Established
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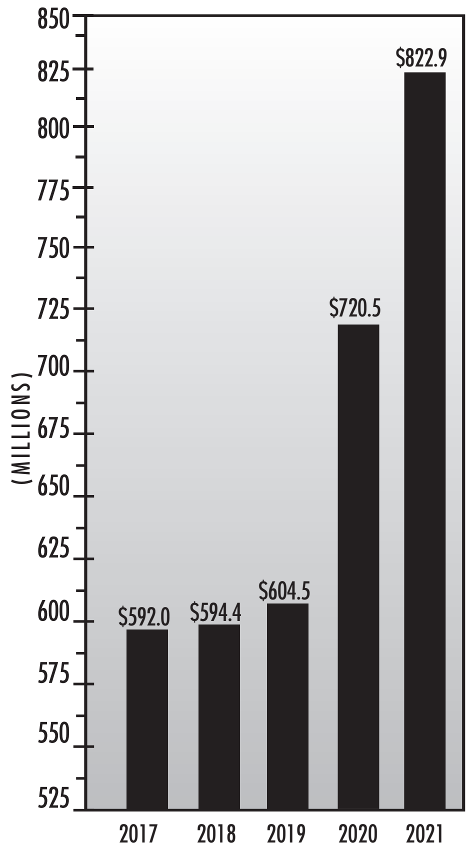
HSB BANCORP, INC.

HSB Bancorp, Inc.
& Subsidiary

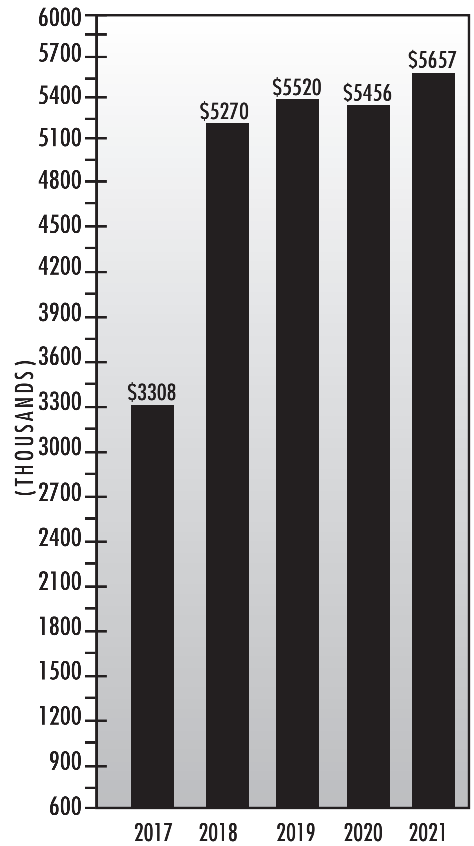
2021
Annual Report

HSB BANCORP, INC. & SUBSIDIARY
FIVE YEAR FINANCIAL HIGHLIGHTS

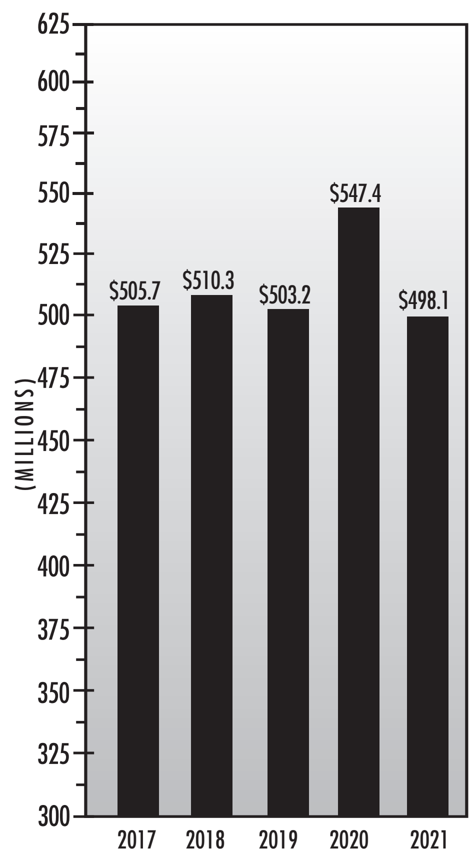
TOTAL ASSETS



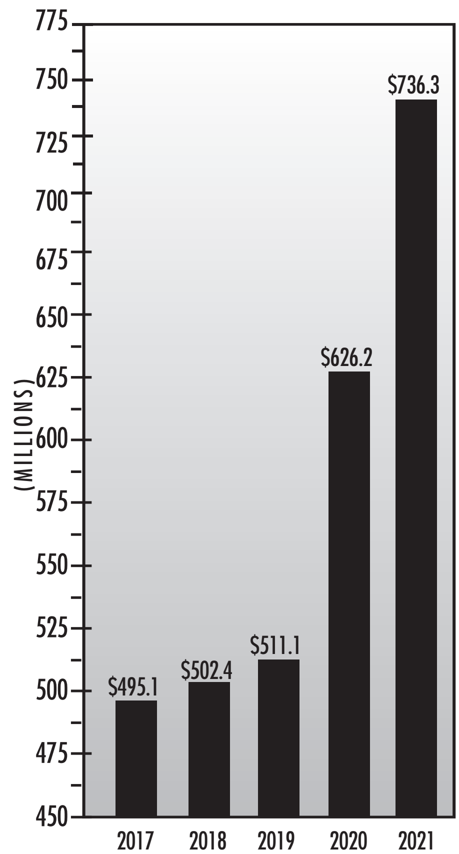
NET INCOME



TOTAL LOANS



TOTAL DEPOSITS



TO OUR STOCKHOLDERS:

Despite the economic uncertainty, fueled by a second year of a global pandemic, we are pleased to report to you that 2021 yielded our highest net profit in our 111-year history! We also achieved another year of astonishing growth in total assets and deposits. At December 31, 2021, total assets were a record $822.9 million, up $102.4 million, or 14%, over last year. This increase is similar to 2020 and, once again, is the result of an increase in customer deposits, up $110.1 million over last year. Most banks across our country continued to experience an unprecedented surge in deposits, attributed to the loan proceeds generated from the Paycheck Protection Program ("PPP") in 2020 and 2021. In addition to the PPP phenomenon, we have also opened a record number of new deposit accounts ourselves, as larger banks continue to consolidate and close branches in our market area. Since the beginning of the pandemic in March 2020, our total deposits have increased $215 million, from $521 million to $736 million, a 41% increase! Likewise, our total assets have increased $209 million (34%).

Due to the surplus of cash, commercial loan demand continues to be strained and extremely competitive across the nation. Our total loan balances decreased $49.3 million from last year. $25.1 million of this decrease was due to the forgiveness of PPP loans by the Small Business Administration ("SBA"). We were a strong participant in the PPP loan program, putting almost $70 million into the hands of 567 small business owners in our area in 2020 and 2021. Most of these loans have already been forgiven and paid off by the SBA. At December 31, 2021, the remaining balance was only $11.4 million. In 2021 we deployed some of our excess deposit funds into investment securities, up $43.6 million over last year.

As a result of the increase in assets, our Tier 1 Capital Ratio declined year over year from 8.9% to 8.3%. The ratio is still well above the regulatory definition of a "well-capitalized" bank (5%), and we will once again focus on increasing it once the effects of the pandemic have normalized. Most banks are projecting an eventual decrease in deposits as small businesses begin to deplete their PPP loan funds. The result would be a corresponding decrease in assets, increasing the capital ratio.

Net income for 2021, $5.7 million, was $201 thousand higher than 2020. This was a remarkable achievement considering the strong forces working against the banking industry the past two years. The low interest rates, coupled with depressed loan demand, continue to have the biggest impact on our bottom line. Fortunately, the fee income derived from the PPP loans, approximately $1.2 million in 2021, helped to offset a portion of this lost interest income. In addition, loan losses have been extraordinarily low due to the various government assistance programs; the provision for loan losses expense was $936 thousand less in 2021 compared to 2020. We were also able to incur further savings by actively managing interest rates on both loans and deposits and curbing operating expenses.

Coinciding with our net income, stockholder dividends remained level at $.85 per share. The total cash payout to our stockholders was $1.375 million in both 2021 and 2020, the highest in our company's history. Since 2002, we have consistently distributed at least 25% of our annual earnings to our stockholders, even during the most challenging years of the 2007-2009 Great Recession. The book value of the stock and earnings per share were $40.10 and $3.50, respectively, at December 31, 2021, compared to $37.87 and $3.37 at December 31, 2020.

This past year, we received two exciting recognitions worth noting. Hebron Savings Bank was recently named, out of 36 community banks in Maryland, the "Best Small Bank in Maryland" by *Newsweek Magazine*. Earlier in the year, we were ranked by *Banking Northeast Magazine* as the "Top Pandemic Performer" bank in the state of Maryland. We are honored by both of these prestigious awards and encourage you to visit our website to read the full articles. Out of the 13 community banks on the Delmarva Peninsula, we remain the third largest in number of branches and hold the highest amount of customer deposits of any bank, large or small, in our three-county branch area of Wicomico, Dorchester, and Somerset Counties.

As a stockholder of HSB Bancorp, Inc., you can be confident that the shares you hold are a solid investment, backed by a strong book value and cash dividends yielding a generous return. On behalf of the directors, officers, and employees, we look forward to serving you for many more years to come. As we continue to look for opportunities to expand our branch network on the Shore, we are committed to remaining your independent community bank!

Sincerely,

Donna K. Defino

Donna K. Defino, CPA, MBA
President & Chief Executive Officer

C O N T E N T S

INDEPENDENT AUDITORS' REPORT

Board of Directors
HSB Bancorp, Inc. & Subsidiary
Hebron, Maryland

Opinion

We have audited the accompanying consolidated financial statements of HSB Bancorp, Inc. and subsidiary, which comprise the consolidated balance sheet as of December 31, 2021, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HSB Bancorp, Inc. and subsidiary as of December 31, 2021, and the results of its operations and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of HSB Bancorp, Inc. and subsidiary and to meet our other ethical responsibilities in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Prior Period Financial Statements

The financial statements as of December 31, 2020, were audited by TGM Group LLC, who merged with UHY LLP as of January 3, 2022, and whose report dated February 8, 2021, expressed an unmodified opinion on those statements.

Responsibilities of Management for the Financial Statements

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about HSB Bancorp, Inc. and subsidiary's ability to continue as a going concern within one year after the date that the consolidated financial statements are available to be issued.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with generally accepted auditing standards will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgement made by a reasonable user based on the consolidated financial statements.

In performing an audit in accordance with generally accepted auditing standards, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements.

- Obtain an understanding of internal control relevant to the audit 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 HSB Bancorp Inc. and subsidiary's internal control. Accordingly, no such opinion is expressed.

- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the consolidated financial statements.

- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about HSB Bancorp Inc. and subsidiary's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

UHY LLP

Salisbury, Maryland
February 2, 2022

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED BALANCE SHEETS
December 31, 2021 and 2020

	2021	2020
ASSETS		
Cash and due from banks	**$ 9,749,783**	$ 10,451,024
Interest-bearing deposits in other banks	**214,635,254**	104,419,125
Debt securities available-for-sale, at fair value	**64,045,400**	20,780,026
Equity securities, at fair value	**4,466,187**	4,091,954
Loans, less allowance for credit losses 2021 $9,300,000; 2020 $9,300,000	**498,051,593**	547,356,449
Accrued interest receivable on investment securities and loans	**1,609,613**	2,288,720
Bank premises and equipment, at cost, less accumulated depreciation	**11,472,196**	11,820,607
Federal Home Loan Bank stock, at cost	**968,100**	1,713,100
Common stock in the HSB Statutory Trust I	**93,000**	93,000
Net deferred income tax benefits	**2,926,134**	2,883,240
Other real estate owned	**234,975**	675,068
Cash value of life insurance	**13,280,277**	12,974,439
Other assets	**1,380,110**	956,961
Total assets	**$ 822,912,622**	$ 720,503,713
LIABILITIES		
Deposits:		
Non-interest bearing demand	**$ 267,209,512**	$ 216,883,240
NOW and Super NOW	**48,463,890**	40,058,824
Money market	**60,216,247**	47,865,290
Savings	**147,321,476**	99,563,131
Time, more than $250,000	**38,075,221**	39,727,502
Other time	**175,061,421**	182,086,819
	736,347,767	626,184,806
Accrued interest payable on deposits and borrowings	**430,872**	532,444
Short-term borrowings	**-**	-
Long-term borrowings	**16,207,043**	27,503,394
Junior subordinated debentures owed to unconsolidated subsidiary trust	**3,093,000**	3,093,000
Other liabilities	**1,990,991**	1,949,545
Total liabilities	**758,069,673**	659,263,189
COMMITMENTS		
STOCKHOLDERS' EQUITY		
Common stock, par value $.01, authorized 10,000,000 shares, issued and outstanding 2021 1,617,069 shares and 2020 1,546,630 shares	**16,171**	15,467
Series A Preferred stock, par value $.01, authorized 2,000,000 shares, issued and outstanding 2021 0 shares and 2020 70,439 shares	**-**	704
Surplus	**6,201,001**	6,201,001
Retained earnings	**58,772,644**	54,490,125
Accumulated other comprehensive (loss) income, net of deferred tax benefit (liability) 2021 $55,757; 2020 ($202,435)	**(146,867)**	533,227
Total stockholders' equity	**64,842,949**	61,240,524
Total liabilities and stockholders' equity	**$ 822,912,622**	$ 720,503,713

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME
Years Ended December 31, 2021 and 2020

		2021		2020
INTEREST INCOME ON				
Loans, including fees	**$**	**24,769,518**	$	26,205,545
Investment securities:				
Taxable		**533,170**		578,494
Exempt from Federal income tax		**133,048**		145,028
Federal funds sold		**-**		-
Deposits in other banks		**236,780**		164,549
		25,672,516		27,093,616
INTEREST EXPENSE ON				
Deposits		**4,093,553**		4,681,546
Borrowings		**715,291**		888,572
Junior subordinated debentures		**62,971**		80,883
		4,871,815		5,651,001
NET INTEREST INCOME		**20,800,701**		21,442,615
Provision for credit losses		**126,281**		1,062,262
NET INTEREST INCOME AFTER PROVISION FOR CREDIT LOSSES		**20,674,420**		20,380,353
OTHER INCOME				
Service charges on deposit accounts		**978,295**		954,032
Earnings of investment in life insurance		**305,838**		325,057
Other		**1,092,394**		1,077,580
		2,376,527		2,356,669
OTHER EXPENSES				
Salaries and benefits		**9,517,542**		9,512,101
Occupancy		**2,353,153**		2,264,208
Losses on other real estate owned		**20,807**		91,769
Other expenses		**3,654,396**		3,658,966
		15,545,898		15,527,044
INCOME BEFORE TAXES ON INCOME		**7,505,049**		7,209,978
Federal and State income taxes		**1,848,021**		1,753,875
NET INCOME	**$**	**5,657,028**	$	5,456,103

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
Years Ended December 31, 2021 and 2020

		2021		2020
NET INCOME	**$**	**5,657,028**	$	5,456,103
Other comprehensive (loss) gain, net of tax:				
Unrealized holding (loss) gain on debt securities available-for-sale arising during the period		**(938,287)**		556,282
Deferred income tax benefits (liabilities)		**258,193**		(148,599)
Other comprehensive (loss) income, net of tax		**(680,094)**		407,683
Total other comprehensive (loss) income		**(680,094)**		407,683
Comprehensive income	**$**	**4,976,934**	$	5,863,786

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Years Ended December 31, 2021 and 2020

	Common Stock	Series A Preferred Stock	Surplus	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
Balances, December 31, 2019	$ 15,467	$ 704	$ 6,201,001	$ 50,392,266	$ 141,809	$ 56,751,247
Net income	-	-	-	5,456,103	-	5,456,103
Other comprehensive income, net of tax	-	-	-	-	407,683	407,683
Cumulative effect of accounting change	-	-	-	16,265	(16,265)	-
Cash dividends paid, $.85 per share	-	-	-	(1,374,509)	-	(1,374,509)
Balances, December 31, 2020	15,467	704	6,201,001	54,490,125	533,227	61,240,524
Net income	**-**	**-**	**-**	**5,657,028**	**-**	**5,657,028**
Other comprehensive loss, net of tax	**-**	**-**	**-**	**-**	**(680,094)**	**(680,094)**
Shares converted, 70,439 shares at $.01 per share	**704**	**(704)**	**-**	**-**	**-**	**-**
Cash dividends paid, $.85 per share	**-**	**-**	**-**	**(1,374,509)**	**-**	**(1,374,509)**
Balances, December 31, 2021	**$ 16,171**	**$ -**	**$ 6,201,001**	**$ 58,772,644**	**$ (146,867)**	**$ 64,842,949**

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2021 and 2020

	2021	2020
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	**$ 5,657,028**	$ 5,456,103
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for credit losses, net	**126,281**	1,062,262
Depreciation, amortization and accretion	**818,424**	859,064
Income on investment in life insurance	**(305,838)**	(325,057)
Losses on other real estate owned	**20,807**	91,769
Deferred income taxes (benefits)	**215,298**	(362,062)
Fair value adjustment on equity securities	**125,767**	(75,689)
Changes in assets and liabilities:		
Decrease (increase) in accrued interest receivable	**679,107**	(738,063)
(Decrease) increase in deferred loan origination fees, net	**(73,878)**	906,090
(Increase) decrease in other assets	**(423,149)**	142,874
Decrease in accrued interest payable	**(101,572)**	(77,714)
Increase in other liabilities	**41,446**	92,518
Net cash provided by operating activities	**6,779,721**	7,032,095
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase available-for-sale investment securities	**(51,204,284)**	-
Purchase of equity securities	**(500,000)**	(500,000)
Proceeds from maturities and paydowns of available-for-sale investment securities	**6,868,474**	9,169,527
Proceeds from sale of stock in Federal Home Loan Bank	**745,000**	180,600
Decrease (increase) in loans, net	**49,077,478**	(46,824,147)
Proceeds from sale of other real estate owned	**594,261**	865,267
Purchase premises and equipment	**(337,863)**	(363,946)
Net cash provided (used) by investing activities	**5,243,066**	(37,472,699)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in demand, NOW, SUPER NOW, money market, and savings deposits, net	**118,840,640**	109,498,886
(Decrease) increase in time deposits, net	**(8,677,679)**	5,605,425
Decrease in borrowings, net	**(11,296,351)**	(3,589,823)
Cash dividends paid	**(1,374,509)**	(1,374,509)
Net cash provided by financing activities	**97,492,101**	110,139,979
Net increase in cash and cash equivalents	**109,514,888**	79,699,375
Cash and cash equivalents, beginning	**114,870,149**	35,170,774
Cash and cash equivalents, ending	**$ 224,385,037**	$ 114,870,149

The Notes to Consolidated Financial Statements are an integral part of these statements.

HSB BANCORP, INC. & SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years Ended December 31, 2021 and 2020

		2021		2020
SUPPLEMENTARY CASH FLOW INFORMATION				
Interest paid	**$**	**4,973,387**	$	5,724,838
Income taxes paid		**1,986,217**		2,178,412
Unrealized (depreciation) appreciation on debt securities available-for-sale		**(938,287)**		556,282
SUPPLEMENTARY NON-CASH INVESTING ACTIVITIES				
Loans converted to other real estate owned	**$**	**174,975**	$	709,472

The Notes to Consolidated Financial Statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Its Significant Accounting Policies

Hebron Savings Bank provides financial services to individuals and corporate customers, and is subject to competition from other financial institutions. The Bank is also subject to the regulations of certain Federal and State agencies and undergoes periodic examinations by those regulatory authorities. The accounting policies of the Bank conform, in all material respects, to U.S. generally accepted accounting principles and general practices within the banking industry.

Significant accounting policies not disclosed elsewhere in the consolidated financial statements are as follows:

Principles of Consolidation

The consolidated financial statements include the accounts of HSB Bancorp, Inc., (the "Company") and its wholly owned subsidiary, Hebron Savings Bank (the "Bank"). All significant intercompany accounts and transactions have been eliminated. The Parent Only financial information of the Company (see Note 18) accounts for the Bank using the equity method of accounting.

The Bank determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a voting interest entity or a variable interest entity under accounting principles generally accepted in the United States. Voting interest entities are entities in which the total equity investment at risk is sufficient to enable the entity to finance itself independently and provides the equity holders with the obligation to absorb losses, the right to receive residual returns and the right to make decisions about the entity's activities. The Company consolidates voting interest entities in which it has all, or at least a majority of, the voting interest. As defined in applicable accounting standards, variable interest entities (VIEs) are entities that lack one or more of the characteristics of a voting interest entity. A controlling financial interest in an entity is present when an enterprise has a variable interest, or a combination of variable interest, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. The enterprise with a controlling financial interest, known as the primary beneficiary, consolidates the VIE. The Company's wholly owned subsidiary, HSB Statutory Trust I is a VIE for which the Company is not the primary beneficiary. Accordingly, the accounts of this entity are not included in the Company's consolidated financial statements.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Securities Held-to-Maturity

Bonds, notes, and debentures for which the Bank has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income using methods approximating the interest method over the periods to maturity. Securities transferred into held-to-maturity from the available-for-sale portfolio are recorded at fair value at time of transfer with unrealized gains or losses reflected in equity and amortized over the remaining life of the security.

