In management's opinion, such loans were made on substantially the same terms as those prevailing for comparable transactions with similar risks. During 2019, total principal additions were \$1.4 million and total principal payments were \$1.1 million. The prior year amount reflects changes in the composition of related parties.

The FHLB of Pittsburgh has a blanket lien on all the company's loans except those loans specifically pledged to the Federal Reserve and removed from the FHLB lien. Currently, the FHLB lien is securing advances to the company in the amount of \$7.0 million and letters of credit issued on behalf of customers of the company in the amount of \$25.8 million.

Note 4. Allowance for Loan Losses

Allowance for Loan Losses – By Segment
December 31, 2019
(in thousands)

	Farmland	Commercial	Commercial Real Estate	Construction	Consumer	Residential	All Other	Unallocated	Total
Allowance for loan losses:									
Beginning balance	\$ 34	\$ 622	\$ 832	\$ 161	\$ 116	\$ 1 334	\$ 59	\$111	\$ 3 269
Charge-offs	--	(231)	--	(36)	(142)	(1)	--	--	(410)
Recoveries	--	23	55	160	84	61	--	--	383
Provision (Recovery)	(1)	250	191	(97)	46	86	7	(8)	474
Ending balance	<u>\$ 33</u>	<u>\$ 664</u>	<u>\$ 1 078</u>	<u>\$ 188</u>	<u>\$ 104</u>	<u>\$ 1 480</u>	<u>\$ 66</u>	<u>\$103</u>	<u>\$ 3 716</u>
Individually evaluated for impairment	\$ --	\$ --	\$ 3	\$ --	\$ 8	\$ 26	\$ --	\$ --	\$ 37
Collectively evaluated for impairment	33	664	1 075	188	96	1 454	66	103	3 679
	<u>\$ 33</u>	<u>\$ 664</u>	<u>\$ 1 078</u>	<u>\$ 188</u>	<u>\$ 104</u>	<u>\$ 1 480</u>	<u>\$ 66</u>	<u>\$103</u>	<u>\$ 3 716</u>
Loans:									
Ending balance	<u>\$4 872</u>	<u>\$20 371</u>	<u>\$137 969</u>	<u>\$24 148</u>	<u>\$7 732</u>	<u>\$207 736</u>	<u>\$ 9 632</u>	<u>\$ --</u>	<u>\$412 460</u>
Ending balance:									
Individually evaluated for impairment	\$ --	\$ --	\$ 106	\$ 35	\$ 8	\$ 2 244	\$ --	\$ --	\$ 2 393
Collectively evaluated for impairment	4 872	20 371	137 863	24 113	7 724	205 492	9 632	--	410 067
Total	<u>\$4 872</u>	<u>\$20 371</u>	<u>\$137 969</u>	<u>\$24 148</u>	<u>\$7 732</u>	<u>\$207 736</u>	<u>\$ 9 632</u>	<u>\$ --</u>	<u>\$412 460</u>

Allowance for Loan Losses – By Segment
December 31, 2018
(in thousands)

	Farmland	Commercial	Commercial Real Estate	Construction	Consumer	Residential	All Other	Unallocated	Total
Allowance for loan losses:									
Beginning balance	\$ 25	\$ 832	\$ 910	\$ 192	\$ 115	\$ 1 299	\$ 68	\$149	\$ 3 590
Charge-offs	--	(700)	(84)	(41)	(96)	(126)	--	--	(1 047)
Recoveries	--	4	116	163	62	69	--	--	414
Provision (Recovery)	9	486	(110)	(153)	35	92	(9)	(38)	312
Ending balance	<u>\$ 34</u>	<u>\$ 622</u>	<u>\$ 832</u>	<u>\$ 161</u>	<u>\$ 116</u>	<u>\$ 1 334</u>	<u>\$ 59</u>	<u>\$111</u>	<u>\$ 3 269</u>
Individually evaluated for impairment	\$ --	\$ 151	\$ 26	\$ 1	\$ 11	\$ 34	\$ --	\$ --	\$ 223
Collectively evaluated for impairment	34	471	806	160	105	1 300	59	111	3 046
	<u>\$ 34</u>	<u>\$ 622</u>	<u>\$ 832</u>	<u>\$ 161</u>	<u>\$ 116</u>	<u>\$ 1 334</u>	<u>\$ 59</u>	<u>\$111</u>	<u>\$ 3 269</u>
Loans:									
Ending balance	<u>\$5 259</u>	<u>\$17 275</u>	<u>\$104 854</u>	<u>\$20 459</u>	<u>\$9 344</u>	<u>\$197 164</u>	<u>\$ 9 602</u>	<u>\$ --</u>	<u>\$363 957</u>
Ending balance:									
Individually evaluated for impairment	\$ --	\$ 302	\$ 1 058	\$ 108	\$ 13	\$ 2 880	\$ --	\$ --	\$ 4 361
Collectively evaluated for impairment	5 259	16 973	103 796	20 351	9 331	194 284	9 602	--	359 596
Total	<u>\$5 259</u>	<u>\$17 275</u>	<u>\$104 854</u>	<u>\$20 459</u>	<u>\$9 344</u>	<u>\$197 164</u>	<u>\$ 9 602</u>	<u>\$ --</u>	<u>\$363 957</u>

Note 4. Allowance for Loan Losses (Continued)

Credit Quality Information – By Class
December 31, 2019
(in thousands)

<u>Internal Risk Rating Grades</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Loss</u>
Commercial – non real estate					
Commercial and industrial	\$ 19 097	\$ 1 274	\$ --	\$ --	\$ --
Commercial real estate					
Owner occupied	51 021	6 178	106	--	--
Non-owner occupied	79 899	765	--	--	--
Construction					
Residential	4 982	--	--	--	--
Commercial	18 378	788	--	--	--
Real estate					
Farmland	4 872	--	--	--	--
Consumer	N/A	N/A	N/A	N/A	N/A
Residential					
Revolving open end	N/A	642	--	N/A	N/A
1-4 family – first liens	N/A	933	387	N/A	N/A
1-4 family – junior liens	N/A	143	--	N/A	N/A
5 or more family	N/A	414	--	N/A	N/A
All Other	N/A	2 539	--	N/A	N/A
Totals	<u>\$178 249</u>	<u>\$13 676</u>	<u>\$ 493</u>	<u>\$ --</u>	<u>\$ --</u>

As a matter of practice, we do not necessarily risk rate consumer or residential mortgage loans. Generally, these loans listed in the risk rating table above are associated with commercial loans that have been risk rated as per our policy. When a loan is designated as a loss, the loss portion is charged off, and if applicable, the remaining balance classified as substandard. Loans identified in the table below as nonperforming are in nonaccrual status.

Credit Quality Information – By Class
December 31, 2019
(in thousands)

<u>Non Risk Rated Loans</u>	<u>Performing</u>	<u>Nonperforming</u>
Consumer	\$ 7 732	\$ --
Residential		
Revolving open end	12 638	--
1-4 family – first liens	167 851	952
1-4 Family – junior liens	3 080	--
5 or more family	20 696	--
All other	7 093	--
Totals	<u>\$219 090</u>	<u>\$952</u>

Note 4. Allowance for Loan Losses (Continued)

Credit Quality Information – By Class
December 31, 2018
(in thousands)

<u>Internal Risk Rating Grades</u>	<u>Pass</u>	<u>Special Mention</u>	<u>Sub- Standard</u>	<u>Doubtful</u>	<u>Loss</u>
Commercial – non real estate					
Commercial and industrial	\$ 16 528	\$ 445	\$ 302	\$ --	\$ --
Commercial real estate					
Owner occupied	40 874	2 764	432	--	--
Non-owner occupied	59 988	480	316	--	--
Construction					
Residential	4 851	--	--	--	--
Commercial	15 311	187	110	--	--
Real estate					
Farmland	5 259	--	--	--	--
Consumer	N/A	N/A	N/A	N/A	N/A
Residential					
Revolving open end	N/A	364	--	N/A	N/A
1-4 family – first liens	N/A	766	339	N/A	N/A
1-4 family – junior liens	N/A	131	21	N/A	N/A
5 or more family	N/A	430	124	N/A	N/A
All other	N/A	--	--	N/A	N/A
Totals	<u>\$ 142 811</u>	<u>\$ 5 567</u>	<u>\$ 1 644</u>	<u>\$ --</u>	<u>\$ --</u>

