Peoples Ltd. and Subsidiaries

Consolidated Financial Statements

December 31, 2019 and 2018

	Page
Independent Auditors' Report	1
Financial Statements	
Consolidated Balance Sheets	2
Consolidated Statements of Income	3
Consolidated Statements of Comprehensive Income	4
Consolidated Statements of Changes in Shareholders' Equity	5
Consolidated Statements of Cash Flows	6
Notes to Consolidated Financial Statements	7

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Independent Auditors' Report

To the Board of Directors of
Peoples Ltd. and Subsidiaries

We have audited the accompanying consolidated financial statements of Peoples Ltd. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

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

Baker Tilly Virchow Krause, LLP

Wilkes-Barre, Pennsylvania
March 30, 2020

Peoples Ltd. and Subsidiaries

Consolidated Balance Sheets
December 31, 2019 and 2018
(In thousands, except share amounts)

	2019	2018
Assets		
Cash and due from banks	$ 27,310	$ 29,534
Available-for-sale securities	108,287	98,131
Loans, net	248,484	231,793
Cash surrender value, life insurance	7,542	2,435
Bank premises and equipment	4,834	4,887
Accrued interest receivable	981	929
Restricted equity securities	1,767	1,541
Deferred income taxes	349	845
Other assets	1,963	1,103
Total	$ 401,517	$ 371,198
Liabilities and Shareholders' Equity		
Liabilities		
Demand deposits:		
Noninterest-bearing	$ 70,645	$ 67,097
Interest-bearing	111,584	94,046
Total	182,229	161,143
Savings deposits	57,338	56,511
Time deposits	104,926	99,922
Total deposits	344,493	317,576
Borrowed funds	16,000	19,000
Accrued interest payable	133	126
Other liabilities	2,612	1,589
Total liabilities	363,238	338,291
Shareholders' Equity		
Common stock, $.50 par value, authorized 2,000,000 shares		
2019 - 681,964 shares issued, 667,309 outstanding		
2018 - 650,356 shares issued, 635,701 outstanding	341	325
Surplus	16,857	14,344
Retained earnings	21,344	20,612
Treasury stock, at cost	(512)	(512)
Accumulated other comprehensive income (loss)	249	(1,862)
Total shareholders' equity	38,279	32,907
Total	$ 401,517	$ 371,198

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statements of Income
Years Ended December 31, 2019 and 2018
(In thousands, except per share amounts)

	2019	2018
Interest Income		
Interest and fees on loans	$ 12,479	$ 11,500
Interest and dividends on investments:		
Taxable interest and dividends	2,742	2,229
Nontaxable interest	474	486
Total interest income	15,695	14,215
Interest Expense		
Interest on deposits	2,858	1,843
Interest on borrowed funds	389	339
Total interest expense	3,247	2,182
Net Interest Income	12,448	12,033
Provision for Loan Losses	420	525
Net Interest Income after Provision for Loan Losses	12,028	11,508
Noninterest Income		
Service charges	1,290	1,210
Gain on sale of loans	856	652
Commissions	106	121
Increase in cash surrender value, life insurance	107	60
Gain on life insurance settlement	-	1,168
Gain on sale of foreclosed assets	13	3
Unrealized gains on equity securities	37	-
Other income	413	336
Total noninterest income	2,822	3,550
Noninterest Expenses		
Salaries and employee benefits	5,181	5,076
Occupancy and equipment	1,089	1,117
Data processing	620	586
Pennsylvania shares tax	278	280
Professional fees	243	256
FDIC insurance	107	183
Other expenses	1,731	1,939
Total noninterest expenses	9,249	9,437
Income Before Provision for Income Taxes	5,601	5,621
Provision for Income Taxes	953	780
Net Income	$ 4,648	$ 4,841
Earnings Per Share	$ 6.97	$ 7.25

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statements of Comprehensive Income
Years Ended December 31, 2019 and 2018
(In thousands)

	2019	2018
Net Income	$ 4,648	$ 4,841
Other Comprehensive Income (Loss)		
Unrealized gain (loss) on available-for-sale securities	2,671	(587)
Tax effect	(560)	123
Total other comprehensive income (loss)	2,111	(464)
Total Comprehensive Income	$ 6,759	$ 4,377

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity
Years Ended December 31, 2019 and 2018
(In thousands, except share amounts)

	Common Stock		Treasury Stock				Accumulated Other Comprehensive	
	Shares	Amount	Shares	Amount	Surplus	Retained Earnings	Income (Loss)	Total
Balance, January 1, 2018	620,244	$ 310	14,635	$ (511)	$ 12,334	$ 19,043	$ (1,398)	$ 29,778
Net income	-	-	-	-	-	4,841	-	4,841
Other comprehensive loss	-	-	-	-	-	-	(464)	(464)
Purchase of treasury stock	-	-	20	(1)	-	-	-	(1)
Cash dividend ($2.04 per share)	-	-	-	-	-	(1,236)	-	(1,236)
5% stock dividend	30,112	15	-	-	2,010	(2,036)	-	(11)
Balance, December 31, 2018	650,356	325	14,655	(512)	14,344	20,612	(1,862)	32,907
Net income	-	-	-	-	-	4,648	-	4,648
Other comprehensive income	-	-	-	-	-	-	2,111	2,111
Cash dividend ($2.16 per share)	-	-	-	-	-	(1,373)	-	(1,373)
5% stock dividend	31,608	16	-	-	2,513	(2,543)	-	(14)
Balance, December 31, 2019	681,964	$ 341	14,655	$ (512)	$ 16,857	$ 21,344	$ 249	$ 38,279

See notes to consolidated financial statements

Peoples Ltd. and Subsidiaries

Consolidated Statements of Cash Flows
Years Ended December 31, 2019 and 2018
(In thousands)