Note 1. The Company and Its Significant Accounting Policies (Continued)

Securities Available-for-Sale

Securities designated as available-for-sale are stated at estimated fair value as determined by quoted market prices. They represent those securities, which management may decide to sell as part of the Bank's asset/liability strategy, or that may be sold in response to changing interest rates or liquidity needs. Changes in unrealized appreciation (depreciation) on securities available-for-sale are reported in other comprehensive income. Realized gains (losses) on securities available-for-sale are included in other income (expense) and, when applicable, are reported as a reclassification adjustment, net of tax, in other comprehensive income. The gains and losses on securities sold are determined by the specific identification method. Premiums and discounts are recognized in interest income using the interest method over the period to maturity. Additionally, declines in the fair value of the individual investment securities below their cost that are other than temporary are reflected as realized losses in the consolidated statements of income.

Equity Securities

Equity securities with readily determinable fair values are carried at fair value, with changes in fair value reported in net income. Any equity securities without readily determinable fair values are carried at cost, minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for identical or similar investments. The entirety of any impairment on equity securities is recognized in earnings.

Other Securities

Federal Home Loan Bank ("FHLB") stock is an equity interest in the FHLB, which does not have a readily determinable fair value because its ownership is restricted and it lacks a market. FHLB stock can be sold back only at its par value of $100 per share and only to the FHLB or another member institution. FHLB stock is carried at cost and is periodically evaluated based on ultimate recovery of par.

Allowance for Credit Losses

Loans are generally carried at the amount of unpaid principal, adjusted for unearned loan fees, which are amortized over the term of the loan using the effective interest rate method. Interest on loans is accrued based on the principal amounts outstanding. It is the Bank's policy to discontinue the accrual of interest when a loan is specifically determined to be impaired or when principal or interest is delinquent for ninety days or more. When a loan is placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Interest income generally is not recognized on specific impaired loans unless the likelihood of further loss is remote. Cash collections on such loans are applied as reductions of the loan principal balance and no interest income is recognized on those loans until the principal balance has been collected. Interest income on other nonaccrual loans is recognized only to the extent of interest payments received. The carrying value of impaired loans is based on the present value of the loan's expected future cash flows or, alternatively, the observable market price of the loan or the fair value of the collateral.

The allowance for loan losses is maintained at a level believed adequate by management to absorb probable losses inherent in the loan portfolio and is based on the size and current risk characteristics of the loan portfolio, an assessment of individual problem loans and actual loss experience, the value of the underlying collateral, and current economic events in specific industries and geographical areas, including unemployment levels, and other pertinent factors, including regulatory guidance and general economic conditions.

Determination of the allowance is inherently subjective, as it requires significant estimates, including the amounts and timing on historical loss experience, and consideration of current economic trends, all of which may be susceptible to significant change. Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for credit losses is charged to operations based on management's periodic evaluation of the factors previously mentioned, as well as other pertinent factors. Evaluations are conducted at least monthly and more often if deemed necessary.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Its Significant Accounting Policies (Continued)

Allowance for Credit Losses (Continued)

The allowance for credit losses typically consists of an allocated component and an unallocated component. The allocated component of the allowance for credit losses reflects expected losses resulting from analyses developed through specific credit allocations for individual loans and historical loss experience for each loan category. The specific credit allocations are based on analyses of all significantly-impaired loans. The historical loan loss element is determined on a pooled basis by segmenting the portfolio by call report codes and then applying historical loss rate percentages, determined by annualizing the Bank's net charge-offs over the previous 12-quarter rolling period. These loss rate percentages are adjusted for eight qualitative factors. The analysis is performed quarterly and loss factors are updated regularly based on actual experience.

Any unallocated portion of the allowance reflects management's estimate of probable inherent but undetected losses within the portfolio due to uncertainties in economic conditions, delays in obtaining information, including unfavorable information about a borrower's financial condition, the difficulty in identifying triggering events that correlate perfectly to subsequent loss rates, and risk factors that have not yet manifested themselves in loss allocation factors. In addition, the unallocated allowance includes a component that explicitly accounts for the inherent imprecision in loan loss migration models. The historical losses used in the migration analysis may not be representative of actual unrealized losses inherent in the portfolio. It is management's intent to continually refine the methodology for the allowance for credit losses in an attempt to directly allocate potential losses in the loan portfolio and minimize the unallocated portion of the allowance for credit losses.

Other Real Estate Owned (OREO)

OREO comprises properties acquired in partial or total satisfaction of problem loans. The properties are recorded at the lower of cost or fair value (appraised value) at the date acquired. Losses arising at the time of acquisition of such properties are charged against the allowance for credit losses. Subsequent write-downs and losses realized from the sale of OREO totaled **$20,807** and $91,769 for 2021 and 2020, respectively, and are included in other expenses. Expenses of operation are also included in other expenses as detailed in Note 11. Property acquired through foreclosure proceedings totaled **$174,975** and $709,472 at December 31, 2021 and 2020, respectively. The Bank financed sales of OREO totaling **$114,439** and $156,147 at December 31, 2021 and 2020, respectively. At December 31, 2021 and 2020, loans secured by residential real estate properties in process of foreclosure totaled approximately **$599,000** and $281,000, respectively.

Reserve for Unfunded Commitments

The reserve for unfunded commitments is established through a provision for unfunded commitments charged to other expenses. The reserve is calculated by utilizing the same methodology and factors as the allowance for credit losses. The reserve, based on evaluations of the collectability of loans and prior loan loss experience, is an amount that management believes will be adequate to absorb possible losses on unfunded commitments (off-balance sheet financial instruments) that may become uncollectible in the future.

Long-Lived Assets

The carrying value of long-lived assets and certain identifiable intangibles, including goodwill, is reviewed by the Bank for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, as prescribed in ASC Topic 360 Property, Plant and Equipment. As of December 31, 2021, certain loans existed in which management considered impaired (See Note 4).

Premises, Equipment, and Depreciation

Land is carried at cost. Other premises and equipment are carried at cost net of accumulated depreciation. Depreciation is computed using the straight-line and accelerated methods over the estimated useful lives of the assets. Maintenance and repairs are expensed as incurred while major additions and improvements are capitalized. Gains and losses on dispositions are included in current operations.

Note 1. The Company and Its Significant Accounting Policies (Continued)

Income Taxes

The provision for federal and state income taxes is based upon the results of operations, adjusted for tax exempt income. Deferred income taxes are provided for the temporary differences between carrying amounts and tax basis of assets and liabilities and are measured at the enacted tax rates that will be in effect when the differences reverse.

Temporary differences, which give rise to deferred tax benefits, relate principally to the allowance for credit losses, deferred subcontractor costs, OREO property, accrued vacation and net unrealized depreciation on securities available-for-sale.

Temporary differences, which give rise to deferred tax liabilities, relate principally to accumulated depreciation, unearned income on loans and net unrealized appreciation on securities available-for-sale.

Revenue Recognition

On January 1, 2019, the Company adopted ASU No. 2014-09 “Revenue from Contracts with Customers” (Topic 606) and all subsequent ASUs that modified Topic 606. The implementation of the new standard did not have a material impact on the measurement or recognition of revenue; as such, a cumulative effect adjustment to opening retained earnings was not deemed necessary. Results for reporting periods beginning after January 1, 2019 are presented under Topic 606, while prior period amounts were not adjusted and continue to be reported in accordance with our historic accounting under Topic 605.

Topic 606 does not apply to revenue associated with financial instruments, including revenue from loans and securities. Topic 606 is applicable to noninterest revenue streams such as deposit related fees, interchange fees and merchant income. However, the recognition of these revenue streams did not change significantly upon adoption of Topic 606. Substantially all of the Company’s revenue is generated from contracts with customers. Noninterest revenue streams in-scope of Topic 606 are discussed below.

Service Charges on Deposit Accounts. Service charges on deposit accounts consist of monthly service fees, check orders, and other deposit account related fees. The Company’s performance obligation for monthly service fees is generally satisfied, and the related revenue recognized, over the period in which the service is provided.
Check orders and other deposit account related fees are largely transactional based, and therefore, the Company’s performance obligation is satisfied, and related revenue recognized, at a point in time. Payment for service charges on deposit accounts is primarily received immediately or at the end of the month through a direct charge to customers’ accounts.

Other Noninterest Income. Other noninterest income consists of: fees, other service charges, safety deposit box rental fees, and other miscellaneous revenue streams. Fees and other service charges are primarily comprised of debit card income, ATM fees, merchant services income, and other service charges. Debit card income is primarily comprised of interchange fees earned whenever the Company’s debit cards are processed through card payment networks. ATM fees are primarily generated when a Company cardholder uses a non-Company ATM. Merchant services income mainly represents fees charged to merchants to process their debit card transactions, in addition to account management fees. Other service charges include revenue from processing wire transfers, cashier’s checks, and other services. The Company’s performance obligation for fees and other service charges are largely satisfied, and related revenue recognized, when the services are rendered or upon completion. Payment is typically received immediately or in the following month. Safe deposit box rental fees are charged to the customer on an annual basis and recognized upon receipt of payment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. The Company and Its Significant Accounting Policies (Continued)

Credit Risk

The Bank has deposits in other financial institutions in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC). At December 31, 2021 and 2020, the balances carried in excess of the limit, including unsecured federal funds sold, were **$15,634,614** and $16,283,047, respectively.

Cash and Cash Equivalents

The Bank has included cash and due from banks, Federal funds sold, and interest-bearing deposits in other banks with maturities less than three months as cash and cash equivalents for the purposes of reporting cash flows.

The Bank is required to maintain cash balances on hand or with the Federal Reserve Bank based on average deposit liabilities. At December 31, 2021 and 2020, these reserve balances amounted to **$0**.

The Bank is required to maintain a non-interest bearing cash reserve at one of its correspondent banks against its corporate credit card account. Such reserve amounted to **$100,000** during the years ended December 31, 2021 and 2020.

Other Comprehensive Income (Loss)

The Bank records unrealized gains and losses on available for sale securities in accumulated other comprehensive income, net of taxes. Unrealized gains and losses on available for sale securities are reclassified into earnings as the gains or losses are realized upon sale of the securities. The credit component of unrealized losses on available for sale securities that are determined to be other-than-temporary impaired are reclassified into earnings at the time the determination is made.

Advertising Costs

The Bank expenses advertising costs for the period in which they are incurred. The Bank incurred advertising costs totaling **$84,397** and $63,397, for the years 2021 and 2020, respectively.

Financial Statement Presentation

Certain amounts in the prior year's financial statements have been reclassified to conform to the current year's presentation.