Credit Quality Information – By Class
December 31, 2018
(in thousands)

<u>Non Risk Rated Loans</u>	<u>Performing</u>	<u>Nonperforming</u>
Consumer	\$ 9 341	\$ 3
Residential		
Revolving open end	11 468	--
1-4 family – first liens	162 619	447
1-4 Family – junior liens	3 576	5
5 or more family	16 874	--
All other	9 602	--
Totals	<u>\$ 213 480</u>	<u>\$ 455</u>

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2019
(in thousands)

With no related allowance:

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Commercial – non real estate					
Commercial and industrial	\$ --	\$ --	\$ --	\$ --	\$ --
Commercial real estate					
Owner occupied	--	--	--	--	--
Non-owner occupied	--	--	--	--	--
Construction					
Residential	--	--	--	--	--
Commercial	--	--	--	--	--
Real estate					
Farmland	--	--	--	--	--
Residential					
Revolving open end	--	--	--	--	--
1 to 4 family – first liens	685	685	--	685	--
1 to 4 family – junior liens	--	--	--	--	--
5 or more family	--	--	--	--	--
Consumer	--	--	--	--	--
All other	--	--	--	--	--
	<u>\$ 685</u>	<u>\$ 685</u>	<u>\$ --</u>	<u>\$ 685</u>	<u>\$ --</u>

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2019
(in thousands)

With an allowance recorded:

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Commercial – non real estate					
Commercial and industrial	\$ --	\$ --	\$ --	\$ --	\$ --
Commercial real estate					
Owner occupied	112	106	3	111	7
Non-owner occupied	--	--	--	--	--
Construction					
Residential	--	--	--	--	--
Commercial	36	35	--	44	4
Real estate					
Farmland	--	--	--	--	--
Residential					
Revolving open end	--	--	--	--	--
1 to 4 family – first liens	1 376	1 341	21	1 374	88
1 to 4 family – junior liens	247	218	5	231	16
5 or more family	--	--	--	--	--
Consumer	8	8	8	9	--
All other	--	--	--	--	--
	<u>\$ 1 779</u>	<u>\$ 1 708</u>	<u>\$ 37</u>	<u>\$ 1 769</u>	<u>\$ 115</u>
Totals:					
Commercial – non real estate	\$ --	\$ --	\$ --	\$ --	\$ --
Commercial real estate	112	106	3	111	7
Construction	36	35	--	44	4
Real estate – farmland	--	--	--	--	--
Residential	2 308	2 244	26	2 290	104
Consumer	8	8	8	9	--
All other	--	--	--	--	--
	<u>\$ 2 464</u>	<u>\$ 2 393</u>	<u>\$ 37</u>	<u>\$ 2 454</u>	<u>\$ 115</u>

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2018
(in thousands)

With no related allowance:

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Commercial – non real estate					
Commercial and industrial	\$ --	\$ --	\$- -	\$ --	\$ --
Commercial real estate					
Owner occupied	--	--	--	--	--
Non-owner occupied	--	--	--	--	--
Construction					
Residential	--	--	--	--	--
Commercial	--	--	--	--	--
Real estate					
Farmland	--	--	--	--	--
Residential					
Revolving open end	--	--	--	--	--
1 to 4 family – first liens	696	685	--	685	32
1 to 4 family – junior liens	--	--	--	--	--
5 or more family	--	--	--	--	--
Consumer	--	--	--	--	--
All other	--	--	--	--	--
	<u>\$ 696</u>	<u>\$ 685</u>	<u>\$- -</u>	<u>\$ 685</u>	<u>\$ 32</u>

Note 4. Allowance for Loan Losses (Continued)

Impaired Loans – By Class
December 31, 2018
(in thousands)

With an allowance recorded:

	<u>Unpaid Principal</u>	<u>Recorded Investment</u>	<u>Related Allowance</u>	<u>Average Recorded Investment</u>	<u>Interest Income Recognized</u>
Commercial – non real estate					
Commercial and industrial	\$1 057	\$ 302	\$151	\$ 671	\$ 4
Commercial real estate					
Owner occupied	441	432	18	439	26
Non-owner occupied	630	626	8	641	34
Construction					
Residential	--	--	--	--	--
Commercial	109	108	1	119	9
Real estate					
Farmland	--	--	--	--	--
Residential					
Revolving open end	--	--	--	--	--
1 to 4 family – first liens	1 819	1 783	26	1 823	84
1 to 4 family – junior liens	319	288	6	296	21
5 or more family	124	124	2	120	9
Consumer	13	13	11	14	--
All other	--	--	--	--	--
	<u>\$4 512</u>	<u>\$3 676</u>	<u>\$223</u>	<u>\$4 123</u>	<u>\$187</u>
Totals:					
Commercial – non real estate	\$1 057	\$ 302	\$151	\$ 671	\$ 4
Commercial real estate	1 071	1 058	26	1 080	60
Construction	109	108	1	119	9
Real estate – farmland	--	--	--	--	--
Residential	2 958	2 880	34	2 924	146
Consumer	13	13	11	14	--
All other	--	--	--	--	--
	<u>\$5 208</u>	<u>\$4 361</u>	<u>\$223</u>	<u>\$4 808</u>	<u>\$219</u>

No additional funds are committed to be advanced on impaired loans, as of December 31, 2019 and 2018.

Note 4. Allowance for Loan Losses (Continued)

Modifications
(in thousands except number of contracts)

For the Year Ended
December 31, 2019

Troubled Debt Restructurings	Number Of <u>Contracts</u>	Pre- Modification Outstanding Recorded <u>Investment</u>	Post- Modification Outstanding Recorded <u>Investment</u>
Commercial – non real estate			
Commercial and industrial	--	\$ --	\$ --
Commercial real estate			
Owner occupied	--	--	--
Non owner occupied	--	--	--
Construction			
Residential	--	--	--
Commercial	--	--	--
Real Estate			
Farmland	--	--	--
Residential			
Revolving open end 1 to 4 family	--	--	--
1 to 4 family – first liens	--	--	--
1 to 4 family – junior liens	--	--	--
5 or more family	--	--	--
Consumer	--	--	--
All Other	--	--	--
Totals	<u>--</u>	<u>\$ --</u>	<u>\$ --</u>

Troubled Debt Restructurings That Subsequently Defaulted	Number of <u>Contracts</u>	Recorded <u>Investment</u>
Commercial – non real estate		
Commercial and industrial	--	\$ --
Commercial real estate		
Owner occupied	--	--
Non owner occupied	--	--
Construction		
Residential	--	--
Commercial	--	--
Real Estate		
Farmland	--	--
Residential		
Revolving open end 1 to 4 family	--	--
1 to 4 family – first liens	--	--
1 to 4 family – junior liens	--	--
5 or more family	--	--
Consumer	--	--
All Other	--	--
Totals	<u>--</u>	<u>\$ --</u>

Note 4. Allowance for Loan Losses (Continued)

Modifications
(in thousands except number of contracts)

For the Year Ended
December 31, 2018

	Number Of Contracts	Pre- Modification Outstanding Recorded Investment	Post- Modification Outstanding Recorded Investment
Troubled Debt Restructurings			
Commercial – non real estate			
Commercial and industrial	--	\$ --	\$ --
Commercial real estate			
Owner occupied	--	--	--
Non owner occupied	--	--	--
Construction			
Residential	--	--	--
Commercial	1	8	8
Real Estate			
Farmland	--	--	--
Residential			
Revolving open end 1 to 4 family	--	--	--
1 to 4 family – first liens	1	139	139
1 to 4 family – junior liens	1	50	50
5 or more family	--	--	--
Consumer	--	--	--
All Other	--	--	--
Totals	<u>3</u>	<u>\$197</u>	<u>\$197</u>
Troubled Debt Restructurings That Subsequently Defaulted	Number of Contracts	Recorded Investment	
Commercial – non real estate			
Commercial and industrial	1	\$ 52	
Commercial real estate			
Owner occupied	1	316	
Non owner occupied	--	--	
Construction			
Residential	--	--	
Commercial	--	--	
Real Estate			
Farmland	--	--	
Residential			
Revolving open end 1 to 4 family	--	--	
1 to 4 family – first liens	--	--	
1 to 4 family – junior liens	--	--	
5 or more family	--	--	
Consumer	--	--	
All Other	--	--	
Totals	<u>2</u>	<u>\$368</u>	

Loans having been greater than 30 days past due at any time subsequent to the restructuring date in the current year are considered as having defaulted.