	2019	2018
Operating Activities		
Net income	$ 4,648	$ 4,841
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	420	525
Depreciation	407	436
Amortization and accretion, net	(145)	(65)
Gain on sale of loans	(856)	(652)
Loans originated for sale	(26,428)	(20,910)
Proceeds from sale of loans originated for sale	25,648	22,217
Writedown on foreclosed assets	50	45
Gain on sale of foreclosed assets	(13)	(3)
Unrealized gains on equity securities	(37)	-
Loss (gain) on sale of equipment	14	(2)
Deferred income taxes	(64)	(144)
Increase in cash surrender value, life insurance	(107)	(60)
Amortization of right-of-use asset	178	-
Gain on life insurance settlement	-	(1,168)
Change in:		
Accrued interest receivable	(52)	(8)
Other assets	47	(3)
Accrued interest payable	7	29
Operating lease liability	(178)	-
Other liabilities	28	47
Net cash provided by operating activities	3,567	5,125
Investing Activities		
Proceeds from calls and maturities of available-for-sale securities	21,355	11,260
Purchase of available-for-sale securities	(28,658)	(17,582)
Proceeds from redemption of restricted equity securities	384	175
Purchase of restricted equity securities	(610)	(177)
Net increase in loans	(15,543)	(18,029)
Life insurance premiums paid	(5,000)	(128)
Proceeds from bank owned life insurance death benefit	-	4,927
Purchase of bank premises and equipment	(381)	(128)
Proceeds from sale of equipment	13	2
Proceeds from the sale of foreclosed assets	119	390
Net cash used in investing activities	(28,321)	(19,290)
Financing Activities		
Net increase in deposits	26,917	24,441
Proceeds from borrowed funds	13,000	6,000
Repayment of borrowed funds	(16,000)	(10,000)
Dividends paid	(1,387)	(1,247)
Purchase of treasury stock	-	(1)
Net cash provided by financing activities	22,530	19,193
(Decrease) Increase in Cash and Due from Banks	(2,224)	5,028
Cash and Due from Banks, Beginning	29,534	24,506
Cash and Due from Banks, Ending	$ 27,310	$ 29,534

See notes to consolidated financial statements

1. Nature of Operations and Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Peoples Ltd. and its wholly-owned subsidiaries, PS Bank (the Bank) and DEPPLL Corp. (collectively, the Company). All significant intercompany balances and transactions have been eliminated in consolidation.

Nature of Operations

The Company provides a full range of basic financial services to individuals, small businesses and corporate customers through offices in Bradford, Lackawanna, Sullivan and Wyoming counties of Pennsylvania. The area is a rural and suburban market with an economic base made up of light manufacturing, retail and agricultural businesses. The Company's primary deposit products are demand deposits and interest bearing time and savings accounts. It offers a full array of loan products to meet the needs of retail and commercial customers.

The Bank is subject to regulation by the Pennsylvania Department of Banking and Securities and the Federal Deposit Insurance Corporation. Peoples Ltd. is subject to regulation by the Federal Reserve Bank of Philadelphia.

Use of Estimates

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

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for loan losses and the valuation of investment securities.

In connection with the determination of the allowance for loan losses, management generally obtains independent appraisals for significant properties. While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in economic conditions. In addition, regulatory agencies, as an integral part of their examination process, periodically review the estimated losses on loans. Such agencies may require the Company to recognize additional losses based on their judgments about information available to them at the time of their examination. Because of these factors, it is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

The Company's investment securities are comprised of a variety of financial instruments. The fair values of these securities are subject to various risks including changes in the interest rate environment and general economic conditions. Due to the increased level of these risks and their potential impact on the fair values of the securities, it is possible that the amounts reported in the accompanying consolidated financial statements could materially change in the near term.

Significant Group Concentrations of Credit Risk

The Company grants loans to customers primarily located in Bradford, Lackawanna, Sullivan and Wyoming counties of Pennsylvania. Although the Company has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent on the economic sector in which the Company operates. The Company does not have any significant concentrations from one industry or customer.

Investments

Debt and equity securities are classified as available-for-sale and recorded at fair value. Unrealized gains and losses on debt securities are excluded from earnings and reported in other comprehensive income (loss). Unrealized gains and losses on equity securities are included in net income.

Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Declines in the fair value of available-for-sale debt securities below their costs that are deemed to be credit-related are reflected in earnings as realized losses. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

Restricted Equity Securities

Restricted equity securities are carried at cost.

The Company, as a member of the Pittsburgh branch of the Federal Home Loan Bank system (FHLB), is required to maintain an investment in capital stock of the FHLB. The carrying value of this stock was $1,757,000 at December 31, 2019 and $1,531,000 at December 31, 2018. Based on redemption provisions of the FHLB, the stock has no quoted market value. The Company is also required to maintain an investment in the Atlantic Community Bankers Bank. The carrying value of this stock was $10,000 at December 31, 2019 and 2018.

Management considers whether these investments are impaired based on the ultimate recoverability of the cost basis rather than by recognizing temporary declines in value. Management believes no impairment has occurred related to these investments at December 31, 2019 and 2018.

Loans

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

The loan receivable portfolio is segmented into commercial, residential, municipal and consumer loans. Commercial loans include commercial and industrial and commercial real estate loans. Residential loans include 1-4 family mortgage loans and home equity loans. Consumer loans consist of personal installment loans and municipal loans consist of loans to local municipalities and authorities. The segments of the Company's loan portfolio are disaggregated to a level that allows management to monitor risk and performance. Common risk characteristics include loan type, collateral type and geographic location.

For all classes of loans receivable except certain residential loans, the accrual of interest is discontinued when the contractual payment of principal or interest has become 90 days past due or management has serious doubts about further collectability of principal or interest, even though the loan is currently performing. For residential loans that are well secured and in the process of collection, the accrual of interest is discontinued after one year of past due payments. When a loan is placed on nonaccrual status, unpaid interest is reversed against interest income. Interest received on nonaccrual loans, including impaired loans, is either applied to principal or recognized as interest income, depending on management's judgment as to the collectability of principal. Generally, loans are restored to accrual status when the obligation is brought current, has performed in accordance with the contractual terms for a reasonable period of time (generally six months) and the ultimate collectability of the total contractual principal and interest is no longer in doubt. The past due status of all classes of loans receivable is determined based on contractual due dates for loan payments.

Allowance for Loan Losses

The allowance for loan losses represents management's estimate of losses inherent in the loan portfolio as of the balance sheet date and is recorded as a reduction to loans. The allowance for loan losses is increased by the provision for loan losses, and decreased by charge-offs, net of recoveries. Loans deemed to be uncollectible are charged against the allowance for loan losses, and subsequent recoveries, if any, are credited to the allowance. All, or part, of the principal balance of loans receivable are charged off to the allowance as soon as it is determined that the repayment of all, or part, of the principal balance is highly unlikely. Consumer loans are generally charged off no later than 120 days past due on a contractual basis (earlier in the event of bankruptcy) or if there is an amount deemed uncollectible.