Note 2. Debt and Equity Securities

Securities available-for-sale are as follows:

	December 31, 2021			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury and obligations of U.S. government agencies	$ 17,462,173	$ 4,301	$ 158,260	$ 17,308,214
Obligations of States and political subdivisions	8,867,468	236,907	14,625	9,089,750
Mortgage-backed securities and CMOs	37,918,384	128,171	399,119	37,647,436
	$ 64,248,025	$ 369,379	$ 572,004	$ 64,045,400

	December 31, 2020			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Obligations of U.S. government agencies	$ 698,204	$ 17,470	$ 1,587	$ 714,087
Obligations of States and political subdivisions	9,057,984	378,240	-	9,436,224
Mortgage-backed securities and CMOs	10,288,176	341,901	362	10,629,715
	$ 20,044,364	$ 737,611	$ 1,949	$ 20,780,026

The following is a summary of gross unrealized losses and fair values, aggregated by investment category and length of time that individual securities have been in continuous unrealized loss position, at December 31, 2021:

	Less than 12 months		12 months or more		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
U.S. Treasury and obligations of U.S. government agencies	$ 16,191,750	$ 157,353	$ 110,422	$ 907	$ 16,302,172	$ 158,260
Obligations of States and political subdivisions	1,240,375	14,625	-	-	1,240,375	14,625
Mortgage-backed securities and CMOs	31,617,619	398,850	38,756	269	31,656,375	399,119
Total securities with unrealized losses	$ 49,049,744	$ 570,828	$ 149,178	$ 1,176	$ 49,198,922	$ 572,004

Note 2. Debt and Equity Securities (Continued)

The Company adopted Accounting Standards Update (ASU) No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" as of January 1, 2020 which requires marketable equity securities to be measured at fair value with changes in fair value recognized in net income. The adoption of ASU No. 2016-01 resulted in a $16,265 increase to beginning retained earnings and a corresponding decrease in beginning accumulated other comprehensive income. The amount reflects the unrealized gain, net of tax, of marketable equity securities held on that date.

For individual securities classified as either available-for-sale or held-to-maturity, the Bank must determine whether a decline in fair value below the amortized cost basis is other than temporary. If the decline in fair value is considered to be other than temporary, the cost basis of the individual security shall be written down to the fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss). At December 31, 2021, the Bank held 1 obligation of a U.S. Government agency and 2 CMOs having continuous unrealized loss positions for more than 12 months. Management has reviewed the investment and determined through various valuation methods that the unrealized loss position as of December 31, 2021 is a temporary unrealized loss relating primarily to changes in market interest rates over the yields available at the time the underlying security was purchased and that the loss is not due to reasons of credit quality.

In addition to the above analysis, management feels it has the ability and intent to hold securities classified as available-for-sale for a period of time sufficient for a recovery of cost and has no plans to sell securities that are currently in a loss position.

The Company recorded a loss of **$125,767** on equity securities during the year ended December 31, 2021 and a gain of $75,689 during the year ended December 31, 2020 related to changes in fair value on equity securities.

Contractual maturities of investment securities at December 31, 2021 are shown below. Actual maturities may differ from contractual maturities because debtors may have the right to call or prepay obligations with or without call or prepayment penalties. Mortgage-backed securities have no stated maturity and primarily reflect investments in various Pass-through and Participation Certificates issued by the Federal National Mortgage Association and the Government National Mortgage Association. Repayment of mortgage-backed securities is affected by the contractual repayment terms of the underlying mortgages collateralizing these obligations and the current level of interest rates.

The following is a summary of maturities of securities available-for-sale:

	December 31, 2021 Securities Available-for-Sale	
Amounts maturing:	Amortized Cost	Fair Value
One year or less	$ 9,536,255	$ 9,486,954
After one year through five years	41,666,651	41,627,585
After five years through ten years	13,045,119	12,930,861
After ten years	-	-
	$ 64,248,025	$ 64,045,400

The Bank has pledged certain debt securities as collateral for deposits of certain government agencies and municipalities. The carrying value of these securities totaled **$9,765,829** and $14,645,157 at December 31, 2021 and 2020, respectively.

Note 3. Bank Owned Life Insurance

The Bank has purchased life insurance contracts on certain senior officers and is the sole owner and primary beneficiary of the policies. Income from these contracts will be used to offset or recover increasing costs associated with employee benefits. Cash value totaled **$13,280,277** and $12,974,439 at December 31, 2021 and 2020, respectively.

Note 4. Loans and Allowances for Credit Losses

The Bank makes loans to customers primarily throughout the Lower Eastern Shore of the State of Maryland. The principal categories of the loan portfolio are as follows:

	2021	2020
Real estate loans:		
Construction	**$ 74,542,108**	$ 83,394,831
Residential Mortgages	**168,781,625**	185,206,974
Commercial Mortgages	**191,382,178**	182,770,489
	434,705,911	451,372,294
Commercial & industrial loans	**69,992,557**	103,719,739
Consumer loans	**3,484,783**	2,469,952
	508,183,251	557,561,985
Less: unearned income on loans	**831,658**	905,536
	507,351,593	556,656,449
Less: allowance for credit losses	**9,300,000**	9,300,000
	$ 498,051,593	$ 547,356,449

Management has an established methodology to determine the adequacy of the allowance for loan losses that assesses the risks and losses inherent in the loan portfolio. For purposes of determining the allowance for loan losses, the Bank has segmented certain loans in the portfolio by product type. Loans are segmented into the following pools: real estate loans, commercial and industrial loans, and consumer loans. Real estate loans are further divided into the following three classes: construction, land development, and other land loans ("construction"), residential mortgages, and commercial mortgages. Each of these segments are reviewed and analyzed quarterly using the Bank's annualized net charge-offs over the previous 12-quarter rolling period for their respective segments as well as the following qualitative factors:

1. Changes in the levels and trends in delinquencies, nonaccruals, classified assets and troubled debt restructurings.
2. Changes in the nature and volume of the portfolio.
3. Effects of any changes in lending policies, procedures, including underwriting standards and collections, charge off and recovery practices.
4. Changes in the experience, depth and ability of management.
5. Changes in the national and local economic conditions and developments, including the condition of various market segments.
6. Changes in the concentration of credits within each pool.
7. Changes in the quality of the Bank's loan review system and the degree of oversight by the Board.
8. Changes in external factors such as competition and the legal environment.

The above factors result in a codified FASB ASC 450-10- 20 calculated reserve for environmental factors.

Note 4. Loans and Allowances for Credit Losses (Continued)

In accordance with FAS 114 (ASC Topic 310), significantly-impaired loans are specifically identified and individually analyzed to determine the amount of their expected loss. All nonaccrual and troubled debt restructured loans are considered to be impaired and are individually analyzed to determine their valuation and reserve amounts. Other loans risk rated “6”, “7”, or “8” (excluding nonaccrual and troubled debt restructured loans) are individually evaluated for impairment. Following such evaluation, any loans determined to be impaired are specifically identified and individually analyzed; any loans determined to be unimpaired are evaluated on a pooled basis under FAS 5 (ASC Topic 450). The establishment of a specific reserve does not necessarily mean that the loan with the specific reserve will definitely incur loss at the reserve level. It is only an estimation of potential loss based upon anticipated events. A specific reserve will not be established unless loss elements can be determined and quantified based on known facts. The total allowance reflects management’s estimate of loan losses inherent in the loan portfolio as of December 31, 2021.

In the normal course of loan portfolio management, loan originators are responsible for the continuous assessment of credit risk arising from the individual borrowers within their portfolio and for assigning appropriate risk ratings. Credit Administration is responsible for the subsequent review and approval of the risk ratings and for ensuring the integrity and operation of the risk rating system and maintenance of the Watch List. The Bank contracts with an independent third party loan review firm that reviews and validates the internal credit risk program on a quarterly basis. Results of these reviews and management’s responses are presented to the Audit Committee for approval. The loan review process complements and reinforces the risk identification and assessment decisions made by the lenders and credit personnel as well as the Bank’s policies and procedures.

Note 4. Loans and Allowances for Credit Losses (Continued)

The activity in the allowance for loan losses for 2021 and 2020 is as follows:

	December 31, 2021						
	Real Estate Loans			Commercial and			
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Unallocated	Total
Beginning Balance	**$ 1,634,997**	**$ 3,396,282**	**$ 2,556,313**	**$ 1,525,365**	**$ 79,988**	**$ 107,055**	**$ 9,300,000**
Charge-offs	**(75,543)**	**(29,565)**	**(5,702)**	**(1,247)**	**(58,468)**	**-**	**(170,525)**
Recoveries	**-**	**3,723**	**-**	**24,242**	**16,279**	**-**	**44,244**
Provision	**(100,336)**	**(305,080)**	**375,900**	**57,051**	**111,863**	**(13,117)**	**126,281**
Ending Balance	**1,459,118**	**3,065,360**	**2,926,511**	**1,605,411**	**149,662**	**93,938**	**9,300,000**
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	**2,926,893**	**9,662,176**	**1,784,557**	**1,273,470**	**86,101**	**-**	**15,733,197**
Balance in allowance	**336,210**	**448,769**	**113,038**	**387,914**	**24,171**	**-**	**1,310,102**
Collectively evaluated for impairment:							
Related loan balance	**71,615,215**	**159,119,449**	**189,597,621**	**68,719,087**	**3,398,682**	**-**	**492,450,054**
Balance in allowance	**1,122,908**	**2,616,591**	**2,813,473**	**1,217,497**	**125,491**	**93,938**	**7,989,898**
Total							
Related loan balance	**74,542,108**	**168,781,625**	**191,382,178**	**69,992,557**	**3,484,783**	**-**	**508,183,251**
Balance in allowance	**1,459,118**	**3,065,360**	**2,926,511**	**1,605,411**	**149,662**	**93,938**	**9,300,000**

	December 31, 2020						
	Real Estate Loans			Commercial and			
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Unallocated	Total
Beginning Balance	$ 1,363,293	$ 3,453,852	$ 2,237,694	$ 1,542,661	$ 149,230	$ 78,270	$ 8,825,000
Charge-offs	-	(307,421)	-	(400,314)	(233,669)	-	(941,404)
Recoveries	48,400	210,784	392	77,705	16,861	-	354,142
Provision	223,304	39,067	318,227	305,313	147,566	28,785	1,062,262
Ending Balance	1,634,997	3,396,282	2,556,313	1,525,365	79,988	107,055	9,300,000
Ending Balance of:							
Individually evaluated for impairment:							
Related loan balance	1,712,030	11,801,398	3,268,353	1,251,299	113,684	-	18,146,764
Balance in allowance	488,443	810,047	255,812	257,139	39,075	-	1,850,516
Collectively evaluated for impairment:							
Related loan balance	81,682,801	173,405,576	179,502,136	102,468,440	2,356,268	-	539,415,221
Balance in allowance	1,146,554	2,586,235	2,300,501	1,268,226	40,913	107,055	7,449,484
Total							
Related loan balance	83,394,831	185,206,974	182,770,489	103,719,739	2,469,952	-	557,561,985
Balance in allowance	1,634,997	3,396,282	2,556,313	1,525,365	79,988	107,055	9,300,000

As of December 31, 2021, and 2020, the allowance for loan losses included an unallocated excess of **$93,938** and $107,055, respectively. Management is comfortable with these amounts as they feel the amounts are adequate to absorb additional inherent potential losses in the loan portfolio as further described in Note 1.