As of December 31, 2019, and 2018 there were \$1.6 million and \$3.3 million of troubled debt restructurings, respectively.

Note 4. Allowance for Loan Losses (Continued)

Nonaccrual and Past Due Loans – By Class
December 31, 2019
(in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due Still Accruing	Non- Accrual
Commercial – non real estate								
Commercial and industrial	\$ --	\$ --	\$ --	\$ --	\$ 20 371	\$ 20 371	\$ --	\$ --
Commercial real estate								
Owner occupied	--	--	--	--	57 305	57 305	--	--
Non owner occupied	--	--	--	--	80 664	80 664	--	--
Construction								
Residential	--	--	--	--	4 982	4 982	--	--
Commercial	38	498	--	536	18 630	19 166	--	--
Real estate								
Farmland	--	--	--	--	4 872	4 872	--	--
Residential								
Revolving open end	--	--	--	--	13 280	13 280	--	--
1 to 4 family – first liens	401	201	1 090	1 692	168 431	170 123	387	952
1 to 4 family – junior liens	--	--	--	--	3 223	3 223	--	--
5 or more family	--	--	--	--	21 110	21 110	--	--
Consumer	10	--	--	10	7 722	7 732	--	--
All other	--	--	--	--	9 632	9 632	--	--
Totals	<u>\$ 449</u>	<u>\$ 699</u>	<u>\$ 1 090</u>	<u>\$ 2 238</u>	<u>\$ 410 222</u>	<u>\$ 412 460</u>	<u>\$ 387</u>	<u>\$ 952</u>
Percentage to Total Loans	<u>0.11%</u>	<u>0.17%</u>	<u>0.26%</u>	<u>0.54%</u>	<u>99.46%</u>		<u>0.09%</u>	<u>0.23%</u>

Included in the 30 or more days past due loans are certain non-accrual loans in the amount of \$904 thousand. The remaining non-accrual loans of \$48 thousand are in current status.

Note 4. Allowance for Loan Losses (Continued)

Nonaccrual and Past Due Loans – By Class
December 31, 2018
(in thousands)

	30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due	Total Past Due	Current	Total Loans	90 Days Past Due Still Accruing	Non- Accrual
Commercial – non real estate								
Commercial and industrial	\$ --	\$ --	\$250	\$ 250	\$ 17 025	\$ 17 275	\$ --	\$ 250
Commercial real estate								
Owner occupied	--	--	--	--	44 070	44 070	--	--
Non owner occupied	--	--	33	33	60 751	60 784	33	--
Construction								
Residential	--	--	--	--	4 851	4 851	--	--
Commercial	19	--	--	19	15 589	15 608	--	--
Real estate								
Farmland	--	--	--	--	5 259	5 259	--	--
Residential								
Revolving open end	--	--	--	--	11 832	11 832	--	--
1 to 4 family – first liens	1 128	885	111	2 124	162 047	164 171	79	447
1 to 4 family – junior liens	16	--	1	17	3 716	3 733	--	5
5 or more family	--	--	--	--	17 428	17 428	--	--
Consumer	15	12	--	27	9 317	9 344	--	3
All other	--	--	--	--	9 602	9 602	--	--
Totals	<u>\$1 178</u>	<u>\$ 897</u>	<u>\$395</u>	<u>\$2 470</u>	<u>\$361 487</u>	<u>\$363 957</u>	<u>\$ 112</u>	<u>\$ 705</u>
Percentage to Total Loans	<u>0.32%</u>	<u>0.25%</u>	<u>0.11%</u>	<u>0.68%</u>	<u>99.32%</u>		<u>0.03%</u>	<u>0.19%</u>

Included in the 30 or more days past due loans are certain non-accrual loans in the amount of \$424 thousand. The remaining non-accrual loans of \$281 thousand are in current status.

The past due policy of the bank is to report all classes of loans past due in the following categories:

- 30 to 59 days past due (principal or interest)
- 60 to 89 days past due (principal or interest)
- 90 days or more past due (principal or interest)
- Nonaccrual status.

Note 4. Allowance for Loan Losses (Continued)

The following table summarizes non-performing assets at December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
	(in thousands)	
Nonperforming assets		
Nonaccrual loans (1)	\$ 952	\$ 705
Other Real Estate Owned	53	170
Total nonperforming assets	<u>\$1 005</u>	<u>\$ 875</u>
Performing troubled debt restructures (2)	<u>\$1 502</u>	<u>\$3 246</u>
Loans past due 90 days accruing interest	<u>\$ 387</u>	<u>\$ 112</u>

- (1) Currently there are two restructurings in non-performing assets with a balance of \$92 thousand at December 31, 2019. There were two restructurings in non-performing assets with a balance of \$54 thousand at December 31, 2018.
- (2) Within this amount is one restructuring with a balance totaling \$13 thousand, 30 or more days past due at December 31, 2019. There were four restructurings with a balance of \$303 thousand at December 31, 2018, 30 or more days past due.

The interest income that would have been earned if the loans classified as nonaccrual had performed in accordance with the original terms was approximately \$60 thousand and \$103 thousand in 2019 and 2018, respectively.

Note 5. Premises and Equipment, Net

Premises and equipment consist of the following:

	<u>December 31</u>	
	<u>2019</u>	<u>2018</u>
	(in thousands)	
Premises and improvements	\$10 574	\$10 263
Furniture and equipment	4 986	4 540
	<u>\$15 560</u>	<u>\$14 803</u>
Less accumulated depreciation	7 663	7 033
	<u>\$ 7 897</u>	<u>\$ 7 770</u>

Depreciation included in noninterest expense for 2019 and 2018 was \$685 thousand and \$545 thousand, respectively.

Note 6. Leases

On January 1, 2019, the company adopted ASU No. 2016-02 “*Leases (Topic 842)*” and all subsequent ASUs that modified Topic 842. The company elected the prospective application approach provided by ASU 2018-11 and did not adjust prior periods for ASC 842. The company also elected certain practical expedients within the standard and consistent with such elections did not reassess whether any expired or existing contracts are or contain leases, did not reassess the lease classification for any expired or existing leases, and did not reassess any initial direct costs for existing leases. As stated in the company’s 2018 annual report, the implementation of the new standard resulted in recognition of a right-of-use asset and lease liability of \$2.1 million at the date of adoption, which is related to the company’s lease of premises and equipment used in operations. Additional right-of-use assets and lease liabilities were recognized during 2019, on the commencement dates of new leases. The right-of-use asset and lease liability are included in other assets and other liabilities, respectively, in the consolidated balance sheets.

Note 6. Leases (Continued)

Lease liabilities represent the company's obligation to make lease payments and are presented at each reporting date as the net present value of the remaining contractual cash flows. Cash flows are discounted at the company's incremental borrowing rate in effect at the commencement date of the lease. Right-of-use assets represent the company's right to use the underlying asset for the lease term and are calculated as the sum of the lease liability and if applicable, prepaid rent, initial direct costs and any incentives received from the lessor.

The company's long-term lease agreements are classified as operating leases. Certain of these leases offer the option to extend the lease term and the company has included such extensions in its calculation of the lease liabilities to the extent the options are reasonably assured of being exercised. The lease agreements do not provide for residual value guarantees and have no restrictions or covenants that would impact dividends or require incurring additional financial obligations.