The allowance for loan losses is maintained at a level considered adequate to provide for losses that can be reasonably anticipated. Management performs a quarterly evaluation of the adequacy of the allowance. The allowance is based on the Company's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, composition of the loan portfolio, current economic conditions and other relevant factors. This evaluation is inherently subjective as it requires material estimates that may be susceptible to significant revision as more information becomes available.

The allowance consists of specific, general and unallocated components.

The specific component relates to loans that are classified as impaired. For loans that are classified as impaired, a specific allowance is established when the collateral value, observable market price, or discounted cash flows of the impaired loan is lower than the carrying value of that loan. A loan is considered impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower's prior payment records, and the amount of the shortfall in relation to the principal and interest owed. Impairment is measured on a loan-by-loan basis. The Company does not separately evaluate individual residential and consumer loans for impairment, unless such loans are part of a larger relationship that is impaired, or are classified as a troubled debt restructuring.

The estimated fair values of substantially all of the Company's impaired loans are measured based on the estimated fair value of the loan's collateral.

For loans secured by real estate, estimated fair values are determined primarily through third-party appraisals. When a real estate secured loan becomes impaired, a decision is made regarding whether an updated certified appraisal of the real estate is necessary. This decision is based on various considerations, including the age of the most recent appraisal, the loan-to-value ratio based on the original appraisal and the condition of the property. Appraised values are discounted, when necessary, to arrive at the estimated selling price of the collateral, which is considered to be the estimated fair value. The discounts also include estimated costs to sell the property.

For loans secured by non-real estate collateral, such as accounts receivable, inventory and equipment, estimated fair values are determined based on the borrower's financial statements, inventory reports, accounts receivable agings or equipment appraisals, invoices or online pricing sources. Indications of value from these sources are generally discounted, as appropriate, based on the age of the financial information or the quality of the assets.

The general component covers pools of loans by loan class including loans not considered impaired, as well as smaller balance homogeneous loans, such as residential 1-4 family, home equity and consumer loans. These pools of loans are evaluated for loss exposure based upon historical loss rates, adjusted for qualitative risk factors. These qualitative risk factors include:

1. Lending policies and procedures, including underwriting standards and collection, charge-off, and recovery practices.

2. National, regional, and local economic and business conditions as well as the condition of various market segments, including the value of underlying collateral for collateral dependent loans.

3. Nature and volume of the portfolio and terms of loans.

4. Experience, ability, and depth of lending management and staff.

5. Volume and severity of past due, classified and nonaccrual loans as well as other loan modifications.

6. Existence and effect of any concentrations of credit and changes in the level of such concentrations.

7. Oversight, including the impact of banking laws and regulations as well as the overall regulatory environment.

8. External factors which may have either a direct or indirect impact on the quality of the loan portfolio.

Each factor is assigned a value to reflect improving, stable or declining conditions based on management's best judgment using relevant information available at the time of the evaluation. Adjustments to the factors are supported through documentation of changes in conditions in a narrative accompanying the allowance for loan loss calculation.

The allowance calculation methodology includes further segregation of loan classes into risk rating categories. The borrower's overall financial condition, repayment sources, guarantors and value of collateral, if appropriate, are evaluated annually for commercial loans or when credit deficiencies arise, such as delinquent loan payments, for residential, municipal and consumer loans. Credit quality risk ratings include classifications of pass, special mention, substandard, doubtful and loss. Loans criticized as special mention have potential weaknesses that deserve management's close attention. If uncorrected, the potential weaknesses may result in deterioration of the repayment prospects. Loans classified substandard have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. They include loans that are inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any. Loans classified doubtful have all the weaknesses inherent in loans classified substandard with the added characteristic that collection or liquidation in full, on the basis of current conditions and facts, is highly improbable. Loans classified as a loss are considered uncollectible and are immediately charged to the allowance for loan losses. Loans not classified are rated pass. To help ensure that risk ratings are accurate and reflect the present and future capacity of borrowers to repay a loan as agreed, the Company has a structured loan rating process encompassing both internal and external oversight. Generally, residential and consumer loans are included in the pass category unless on nonaccrual status at which time they are classified as substandard, or they are associated with a closely related criticized commercial credit. The Company's commercial loan officers are responsible for the timely and accurate risk rating of the commercial loans in their portfolio at origination and on an ongoing basis. The Company utilizes an external loan review consultant to conduct a loan review of its portfolio each year. The external consultant generally reviews all commercial loan relationships exceeding a specified threshold.

An unallocated component is maintained to cover uncertainties that could affect management's estimate of probable losses. The unallocated component of the allowance reflects the margin of imprecision inherent in the underlying assumptions used in the methodologies for estimating specific and general losses in the portfolio.

Loans whose terms are modified are classified as troubled debt restructurings if the Company grants such borrowers concessions and it is deemed that those borrowers are experiencing financial difficulty. Concessions granted under a troubled debt restructuring generally involve a temporary reduction in interest rate or an extension of a loan's stated maturity date. Non-accrual troubled debt restructurings are restored to accrual status if principal and interest payments, under the modified terms, are current for six consecutive months after modification. Loans classified as troubled debt restructurings are generally designated as impaired.

In addition, federal and state regulatory agencies, as an integral part of their examination process, periodically review the Company's allowance for loan losses and may require the Company to recognize additions to the allowance based on their judgments about information available to them at the time of their examination, which may not be currently available to management. Based on management's comprehensive analysis of the loan portfolio, management believes the current level of the allowance for loan losses is adequate.

The Company made no significant changes to its accounting policies or methodologies for the allowance for loan losses in 2019 or 2018.

Revenue Recognition

The Company earns income from various sources, including loans, investment securities, bank-owned life insurance, deposit accounts, and sales of assets.

Interest income on loans is accrued on the unpaid principal balance and recorded daily. Loan origination fees, net of certain direct origination costs, are deferred and recognized as an adjustment of the related loan yield using the interest method. Other loan fees, including late charges, are recognized as they occur.

Interest income on debt securities is recognized on the accrual basis. Purchase premiums and discounts are recognized using the interest method over the term of the securities. Dividends on equity securities are recorded when declared.