Note 4. Loans and Allowances for Credit Losses (Continued)

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act") was signed into law, which established the Paycheck Protection Program ("PPP") and allocated $349 billion of loans to be issued by financial institutions. Under the program, the Small Business Administration ("SBA") will forgive loans, in whole or in part, made by approved lenders to eligible borrowers for Paycheck and other permitted purposes in accordance with the requirements of the program. These loans carry a fixed rate of 1.00% and a term of two years, if not forgiven, in whole or in part. The loans are 100% guaranteed by the SBA. The Bank receives a processing fee ranging from 1% to 5% based on the size of the loan from the SBA. The Paycheck Protection Program and Health Care Enhancement Act ("PPP/ HCEA Act") was signed into law on April 24, 2020. The PPP/HCEA Act authorized additional funding under the CARES Act of $310 billion for PPP loans to be issued by financial institutions through the SBA. In December 2020, the Consolidated Appropriations Act 2021 ("CAA") was passed, which extended the PPP and allocated additional funds for 2021. The Second Draw PPP loans were generally subject to the same terms, conditions, and requirements as PPP loans issued under the CARES and PPP/HCEA Acts except the loan term was extended from two years to five years. The Company provided **$69,034,653** in funding to over 500 customers through the PPP programs through December 31, 2021. As of December 31, 2021, the Company had **$11,438,739** of these loans outstanding. Because these loans are 100% guaranteed by the SBA they do not have an associated reserve at this time.

Following is an aging analysis by loan class and amount as of December 31, 2021 and 2020:

	December 31, 2021					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	$ 89,802	$ 693,061	$ -	$ -	$ 6,279	$ 789,142
Greater than 90 Days Past Due	-	-	-	-	-	-
Nonaccrual loans - non current	2,318,556	855,068	283,404	567,893	282	4,025,203
Total Past Due	2,408,358	1,548,129	283,404	567,893	6,561	4,814,345
Current nonaccrual loans	-	601,920	202,962	-	-	804,882
Current accrual loans	72,133,750	166,631,576	190,895,812	69,424,664	3,478,222	502,564,024
Total Loans	$ 74,542,108	$ 168,781,625	$ 191,382,178	$ 69,992,557	$ 3,484,783	$ 508,183,251

	December 31, 2020					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
30-89 Days Past Due	$ -	$ 1,841,557	$ -	$ 177,172	$ 8,989	$ 2,027,718
Greater than 90 Days Past Due	-	-	-	-	-	-
Nonaccrual loans - non current	1,609,000	2,028,033	969,029	210,519	282	4,816,863
Total Past Due	1,609,000	3,869,590	969,029	387,691	9,271	6,844,581
Current nonaccrual loans	-	809,629	-	255,686	-	1,065,315
Current accrual loans	81,785,831	180,527,755	181,801,460	103,076,362	2,460,681	549,652,089
Total Loans	$ 83,394,831	$ 185,206,974	$ 182,770,489	$ 103,719,739	$ 2,469,952	$ 557,561,985

Note 4. Loans and Allowances for Credit Losses (Continued)

The Bank's policies, consistent with regulatory guidelines, provide for the classification of loans that are considered to be of lesser quality as special mention, substandard, or doubtful assets. Special mention is a warning or watch classification, which portrays one or more deficiencies in the credit quality of the borrower or the pledged collateral. Substandard loans include loans with a high loan-to-value ratio or credits that are unable to adjust due to unfavorable industry or economic conditions. Loans classified as doubtful are critical credits with an element of probable loss and insufficient collateral. The risk ratings are adjusted, as necessary, if loans become delinquent, if significant adverse information is discovered regarding the underlying credit, and if the normal periodic reviews of the underlying credits indicate that a change in risk rating is appropriate. A summary of the risk rating of loans receivable as of December 31, 2021 and 2020 is as follows:

	December 31, 2021					
	Real Estate Loans			**Commercial and Industrial**		
	Construction	**Residential Mortgages**	**Commercial Mortgages**		**Consumer**	**Total**
Pass	**$ 69,033,840**	**$ 154,892,083**	**$ 177,052,288**	**$ 65,655,261**	**$ 3,478,653**	**$ 470,112,125**
Special Mention	**2,128,987**	**6,873,390**	**12,021,811**	**3,322,754**	**5,848**	**24,352,790**
Substandard	**3,379,281**	**7,016,152**	**2,308,079**	**1,014,542**	**282**	**13,718,336**
Doubtful	**-**	**-**	**-**	**-**	**-**	**-**
	$ 74,542,108	**$ 168,781,625**	**$ 191,382,178**	**$ 69,992,557**	**$ 3,484,783**	**$ 508,183,251**

	December 31, 2020					
	Real Estate Loans			Commercial and Industrial		
	Construction	Residential Mortgages	Commercial Mortgages		Consumer	Total
Pass	$ 77,459,339	$ 166,211,738	$ 167,154,804	$ 102,277,686	$ 2,469,670	$ 515,573,237
Special Mention	3,737,942	9,404,002	10,372,445	531,313	-	24,045,702
Substandard	2,197,550	9,591,234	5,243,240	910,740	282	17,943,046
Doubtful	-	-	-	-	-	-
	$ 83,394,831	$ 185,206,974	$ 182,770,489	$ 103,719,739	$ 2,469,952	$ 557,561,985

Management considers a loan to be impaired when, based on current information and events, it is determined that the Bank will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Determination of impairment is treated the same across all classes of loans. When management identifies a loan as impaired, the impairment is measured based on the fair value of the collateral, less selling costs, or the present value of expected future cash flows, discounted at the loan's effective interest rate. If management determines that the value of the impaired loan is less than the carrying value of the loan, impairment is recognized through a reserve amount or charge-off to the allowance. The total allowance reflects management’s estimate of loan losses inherent in the loan portfolio as of December 31, 2021.

Note 4. Loans and Allowances for Credit Losses (Continued)

Impaired loans, which include loans on non-accrual status, TDRs and other specifically identified loans, as of December 31, 2021 and 2020, are as follows:

	December 31, 2021					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Recorded Investment with a related allowance	$ 2,880,931	$ 2,929,740	$ 1,155,002	$ 1,128,376	$ 74,964	$ 8,169,013
Recorded Investment with no related allowance	45,962	6,732,436	629,555	145,094	11,137	7,564,184
Total Recorded Investment	$ 2,926,893	$ 9,662,176	$ 1,784,557	$ 1,273,470	$ 86,101	$ 15,733,197
Unpaid Principal Balance	$ 2,935,555	$ 10,921,049	$ 1,784,557	$ 1,494,274	$ 89,274	$ 17,224,709
Related Allowance	336,210	448,769	113,038	387,914	24,171	1,310,102
Average Recorded Investment	3,109,683	9,395,386	1,916,219	1,548,331	99,893	16,069,512
Interest Income Recognized	116,646	413,878	79,474	28,794	3,104	641,896

	December 31, 2020					
	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
Recorded Investment with a related allowance	$ 1,483,611	$ 3,743,338	$ 2,064,333	$ 1,251,299	$ 113,684	$ 8,656,265
Recorded Investment with no related allowance	228,419	8,058,060	1,204,020	-	-	9,490,499
Total Recorded Investment	$ 1,712,030	$ 11,801,398	$ 3,268,353	$ 1,251,299	$ 113,684	$ 18,146,764
Unpaid Principal Balance	$ 1,645,149	$ 13,464,936	$ 3,268,353	$ 1,323,025	$ 116,857	$ 19,818,320
Related Allowance	488,443	810,047	255,812	257,139	39,075	1,850,516
Average Recorded Investment	1,696,842	11,952,215	3,371,361	1,236,678	122,537	18,379,633
Interest Income Recognized	42,970	523,018	127,644	28,694	4,016	726,342

The Bank generally places loans on nonaccrual status when the full and timely collection of interest or principal becomes uncertain, part of the principal balance has been charged off and no restructuring has occurred, or the loan reaches 90 days past due. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income, and future payments are applied to principal. Loans are returned to accrual status when the borrower makes at least six regularly scheduled payments and the collectability is no longer doubtful. The Bank classifies loans on nonaccrual status as impaired. Information regarding these loans as of December 31, 2021 and 2020 is summarized as follows:

	Real Estate Loans			Commercial and Industrial	Consumer	Total
	Construction	Residential Mortgages	Commercial Mortgages			
December 31, 2021	$ 2,318,556	$ 1,456,988	$ 486,366	$ 567,893	$ 282	$ 4,830,085
December 31, 2020	$ 1,609,000	$ 2,837,662	$ 969,029	$ 466,205	$ 282	$ 5,882,178

Note 4. Loans and Allowances for Credit Losses (Continued)

In situations where, for economic or legal reasons related to a borrower's financial difficulties, the Bank may grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, 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 to more affordable terms before their loan reaches nonaccrual status. These modified terms may include rate reductions, principal or interest forgiveness, or other actions intended to minimize the loss and to avoid foreclosure or repossession of the collateral. For TDRs with interest rates modified below market, the “specific” valuation allowance amounts were determined by comparing the discounted future expected present value of cash flows under the modified agreements against the carrying value of the original loan and a separate reserve in the allowance for loan losses has been established and identified as for TDRs. TDRs with principal reductions are individually evaluated for impairment and have been charged off to their net realizable value through the allowance for loan losses.

The following table includes the recorded investment and number of modifications for TDRs. The Bank reports the recorded investment in the loans prior to a modification and also the recorded investment in the loans after the loans were restructured.

	December 31, 2021					
	Real Estate Loans			**Commercial and**		
	Construction	**Residential Mortgages**	**Commercial Mortgages**	**Industrial**	**Consumer**	**Total**
Number of modifications	**1**	**51**	**3**	**10**	**7**	**72**
Recorded investment prior to modification	**$ 2,144,778**	**$ 9,034,729**	**$ 1,965,580**	**$ 2,311,179**	**$ 158,213**	**$ 15,614,479**
Recorded investment after modification	**$ 739,093**	**$ 7,403,000**	**$ 1,394,309**	**$ 995,528**	**$ 85,819**	**$ 10,617,749**

	December 31, 2020					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Number of modifications	2	62	4	9	7	84
Recorded investment prior to modification	$ 3,045,102	$ 11,189,812	$ 2,860,824	$ 1,070,228	$ 158,213	$ 18,324,179
Recorded investment after modification	$ 1,327,673	$ 8,189,502	$ 2,385,605	$ 700,552	$ 113,402	$ 12,716,734

TDRs, included in impaired loans, which are not performing as agreed in the current reporting period, are as follows:

	December 31, 2021					
	Real Estate Loans			**Commercial and**		
	Construction	**Residential Mortgages**	**Commercial Mortgages**	**Industrial**	**Consumer**	**Total**
Number of modifications	**1**	**11**	**1**	**3**	**-**	**16**
Recorded investment	**$ 739,093**	**$ 952,968**	**$ 283,404**	**$ 505,846**	**$ -**	**$ 2,481,311**

	December 31, 2020					
	Real Estate Loans			Commercial and		
	Construction	Residential Mortgages	Commercial Mortgages	Industrial	Consumer	Total
Number of modifications	2	18	1	1	-	22
Recorded investment	$ 1,327,673	$ 1,587,307	$ 283,404	$ 118,472	$ -	$ 3,316,856

Note 4. Loans and Allowances for Credit Losses (Continued)

Troubled debt restructurings (TDRs) with a commitment to lend additional funds were **$0** at December 31, 2021 and 2020.