The following tables present information about the company's leases (in thousands):

	<u>December, 31 2019</u>
Lease liabilities	\$ 2 437
Right-of-use assets, net	\$ 2 404
Weighted average remaining lease term	7.66 years
Weighted average discount rate	3.14%

	<u>For the Year Ended December 31, 2019</u>
Lease cost (in thousands)	
Operating lease cost	\$ 385
Variable lease cost	8
Short-term lease cost	--
Total lease cost	<u>\$ 393</u>

Cash paid for amounts included in the measurement of lease liabilities \$ 352

A maturity analysis of operating lease liabilities and reconciliation of the undiscounted cash flows to the total of operating lease liabilities is as follows:

	Lease Payments Due (in thousands)
Years ending December 31,	
2020	\$ 350
2021	358
2022	363
2023	356
2024	342
Thereafter	996
Total undiscounted cash flows	<u>\$ 2 765</u>
Discount	<u>(328)</u>
Lease liabilities	<u>\$ 2 437</u>

Note 7. Deposits

The aggregate amount of time deposits with a balance of \$250,000 or more was \$47.4 million and \$40.0 million at December 31, 2019 and 2018, respectively. At December 31, 2019, the company had one depositor whose aggregate deposits were approximately 6.8% of total deposits.

Note 7. Deposits (Continued)

At December 31, 2019, the scheduled maturities of all time deposits (in thousands) are as follows:

2020	\$ 75 889
2021	19 319
2022	13 756
2023	9 802
2024	11 720
	<u>\$ 130 486</u>

Brokered deposits totaled \$2.0 million at December 31, 2019 and 2018. Also included in total deposits were reciprocal deposits of \$49.5 million and \$42.1 million as of December 31, 2019 and 2018, respectively.

Deposits of the company's directors, executive officers and associates totaled \$4.2 million at December 31, 2019 and totaled \$10.3 million at December 31, 2018.

Note 8. Borrowings

Short-term borrowings consist of securities sold under agreements to repurchase, FHLB open repo plus advances, and federal funds purchased. Securities sold under agreement to repurchase totaled \$1.9 million and \$3.3 million as of December 31, 2019 and 2018, respectively. FHLB open repo plus advances totaled \$2 million as of December 31, 2019 and \$0 as of December 31, 2018.

The table below presents selected information on these short-term borrowings (in thousands):

	December 31	
	2019	2018
Balance outstanding at year end	\$ 3 910	\$ 3 287
Maximum balance at any month-end during the year	\$ 3 910	\$ 3 754
Average balance for the year	\$ 1 952	\$ 2 685
Weighted average rate for the year	0.70%	0.74%
Weighted average rate at year end	1.24%	0.78%

Total FHLB advances at December 31, 2019 and 2018 were \$5.0 million and \$5.5 million, respectively. At December 31, 2019 and 2018 the company had one non-amortizing \$5 million Federal Home Loan Bank advance. The advance has an interest rate of 2.22% and a maturity date of March 28, 2022. The company also had an amortizing Federal Home Loan Bank advance with an interest rate of 1.43% and a balance of \$0.5 million at December 31, 2018. This advance matured and was paid off on June 26, 2019.

Noncore funding capabilities, including borrowing, provide additional liquidity. The subsidiary bank maintains a federal funds line with two financial institutions and is a member of the Federal Home Loan Bank of Pittsburgh. The subsidiary bank also has a credit line with the Federal Reserve discount window. At December 31, 2019, the subsidiary bank had total credit available through these institutions of approximately \$194.4 million.

There were no securities sold under agreement to repurchase to the company's directors, executive officers and associates at December 31, 2019, and \$1.9 million at December 31, 2018.

Note 9. Employee Benefit Plans

The company's defined benefit pension plan, covering full-time employees over 21 years of age upon completion of one year of service, was frozen as of October 31, 2009, the end of the plan year. Benefits will be based on average compensation for the five consecutive full calendar years of service which produces the highest average as of October 31, 2009. No additional participants may enter the plan, and there will be no further increases in benefits due to increases in salaries and years of service.

Note 9. Employee Benefit Plans (Continued)

The company sponsors an unfunded postretirement life insurance plan covering certain retirees with 25 years of service who are over the age of 60 and an unfunded health care plan for certain retirees that met certain eligibility requirements. These plans are not available to future retirees.

The company sponsors a 401(k)-retirement savings plan available to all employees meeting certain age requirements. Employees become eligible to participate in the plan upon reaching age 21. Employees can make a salary deferral election authorizing the company to withhold up to the amount allowed by law each calendar year. The company may make a discretionary matching contribution each plan year. The company may also make other discretionary contributions to the plan. The company made 401(k) matching contributions of \$388 thousand and \$333 thousand in 2019 and 2018, respectively.

The company has entered into contracts with two retirees where the company has agreed to pay the beneficiary of one participant \$50,000 and the beneficiary of another participant \$25,000 at the death of the participants. These postretirement benefits were accrued for as of December 31, 2019 and 2018. While these liabilities are unfunded, life insurance has been obtained by the company to help offset these payments.

Obligations and funded status:

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
	(in thousands)		(in thousands)	
Change in benefit obligation:				
Benefit obligation, beginning	\$ 8 727	\$ 9 841	\$ 276	\$ 289
Interest cost	370	354	11	10
Actuarial loss (gain)	1 451	(944)	15	--
Benefits paid	(566)	(524)	(23)	(23)
Benefit obligation, ending	<u>\$ 9 982</u>	<u>\$ 8 727</u>	<u>\$ 279</u>	<u>\$ 276</u>
Change in plan assets:				
Fair value of plan assets, beginning	\$ 8 904	\$ 9 719	\$ --	\$ --
Actual return on plan assets	1 416	(440)	--	--
Employer contributions	147	149	23	23
Benefits paid	(566)	(524)	(23)	(23)
Fair value of plan assets, ending	<u>\$ 9 901</u>	<u>\$ 8 904</u>	<u>\$ --</u>	<u>\$ --</u>
Funded status at end of year	\$ (81)	\$ 177	\$ (279)	\$ (276)
Accounts recognized on consolidated balance sheet as:				
(Accrued) prepaid benefit cost	<u>\$ (81)</u>	<u>\$ 177</u>	<u>\$ (279)</u>	<u>\$ (276)</u>
Amounts recognized in accumulated other comprehensive loss consists of:				
Net actuarial loss (gain)	\$ 3 617	\$ 3 277	\$ 3	\$ (12)
Deferred tax (asset) liability	(903)	(819)	(1)	3
	<u>\$ 2 714</u>	<u>\$ 2 458</u>	<u>\$ 2</u>	<u>\$ (9)</u>

The accumulated benefit obligation for the defined benefit pension plan was \$10.0 million and \$8.7 million at December 31, 2019 and 2018, respectively.

Note 9. Employee Benefit Plans (Continued)

Components of net periodic benefit (income) cost and other amounts recognized in accumulated other comprehensive loss:

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
	(in thousands)		(in thousands)	
Components of net periodic benefit cost (income):				
Interest cost	\$ 370	\$ 354	\$ 11	\$ 10
Expected return on plan assets	(556)	(598)	--	--
Amortization of actuarial loss	251	243	--	--
Net periodic benefit cost (income)	<u>\$ 65</u>	<u>\$ (1)</u>	<u>\$ 11</u>	<u>\$ 10</u>
Other changes in plan assets and benefit obligations recognized as other comprehensive loss (income):				
Net actuarial loss	\$ 591	\$ 95	\$ 15	\$ --
Deferred tax	(84)	37	(4)	--
Amortization of actuarial loss	(251)	(243)	--	--
Total recognized as other comprehensive loss (income)	<u>\$ 256</u>	<u>\$ (111)</u>	<u>\$ 11</u>	<u>\$ --</u>

The estimated net loss for the defined benefit pension plan that will be amortized from accumulated other comprehensive loss into net periodic benefit cost over the next fiscal year approximates \$297 thousand.