Service charges on deposits include maintenance and analysis fees, overdraft fees and automated teller machine (ATM) fees. Revenue is recognized when the Company's performance obligation is completed which is generally monthly for account services or when a transaction has been completed. Payment for service charges on deposit accounts is received immediately or in the following month through a direct charge to customers' accounts.

Commissions are received from third parties based on the sale of the third party's investment and insurance products to the Company's customers. The Company's performance obligation is complete when the sale occurs.

Other income includes other fees and revenue which are generally transactional in nature and are recorded as they occur.

Gains or losses on sales of assets are generally recognized when the asset has been legally transferred to the buyer and the Company has no continuing involvement with the asset. The Company does not generally finance the sale.

Cash Surrender Value, Life Insurance

The Company is the owner and beneficiary of life insurance policies on certain employees and directors. The life insurance investment is carried at the cash surrender value of the underlying owned policies. The increase in the cash surrender value is recognized as a component of noninterest income. The policies can be liquidated, if necessary, with tax costs associated. However, the Company intends to hold these policies and, accordingly, the Company has not provided for deferred income taxes on the earnings from the increase in cash surrender value.

Bank Premises and Equipment

Bank premises (including leasehold improvements) and equipment are carried at cost, less accumulated depreciation. Depreciation is provided on the straight-line method over the estimated lives of the assets for owned assets or the lesser of the lease term or the estimated lives of the assets for leasehold improvements.

Foreclosed Assets

Assets acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at fair value less costs to sell at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, valuations are periodically performed and the assets are carried at the lower of carrying amount or fair value less cost to sell. Revenue and expenses from operations and changes in the valuation allowance are included in other expenses.

Foreclosed assets totaled $142,000 and $230,000 at December 31, 2019 and 2018, respectively, and are included in other assets. Foreclosed assets include $72,000 and $67,000 of residential real estate at December 31, 2019 and 2018, respectively. Residential real estate in process of foreclosure was $291,000 and $366,000 at December 31, 2019 and 2018, respectively.

Income Taxes

Income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid or refunded for the current period by applying the provisions of the enacted tax law to the taxable income or excess of deductions over revenues. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities. Enacted changes in tax rates and laws are recognized in the period in which they occur. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

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

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company - put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Advertising Costs

Advertising costs are expensed as incurred and totaled $150,000 in 2019 and $147,000 in 2018.

Earnings Per Share

Earnings per share is based on the weighted average number of shares of common stock outstanding. 2018 earnings per share is adjusted for the effect of the 2019 stock dividend. The Company's basic and diluted earnings per share are the same since there are no dilutive shares of potential common stock outstanding.

Treasury Stock

Treasury stock is recorded at cost. The subsequent disposition or sale of the treasury stock is recorded using the average cost method.

Statements of Cash Flows

For purposes of reporting cash flows, cash and cash equivalents include cash on hand and amounts due from banks.

Interest paid totaled $3,240,000 in 2019 and $2,153,000 in 2018. The Company paid $1,000,000 of income tax payments in 2019 and $1,050,000 in 2018. Amounts transferred from loans to foreclosed assets were $68,000 in 2019 and $18,000 in 2018. Right-of-use assets and operating lease liabilities recognized in 2019 were $1,073,000.

Comprehensive Income

Comprehensive income consists of net income and other comprehensive income (loss). Other comprehensive income (loss) consists solely of the net unrealized gains (losses) on available-for-sale securities, net of deferred income taxes. Accumulated other comprehensive income (loss) consists of net unrealized gains of $313,000 less deferred income taxes of $64,000 at December 31, 2019 and $2,357,000 less deferred income taxes of $495,000 at December 31, 2018.

Reclassifications

Certain 2018 amounts have been reclassified to conform to the 2019 reporting format.

Subsequent Events

Subsequent events were evaluated for recognition or disclosure through March 30, 2020, the date the consolidated financial statements were available to be issued.

In response to the COVID-19 pandemic, on March 18, 2020, the Pennsylvania governor ordered non-essential businesses to close for at least two weeks in an effort to contain the spread of the virus. While banks are considered essential businesses, many of the Company’s customers have been negatively affected and have begun to request relief on loan payments. Recent regulatory agency guidance have stressed the need for banks to work with its customers. Management is reviewing all options available to assist customers through this crisis.

The extent of the impact of COVID-19 on the Company’s financial performance will depend on future developments, including the duration and spread of the outbreak and related governmental or other regulatory actions.

Recent Accounting Standards

In February 2016, the FASB issued ASU No. 2016-02 *Leases*. The core principle of this ASU and related guidance subsequently issued is that a lessee should recognize the assets and liabilities that arise from leases. Specifically, a lessee should recognize on the balance sheet a liability to make lease payments (the lease liability) and a right-of-use asset (ROU) representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee would be permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and liabilities. The ASU does not significantly change the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee from current U.S. GAAP. The Company adopted this guidance as of January 1, 2019 using the optional transition method under ASU 2018-11 which allows the guidance to be adopted without adjusting prior periods and recognized approximately $1,073,000 of ROU assets and related lease liabilities. There was no effect on shareholders' equity or net income as a result of adoption. The ROU assets and lease liabilities are calculated based on the present value of future lease payments using an estimated incremental borrowing rate. The Company used FHLB borrowing rates to determine the incremental borrowing rate. The guidance also provides a number of optional practical expedients in transition. The Company elected the "package of practical expedients," which allows for no look-back on prior conclusions about lease identification, lease classification and initial direct costs. The Company elected the "use-of-hindsight" practical expedient which allows the use of hindsight in judgments that impact the lease term. In order to establish the value of the ROU and lease liability and in accordance with the guidance, management determined the term of the leases held by carefully evaluating and assessing each lease and applying economic and other relevant factors to determine whether the Company is reasonably certain to exercise or not to exercise a renewal option within each lease. The Company also elected not to include leases less than 12 months.

In June 2016, the FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments.* ASU No. 2016-13 requires financial assets measured at amortized cost to be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The measurement of expected credit losses is based on relevant information about past events, including historical experience, current conditions and reasonable and supportable forecasts that affect the collectability of the reported amount. ASU No. 2019-10 issued in November 2019 deferred the effective date for this guidance to 2023. The Company is in the process of evaluating the potential impact of adopting this ASU.