The CARES Act permitted banks to suspend requirements under U.S. GAAP for loan modifications to borrowers affected by COVID-19 that would otherwise be characterized as TDRs and suspend any determination related thereto if (i) the loan modification was made between March 1, 2020 and the earlier of December 31, 2020 or 60 days after the end of the COVID-19 emergency declaration and (ii) the applicable loan was not more than 30 days past due as of December 31, 2019. Federal bank regulatory authorities also issued guidance to encourage banks to make loan modifications for borrowers affected by COVID-19 and to assure banks that they will not be criticized by examiners for doing so. On December 27, 2020, the Consolidated Appropriations Act, 2021 (the "Act") was signed into law which extended the temporary relief granted to banking institutions under the CARES Act. Section 541, Extension of Temporary Relief from Trouble Debt Restructurings and Insurer Clarification, of the Act extended the timeline provided in the CARES Act to the earlier of (a) January 1, 2022 or (b) the date that is 60 days after the date in which the National Emergencies Act terminates. All other criteria specified in the CARES Act remains unchanged.

In the normal course of banking business, loans are made to senior officers and directors and their affiliated interests. In the opinion of management, these loans are consistent with sound banking practices, are within regulatory lending limitations, and do not involve more than the normal risk of collectability.

Loans to senior officers, directors, and their affiliates at December 31, 2021 and 2020 are summarized as follows:

		2021		2020
Loans, beginning	**$**	**10,503,000**	$	19,802,000
Additions		**6,336,000**		2,770,000
Repayments/eliminations		**(6,781,000)**		(12,069,000)
Loans, ending	**$**	**10,058,000**	$	10,503,000

Outstanding loan commitments and unused lines and letters of credit were approximately as follows:

		2021		2020
Loan commitments, including approved loans and unused lines of credit	**$**	**163,441,000**	$	144,071,000
Letters of credit		**5,764,000**		6,604,000

Loan commitments and lines of credit are agreements to lend to customers as long as there is no violation of any conditions of the contracts. Loan commitments generally have interest rates fixed at current market amounts, fixed expiration dates, and may require payment of a fee. Lines of credit generally have variable interest rates. Many of the loan commitments and lines of credit are expected to expire without being drawn upon; accordingly, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral or other security obtained, if deemed necessary by the Bank upon extension of credit, is based on management's credit evaluation. Collateral held varies but may include deposits held in financial institutions, U.S. Treasury securities, other marketable securities, accounts receivable, inventory, property and equipment, personal residences, income-producing commercial properties, and land under development. Personal guarantees are also obtained to provide added security for certain commitments.

Letters of credit are commitments issued to guarantee the performance of a customer to a third party. Loan commitments and letters of credit are made on the same terms, including collateral, as outstanding loans. The Bank has accrued credit losses of **$375,000**, related to these financial instruments with off-balance sheet risk in other liabilities at December 31, 2021 and 2020.

Note 5. Premises, Equipment, and Depreciation

Bank premises and equipment are as follows:

	December 31, 2021		
	Cost	**Accumulated Depreciation**	**Net**
Land	**$ 4,551,538**	**$ -**	**$ 4,551,538**
Buildings and land improvements	**9,414,567**	**3,699,141**	**5,715,426**
Furniture and equipment	**8,962,231**	**7,756,999**	**1,205,232**
	$ 22,928,336	**$ 11,456,140**	**$ 11,472,196**

	December 31, 2020		
	Cost	Accumulated Depreciation	Net
Land	$ 4,551,538	$ -	$ 4,551,538
Buildings and land improvements	9,396,306	3,474,861	5,921,445
Furniture and equipment	8,742,267	7,394,643	1,347,624
	$ 22,690,111	$ 10,869,504	$ 11,820,607

Depreciation expense totaled **$686,274** and $714,000 for the years ended December 31, 2021 and 2020, respectively.

Note 6. Income Taxes

Components of income tax expense for the years ended December 31, 2021 and 2020 are as follows:

		2021		2020
Currently payable				
Federal	$	**1,139,763**	$	1,479,696
State		**492,959**		636,242
Total current		**1,632,722**		2,115,938
Deferred income taxes (benefits)				
Federal		**150,750**		(253,513)
State		**64,549**		(108,550)
Total deferred		**215,299**		(362,063)
	$	**1,848,021**	$	1,753,875

A reconciliation of tax computed at the federal statutory tax rate of 21% for the years ended December 31, 2021 and 2020 to the actual tax expense is as follows:

		2021		2020
Tax at federal statutory rate	$	**1,576,060**	$	1,514,096
Tax effect of:				
Tax exempt income		**(176,307)**		(194,261)
Other		**7,983**		19,375
State income taxes, net of federal benefit		**440,285**		414,665
	$	**1,848,021**	$	1,753,875

Income taxes included in other assets on the balance sheet are as follows:

		2021		2020
Federal income tax refund claims	$	**245,645**	$	35,408
State income tax refund claims		**143,444**		36,403
Deferred tax benefits:				
Allowance for credit losses	$	**2,559,127**	$	2,559,127
Deferred subcontractor costs		**-**		24,174
OREO property		**72,440**		241,974
Accrued vacation		**168,701**		159,577
Unearned income on loans		**212,578**		240,171
Net unrealized depreciation on securities available-for-sale		**55,757**		-
		3,068,603		3,225,023
Deferred tax liabilities:				
Accumulated depreciation		**142,469**		139,348
Net unrealized appreciation on securities available-for-sale		**-**		202,435
		142,469		341,783
Net deferred income tax benefits	$	**2,926,134**	$	2,883,240

Management has determined that no valuation allowance is required as it believes it is more likely than not that all of the deferred tax assets will be fully realizable in the future. At December 31, 2021 and 2020, management believes there are no uncertain tax positions under ASC Topic 740 Income Taxes. The Bank's federal and state income tax returns for 2018, 2019, and 2020 are subject to examination by the IRS and/or state tax authorities, generally for three years after they were filed. The 2021 income returns will be filed in 2022.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 7. Junior Subordinated Debentures owed to Unconsolidated Subsidiary Trust

The Company sponsored a trust, HSB Statutory Trust I, of which 100% of the common equity is owned by the Company. Trust I was formed for the purpose of issuing Company-obligated mandatorily redeemable capital securities (the capital securities) to third-party investors and investing the proceeds from the sale of such capital securities solely in junior subordinated debt securities of the Company (the debentures). The debentures held by the trust are the sole assets of that trust. Trust I is a variable interest entity (VIE), however, since the Company is not the primary beneficiary of this arrangement, the accounts of this entity are not included in the consolidated financial statements. Distributions on the capital securities issued by the trust are payable quarterly at a 5.95% rate per annum for 5 years until June 2010, then floating at the 3-month LIBOR plus 1.85% thereafter. The capital securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the capital securities subject to the terms of each of the guarantees. Both the capital securities of the statutory trust and the junior subordinated debentures are scheduled to mature on June 2035, unless called by the Company.

Despite the fact that HSB Statutory Trust I is not included in the Company's consolidated financial statements, the trust preferred securities issued by these subsidiary trusts are included in the Tier 1 capital of the Company for regulatory capital purposes. Federal Reserve Board rules limit the aggregate amount of restricted core capital elements (which includes trust preferred securities, among other things) that may be included in the Tier 1 capital of most bank holding companies to 25% of all core capital elements, including restricted core capital elements, net of goodwill less any associated deferred tax liability. Amounts of restricted core capital elements in excess of these limits generally may be included in Tier 2 capital. The current quantitative limits do not preclude the Company from including the $3.0 million in trust preferred securities outstanding in Tier 1 capital.

Note 8. Deposits

Time deposits and their remaining maturities at December 31, 2021 are approximately as follows:

2022	$	87,898,000
2023		35,002,000
2024		46,770,000
2025		29,377,000
2026 and thereafter		14,090,000
	$	213,137,000

Interest expense on deposits for the years ended December 31, 2021 and 2020 is as follows:

		2021		2020
NOW, Super NOW and money market	**$**	**171,147**	$	187,790
Savings		**110,580**		127,413
Time, more than $250,000		**738,461**		885,093
Other time		**3,073,365**		3,481,250
	$	**4,093,553**	$	4,681,546

Deposit balances of senior officers and directors and their affiliated interests totaled **$22,949,344** and $20,920,147 at December 31, 2021 and 2020, respectively.

Overdraft deposit balances, included in loans, totaled **$83,671** and $131,616 at December 31, 2021 and 2020, respectively.

The Bank began offering time deposits through the Certificate of Deposit Account Registry Service (CDARS) in 2019 through a third-party provider. These deposits totaled **$14,848,144** and $17,257,335 at December 31, 2021 and 2020, respectively, and are included in other time deposits on the balance sheet.

Note 9. Benefit Plans

The Bank has a 401(k) profit sharing plan covering substantially all full-time employees. The plan requires the Bank to match employee contributions up to 5% of compensation, as defined under the plan, and permits additional contributions at the discretion of management.

Expense under this plan totaled **$266,993** and $252,704 for the years ended December 31, 2021 and 2020, respectively.

Note 10. Lease Commitments

The Bank leases one of its branch facilities under an operating lease which expires in 2026, with one 5-year renewal option. The Bank leases the land on which one of the Bank's branch facilities resides under an operating lease through 2022, with eight 5-year renewal options. The Bank leases a portion of a parking lot at one of its branch facilities under an operating lease through May 2022. The Bank also leases a portion of a parking lot adjacent to one of its branch facilities under an operating lease through August 2023, with one 2-year renewal option.

Minimum lease commitments for the next five years are approximately as follows:

2022	$	89,000
2023		85,000
2024		80,000
2025		81,000
2026		82,000

Rent expense under these arrangements totaled **$92,203** and $90,520 for the years ended December 31, 2021 and 2020, respectively.