Assumptions

	Pension Benefits		Other Postretirement Benefits	
	2019	2018	2019	2018
Weighted-average assumptions used to determine net periodic benefit cost:				
Discount rate	4.38%	3.70%	4.20%	3.55%
Expected return on plan assets	6.43%	6.34%	--	--
Weighted-average assumptions used to determine benefit obligations:				
Discount rate	3.25%	4.38%	3.00%	4.20%
Expected return on plan assets	5.01%	6.43%	--	--

Note 9. Employee Benefit Plans (Continued)

Long-Term Rate of Return

The plan sponsor selects the expected long-term rate-of-return-on-assets assumption in consultation with their actuary. This rate is intended to reflect the average rate of earnings expected to be earned on the funds invested or to be invested to provide plan benefits. Historical performance is reviewed, especially with respect to real rates of return (net of inflation), for the major asset classes held or anticipated to be held by the trust, and for the trust itself. Undue weight is not given to recent experience that may not continue over the measurement period, with higher significance placed on current forecasts of future long-term economic conditions.

Because assets are held in a qualified trust, anticipated returns are not reduced for taxes. Further, solely for this purpose, the plan is assumed to continue in force and not terminate during the period during which assets are invested. However, consideration is given to the potential impact of current and future investment policy, cash flow into and out of the trust, and expenses (both investment and non-investment) typically paid from plan assets (to the extent such expenses are not explicitly estimated within periodic cost).

The fair value (in thousands) of the company's pension assets as of December 31, 2019 and 2018, respectively, are as follows:

Asset Category	Total	Fair Value Measurement at December 31, 2019		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash & cash equivalents	\$ 201	\$ 201	\$ - -	\$ - -
Equity securities				
U.S. companies	4 888	4 888	- -	- -
International companies	909	909	- -	- -
U. S. Treasury securities	1 308	- -	1 308	- -
U. S. Government Agencies	432	- -	432	- -
U. S. Corporate bonds	2 152	- -	2 152	- -
International Corporate bonds	11	- -	11	- -
Total	<u>\$9 901</u>	<u>\$5 998</u>	<u>\$3 903</u>	<u>\$- -</u>

Asset Category	Total	Fair Value Measurement at December 31, 2018		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash & cash equivalents	\$ 247	\$ 247	\$ - -	\$ - -
Equity securities				
U.S. companies	3 990	3 990	- -	- -
International companies	751	751	- -	- -
U. S. Treasury securities	1 134	- -	1 134	- -
U. S. Government Agencies	472	- -	472	- -
U. S. Corporate bonds	2 226	- -	2 226	- -
International Corporate bonds	84	- -	84	- -
Total	<u>\$8 904</u>	<u>\$4 988</u>	<u>\$3 916</u>	<u>\$- -</u>

Note 9. Employee Benefit Plans (Continued)

Asset Allocation

The pension plan's asset allocations at December 31, 2019 and 2018 by asset category are as follows:

Asset Category	Plan Assets at December 31	
	2019	2018
Equities	59%	53%
Fixed income/cash	41%	47%
Total	<u>100%</u>	<u>100%</u>

The trust fund is diversified to maintain a reasonable level of risk without imprudently sacrificing return, with a targeted asset allocation of 50% equities, 50% fixed income and cash, with a range of 40% to 60%. The trust fund allocation is reviewed on a monthly basis and rebalanced to within the acceptable ranges as needed. The investment manager selects investment fund managers with demonstrated experience and expertise and funds with demonstrated historical performance for the implementation of the plan's investment strategy. The investment manager will consider both actively and passively managed investment strategies and will allocate funds across the asset classes to develop an efficient investment structure.

It is the responsibility of the trustee to administer the investments of the trust within reasonable costs, being careful to avoid sacrificing quality. These costs include, but are not limited to, management and custodial fees, consulting fees, transaction costs and other administrative costs chargeable to the trust.

There was no company common stock included in the equity securities of the pension plan at December 31, 2019 and 2018.

Cash Flow

The company currently expects to make contributions of \$381 thousand to its pension plan in 2020 and \$28 thousand to its postretirement plan in 2020.

The following benefit payments (in thousands) are expected to be paid:

	Pension Benefits	Other Postretirement Benefits
2020	\$ 599	\$ 28
2021	600	28
2022	599	27
2023	591	26
2024	601	25
Thereafter	2 898	102

For measurement purposes, a 6.6% and 7.00% annual rate of increase in per capita health care costs of covered benefits was assumed for the retiree health care plan for 2019 and 2018.

Note 9. Employee Benefit Plans (Continued)

Cash Flow (Continued)

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

	<u>1% Increase</u>	<u>1% Decrease</u>
	<u>(in thousands)</u>	
Effect on the health care component of the accumulated postretirement benefit obligation	\$12	\$(11)
Effect on interest cost component of net periodic other postretirement health care benefit cost	- -	- -

Note 10. Weighted Average Number of Shares Outstanding and Earnings Per Common Share

The following shows the weighted average number of shares used in computing earnings per share. There were no potentially dilutive shares outstanding for 2019 and 2018.

	<u>2019</u>		<u>2018</u>	
	<u>Average</u>	<u>Per Share</u>	<u>Average</u>	<u>Per Share</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>
	<u>(in thousands)</u>		<u>(in thousands)</u>	
Basic earnings				
per common share	4 134	<u>\$.78</u>	3 604	<u>\$.94</u>
Effect of dilutive securities:	<u>- -</u>		<u>- -</u>	
Diluted earnings				
per common share	<u>4 134</u>	<u>\$.78</u>	<u>3 604</u>	<u>\$.94</u>

Note 11. Income Taxes

The company files income tax returns in the U. S. Federal jurisdiction and the states of West Virginia and Maryland. With few exceptions, the company is no longer subject to U. S. Federal, state and local income tax examinations by tax authorities for years prior to 2016.

The asset and liability method is used in accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Note 11. Income Taxes (Continued)

Net deferred tax assets (in thousands) consist of the following components as of December 31, 2019 and 2018:

	<u>2019</u>	<u>2018</u>
Deferred tax assets:		
Reserve for loan losses	\$ 508	\$ 353
Defined benefit pension plan	41	--
Other postretirement benefits	83	80
Nonaccrual interest	96	140
Net loan origination fees	35	18
OREO valuation allowance	13	47
OREO built in gain	2	31
Lease liability	595	--
Paid time off (PTO) accrual	25	--
Employee stock incentive	7	--
Securities available for sale	--	63
	<u>\$1 405</u>	<u>\$ 732</u>
Deferred tax liabilities:		
Depreciation	\$ 277	\$ 244
Intangibles	3	4
Equity securities	4	3
Securities Available for sale	140	--
Right of use asset	587	--
Defined benefit pension plan	--	20
Other	9	--
	<u>\$1 020</u>	<u>\$ 271</u>
Net deferred tax assets	<u>\$ 385</u>	<u>\$ 461</u>

The provision for income taxes charged to operations for the years ended December 31, 2019 and 2018 consists of the following (in thousands):

	<u>2019</u>	<u>2018</u>
Current tax expense	\$ 940	\$ 847
Deferred tax (benefit) expense	(39)	107
	<u>\$ 901</u>	<u>\$ 954</u>

The income tax provision differs from the amount of income tax determined by applying the federal income tax rate to pretax income for the years ended December 31, 2019 and 2018 due to the following (in thousands):

	<u>2019</u>	<u>2018</u>
Computed "expected" tax expense	\$ 864	\$ 913
Increase (decrease) in income taxes resulting from:		
Tax exempt income	(97)	(104)
State income tax expense, net of federal benefit	115	126
Other	19	19
	<u>\$ 901</u>	<u>\$ 954</u>

Note 11. Income Taxes (Continued)

The realization of deferred income tax assets is assessed, and a valuation allowance is recorded if it is “more likely than not” that all or a portion of the deferred tax asset will not be realized. “More likely than not” is defined as greater than a 50% chance. Management considers all available evidence, both positive and negative, to determine whether, based on the weight of that evidence, a valuation allowance is needed. Management’s assessment is primarily dependent on historical taxable income and projections of future taxable income, which are directly related to the company’s core earnings capacity and its prospects to generate core earnings in the future. Projections of core earnings and taxable income are inherently subject to uncertainty and estimates that may change given the uncertain economic outlook, banking industry conditions and other factors. Based upon an analysis of available evidence, management has determined that it is “more likely than not” that the company’s deferred income tax assets as of December 31, 2019 will be fully realized and therefore no valuation allowance to the company’s deferred income tax assets was recorded. However, the company can give no assurance that in the future its deferred income tax assets will not be impaired because such determination is based on projections of future earnings and the possible effect of certain transactions, which are subject to uncertainty and based on estimates that may change due to changing economic conditions and other factors. Due to the uncertainty of estimates and projections, it is possible that the company will be required to record adjustments to the valuation allowance in future reporting periods.