2. Investments

The amortized cost and fair value of available-for-sale securities at December 31 are summarized as follows (in thousands):

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government sponsored enterprises (GSE)	$ 18,472	$ 1	$ 61	$ 18,412
State and municipal obligations	25,497	324	8	25,813
Mortgage-backed securities, GSE - residential	63,892	415	358	63,949
Total debt securities	107,861	740	427	108,174
Equity securities	68	45	-	113
Total	$ 107,929	$ 785	$ 427	$ 108,287

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. government sponsored enterprises (GSE)	$ 17,972	$ 1	$ 382	$ 17,591
State and municipal obligations	26,855	25	460	26,420
Mortgage-backed securities, GSE - residential	55,593	89	1,638	54,044
Total debt securities	100,420	115	2,480	98,055
Equity securities	68	8	-	76
Total	$ 100,488	$ 123	$ 2,480	$ 98,131

Investments with a fair value of $47,592,000 at December 31, 2019 and $41,436,000 at December 31, 2018 are pledged as collateral to secure public deposits and for other purposes as required by law.

The amortized cost and fair value of debt securities at December 31, 2019 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or repayment penalties (in thousands):

	Amortized Cost	Fair Value
Due in one year or less	$ 1,658	$ 1,659
Due after one year through five years	33,698	33,878
Due after five years through fifteen years	8,613	8,688
Subtotal	43,969	44,225
Mortgage-backed securities, GSE - residential	63,892	63,949
Total	$ 107,861	$ 108,174

The following table presents gross unrealized losses and fair value of investments aggregated by investment category and length of time that individual securities have been in a continuous loss position (in thousands):

	December 31, 2019					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government sponsored enterprises (GSE)	$ 2,974	$ 25	$ 13,437	$ 36	$ 16,411	$ 61
State and municipal obligations	70	1	4,809	7	4,879	8
Mortgage-backed securities, GSE - residential	5,329	12	25,314	346	30,643	358
Total debt securities	$ 8,373	$ 38	$ 43,560	$ 389	$ 51,933	$ 427

	December 31, 2018					
	Less than 12 Months		12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. government sponsored enterprises (GSE)	$ 998	$ 2	$ 15,592	$ 380	$ 16,590	$ 382
State and municipal obligations	10,723	115	10,886	345	21,609	460
Mortgage-backed securities, GSE - residential	5,668	42	38,088	1,596	43,756	1,638
Total debt securities	$ 17,389	$ 159	$ 64,566	$ 2,321	$ 81,955	$ 2,480

The Company had 107 debt securities in unrealized loss positions at December 31, 2019. The unrealized losses are considered to result from changes in interest rates and not from downgrades in the creditworthiness of the issuers. In analyzing an issuer's financial condition, management considers whether the securities are general obligation or revenue bonds, whether they are issued by the federal government or its agencies, whether downgrades by bond rating agencies have occurred, and the results of reviews of the issuer's financial condition. The Company does not intend to sell these securities nor is it more likely than not that it will be required to sell these securities prior to recovery. No declines are deemed to be other-than-temporary.

3. Loans and Allowance for Loan Losses

Loans at December 31 are summarized as follows (in thousands):

	2019	2018
Mortgage loans on real estate:		
Residential 1-4 family	$ 82,677	$ 80,204
Commercial real estate	88,475	82,927
Home equity	28,477	26,519
Total mortgage loans on real estate	199,629	189,650
Commercial and industrial	39,605	33,003
Municipal	9,645	9,786
Consumer	2,384	1,858
Total loans	251,263	234,297
Allowance for loan losses	(2,779)	(2,504)
Loans, net	$ 248,484	$ 231,793

The Company had $2,160,000 and $524,000 of residential mortgage loans held for sale at December 31, 2019 and 2018, respectively, which are included above. These loans are carried at the lower of cost or fair value.

Changes in the allowance for loan losses in 2019 are as follows (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance, January 1, 2019	$ 579	$ 1,111	$ 143	$ 333	$ 20	$ 20	$ 298	$ 2,504
Charge-offs	(2)	(147)	-	-	-	(32)	-	(181)
Recoveries	-	-	-	-	-	36	-	36
Provision	43	251	18	35	7	38	28	420
Ending balance, December 31, 2019	$ 620	$ 1,215	$ 161	$ 368	$ 27	$ 62	$ 326	$ 2,779
Ending balance individually evaluated for impairment	$ 25	$ 55	$ -	$ -	$ -	$ -	$ -	$ 80
Ending balance collectively evaluated for impairment	$ 595	$ 1,160	$ 161	$ 368	$ 27	$ 62	$ 326	$ 2,699
Loans receivable at December 31, 2019:								
Total balance	$ 82,677	$ 88,475	$ 28,477	$ 39,605	$ 9,645	$ 2,384	$ -	$ 251,263
Ending balance individually evaluated for impairment	$ 411	$ 1,907	$ 79	$ -	$ -	$ -	$ -	$ 2,397
Ending balance collectively evaluated for impairment	$ 82,266	$ 86,568	$ 28,398	$ 39,605	$ 9,645	$ 2,384	$ -	$ 248,866

Changes in the allowance for loan losses in 2018 are as follows (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Unallocated	Total
Allowance for loan losses:								
Beginning balance, January 1, 2018	$ 550	$ 1,011	$ 120	$ 289	$ 11	$ 28	$ 263	$ 2,272
Charge-offs	(24)	(214)	-	(4)	-	(104)	-	(346)
Recoveries	-	-	-	4	-	49	-	53
Provision	53	314	23	44	9	47	35	525
Ending balance, December 31, 2018	$ 579	$ 1,111	$ 143	$ 333	$ 20	$ 20	$ 298	$ 2,504
Ending balance individually evaluated for impairment	$ -	$ 136	$ -	$ -	$ -	$ -	$ -	$ 136
Ending balance collectively evaluated for impairment	$ 579	$ 975	$ 143	$ 333	$ 20	$ 20	$ 298	$ 2,368
Loans receivable at December 31, 2018:								
Total balance	$ 80,204	$ 82,927	$ 26,519	$ 33,003	$ 9,786	$ 1,858	$ -	$ 234,297
Ending balance individually evaluated for impairment	$ 497	$ 2,273	$ 160	$ -	$ -	$ -	$ -	$ 2,930
Ending balance collectively evaluated for impairment	$ 79,707	$ 80,654	$ 26,359	$ 33,003	$ 9,786	$ 1,858	$ -	$ 231,367