Note 11. Other Operating Expenses

Other operating expenses include the following:

		2021		2020
Advertising and marketing	**$**	**124,210**	$	81,446
ATM and debit card processing		**736,099**		624,391
Bank service charges		**87,736**		89,170
Courier and travel		**133,796**		141,108
Data processing outsourced		**335,199**		300,070
Directors' fees		**289,522**		291,976
Donations		**50,891**		47,738
Dues and subscriptions		**85,567**		83,330
FDIC and Maryland assessments		**481,837**		472,994
Insurance		**126,384**		112,821
Loan collection and OREO operating		**117,741**		151,613
Long and short		**5,150**		56,970
Other fees		**39,249**		11,296
Postage		**160,679**		156,110
Professional services		**310,106**		492,601
Seminars		**14,856**		19,564
Stationery, printing, and supplies		**296,577**		283,820
Telephone		**258,797**		241,948
	$	**3,654,396**	$	3,658,966

Note 12. Borrowings and Credit Facilities

The Bank has borrowings from the FHLB totaling **$16,207,043** and $27,503,394 at December 31, 2021 and 2020, respectively. Interest rates on the borrowings are fixed and range from .63% to 5.94%, maturing at various dates through August 2038. Based on lendable collateral value, the Bank has available for future borrowings approximately **$69,000,000** and $62,000,000 at December 31, 2021 and 2020, respectively. The Bank has pledged approximately **$104,000,000** and $114,000,000 at December 31, 2021 and 2020, respectively, of its wholly owned residential (1-4 units) first mortgage loan portfolio, as collateral for this credit facility. The Bank has purchased stock of the FHLB as a condition for obtaining a credit facility from the FHLB.

The Company prepaid nine of its outstanding FHLB borrowings totaling **$6,960,780** during year ended December 31, 2021, which resulted in the recognition of **$221,486** in prepayment fees.

At December 31, 2021, the scheduled maturities of borrowings are approximately as follows:

2022	$	-
2023		118,000
2024		-
2025		2,668,000
2026		1,390,000
2027 and thereafter		12,031,000
	$	16,207,000

Additionally, the Bank has unsecured credit availability of $10,000,000 with one correspondent bank and secured credit availability of $8,000,000 with another correspondent bank for short-term liquidity needs, if necessary. The secured credit facility must be collateralized with securities at the time of usage. At December 31, 2021 and 2020, there were no borrowings outstanding under any of the credit facilities. At December 31, 2021, securities pledged under the secured credit facility had an amortized cost and fair value of **$121,666** and **$123,827,** respectively. At December 31, 2020, securities pledged under the secured credit facilities had an amortized cost and fair value of $160,411 and $166,043, respectively.

Note 13. Regulatory Capital Requirements

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

The Common Equity Tier 1, Tier 1 and Total capital ratios are calculated by dividing the respective capital amounts by risk-weighted assets. Risk-weighted assets are calculated based on regulatory requirements and include total assets, with certain exclusions, allocated by risk weight category, and certain off-balance-sheet items, among other things. The leverage ratio is calculated by dividing Tier 1 capital by adjusted quarterly average total assets, which exclude goodwill and other intangible assets, among other things.

Note 13. Regulatory Capital Requirements (Continued)

The Bank is subject to the Basel III Capital Rules. The Basel III Capital Rules require the Bank to maintain (i) a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 4.5%, plus a 2.5% "capital conservation buffer" (which is added to the 4.5% Common Equity Tier 1 capital ratio, effectively resulting in a minimum ratio of Common Equity Tier 1 capital to risk-weighted assets of at least 7.0%), (ii) a minimum ratio of Tier 1 capital to risk-weighted assets of at least 6.0%, plus the capital conservation buffer (which is added to the 6.0% Tier 1 capital ratio, effectively resulting in a minimum Tier 1 capital ratio of 8.5%), (iii) a minimum ratio of Total capital (that is, Tier 1 plus Tier 2) to risk-weighted assets of at least 8.0%, plus the capital conservation buffer (which is added to the 8.0% Total capital ratio, effectively resulting in a minimum Total capital ratio of 10.5%) and (iv) a minimum leverage ratio of 4.0%, calculated as the ratio of Tier 1 capital to average quarterly assets.

The implementation of the capital conservation buffer began on January 1, 2016 and was phased in over a four-year period (increasing by 0.625% on January 1, 2016 and by 0.625% on each subsequent January 1, until it reached 2.5% on January 1, 2019). The capital conservation buffer is designed to absorb losses during periods of economic stress and, as detailed above, effectively increases the minimum required risk-weighted capital ratios. The Basel III Capital Rules also provide for a "countercyclical capital buffer" that is applicable to only certain covered institutions and does not have any current applicability to the Company or Bank. Banking institutions with a ratio of Common Equity Tier 1 capital to risk-weighted assets below the effective minimum (4.5% plus the capital conservation buffer and, if applicable, the countercyclical capital buffer) will face constraints on dividends, equity repurchases and compensation based on the amount of the shortfall.

Management believes, as of December 31, 2021 and 2020, that the Company and Bank meet all capital adequacy requirements to which it is subject. The most recent notification from the FDIC categorized the Bank as "well capitalized" under the regulatory framework for prompt corrective action. To be categorized as "well capitalized" the Bank must maintain minimum Common Equity Tier 1, Tier 1 and Total capital to risk-weighted assets and Tier I leverage ratios. There have been no conditions or events since that notification that management believes have changed the Bank's category.

As discussed in Note 7, the capital securities held by the HSB Statutory Trust I qualifies as Tier 1 capital for the Company under Federal Reserve Board guidelines.

Note 13. Regulatory Capital Requirements (Continued)

A comparison of capital as of December 31, 2021 and 2020 for the Company and Bank is presented below. The minimum required capital amounts presented include the minimum required capital levels as of December 31, 2021 and December 31, 2020. Capital amounts and ratios for minimum capital adequacy presented in the following table do not include capital conservation buffers. Capital levels required to be considered well capitalized are based upon prompt corrective action regulations, as amended to reflect the changes under the Basel III Capital Rules.

As of December 31, 2021	**Actual**		**For Minimum Adequacy Purposes**		**To Be Well Capitalized Under Prompt Corrective Action Provisions**	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
Total Capital (to Risk-Weighted Assets)						
Company	**$ 74,785,000**	**13.7%**	**$ 43,606,000**	**8.0%**	**$ -**	**N/A**
Bank	**74,754,000**	**13.7%**	**43,620,000**	**8.0%**	**54,525,000**	**10.0%**
Tier I Capital (to Risk-Weighted Assets)						
Company	**67,934,000**	**12.5%**	**32,713,000**	**6.0%**	**-**	**N/A**
Bank	**67,904,000**	**12.5%**	**32,699,000**	**6.0%**	**43,598,000**	**8.0%**
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	**64,934,000**	**11.9%**	**24,534,000**	**4.5%**	**-**	**N/A**
Bank	**67,904,000**	**12.5%**	**24,524,000**	**4.5%**	**35,423,000**	**6.5%**
Tier I Capital (to Average Assets)						
Company	**67,934,000**	**8.3%**	**32,621,000**	**4.0%**	**-**	**N/A**
Bank	**67,904,000**	**8.3%**	**32,607,000**	**4.0%**	**40,759,000**	**5.0%**

As of December 31, 2020	Actual		Adequacy Purposes		Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total Capital (to Risk-Weighted Assets)						
Company	$ 70,623,000	12.7%	$ 44,417,000	8.0%	$ -	N/A
Bank	70,582,000	12.7%	44,399,000	8.0%	55,499,000	10.0%
Tier I Capital (to Risk-Weighted Assets)						
Company	63,651,000	11.5%	33,296,000	6.0%	-	N/A
Bank	63,611,000	11.5%	33,299,000	6.0%	44,399,000	8.0%
Common Equity Tier I Capital (to Risk-Weighted Assets)						
Company	60,651,000	10.9%	24,971,000	4.5%	-	N/A
Bank	63,611,000	11.5%	24,974,000	4.5%	36,074,000	6.5%
Tier I Capital (to Average Assets)						
Company	63,651,000	8.9%	28,543,000	4.0%	-	N/A
Bank	63,611,000	8.9%	28,547,000	4.0%	35,684,000	5.0%

According to FDIC capital guidelines, the Bank is considered to be “Well Capitalized.”

Under Maryland banking law, the Board of Directors may declare cash dividends from undivided profits after providing for expenses, losses, interest and taxes accrued or due.

Note 14. Issuance of Preferred Stock

On October 15, 2008, the Company issued Series A Preferred Stock (the “Preferred Shares”) to all Common stockholders with less than 1,000 shares on a one-for-one basis. No dividends or distributions will be given to Common stockholders unless the Series A Preferred stockholders receive at least an equal amount. Dividends on the Preferred Shares are not cumulative and no rights accrue. The Preferred Shares are not entitled to vote and are entitled to receive any liquidation amount, prior to payment to Common stockholders.   Except as noted above, all pertinent rights and privileges of the Preferred Shares are the same as the Common Stock.

At the Annual Meeting of Shareholders of the Company held on April 20, 2021, the shareholders approved a proposal to amend the Company’s charter pursuant to which the Preferred Shares of the Company were to be classified as, and changed into, shares of common stock (the “Common Stock”), of the Company (the “Classification Amendment”). The Classification Amendment became effective on April 30, 2021 (the “Effective Date”). The effect of the Classification Amendment was that record holders of Preferred Shares as of the Effective Date no longer own Preferred Shares, but now own an equal number of shares of Common Stock.

Note 15. Fair Values of Financial Instruments

Disclosure about Fair Value of Financial Instruments (“ASC Topic 825") requires the disclosure of the estimated fair values of financial instruments. Quoted market prices, where available, are shown as estimates of fair values. Because no quoted market prices are available for a significant part of the Company’s financial instruments, the fair values of such instruments have been derived based on the amount and timing of future cash flows and estimated discount rates.

Present value techniques used in estimating the fair value of many of the Company’s financial instruments are significantly affected by the assumptions used. Fair values derived from using present value techniques are not substantiated by comparisons to independent markets and, in many cases, could not be realized in immediate settlement of the instruments.

ASC Topic 825 excludes certain financial instruments and all nonfinancial instruments from its disclosure requirements. Accordingly, the aggregate fair value amounts presented do not represent the underlying value of the Company.

Note 15. Fair Values of Financial Instruments (Continued)

The following table shows the estimated fair values and the related carrying values of the Bank's financial instruments at December 31, 2021 and 2020. Items that are not financial instruments are not included.