Note 12. Commitments and Contingent Liabilities

In the normal course of business, there are outstanding various commitments and contingent liabilities which are not reflected in the accompanying financial statements. The company does not anticipate losses as a result of these transactions. See Note 15 with respect to financial instruments with off-balance-sheet risk.

The company must maintain a reserve against its deposits in accordance with Regulation D of the Federal Reserve Act. For the final bi-weekly reporting periods which included December 31, 2019 and 2018, this requirement was met by the amount of vault cash.

In the normal course of business, the company may be involved in various legal proceedings. Based on the information presently available, management believes that the ultimate outcome in such proceedings, in the aggregate, will not have a material adverse effect on the business or the financial condition or results of operations of the company.

Note 13. Retained Earnings

Federal and state banking regulations place certain restrictions on dividends paid and loans or advances made by the bank to the company. The approval of the State Banking Commissioner is required if the total of all dividends declared in any calendar year exceeds the bank’s net profits for that year combined with its retained net profits for the preceding two calendar years.

At January 1, 2020 the bank had available \$5.2 million for the payment of dividends.

In addition, dividends paid by the bank to the company would be prohibited if the effect thereof would cause the bank’s capital to be reduced below applicable minimum capital requirements.

Note 14. Accumulated Other Comprehensive Income (Loss)

The balances in accumulated other comprehensive (loss) are shown in the following table (in thousands):

	Net Unrealized Gains (Losses) on Securities	Adjustments Related to Pension and Other Post Retirement Benefits	Accumulated Other Comprehensive Loss, net
Balance at December 31, 2017	<u>\$ (168)</u>	<u>\$(2 560)</u>	<u>\$(2 728)</u>
Net unrealized holding losses on securities, net of tax of \$7	(18)	- -	(18)
Change in benefit obligation and plan assets for pension and other postretirement benefits, net of tax of \$37	- -	111	111
Cumulative effect adjustment (ASU 2016-01)	<u>(2)</u>	<u>- -</u>	<u>(2)</u>
Balance at December 31, 2018	<u>(188)</u>	<u>(2 449)</u>	<u>(2 637)</u>
Net unrealized holding gains on securities, net of tax of \$204	610	- -	610
Change in benefit obligation and plan assets for pension and other postretirement benefits, net of tax of \$88	- -	(267)	(267)
Balance at December 31, 2019	<u>\$ 422</u>	<u>\$(2 716)</u>	<u>\$(2 294)</u>

The following table presents information on amounts reclassified out of accumulated other comprehensive loss, by category during the years ended December 31, 2019 and 2018 (in thousands):

	2019	2018	Affected Line Item on the Consolidated Statements of Income
Available for sale securities			
Realized loss on securities available for sale, net	\$ (7)	\$ (6)	Losses on sales of securities available for sale
Tax effect	(2)	(1)	Income tax expense
Net of tax	<u>\$ (5)</u>	<u>\$ (5)</u>	Net of tax
Pension and other postretirement benefits			
Amortization of net actuarial loss (1)	\$(251)	\$(243)	Other operating expenses
Tax effect	(63)	(61)	Income tax expense
Net of tax	<u>\$(188)</u>	<u>\$(182)</u>	Net of tax
Total reclassifications for the period	<u>\$(193)</u>	<u>\$(187)</u>	Net of tax

(1) This accumulated other comprehensive loss component is included in the computation of net pension benefit cost (see Note 9 Employee Benefit Plans for additional details).

Note 15. Financial Instruments With Off-Balance-Sheet Risk

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. Those financial instruments include commitments to extend credit and standby letters of credit. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the balance sheet.

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

A summary of the contract or notional amount of the company's exposure to off-balance-sheet risk as of December 31, 2019 and 2018 (in thousands) is as follows:

	<u>2019</u>	<u>2018</u>
Financial instruments whose amounts represent credit risk:		
Commitments to extend credit	\$61 690	\$44 535
Standby letters of credit	6 149	304

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 many 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 borrower. Collateral held varies but typically is cash or real estate.

Unfunded commitments under commercial lines of credit are commitments for possible future extensions of credit to existing customers. The majority of the lines of credit are collateralized and usually contain a specified maturity date.

Standby letters of credit are conditional commitments issued by the company to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The company generally holds collateral supporting those commitments if deemed necessary.

Note 16. Fair Value Measurements

Determination of Fair Value

The company determines the fair values of its financial instruments based on the fair value hierarchy established by ASC Topic 820, which also clarifies that the fair value of certain assets and liabilities is an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market and in an orderly transaction between market participants on the measurement date.

The fair value measurements and disclosures topic specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the company's market assumptions.

Note 16. Fair Value Measurements (Continued)

Fair Value Hierarchy

In accordance with this guidance, the company groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded, and the reliability of the assumptions used to determine fair value.

Level 1—Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2—Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Level 3—Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

The carrying amounts and estimated fair values of the company's financial instruments are presented in the following tables (in thousands). Fair values for December 31, 2019 and 2018 were estimated using an exit price notion.

Note 16. Fair Value Measurements (Continued)

The carrying amounts and estimated fair values of the company's financial instruments are as follows (in thousands):

	Fair Value Measurements at December 31, 2019 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Assets					
Cash and cash equivalents	\$ 28 261	\$28 261	\$ --	\$ --	\$ 28 261
Certificates of deposits in other financial institutions	4 245	--	4 310	--	4 310
Securities available for sale	50 471	--	50 471	--	50 471
Equity securities	133	--	133	--	133
Loans held for sale	2 034	--	2 034	--	2 034
Loans, net	408 744	--	--	404 654	404 654
FHLB Stock	727	--	727	--	727
BOLI	7 641	--	7 641	--	7 641
Accrued interest receivable	1 178	--	1 178	--	1 178
Liabilities					
Deposits	\$ 449 880	\$ --	\$ 450 883	\$ --	\$ 450 883
Short term borrowings	3 910	--	3 910	--	3 910
Long term borrowings	5 000	--	5 042	--	5 042
Accrued interest payable	337	--	337	--	337

	Fair Value Measurements at December 31, 2018 Using				
	Carrying Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
Assets					
Cash and cash equivalents	\$ 49 424	\$49 424	\$ --	\$ --	\$ 49 424
Certificates of deposits in other financial institutions	6 997	--	6 956	--	6 956
Securities available for sale	48 463	--	48 463	--	48 463
Equity securities	132	--	132	--	132
Loans held for sale	323	--	323	--	323
Loans, net	360 688	--	--	355 546	355 546
FHLB Stock	645	--	645	--	645
BOLI	7 457	--	7 457	--	7 457
Accrued interest receivable	1 053	--	1 053	--	1 053
Liabilities					
Deposits	\$ 424 127	\$ --	\$ 424 322	\$ --	\$ 424 322
Short term borrowings	3 287	--	3 287	--	3 287
Long term borrowings	5 516	--	5 432	--	5 432
Accrued interest payable	355	--	355	--	355

Note 16. Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Recurring Basis

The following table describes the valuation techniques used by the company to measure certain assets recorded at fair value on a recurring basis in the financial statements.

Securities

Securities available for sale and equity securities are recorded at fair value on a recurring basis. Fair value measurement is based upon quoted market prices, when available (Level 1). If quoted market prices are not available, fair values are measured utilizing independent valuation techniques of identical or similar securities for which significant assumptions are derived primarily from or corroborated by observable market data. Third party vendors compile prices from various sources and may determine the fair value of identical or similar securities by using pricing models that consider observable market data (Level 2).