The following table summarizes information on impaired loans by loan portfolio class at December 31 (in thousands):

	December 31, 2019				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential 1-4 family	$ 337	$ 351	$ -	$ 352	$ 17
Commercial real estate	1,539	1,569	-	1,652	108
Home equity	79	86	-	86	-
With an allowance recorded:					
Residential 1-4 family	74	150	25	150	2
Commercial real estate	368	705	55	713	-
Home equity	-	-	-	-	-
Total:					
Residential 1-4 family	411	501	25	502	19
Commercial real estate	1,907	2,274	55	2,365	108
Home equity	79	86	-	86	-

	December 31, 2018				
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Average Recorded Investment	Interest Income Recognized
With no related allowance recorded:					
Residential 1-4 family	$ 497	$ 584	$ -	$ 586	$ 7
Commercial real estate	1,773	1,792	-	1,900	108
Home equity	160	160	-	164	10
With an allowance recorded:					
Residential 1-4 family	-	-	-	-	-
Commercial real estate	500	720	136	549	-
Home equity	-	-	-	-	-
Total:					
Residential 1-4 family	497	584	-	586	7
Commercial real estate	2,273	2,512	136	2,449	108
Home equity	160	160	-	164	10

The following table presents information on nonaccrual loans by loan portfolio class at December 31 (in thousands):

	2019	2018
Residential 1-4 family	$ 502	$ 558
Commercial real estate	453	681
Home equity	28	31
Total	$ 983	$ 1,270

The following table presents information on the loan portfolio classes by the Company's internal risk ratings system at December 31, 2019 (in thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Total
Pass	$ 82,168	$ 86,647	$ 28,396	$ 39,584	$ 9,645	$ 2,384	$ 248,824
Special mention	-	-	-	-	-	-	-
Substandard	509	1,828	81	21	-	-	2,439
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	$ 82,677	$ 88,475	$ 28,477	$ 39,605	$ 9,645	$ 2,384	$ 251,263

The following table presents information on the loan portfolio classes by the Company's internal risk ratings system at December 31, 2018 In thousands):

	Residential 1-4 Family	Commercial Real Estate	Home Equity	Commercial and Industrial	Municipal	Consumer	Total
Pass	$ 79,579	$ 80,744	$ 26,342	$ 32,967	$ 9,786	$ 1,858	$ 231,276
Special mention	-	-	-	-	-	-	-
Substandard	625	2,183	177	36	-	-	3,021
Doubtful	-	-	-	-	-	-	-
Loss	-	-	-	-	-	-	-
Total	$ 80,204	$ 82,927	$ 26,519	$ 33,003	$ 9,786	$ 1,858	$ 234,297

The following table presents information on the loan portfolio classes by past due status at December 31, 2019 (in thousands):

	30-59 Days Past Due	60-89 Day Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment ≥ 90 Days and Accruing
Residential 1-4 family	$ 402	$ -	$ 666	$ 1,068	$ 81,609	$ 82,677	$ 164
Commercial real estate	-	-	453	453	88,022	88,475	-
Home equity	6	49	103	158	28,319	28,477	75
Commercial and industrial	-	45	-	45	39,560	39,605	-
Municipal	-	-	-	-	9,645	9,645	-
Consumer	-	43	-	43	2,341	2,384	-
Total	$ 408	$ 137	$ 1,222	$ 1,767	$ 249,496	$ 251,263	$ 239

The following table presents information on the loan portfolio classes by past due status at December 31, 2018 (in thousands):

	30-59 Days Past Due	60-89 Day Past Due	Greater Than 90 Days	Total Past Due	Current	Total Loans	Recorded Investment ≥ 90 Days and Accruing
Residential 1-4 family	$ 600	$ -	$ 659	$ 1,259	$ 78,945	$ 80,204	$ 101
Commercial real estate	-	-	680	680	82,247	82,927	-
Home equity	184	55	32	271	26,248	26,519	1
Commercial and industrial	-	21	-	21	32,982	33,003	-
Municipal	-	-	-	-	9,786	9,786	-
Consumer	8	-	-	8	1,850	1,858	-
Total	$ 792	$ 76	$ 1,371	$ 2,239	$ 232,058	$ 234,297	$ 102

The Company may grant a concession or modification for economic or legal reasons related to a borrower's financial condition that it would not otherwise consider resulting in a modified loan which is then identified as a troubled debt restructuring (TDR). The Company may modify loans through rate reductions, extensions of maturity, interest only payments, or payment modifications to better match the timing of cash flows due under the modified terms with the cash flows from the borrowers' operations. Loan modifications are intended to minimize the economic loss and to avoid foreclosure or repossession of the collateral. TDRs are generally considered impaired loans for purposes of calculating the Company's allowance for loan losses.

The Company identifies loans for potential restructure primarily through direct communication with the borrower and evaluation of the borrower's financial statements, revenue projections, tax returns, and credit reports. Even if the borrower is not presently in default, management will consider the likelihood that cash flow shortages, adverse economic conditions, and negative trends may result in a payment default in the near future.

There were no TDRs made in 2019 and 2018. No TDRs defaulted in 2019 or 2018.

There are no commitments to lend additional funds to borrowers whose loans were modified.

4. Bank Premises and Equipment

Bank premises and equipment at December 31 is summarized as follows (in thousands):

	2019	2018
Land	$ 1,360	$ 1,360
Bank premises	5,923	5,910
Equipment, furniture and fixtures	5,714	5,408
Total	12,997	12,678
Less accumulated depreciation	8,163	7,791
Net	$ 4,834	$ 4,887

5. Deposits

The aggregate amount of certificates of deposit with a minimum denomination of $250,000 was $23,539,000 and $23,644,000 at December 31, 2019 and 2018, respectively.

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

Years ending December 31:	
2020	$ 75,745
2021	18,990
2022	5,615
2023	2,684
2024	1,892
Total	$ 104,926

6. Borrowed Funds

The Company has a maximum borrowing capacity with the FHLB of $133,007,000 including a $58,000,000 line of credit. The Company had no borrowings under the line at December 31, 2019 and 2018. The Company has used $375,000 in 2019 and 2018 of its borrowing capacity to issue irrevocable letters of credit to collateralize public deposits. Advances from the FHLB are secured by qualifying assets of the Company, which include FHLB stock, certain U.S. government sponsored enterprise securities, and first mortgage loans.