	2021		2020	
	Carrying Amount	**Estimated Fair Value**	Carrying Amount	Estimated Fair Value
Financial assets:				
Cash and due from banks	**$ 9,749,783**	**$ 9,749,783**	$ 10,451,024	$ 10,451,024
Interest-bearing deposits in other banks	**214,635,254**	**214,635,254**	104,419,125	104,419,125
Debt securities available-for-sale	**64,045,400**	**64,045,400**	20,780,026	20,780,026
Equity securities	**4,466,187**	**4,466,187**	4,091,954	4,091,954
Loans, net of allowance for credit losses	**498,051,593**	**526,822,569**	547,356,449	595,157,488
Accrued interest receivable	**1,609,613**	**1,609,613**	2,288,720	2,288,720
Federal Home Loan Bank stock	**968,100**	**968,100**	1,713,100	1,713,100
Common stock-Statutory Trust I	**93,000**	**93,000**	93,000	93,000
Cash value of life insurance	**13,280,277**	**13,280,277**	12,974,439	12,974,439
Financial liabilities:				
Deposits	**$ 736,347,767**	**$ 730,564,769**	$ 626,184,806	$ 633,560,815
Accrued interest payable	**430,872**	**430,872**	532,444	532,444
Short-term borrowings	**-**	**-**	-	-
Long-term borrowings	**16,207,043**	**16,840,045**	27,503,394	29,221,356
Junior subordinated debentures owed to unconsolidated subsidiary trust	**3,093,000**	**1,799,171**	3,093,000	1,348,050
Unrecognized financial instruments:				
Commitments to extend credit	**163,441,000**	**163,441,000**	144,071,000	144,071,000
Standby letters of credit	**5,764,000**	**5,764,000**	6,604,000	6,604,000

For purposes of the above disclosures of estimated fair value, the following assumptions were used:

Cash and cash equivalents

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds sold is considered to approximate cost because of their short-term nature.

Investment Securities

Fair values for securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on quoted market prices of comparable instruments. See Note 16 for further discussion.

Note 15. Fair Values of Financial Instruments (Continued)

Loans

The estimated fair value for certain homogeneous categories of loans, such as residential mortgages, is based on the quoted market price for securities backed by similar loans, adjusted for differences in loan characteristics. The estimated fair value of other loans is determined by discounting future cash flows using current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities.

Deposits

The estimated fair value of deposits with no stated maturity, such as non-interest-bearing demand deposits, savings, NOW and super NOW accounts and money market accounts, is equal to the amount payable on demand at the reporting date (that is, their carrying amounts). The fair value of certificates of deposit is based on the rates currently offered for deposits of similar maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

Borrowings

The estimated fair value approximates carrying value for short-term borrowings. The fair value of long-term fixed rate borrowings is estimated by discounting future cash flows using current interest rates currently offered for similar financial instruments.

Junior Subordinated Debentures

Fair value is usually estimated based on quoted market prices of similar instruments. If quoted market prices are not available the fair value is determined by using the discounted value of expected cash flows using market rates.

Other Assets and Liabilities

The estimated fair value for cash and due from banks, interest-bearing deposits in other banks, and Federal funds sold is considered to approximate cost because of their short-term nature.

Other assets and liabilities of the Bank that are not defined as financial instruments are not included in the above disclosures, such as property and equipment. Also, non-financial instruments typically not recognized in the financial statements nevertheless may have value but are not included in the above disclosures. These include, among other items, the estimated earnings power of core deposit accounts, the trained work force, customer goodwill, and similar items.

The following table presents the carrying amount, fair value, and placement in the fair value hierarchy of the Bank's financial instruments not disclosed elsewhere as of December 31, 2021. This table excludes financial instruments for which the carrying amount approximates fair value.

	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
Financial Assets:					
Loans, net	$ 498,051,593	$ 526,822,569	$ -	$ -	$ 526,822,569
Financial Liabilities:					
Deposits	736,347,767	730,564,769	-	730,564,769	-
Long-term borrowings	16,207,043	16,840,045	-	16,840,045	-
Junior subordinated debentures owed to unconsolidated subsidiary trust	3,093,000	1,799,171	-	1,799,171	-

Note 16. Fair Value Measurements

ASC Topic 820 Fair Value Measurements and Disclosures provides a framework for measuring and disclosing fair value under generally accepted accounting principles. ASC Topic 820 requires disclosures about the fair value of assets and liabilities recognized in the balance sheet in periods subsequent to initial recognition, whether the measurements are made on a recurring basis (for example, available-for-sale investment securities) or on a nonrecurring basis (for example, impaired loans and OREO).

ASC Topic 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC Topic 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value.

Fair Value Hierarchy

Level 1 – Quoted prices in active markets for identical assets or liabilities
Level 2 – Other significant observable inputs (including quoted prices in active markets for similar assets or liabilities)
Level 3 – Significant unobservable inputs (including the Bank's own assumptions in determining the fair value of assets or liabilities)

In determining the appropriate levels, the Bank performs a detailed analysis of assets and liabilities that are subject to ASC Topic 820.

The following table presents fair value measurements on a recurring basis as of December 31, 2021:

	Level 1	Level 2	Level 3	Fair Value
Securities available-for-sale:				
U.S. Treasury and obligations of				
U.S. government agencies	$ -	$ 17,308,214	$ -	$ 17,308,214
Obligations of States and				
political subdivisions	-	9,089,750	-	9,089,750
Mortgage-backed securities				
and CMOs	-	37,647,436	-	37,647,436
	-	64,045,400	-	64,045,400
Equity	-	4,466,187	-	4,466,187
Total	$ -	$ 68,511,587	$ -	$ 68,511,587

Level 1 securities are based on quoted market prices. When quoted market prices are not available, Level 2 securities are based on the data provider's logic matrix table for quoted market prices of comparable instruments. Level 3 securities are valued by default matrix pricing. The Company obtains fair value measurements from an independent pricing service.

The Bank had no significant transfers of available-for-sale securities in which the fair value measurements are valued on a recurring basis between Level 1 and Level 2 during the period ending December 31, 2021.

Note 16. Fair Value Measurements (Continued)

The Bank may also be required, from time to time, to measure certain other financial assets and liabilities at fair value on a non-recurring basis in accordance with GAAP. The following table presents fair value measurements on a non-recurring basis as of December 31, 2021:

	Level 1	Level 2	Level 3	Fair Value
Impaired loans	$ -	$ -	$ 14,423,095	$ 14,423,095
OREO	-	234,975	-	234,975
Total	$ -	$ 234,975	$ 14,423,095	$ 14,658,070

The Bank is predominantly a cash flow lender with real estate serving as collateral on a majority of loans. In accordance with ASC Topic 310 Receivables, loans which the Bank has deemed to be impaired financial assets are primarily valued on a nonrecurring basis at the fair values of the underlying real estate collateral. The Bank determines such fair values from independent appraisals. When appropriate, management may also reduce the independent appraised value based on the current listing price of real estate for sale, prior experience in selling similar real estate or other factors not considered in the independent appraisal. In addition, on non-collateral dependent TDRs the impairment is measured as the present value of expected future cash flows discounted at the loan's original effective interest rate. All impaired loans are classified as Level 3 inputs.

Non-Financial Assets and Non-Financial Liabilities:

Application of ASC Topic 820 to non-financial assets and non-financial liabilities became effective January 1, 2009. The Corporation has no non-financial assets or non-financial liabilities measured at fair value on a recurring basis. Certain non-financial assets and non-financial liabilities typically measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment.

In accordance with ASC Topic 360 Property, Plant and Equipment, foreclosed real estate (OREO) was adjusted to their fair values, resulting in an impairment charge, which was included in earnings for the year. Foreclosed real estate, which are considered to be non-financial assets, have been valued using a market approach. The values were determined using current market prices of similar real estate assets, less costs to sell, which the Bank considers to be Level 2 inputs.

Note 17. Date of Management's Review

In preparing the financial statements, the Bank has evaluated events and transactions for potential recognition or disclosure through February 2, 2022, the date that the financial statements were available to be issued.

Note 18. Parent Company Financial Information

Comparative Balance Sheets, Statements of Income, and Statements of Cash Flows for HSB Bancorp, Inc. (Parent Only) are presented below:

BALANCE SHEETS
December 31, 2021 and 2020

		2021		2020
ASSETS				
Cash and due from banks	**$**	**70,731**	$	79,001
Investment in Bank		**67,756,029**		64,144,148
Investment in the HSB Statutory Trust I		**93,000**		93,000
Other assets		**18,834**		20,038
Total assets	**$**	**67,938,594**	$	64,336,187
LIABILITIES				
Borrowed funds from subsidiary	**$**	**3,093,000**	$	3,093,000
Accrued interest payable on borrowed funds		**2,645**		2,663
Total liabilities		**3,095,645**		3,095,663
STOCKHOLDERS' EQUITY				
Common stock		**16,171**		15,467
Series A Preferred stock		**-**		704
Surplus		**6,201,001**		6,201,001
Retained earnings		**58,772,644**		54,490,125
Accumulated other comprehensive (loss) income		**(146,867)**		533,227
Total stockholders' equity		**64,842,949**		61,240,524
Total liabilities and stockholders' equity	**$**	**67,938,594**	$	64,336,187

Note 18. Parent Company Financial Information (Continued)

The borrowed funds from subsidiary balance represent the junior subordinated debt securities payable to the wholly owned subsidiary trust that was deconsolidated as a result of applying the provisions of FIN 46. The Company continues to guarantee the capital securities issued by the trust, which totaled **$3,000,000** at December 31, 2021 (see Note 7 for further discussions on FIN 46R).

STATEMENTS OF INCOME
Years Ended December 31, 2021 and 2020

		2021		2020
Dividend income from bank	**$**	**1,435,603**	$	1,455,056
Undistributed net income of bank		**4,291,977**		4,076,126
Other operating income		**1,893**		2,432
Other operating expenses		**(91,199)**		(97,469)
Income before taxes		**5,638,274**		5,436,145
Income tax benefits (*)		**(18,754)**		(19,958)
NET INCOME	**$**	**5,657,028**	$	5,456,103

(*) Benefits from filing a consolidated federal income tax return.

STATEMENTS OF CASH FLOWS
Years Ended December 31, 2021 and 2020

		2021		2020
CASH FLOWS FROM OPERATING ACTIVITIES				
Net income	**$**	**5,657,028**	$	5,456,103
Adjustments to reconcile net income to net cash provided by operating activities:				
Equity in undistributed net income of subsidiary		**(4,291,977)**		(4,076,126)
Changes in assets or liabilities:				
Decrease in other assets		**1,206**		11,000
Decrease in liabilities		**(18)**		(2,160)
Net cash provided by operating activities		**1,366,239**		1,388,817
CASH FLOWS FROM FINANCING ACTIVITIES				
Dividends paid		**(1,374,509)**		(1,374,509)
Net cash used in financing activities		**(1,374,509)**		(1,374,509)
Net (decrease) increase in cash		**(8,270)**		14,308
Cash, beginning of year		**79,001**		64,693
Cash, end of year	**$**	**70,731**	$	79,001

OFFICERS & DIRECTORS

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KIMBERLY T. THOMAS, CPA, Vice-President & Secretary/Treasurer
CATHY D. BRINSFIELD, Vice-President & Assistant Secretary
W. TRENT PUSEY, Vice-President

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LORANCE J. ROHLFING, Senior Vice-President & Chief Credit Officer

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