Description	Balance as of December 31	Fair Value Measurements at December 31, 2019 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government sponsored agency securities	\$ 13 522	\$ -	\$ 13 522	\$ -
Mortgage-backed	35 499	-	35 499	-
State and municipal securities	<u>1 450</u>	-	<u>1 450</u>	-
Total available for sale securities	<u>50 471</u>	-	<u>50 471</u>	-
Equity securities	<u>133</u>	-	<u>133</u>	-
Total securities	<u>\$ 50 604</u>	<u>\$ -</u>	<u>\$ 50 604</u>	<u>\$ -</u>

Description	Balance as of December 31	Fair Value Measurements at December 31, 2018 Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Available for sale securities				
U.S. Government sponsored agency securities	\$ 36 273	\$ -	\$ 36 273	\$ -
Mortgage-backed	10 446	-	10 446	-
State and municipal securities	<u>1 744</u>	-	<u>1 744</u>	-
Total available for sale securities	<u>48 463</u>	-	<u>48 463</u>	-
Equity securities	<u>132</u>	-	<u>132</u>	-
Total securities	<u>\$ 48 595</u>	<u>\$ -</u>	<u>\$ 48 595</u>	<u>\$ -</u>

Note 16. Fair Value Measurements (Continued)

Assets Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis in accordance with generally accepted accounting principles.

The following describes the valuation techniques used by the company to measure certain assets recorded at fair value on a nonrecurring basis in the financial statements:

Impaired Loans: ASC 820 applies to loans measured for impairment at an observable market price (if available), present value of expected future cash flows discounted at the loan's effective interest rate, or at the fair value of the loan's collateral (if the loan is collateral dependent). Fair value of the loan's collateral, when the loan is dependent on collateral, is determined by appraisals or independent valuation which is then adjusted for the cost related to liquidation of the collateral. Loans are designated as impaired when, in the judgment of management based on current information and events, it is probable that all amounts according to the contractual terms of the loan agreement will not be collected when due. The measurement of loss associated with impaired loans can be based on either the observable market price of the loan or the fair value of the collateral. Fair value is measured based on the value of the collateral securing the loans. Collateral may be in the form of real estate or business assets including equipment, inventory, and accounts receivable. The vast majority of the collateral is real estate. The value of real estate collateral is determined utilizing an income or market valuation approach based on an appraisal conducted by a licensed appraiser outside of the company using observable market data. In certain instances, an internal independent collateral valuation may be performed to determine value. The value of business equipment is based upon an outside appraisal if deemed significant, or the net book value on the applicable business's financial statements if not considered significant using observable market data. Likewise, values for inventory and accounts receivables collateral are based on financial statement balances or aging reports. Any fair value adjustments are recorded in the period incurred as provision for loan losses on the consolidated statements of income. The carrying values of all impaired loans are considered to be Level 3.

Other Real Estate Owned: Certain assets such as other real estate owned (OREO) are measured at fair value less cost to sell. We believe that the fair value component in its valuation follows the provisions of ASC 820.

Real estate acquired through foreclosure is transferred to other real estate owned (OREO). The measurement of loss associated with OREO is based on the fair value of the collateral less anticipated selling costs compared to the unpaid loan balance. The value of real estate collateral is determined based on an internal evaluation, appraisal outside of the company, or comparative market analysis. Any fair value adjustments are recorded in the period incurred and expensed against current earnings. The carrying values of all OREO are considered to be Level 3.

Loans held for sale: Loans held for sale are carried at cost which approximates estimated fair value. At December 31, 2019, these loans consisted of one-to-four family residential loans originated for sale in the secondary market. Fair value is based on the price secondary markets are currently offering for similar loans using observable market data which is not materially different than cost due to the short duration between origination and sale (Level 2). As such, the company records fair value adjustments on a nonrecurring basis. No nonrecurring fair value adjustments were recorded on loans held for sale at December 31, 2019. Gains and losses on the sale of loans are recorded within "Secondary Market Income" on the Consolidated Statements of Income.

Note 16. Fair Value Measurements (Continued)

The following table summarizes the company's assets that were measured at fair value (in thousands) on a nonrecurring basis as of December 31, 2019 and 2018.

Description	Balance as of December 31, 2019	Carrying Value at December 31, 2019		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Input (Level 3)
Assets				
Impaired Loans with a valuation allowance	\$ 1 671	\$ - -	\$ - -	\$ 1 671
OREO	53	--	--	53

Description	Balance as of December 31, 2018	Carrying Value at December 31, 2018		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Input (Level 2)	Significant Unobservable Input (Level 3)
Assets				
Impaired Loans with a valuation allowance	\$ 3 453	\$ - -	\$ - -	\$ 3 453
OREO	170	- -	- -	170

Quantitative information about Level 3 Fair Value Measurement for December 31, 2019				
Asset	Fair			
	Value (000s)	Valuation Technique(s)	Unobservable Input	Weighted Average
Impaired loans with a valuation allowance	\$1 671	Appraisal and income or market valuation	Market discount	2.2%
OREO	\$ 53	Appraisal and income or market valuation	Market discount	49.3%

Quantitative information about Level 3 Fair Value Measurement for December 31, 2018				
Asset	Fair			
	Value (000s)	Valuation Technique(s)	Unobservable Input	Weighted Average
Impaired loans with a valuation allowance	\$3 453	Appraisal and income or market valuation	Market discount	6.1%
OREO	\$ 170	Appraisal and income or market valuation	Market discount	53.0%

Note 17. Regulatory Matters

The final rules implementing Basel Committee on Banking Supervision's capital guidelines for U.S. Banks (Basel III rules) became effective on January 1, 2015, with full compliance with all of the requirements being phased in over a multi-year schedule, and fully phased in by January 1, 2019. As part of these requirements, the Common Equity Tier 1 Capital (CET1) ratio is calculated and utilized in the assessment of capital for banking institutions. Under Basel III capital guidelines, Bank of Charles Town is required to maintain minimum total capital, CET1 capital, Tier 1 capital, and Tier 1 capital leverage ratios of 8.0%, 4.5%, 6.0%, and 4.0%, respectively. Failure to meet minimum capital requirements can initiate certain mandatory, possibly additional discretionary, actions by regulators. The capital amounts and classification are also subject to qualitative judgments by the

Note 17. Regulatory Matters (Continued)

regulators about components, risk weightings, and other factors. The most recent notification from the bank's primary federal regulator categorized the bank as well-capitalized. There are no conditions or events since that notification that management believes have changed the bank's category. The bank had a capital conservation buffer of 6.83% as of December 31, 2019.

The implementation of a capital conservation buffer began on January 1, 2016 and was phased in over a four-year period until it reached 2.5% on January 1, 2019. Including the fully phased-in buffer at December 31, 2019, the minimum total capital, CET 1 capital, and Tier 1 capital ratios were 10.5%, 7.0%, and 8.5%, respectively. There is no capital conservation buffer for the Tier 1 Leverage ratio.

The bank's actual capital amounts and ratios are presented in the table.

			Minimum Required – Including Basel III Phase-In Schedule		Required To Be Considered Well Capitalized	
Actual						
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)						
As of December 31, 2019:						
Total capital (to risk-weighted assets):						
Bank of Charles Town	\$57 746	14.83%	\$40 878	10.50%	\$38 931	10.0%
CET 1 capital (to risk-weighted assets):						
Bank of Charles Town	\$54 030	13.88%	\$27 252	7.00%	\$25 305	6.5%
Tier 1 capital (to risk-weighted assets):						
Bank of Charles Town	\$54 030	13.88%	\$33 092	8.50%	\$31 145	8.0%
Tier 1 Leverage (to average assets):						
Bank of Charles Town	\$54 030	10.48%	\$20 617	4.00%	\$25 771	5.0%
			Minimum Required – Including Basel III Phase-In Schedule		Required To Be Considered Well Capitalized	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
(in thousands)						
As of December 31, 2018:						
Total capital (to risk-weighted assets):						
Bank of Charles Town	\$54 922	16.60%	\$32 674	9.88%	\$33 087	10.0%
CET 1 capital (to risk-weighted assets):						
Bank of Charles Town	\$51 653	15.61%	\$21 093	6.38%	\$21 507	6.5%
Tier 1 capital (to risk-weighted assets):						
Bank of Charles Town	\$51 653	15.61%	\$26 056	7.88%	\$26 470	8.0%
Tier 1 Leverage (to average assets):						
Bank of Charles Town	\$51 653	10.61%	\$19 467	4.00%	\$24 334	5.0%

Note 18. Revenue

On January 1, 2018, the company adopted ASU No. 2014-09, “Revenue from Contracts with Customers: Topic 606”, and all subsequent amendments to the ASU No. 2014-09. Using Topic 606 guidelines, the company concluded that Topic 606 applies to noninterest income excluding certain out-of-scope revenue streams (e.g. gains on securities transactions, bank owned life insurance income, etc.).