The Company has a $7,000,000 unsecured federal funds borrowing agreement with Atlantic Community Bankers Bank. There were no borrowings at December 31, 2019 and 2018.

Borrowed funds from FHLB consisted of the following at December 31 (in thousands):

	2019	2018
Fixed rate advances:		
Due in 2019	$ -	$ 16,000
Due in 2020	3,000	3,000
Due in 2021	8,000	-
Due in 2022	5,000	-
Total	$ 16,000	$ 19,000

The weighted average interest rate was 2.09 percent in 2019 and 1.89 percent in 2018.

7. Income Taxes

The provision for income taxes consists of the following (in thousands):

	2019	2018
Current	$ 1,017	$ 924
Deferred	(64)	(144)
Total	$ 953	$ 780

A reconciliation between the effective income tax expense and the amount computed using the federal statutory rate of 21% in 2019 and 2018 is as follows (in thousands):

	2019	2018
Federal income tax expense at statutory rate	$ 1,168	$ 1,181
Effect of:		
Tax-exempt income	(185)	(416)
Other items	(30)	15
Total	$ 953	$ 780

The following temporary differences gave rise to the net deferred tax asset at December 31 (in thousands):

	2019	2018
Deferred tax assets (liabilities):		
Allowance for loan losses	$ 444	$ 356
Deferred compensation	51	48
Other	11	14
Unrealized (gains) losses on available-for-sale debt securities - AOCI	(65)	495
Unrealized (gains) losses on equity securities	(10)	-
Depreciation	(82)	(68)
Net deferred tax asset	$ 349	$ 845

A valuation allowance has not been established as the Company believes that the deferred tax assets are more likely than not realizable.

The Company had no unrecognized tax benefits at December 31, 2019 and 2018. There were no interest and penalties recognized in 2019 and 2018.

8. Retirement Plan

The Company sponsors a defined contribution retirement plan. Retirement plan expense was $267,000 in 2019 and $264,000 in 2018.

9. Financial Instruments With Off-Balance-Sheet Risk

Overview

The Company is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The Company's exposure to credit loss is represented by the contractual amount of these commitments. The Company follows the same credit policies in making commitments as it does for on-balance-sheet instruments. Unless noted otherwise, the Company does not require collateral or other security to support financial instruments with off-balance-sheet credit risk.

Commitments to Extend Credit

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

Unfunded commitments under commercial lines-of-credit and revolving credit lines are commitments for possible future extensions of credit to existing customers. These commitments may or may not be collateralized and usually contain a specified maturity date and may not be drawn upon to the total extent to which the Company is committed.

Standby letters of credit written are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Essentially all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Company generally holds collateral supporting those commitments if deemed necessary.

Collateral Requirements

To reduce credit risk related to the use of credit-related financial instruments, the Company might deem it necessary to obtain collateral. The amount and nature of the collateral obtained is based on the Company's credit evaluation of the customer. Collateral held varies but may include cash, securities, accounts receivable, inventory, property, plant and equipment and real estate. The Company has not incurred any losses on its commitments in either 2019 or 2018.

Financial instruments whose contract amount represents credit risk were as follows (in thousands):

	2019	2018
Commitments to extend credit	$ 32,840	$ 39,616
Standby letters of credit	4,804	3,245

10. Leases

The Company leases three branches under the terms of agreements classified as operating leases. The Company has recognized a ROU asset of $995,070 at December 31, 2019 for its operating leases which is included in other assets. Expected future lease payments at December 31, 2019 under these operating leases are as follows (in thousands):

Years ending December 31:	
2020	$ 212,376
2021	217,498
2022	146,988
2023	134,388
2024	134,388
Thereafter	246,378
Total lease payments	1,092,016
Present value discount	96,946
Operating lease liability – included in other liabilities	$ 995,070

These leases include options to renew which run for periods up to 7 years. The Company evaluates the options to determine whether it is reasonably certain it will exercise them. The Company has concluded it is not reasonably certain of exercising any lease past the existing term. The discount rate used in determining the operating lease liability was the FHLB fixed advance rate which corresponded with the remaining lease term for each lease as of January 1, 2019. At December 31, 2019, the weighted average discount rate was 3 percent and the weighted average remaining lease term was 6 years. There were no operating or finance leases entered into during 2019.

Operating lease expense was $258,000 in 2019 and $246,000 in 2018. Short-term lease expense was $40,000. Cash paid for operating leases was $208,000 in 2019.

11. Related Party Transactions

The Company has granted loans to principal officers, directors, significant shareholders (greater than 10 percent) and their affiliates. The following table summarizes the activity in these loans (in thousands):

	2019	2018
Balance, beginning	$ 4,147	$ 1,325
New loans	700	4,890
Repayment	(819)	(2,068)
Balance, ending	$ 4,028	$ 4,147

Related party deposits were $3,302,000 at December 31, 2019 and $3,570,000 at December 31, 2018.

12. Regulatory Matters

The Bank is subject to various regulatory capital requirements administered by state and federal 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 consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of its assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the bank to maintain minimum amounts and ratios of total, common equity Tier 1 and Tier I capital to risk-weighted assets, and of Tier I capital to average assets. Management believes, as of December 31, 2019, that the Bank meets all capital adequacy requirements to which they are subject.

The Federal Reserve Bank has established capital guidelines for bank holding companies. These guidelines allow small bank holding companies, as defined, an exemption from regulatory capital requirements. Peoples Ltd. meets the eligibility criteria and is exempt from regulatory capital requirements. The Bank's capital ratios are shown below ($ in thousands):

	December 31, 2019					
	Actual		For Capital Adequacy Purposes		To be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
Total capital (to risk-weighted assets)	$ 40,668	15.2 %	$ ≥21,417	≥8.0 %	$ ≥26,772	≥10.0 %
Common equity Tier 1 (CET1) capital (to risk-weighted assets)	37,889	14.2	≥12,047	≥4.5	≥17,402	≥ 6.5
Tier 1 capital (to risk-weighted assets)	37,889	14.2	≥16,063	≥6.0	≥21,417	≥ 8.0
Tier 1 capital (to average assets)	37,889	9.3	≥16,228	≥4.0	≥20,285	≥ 5.0