Service Charges on Deposit Accounts

The majority of the company’s noninterest income is derived from short term contracts associated with services provided for deposit accounts and other ancillary services. These revenue streams are principally comprised of overdrawn account charges, account maintenance charges, and ATM fees. The company’s performance obligations on revenue generated from deposit accounts and other services are generally satisfied immediately, when the transaction occurs, or by month-end. Typically, the duration of a contract does not extend beyond the services performed. Due to the short duration of most customer contracts which generate these sources of noninterest income, no significant judgments must be made in the determination of the amount and timing of revenue recognized.

Trust and Financial Services

Trust and financial services income are primarily comprised of fees earned from the management and administration of trusts and other customer assets. The company’s performance obligation is generally satisfied over time and the resulting fees are recognized monthly, based upon the month-end market value of the assets under management and the applicable fee rate. Payment is generally received a few days after month end. Optional services such as real estate sales and tax return preparation services are also available to existing trust and asset management customers. The company’s performance obligation for these transactional-based services is generally satisfied, and related revenue recognized, at a point in time (i.e., as incurred). Payment is received shortly after services are rendered. Brokerage fees are earned when a financial instrument trade is completed. The revenue amount depends on the number of shares purchased or sold. Revenue from these services is recognized monthly.

Interchange Fees

The company earns interchange fees from debit and credit cardholder transactions conducted through the Visa payment network. Interchange fees from cardholder transactions represent a percentage of the underlying transaction value and are recognized daily, concurrently with the transaction processing services provided to the cardholder.

Secondary Market Income

Secondary market income is comprised of gains on sales of loans (out of scope) and fees received for residential real estate loans that are initiated by the bank and closed by other financial institutions. The company’s performance obligation on these transactions is generally satisfied when the loan closes. The resulting fees are recognized and collected in the month the loan is closed by the other financial institution.

Note 18. Revenue (Continued)

Noninterest income disaggregated by major source, for the years ended December 31, 2019 and 2018, consisted of the following:

	Years Ended December 31,	
	2019	2018
Noninterest income (in thousands):		
Trust and financial services:		
Trust asset management fees (1)	\$ 1 103	\$ 1 072
Brokerage fees (1)	231	145
Service charges on deposit accounts:		
Overdraft & return check charges (1)	958	915
Charges - use of foreign ATMS (1)	129	134
Other service charges (1)	86	80
Secondary market income		
Wholesale/broker fee income (1)	73	381
Gain on sales of loans in the secondary market	977	72
Interchange fees (1)	1 384	1 319
Earnings on bank owned life insurance	184	178
Loss on sales of securities available for sale	(7)	(6)
Other operating income (2)	347	385
Total noninterest income	<u>\$ 5 465</u>	<u>\$ 4 675</u>

(1) Income within the scope of Topic 606.

(2) For 2019, includes other income within the scope of Topic 606 amounting to \$302 thousand. For 2018, includes other income within the scope of Topic 606 amounting to \$204 thousand.

Contract Balances

A contract asset balance occurs when an entity performs a service for a customer before the customer pays consideration (resulting in a contract receivable) or before payment is due (resulting in a contract asset). A contract liability balance is an entity's obligation to transfer a service to a customer for which the entity has already received payment (or payment is due) from the customer. The company's noninterest revenue streams are largely based on transactional activity, or standard month-end revenue accruals such as asset management fees based on month-end market values. Consideration is often received immediately or shortly after the company satisfies its performance obligation and revenue is recognized. The company does not typically enter into long-term revenue contracts with customers, and therefore, does not experience significant contract balances. As of December 31, 2019, and December 31, 2018, the company did not have any significant contract balances.

Note 19. Parent Company Only Financial Statements

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Balance Sheets
December 31, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
ASSETS		
Cash	\$ 21	\$ 344
Investment in subsidiary	51 736	49 016
Equity securities, at fair value	133	132
Other assets	<u>37</u>	<u>35</u>
Total Assets	<u>\$51 927</u>	<u>\$49 527</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Other liabilities	\$ 5	\$ 3
Total Liabilities	<u>\$ 5</u>	<u>\$ 3</u>
STOCKHOLDERS' EQUITY		
Common stock	\$ 4 483	\$ 4 483
Surplus	14 358	14 358
Undivided profits	38 869	36 814
Accumulated other comprehensive loss, net	<u>(2 294)</u>	<u>(2 637)</u>
	\$55 416	\$53 018
Less cost of shares acquired for the treasury	<u>(3 494)</u>	<u>(3 494)</u>
Total Stockholders' Equity	<u>\$51 922</u>	<u>\$49 524</u>
Total Liabilities and Stockholders' Equity	<u>\$51 927</u>	<u>\$49 527</u>

Note 19. Parent Company Only Financial Statements (Continued)

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Statements of Income
Years Ended December 31, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
Income		
Dividends from subsidiary	\$ 963	\$ 646
Other income	<u>3</u>	<u>15</u>
Total Income	<u>\$ 966</u>	<u>\$ 661</u>
Expenses		
Public relations & new business development	\$ 7	\$ 5
Transfer agent expense	34	31
Director and committee fees	19	21
Legal fees	15	9
Other professional fees	35	31
Postage	8	8
Proxy solicitation	10	10
Printing, stationery and supplies	28	19
Other taxes	<u>6</u>	<u>6</u>
Total Expenses	<u>\$ 162</u>	<u>\$ 140</u>
Income before Income Tax Benefit and Equity in Undistributed Income of Subsidiary	\$ 804	\$ 521
Income Tax Benefit	<u>(32)</u>	<u>(26)</u>
Income before Equity in Undistributed Income of Subsidiary	\$ 836	\$ 547
Equity in Undistributed Income of Subsidiary	<u>2 377</u>	<u>2 845</u>
Net Income	<u><u>\$3 213</u></u>	<u><u>\$3 392</u></u>

Note 19. Parent Company Only Financial Statements (Continued)

POTOMAC BANCSHARES, INC.
(Parent Company Only)
Statements of Cash Flows
Years Ended December 31, 2019 and 2018
(in thousands)

	<u>2019</u>	<u>2018</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 3 213	\$ 3 392
Adjustments to reconcile net income to net cash provided by operating activities:		
Equity in undistributed income of Subsidiary	(2 377)	(2 845)
Deferred tax expense	--	3
Fair value adjustment on equity securities	(1)	(14)
Increase in other assets	(2)	(34)
Increase (decrease) in other liabilities	<u>2</u>	<u>(67)</u>
Net cash provided by operating activities	<u>\$ 835</u>	<u>\$ 435</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Additional investment in subsidiary	<u>\$ --</u>	<u>\$(10 700)</u>
Net cash used in investing activities	<u>\$ --</u>	<u>\$(10 700)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of common stock, net of issuance costs	\$ --	\$ 11 225
Cash dividends	<u>(1 158)</u>	<u>(1 005)</u>
Net cash (used in) provided by financing activities	<u>\$ (1 158)</u>	<u>\$ 10 220</u>
Decrease in cash and cash equivalents	\$ (323)	\$ (45)
CASH AND CASH EQUIVALENTS		
Beginning	\$ 344	\$ 389
Ending	<u>\$ 21</u>	<u>\$ 344</u>

Note 20. Subsequent Events

In preparing these financial statements, the company has evaluated events and transactions for potential recognition or disclosure through March 16, 2020, the date the financial statements were available to be issued. There are two types of subsequent events: (1) recognized, or those that provide additional evidence about conditions that existed at the date of the balance sheet, including estimates inherent in the process of preparing financial statements, and (2) nonrecognized, or those that provide evidence about conditions that did not exist at the date of the balance sheet but arose after that date. In the opinion of management, all subsequent events requiring recognition or disclosure have been included in the consolidated annual statements.



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