	December 31, 2018									
	Actual			For Capital Adequacy Purposes				To be Well Capitalized Under Prompt Corrective Action Provisions		
	Amount		Ratio	Amount		Ratio		Amount		Ratio
Total capital (to risk-weighted assets)	$	37,172	14.5 %	$	≥20,521	≥8.0 %	$	≥25,652		≥10.0 %
Common equity Tier 1 (CET1) capital (to risk-weighted assets)		34,668	13.5		≥11,543	≥4.5		≥16,674		≥ 6.5
Tier 1 capital (to risk-weighted assets)		34,668	13.5		≥15,391	≥6.0		≥20,521		≥ 8.0
Tier 1 capital (to average assets)		34,668	9.3		≥14,978	≥4.0		≥18,723		≥ 5.0

Federal and state banking regulations place certain restrictions on dividends paid by the Bank to Peoples Ltd. The amount of total dividends is generally limited to the retained earnings of the Bank. However, dividend payments would be prohibited if the effect thereof would cause the Bank's capital to be reduced below applicable minimum capital requirements as discussed above.

13. Fair Value Disclosures

Fair value is defined as an exit price representing the amount that would be received to sell an asset or settle a liability in an orderly transaction between market participants. A three-level hierarchy exists for fair value measurements based upon the inputs to the valuation of an asset or liability.

Level 1 - Valuation is based on quoted prices in active markets for identical assets or liabilities;

Level 2 - Valuation is determined from quoted prices for similar assets and liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument;

Level 3 - Valuation is derived from model-based and other techniques in which at least one significant input is unobservable and which may be based on the Company's own estimates about the assumptions that a market participant would use to value the asset or liability.

The following table sets forth the Company's financial assets and liabilities measured at fair value on a recurring basis by level within the fair value hierarchy (in thousands):

	December 31, 2019			
	Total	Level 1	Level 2	Level 3
U.S. government sponsored enterprises	$ 18,412	$ -	$ 18,412	$ -
State and municipal obligations	25,813	-	25,813	-
Mortgage-backed securities, GSE - residential	63,949	-	63,949	-
Total debt securities	108,174	-	108,174	-
Equity securities	113	113	-	-
Total	$ 108,287	$ 113	$ 108,174	$ -

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
U.S. government sponsored enterprises	$ 17,591	$ -	$ 17,591	$ -
State and municipal obligations	26,420	-	26,420	-
Mortgage-backed securities, GSE - residential	54,044	-	54,044	-
Total debt securities	98,055	-	98,055	-
Equity securities	76	76	-	-
Total	$ 98,131	$ 76	$ 98,055	$ -

The classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

Other securities are measured at fair value using quoted market prices in an active market for identical assets and are classified as Level 1 in the hierarchy. All debt securities are measured at fair value using matrix pricing, which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities' relationship to other benchmark quoted prices and are classified as Level 2 in the hierarchy.

The following table presents the Company's financial instruments subject to fair value adjustments on a nonrecurring basis by level within the fair value hierarchy (in thousands):

	December 31, 2019			
	Total	Level 1	Level 2	Level 3
Impaired loans, net	$ 362	$ -	$ -	$ 362
Foreclosed assets	130	-	-	130

	December 31, 2018			
	Total	Level 1	Level 2	Level 3
Impaired loans, net	$ 364	$ -	$ -	$ 364
Foreclosed assets	115	-	-	115

Impaired loans that are collateral dependent are written down to fair value through partial charge-offs or the establishment of specific reserves. Such collateral is primarily real estate whose value is based on appraisals performed by certified appraisers. These values are generally adjusted based on management's knowledge of changes in market conditions or other factors and include estimated liquidation expenses which are generally 10 percent of the collateral value. Management's assumptions of the collateral value include consideration of location and occupancy as well as condition of the property or asset. At December 31, 2019 and 2018, management adjustments to the collateral value for these factors ranged from 10 percent to 15 percent. Since the adjustments may be significant, are based on management's estimates and are generally unobservable, they have been classified as Level 3.

Assets taken in foreclosure of defaulted loans are measured at the lower of cost or fair value less costs to sell of 10 percent. The fair value of the real property is generally determined using appraisals or other indications of value based on recent comparable sales of similar properties or assumptions generally observable in the marketplace, and the related nonrecurring fair value measurement adjustments have generally been classified as Level 3.

In addition to the disclosures of financial instruments recorded at fair value, U.S. GAAP requires the disclosure of the estimated fair value of all the Company's financial instruments. The majority of the Company's assets and liabilities are considered financial instruments. However, many of these instruments lack an available market. In addition, the Company's general practice and intent is to hold its financial instruments to maturity. The Company has considered the fair value measurement criteria as required under the accounting standard relating to fair value measurement as noted above. Fair value estimates have been determined based on the methodologies management considers most appropriate for each financial instrument.

The following are the carrying amounts and estimated fair values of the Company's financial instruments as of December 31 (in thousands):

	2019				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 27,310	$ 27,310	$ 27,310	$ -	$ -
Available-for-sale securities	108,287	108,287	113	108,174	-
Loans, net	248,484	255,975	-	-	255,975
Accrued interest receivable	981	981	-	981	-
Restricted equity securities	1,767	1,767	-	1,767	-
Financial liabilities:					
Deposits	344,493	345,068	-	345,068	-
Borrowed funds	16,000	16,039	-	16,039	-
Accrued interest payable	133	133	-	133	-

	2018				
	Carrying Amount	Estimated Fair Value	Level 1	Level 2	Level 3
Financial assets:					
Cash and due from banks	$ 29,534	$ 29,534	$ 29,534	$ -	$ -
Available-for-sale securities	98,131	92,131	76	98,055	-
Loans, net	231,793	232,004	-	-	232,004
Accrued interest receivable	929	929	-	929	-
Restricted equity securities	1,541	1,541	-	1,541	-
Financial liabilities:					
Deposits	317,576	316,839	-	316,839	-
Borrowed funds	19,000	18,921	-	18,921	-
Accrued interest payable	126	126	-	126	-

14. Gain on Life Insurance Settlement

As discussed in Note 1 to the consolidated financial statements, the Company is the owner and beneficiary of life insurance policies on certain employees and directors. During 2018, three of the insured individuals passed away. The Company received $4,927,000 in the settlement of the related policies. A gain on life insurance settlement of $1,168,000, representing the excess of the proceeds received over the carrying value, as well as the reversal of certain related liabilities, was recognized.